

The State of State (and Local) Tax Policy

What are tax and expenditure limits?

FISCAL FEDERALISM AND FISCAL INSTITUTIONS

Q. What are tax and expenditure limits?

A. Tax and expenditure limits (TEs) restrict the growth of government revenues or spending by either capping them at fixed-dollar amounts or limiting their growth rate to match increases in population, inflation, personal income, or some combination of those factors. As of 2020, 33 states had at least one kind of TEL, including those states requiring a supermajority vote of the legislature to raise new taxes or revenues.

DESIGNING TAX AND EXPENDITURE LIMITS

Spending versus revenue limits. States can limit their own revenues, appropriations, or both. Some states also limit the growth of local revenues, for example, restricting the growth of local property taxes. Appropriations and spending limits are more common than revenue limits. In 2020, 25 states imposed limits on their own government spending (figure 1). By contrast, 21 limited state revenue; 13 of these states capped both. Among states with revenue limits, 19 required a legislative supermajority (usually three-fifths or two-thirds of the legislature) to raise taxes or revenue, six limited revenue via other mechanisms, and four did both.

Mechanism. The means states use to limit spending and revenue vary considerably. The limit can be either a cap on growth or a restriction on the level, for example. The most common formula restricts expenditure *growth* to the pace of personal income, but some states include population and inflation growth in the formula. Other states restrict expenditures to a specific *level*, also often determined by a formula, such as a set percentage of personal income. Idaho, for example, limits expenditures to 5.33 percent of state personal income, thereby allowing expenditures to grow at the same rate as the economy. Another method is to restrict expenditures to a percentage of *projected* revenue, maintaining a cushion in case revenues fall short of projections.

Stringency. In general, constitutional provisions are more difficult to change or override than statutory TELs. By the same token, TELs imposed directly by voters rather than by legislators are more restrictive (New 2010). The most stringent revenue limits require that surplus revenue go back to taxpayers as rebates or be sequestered in rainy day funds. Oregon's "Kicker" rebate and Colorado's Taxpayer Bill of Rights are examples.

In some states, lawmakers can evade their TELs by imposing unfunded mandates upon, or transferring program responsibility to, local governments. Several states prohibit such actions, however and, more often, the measure of a TEL's stringency is whether the governor or legislature can override the cap with a simple

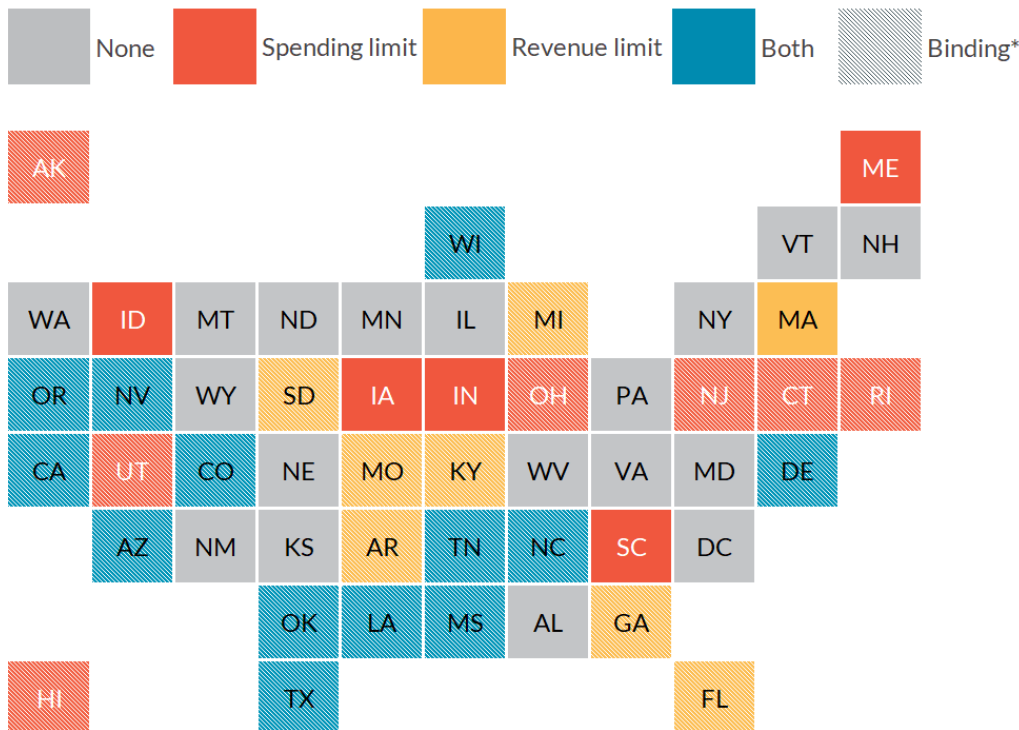
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majority. Several states have what, at first glance, appear to be restrictive TELs, but require only simple legislative majorities to override (i.e., the same threshold for approving a standard budget). Fifteen states require either a legislative supermajority or a popular vote to override their spending limits, and five impose this requirement on their revenue limits. Additionally, as mentioned, 19 states stringently bind revenues by requiring a legislative supermajority to raise new taxes or revenues.

FIGURE 1

Tax and Expenditure Limits by State
2020



Source: Urban-Brookings Tax Policy Center analysis of literature, including Kallen (2017), Lee (2018), NASBO (2015), and Waisanen (2010); as well as independent review of state statutes, constitutional provisions, and state sources.

Notes: Binding limits require either a vote of the people or legislative supermajority vote to override. Legislative supermajority requirements to raise new taxes or revenues are counted among binding expenditure limits. Four states (Georgia, North Carolina, Texas, and Nevada) constitutionally cap or ban state income taxes. These are classified above as binding revenue limits, since they require a supermajority vote of the legislature to amend. Nebraska constitutional prohibits a state property tax, but we do not count this as a revenue limit, since property taxes do not generally constitute a large share of state revenue. States with both a spending and revenue limit are classified as binding if either of their limits meets the above criteria.

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BACKGROUND

Most TELs emerged during the “tax revolt” of the late 1970s or the economic recession of the early 1990s. Although many of the best-known local property tax limits, such as California’s Proposition 13 and Massachusetts’s Proposition 2½, were adopted through citizen initiatives, most state TELs originated in their legislatures and limited expenditures, not revenue. As of [2015](#), only nine states had enacted TELs through voter initiative. New (2010) found that TELs adopted through citizen referendum were more effective than those adopted by legislatures.

Evidence on whether TELs limit state and local spending is mixed (Gordon 2008). Rueben (1996) found that laws’ details matter and that TELs requiring a legislative supermajority or popular vote to modify spending reduced state general fund expenditures by 2 percent. However, those savings were partly offset by higher local spending.

Knight (2000) found that states with both a supermajority requirement to raise taxes (a kind of revenue limit) and an additional tax or expenditure limit had lower expenditures than states with just one constraint. Poterba and Rueben (1999) found that TELs affect the costs of state borrowing in two ways: not surprisingly, spending limits lower the costs and revenue limits increase them.

The strictest tax limitations, like the original implementation of the TABOR rule in Colorado, can prevent states from saving revenues in rainy day funds to cushion against downturns. Randall and Rueben (2017) synthesized decades of research on TELs and other budgetary institutions, concluding that states should reform TELs that prevent them from saving during good times. Rueben, Randall and Boddupalli (2018) found that, during the Great Recession, states with binding revenue limits or a combination of binding revenue and expenditure limits were more responsive to deficit shocks than states with weaker rules.

PROPERTY TAX LIMITS

Property tax limits constitute a special category of revenue limit because, in most cases, they are set by state governments but apply to local governments. Only [two states](#)—New Hampshire and Vermont—do not limit property taxes. State restrictions can apply to the property, to the jurisdiction, or both. Rate limits impose maximum rates on jurisdictions (e.g., counties, municipalities, and school districts). Limits on the growth of property tax assessments are typically applied to properties.

For example, [Arizona](#) limits residential property assessment to 10 percent of a home’s value, growth in its property tax base to 5 percent annually, combined state and local tax rates for owner-occupied residences to a maximum of 1 percent of the state’s limited property value, and growth in local property tax levies to 2 percent annually plus new construction. The state also caps [expenditures](#) for most local governments.

Updated May 2020

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