The Secret Tax Explosion

Special districts are growing like weeds—and raising tax burdens as they proliferate.

BY: Frank Shafroth | September 2013

The structure of local government in America is changing. In the last half century, the number of school districts has declined by more than 80 percent and the number of counties and municipalities has either declined or barely budged. There has, however, been an explosion in special-purpose districts. A whole new kind of government is now the most prevalent form of government in the U.S.—and that's raising all sorts of taxing questions.

The Internal Revenue Service is asking whether these districts are eligible to issue tax-exempt debt. Similarly, rating agencies and some taxpayers question whether there's sufficient transparency and accountability in the taxing processes that special districts use.

The extraordinary growth in special districts appears to be a response, at least in part, to the spread of tax and debt limitations, as well as popular resistance to general tax increases. In Colorado, for instance, in the wake of the 1992 adoption of its Taxpayer Bill of Rights, there was a proliferation of new quasi-governments. By 2005, special districts accounted for 87 percent of all local governments in Colorado. The irony: A citizens' initiative to reduce the size and role of government achieved the obverse. The increase in special-purpose districts is due to local governments' seeking budget relief, while still desiring to maintain services.

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Special districts, which generally provide services not being supplied by existing general-purpose governments, may serve multiple states or counties—or be as small as one person. In Texas, for example, it only took one person to create a utility district out of 1,000 acres of Shiney Hiney Ranch. A former Dallas medical student, who'd moved to a trailer home on Shiney Hiney a month before an election, voted to create "a special district with rights to invoke eminent domain and to issue $400 million in bonds, along with setting a $1 property tax rate (per $100 of assessed value)," according to the *Denton Record-Chronicle.*

It's how these districts are supported that raises questions about tax burdens and transparency. When special districts are created to run enterprise activities—airports, harbors, hospitals, water and sewer utilities—they rely either entirely or predominantly on user fees. Special districts for non-enterprise activities, like fire and police, however, lean heavily on property tax as a revenue source.

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The lines of revenue raising can be opaque. In Travis County, Texas, for example, 118 different entities can levy property taxes. Many of those entities tax only certain areas within the county, which means no one is taxed by all 118. Throughout the state, the number of entities with the power to levy property taxes has also increased. In 1992 cities and counties were roughly a third of those that could levy property taxes, school districts made up another third and the last third consisted of special-purpose districts. By 2010, special-purpose districts made up 87 percent of the growth in property taxing authorities over the last two decades. As a result, special-purpose tax districts constitute more than 40 percent of property taxing entities in Texas.

According to data provided by the comptroller's office, Texas' population has grown by more than 40 percent since 1992, even as property taxes have increased by 188 percent. Some of the money goes to counties, cities and school districts, but the bulk goes to special-purpose districts.

The upsurge in special districts has meant an explosion of new taxes. Ironically, this is happening in states that are often perceived as anti-tax. This unprecedented growth in special districts is leading to a showdown with the federal government over the ability of local governments to issue public capital debt and could preempt the authority of many states and localities.