

The Residential Property Tax Exemption

This paper was prepared by the Oak Bluffs Assessors in response to a request from the Chair of the Board of Selectmen. Our goal is to provide a brief overview of residential exemptions, how they work, and how they might be best implemented. The staff in the assessing department are neither recommending nor discouraging an exemption. That is a decision for the Selectmen. We are here to support the Selectmen and any other interested parties by providing information, and implementing a residential exemption fairly and accurately if the time ever comes for one.

Residential Property Tax Relief

Property tax payers in New York, Florida, California and many other states enjoy reduced taxes on their principal residence. In fact, according to the Lincoln Institute, all but three states offer property tax relief for residents in the form of a homestead exemption or property tax credits.

In Massachusetts, local boards of selectmen have the yearly option of granting a residential exemption at the classification hearing where the tax rate is set. Oak Bluffs has never offered its residents this exemption, and only Vineyard Haven currently provides one on Island. Nantucket was an early adopter, and several Cape towns have recently adopted the exemption for the first time.

The residential exemption in Massachusetts reduces the taxable value of all residential parcels that are determined to be the domicile of the owner. It is important to note that under Massachusetts law, a person may have many residences but they may have only one domicile. Local assessors determine who qualifies under the domicile criteria and who does not before granting residential exemptions.

Tax Levy

In order to determine the impacts of a residential exemption on individuals, one must consider how property taxes are determined by towns in this state. Although the laws are complicated, the fundamentals are relatively straightforward. The town creates a budget, estimates receipts not from property taxes, and then “levies” the difference in property taxes. That tax levy is the total amount of money to be raised in the fiscal year by property taxes.

Tax Base and Tax Rate

The assessors have the duty of valuing all property at full and fair cash value each year. This sum total of all taxable property is the tax base. Once this has been completed, the tax rate can be set. The assessors divide the tax levy (everything being raised in property taxes that year) by the tax base (value of all taxable property). The taxes due on any given property are established by multiplying the value of the property by the tax rate.*

Tax Rate = Tax Levy / Tax Base

Property Taxes = Property Value x Tax Rate

How the Residential Exemption Works

Residential property tax exemptions in Massachusetts have the effect of reducing the taxable value of a qualified property from full and fair cash value by the exemption amount. As an example, if you own a home assessed at \$500,000 and the selectmen grant residents a \$50,000 exemption, you will only be taxed on \$450,000 in value.

Continuing with the example, if a town has 1600 qualified properties and they all exempt \$50,000 from their assessed value, you've reduced the tax base (value of all taxable property) by \$80,000,000. That has the automatic effect of increasing the tax rate. The old tax rate was the tax levy divided by the full and fair cash value of all taxable property. The tax rate with the exemption is that same tax levy divided by the full and fair cash value less \$80,000,000 in this example.

Residential Exemption Impacts

A property tax exemption increases the tax rate for all residential property. While the exemption will lower the total taxes due for the vast majority of resident homeowners, some residents with higher value properties will pay more through the tax rate increase than they gain from the exemption. This is called a breakeven, and our best estimate is it would mean higher taxes for residents with properties assessed above \$1,750,000, regardless of the exemption amount. It is important to mention that our estimates could well be off, as we don't yet know how many properties will qualify.

While a small number of residents who occupy their homes would be negatively impacted by a residential exemption, and most resident homeowners would enjoy a substantial savings, there are numerous other groups that would be negatively impacted by an exemption.

Massachusetts law requires that the residential class of property owners bear the cost of a residential exemption (although the selectmen may shift taxes on other classes during the same classification hearing). In other words, residential property owners as a group need to contribute the same amount to the tax levy, exemption or not. That means that all residential property not owned and occupied as a domicile will receive a tax bill calculated at the full and fair assessed value but at the higher tax rate. This includes second homeowners, rental homeowners, and owners of bare land. Our office has modeled these impacts based on different exemption amounts and assumptions on the number of properties that would qualify, but it is impossible to know the exact amounts without a concrete qualification effort.

Exemption Options

The Oak Bluffs Board of Selectmen has absolute authority over the decision to grant a residential exemption, and it is not a binary decision. The State allows a range of exemption amounts from zero to 35% of the average residential property value.

In Fiscal Year 2019 the average value of all residential properties was \$657,804. That meant the board could have granted exemptions from zero to \$230,231.

Every single qualified property owner receives the same dollar value exemption in any given year (except in very specific and unusual circumstances). In other words, the lower the value of the qualified home, the more the property tax bill is reduced in percentage terms by an exemption.

While residential exemptions are often quoted in percent terms when comparing towns or options during a hearing, it is best to use dollar terms to avoid confusion over the underlying mechanism. For instance, if the Selectmen had granted a 35% exemption in FY19, a \$500,000 house would not have been limited to an exemption amount of 35% of \$500,000 (\$175,000) but rather they would have received an exemption of \$230,231 (46% of \$500,000).

Roles of Selectmen and Assessors

While the selectmen are charged with the decision to grant a residential exemption, the board of assessors and their staff are responsible for executing that decision. Assessors must do a great deal of work qualifying property owners ahead of the granting of an exemption, or the town faces potentially serious legal and financial consequences. As soon as the selectmen make their decision, assessors must notify the Massachusetts Department of Revenue of how many exemptions they will grant. This determines the tax rate as adjusted for that year's specific exemption.

The Importance of Pre-Qualification

Care is essential. Estimate too high and the town will be collecting taxes above their Proposition 2 ½ levy limit. Estimate too low, and the overlay account (principally used to cover abatements) may well be sent into deficit. It is a great understatement to say neither outcome pleases the DOR. The higher the exemption amount and the less prepared the town, the greater the impact.

Recent adopters of residential exemptions on the Cape have learned the hard way that qualifying property owners is a challenging and time consuming task. Failure to prepare ahead of time can lead to serious impacts for the town and inequitable distribution of exemptions. Towns that have prepared carefully ahead of time have avoided these pitfalls and also found that both qualified and un-qualified taxpayers appreciated the informed and controlled process.

Current Assessor Staffing

The assessing department in the Town of Oak Bluffs currently operates with low staff-to-parcel and staff-to-assessed-value ratios. In recent years the office has used far fewer contractor services than other Island towns. Those two factors mean all taxpayers in Oak Bluffs have saved money relative to the taxpayers of neighboring towns. This has been a conscious decision by Town leaders to run a tight ship, and they should be congratulated by tax sensitive taxpayers for their efforts. However, this also means the office is less prepared to qualify exemption candidates than typically staffed towns.

The Demands of Qualification

In order to smoothly implement a residential exemption and avoid serious financial and legal pitfalls, preparation and investment are required. A ballpark estimate of qualified properties comes in at

around 1600, but we could be off by hundreds of properties and won't know for sure unless we actually qualify people. Qualification involves mailing likely property owners a state certified form to be completed by the taxpayer who will also provide documentation, usually in the form of tax returns (dollar amount and social security numbers redacted) and other supporting documents. These completed applications will need to be reviewed by qualified staff, and the assessing system updated with the correct status. The paperwork, amounting to thousands of pages, will need to be carefully filed for quick access by staff.

It has been our experience that a significant number of standardized applications for other exemptions come to us incomplete. Staff will need to follow up with those applicants who do not provide adequate responses in order to get actionable applications.

Most application determinations will go smoothly, but the courts in Massachusetts have determined that one can't have a hard and fast rule on proving domicile, so the outliers will require careful staff and Board of Assessors review. Taxpayers who disagree with decisions may appeal to the Appellate Tax Board, a time consuming prospect for the staff.

While the qualification process would clearly be time consuming and require additional staffing, it only needs to happen once. Keeping the assessing system updated with status changes will add to the time it takes to process some transfers and mailing address changes, but the impact on the office will be minor relative to the initial task of mass qualification.

Conclusion

The laws and regulations for residential exemptions in Massachusetts are not without their flaws. The entire process runs the risk of putting the cart before the horse. Selectmen are challenged each year with the decision of whether or not to grant an exemption, but often the assessors aren't prepared to act equitably if an exemption is granted. Even if selectmen have no interest in granting an exemption in the near future, it might well be prudent for the town to be prepared, in case conditions or attitudes change.

**Please note, these are the fundamentals of setting the tax rate. In reality, many other factors influence property taxes besides a residential exemption. During the classification hearing, the selectmen not only decide on a residential exemption, but may also choose to set different tax rates for commercial, industrial and personal property, grant discounts to open space or small businesses.*

The assessors will be happy to provide more information on the process if requested.