New York’s Tax and Debt Limits and Classified Property Tax Assessments: Time for a Constitutional Amendment?

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I. Introduction

During the 1981 session, New York legislators plan to revise section 306 of the Real Property Tax Law, which requires property to be assessed for taxation at its full value. A change, however, in this law may also have an unintended effect on the manner in which local government borrowing and taxing powers are restricted by the state constitution, thus substantially reducing the amount of revenue that local governments may obtain by borrowing and taxing. This result would have immediate impact on municipalities such as New York City which raise revenues at levels close to the constitutional limits. The effect could also be felt by all local governments which raise revenues through borrowing by making locally issued bonds a speculative investment, causing interest rates to rise.

An important impetus to the enactment of legislation amending section 306 is the court of appeals decision in Hellerstein v. Assessor, Town of Islip, which required the Town of Islip to assess all real property at its full value in compliance with the law. This decision overruled a series of cases which treated section 306 as unenforceable. Other recent developments, especially decisions re-

3. N.Y. CONST. art. VIII, §§ 4 (borrowing), 10 (taxing). In addition to these restrictions, article XVIII, § 4 restricts debt for slum-clearance projects. Because this limitation is calculated in a different manner than are the article VIII restrictions, the legislation described in this Comment may not have any of the described potential effects on this restriction. See note 46 infra.
4. See note 175 infra and accompanying text.
6. See notes 96-97 infra and accompanying text.
This Comment will discuss the effect of a modification of the assessment standard on New York's constitutional borrowing and taxing restrictions, which were adopted when illegal fractional assessment was the rule throughout the state. Section II describes these tax and debt restrictions, which limit the amount of revenue that local governments may obtain from these sources to certain percentages of local property wealth. Section III describes property tax assessment systems, including the classified assessment system declared illegal in New York in *Hellerstein*. Section IV discusses the interaction between recently proposed classification legislation and the tax and debt limits. Section V considers the possible effect of the classification legislation upon antecedent municipal debts.

II. Constitutional Tax and Debt Limits in New York

Many states have placed a check on excessive governmental spending by establishing restrictions on the power of local government officials to raise revenue by taxing and borrowing. These limits are frequently stated in terms of either the assessed or full values of local property. New York's restrictions are found in article VIII of the constitution, and date back to the late 1800's.

Even in the earliest versions of these limitations, numerous exceptions and exemptions existed, and their number has increased over the years. The limitations do establish some guidelines, however, and municipal borrowing and taxing powers bear a substantial relationship to the limits while not strictly adhering to them.

7. *See note 45 infra.*
9. *Id.*
10. *N.Y. Const. art. VIII, §§ 4 (borrowing limit), 10 (tax limit).*
12. When the first restriction limiting debt to a fixed percentage of assessed value was enacted in 1884, it contained an exclusion for debt associated with water bonds and for certificates of indebtedness or revenue bonds issued in anticipation of taxes of the year payable. *Id.* at 140.
13. *See N.Y. Const. art. VIII, §§ 4, 5A.*
14. *See McCabe v. Gross*, 274 N.Y. 39, 46, 8 N.E.2d 269, 271-72 (1937) ("The mischief to be prevented [by the debt limits] was the creation of an excessive debt, the carrying charges
A. Constitutional Debt Restrictions

New York's constitutional debt restrictions apply only to long-term debt. Short-term debt is restricted, if at all, by state and local law.\textsuperscript{16}

Long-term debt is used to fund capital projects, the rationale being that the cost of the project can be amortized over a period of time and all the users can subsidize the investment.\textsuperscript{16} Long-term debt must be intended for municipal purposes.\textsuperscript{17} It may not be contracted for longer than the period of usefulness of the object or purpose of the indebtedness, and for no longer than forty years.\textsuperscript{18} Long-term debt must be backed by the full faith and credit of the jurisdiction.\textsuperscript{19} Municipalities are prohibited from issuing bonds backed only by a moral obligation.\textsuperscript{20}

The constitutional debt limits restrict the power of local governments to borrow out of proportion to local property wealth. These limitations are measured in terms of percentages of the full valuation of taxable real estate within the jurisdiction.\textsuperscript{21} The value of taxable real estate is averaged over five years\textsuperscript{22} so that fluctuations of which would fall upon current revenues, and the principal upon posterity.").


18. N.Y. Const. art. VIII, § 2.


21. The following limits are applied to the full valuation of local real property:

1) counties: seven percent, except for Nassau County: ten percent
2) City of New York: ten percent
3) cities other than New York, with populations over 125,000: nine percent
4) cities with populations less than 125,000: seven percent
5) towns and villages: seven percent
6) school districts within cities with less than 125,000 inhabitants: five percent (subject to increase).

N.Y. Const. art. VIII, § 4.

22. N.Y. Const. art. VIII, § 10.
in real estate values due to short-term economic conditions are minimized.\textsuperscript{23}

For a number of reasons, the effective debt limits are actually far higher than the constitutional restrictions would make them appear. Overlapping jurisdictions issue debt supported by the same property so that borrowing powers as applied to any individual's property may easily exceed the limits.\textsuperscript{24} Also, numerous types of indebtedness\textsuperscript{25} and specific instances of borrowing are excluded from the limits.\textsuperscript{26} Consequently, the debt restrictions are subject to substantial stretching by the overlapping jurisdictions and the numerous exceptions and exemptions.\textsuperscript{27}

\section*{B. Constitutional Tax Limits}

The constitutional tax limits operate in much the same way as the debt limits.\textsuperscript{28} They limit the ability of local governments to levy real property taxes; other non-property taxes are authorized or limited by statutes.\textsuperscript{29} The base for the tax limitation is the same as that for the debt limit: the five year average of the full value of taxable real estate in the jurisdiction.\textsuperscript{30} Where taxing jurisdictions

\begin{itemize}
\item \textsuperscript{23} See Temporary State Commission on the 1967 Constitutional Convention, Local Finance 50 (Jan. 27, 1967) [hereinafter cited as Local Finance].
\item \textsuperscript{24} When statutory limits are included (for example, three percent for fire districts and ten percent for village school districts pursuant to N.Y. Local Fin. Law art. 2, tit. 8, § 104.00 (McKinney 1968), the limits applied to an individual's property are substantially higher, rising as high as 37%, for Nassau County). See Macchiarola, Local Finances under the New York State Constitution with an Emphasis on New York City, 35 Fordham L. Rev. 263, 274, 276 (1966).
\item \textsuperscript{25} N.Y. Const. art. VIII, § 5A.
\item \textsuperscript{26} Id. § 4.
\item \textsuperscript{27} "[T]he numerous exemptions distort any real relation between capacity and power to incur debt. . . . In effect, they afford little meaningful regulation of municipal finance." Macchiarola, supra note 24. See also Gelfand, Seeking Local Government Financial Integrity Through Debt Ceilings, Tax Limitations, and Expenditure Limits: The New York City Fiscal Crisis, the Taxpayers' Revolt, and Beyond, 63 Minn. L. Rev. 545, 560, 568-69 (1979).
\item \textsuperscript{28} The limits are:
\begin{itemize}
\item 1) counties: one and one-half to two percent
\item 2) City of New York: two and one-half percent
\item 3) cities other than New York: two percent
\item 4) villages: two percent
\item 5) school districts within cities with less than 125,000 inhabitants: one and one-fourth to two percent.
\end{itemize}
\item \textsuperscript{29} N.Y. Const. art. VIII, § 10.
\item \textsuperscript{30} See, e.g., N.Y. Tax Law (McKinney 1975).
\end{itemize}
overlap, the tax limitations are added, so that a single parcel of property may be subject to taxes covered by a number of limitations.\textsuperscript{31}

The most important exclusion from the tax limits enables jurisdictions to levy taxes outside the limits in order to pay interest or principal on indebtedness.\textsuperscript{32} Although the legislature has a constitutional duty to restrict local powers of taxation, assessment and indebtedness to prevent abuses,\textsuperscript{33} it is also prevented by the constitution from interfering with local tax levies to repay borrowing.\textsuperscript{34}

Another important exclusion from the tax limits involves the assignment of periods of probable usefulness to non-capital budget items, and then borrowing, as opposed to taxing, to pay for these expenditures.\textsuperscript{35} Section 11 of the Local Finance Law\textsuperscript{36} establishes periods of probable usefulness for capital expenses, but also includes a number of projects that could more properly be considered expense budget items.\textsuperscript{37} The courts periodically invalidate these budgetary loopholes. For example, in \textit{Hurd v. City of Buffalo},\textsuperscript{38} the appellate division held a provision of section 11\textsuperscript{39} unconstitutional because it exempted from the constitutional tax limits certain municipal tax levies for pension and retirement payments. The court reasoned that if these payments were to be considered to have useful lives beyond the year that the expenditures were

\begin{itemize}
  \item \textsuperscript{31} The total of tax limits when overlapping jurisdictions are included ranges from 2.5\% in New York City to 6.0\% for cities with populations of 125,000 or less. \textit{Local Finance, supra} note 23, at 47.
  \item \textsuperscript{32} N.Y. Const. art. VIII, § 12.
  \item \textsuperscript{33} Id.
  \item \textsuperscript{34} Id.
  \item \textsuperscript{35} This is authorized by N.Y. Const. art. VIII, § 11b. \textit{See Local Finance, supra} note 23, at 55.
  \item \textsuperscript{36} N.Y. Local Fin. Law § 11 (McKinney 1968 & Supp. 1980).
  \item \textsuperscript{37} \textit{See Association of the Bar of the City of New York, Proposals to Strengthen Local Finance Laws in New York State} 20 (Vol. 34, No. 1/2, Jan./Feb. 1979) [hereinafter cited as \textit{Bar Association Proposal}]. \textit{See also} K. Auletta, \textit{The Streets Were Paved with Gold} 98 (1979). Estimated useful lifetimes of budget items have not always been overestimated in the Local Finance Law. "At least until the 1960's, allowable funding times tended to be on the conservative, or short, side. . . . The financing of the IND subway, as an egregious example, was originally planned with four-year bonds, although economic conditions eventually forced a lengthening of the maturities." C. Morris, \textit{The Cost of Good Intentions} 131 (1980).
  \item \textsuperscript{38} 41 A.D.2d 402, 343 N.Y.S.2d 950 (4th Dep't 1973), aff'd, 34 N.Y.2d 628, 311 N.E.2d 504, 335 N.Y.S.2d 369 (1974).
  \item \textsuperscript{39} N.Y. Local Fin. Law art. 2, tit. 1, § 11a(42-a) (McKinney 1972) (repealed 1975).
\end{itemize}
made, almost all municipal expenditures could be considered similarly.\textsuperscript{40} The local finance law, however, still contains a large number of expense budget items assigned periods of usefulness to permit borrowing.\textsuperscript{41} Therefore, since overlapping jurisdictions are permitted to levy taxes on the same property and some taxes are not subject to constitutional limitations, the constitutional tax limits, like the debt limits, are less powerful in practice than in appearance.

C. The Property Value Base for the Constitutional Limits

Debt and tax limits in New York are determined with reference to the average full value of taxable real estate in the jurisdiction.\textsuperscript{42} Full value is calculated by local officials from the total of assessed values in the jurisdiction using studies made by the New York State Board of Equalization and Assessment.\textsuperscript{43} The State Board analyzes assessment levels and develops equalization rates\textsuperscript{44} which represent the local ratio of assessments to full value.\textsuperscript{45} Constitutional


\textsuperscript{41} See, e.g., N.Y. LOCAL FIN. LAW art. 2, tit. 1, §§ 11a(39) (judgments resulting from property tax reduction proceedings); 53a (computer installation for tax assessment system); 73 (manpower development programs); 74 (off-track betting equipment); 76 (exterior cleaning of public buildings) (McKinney 1968 & Supp. 1981). See also Debt Limit and New York City, supra note 16, at 190-91.

\textsuperscript{42} N.Y. CONST. art. VIII, § 10.

\textsuperscript{43} The State Board of Equalization and Assessment was established pursuant to N.Y. REAL PROP. TAX LAW §200 (McKinney 1972 & Supp. 1980).

\textsuperscript{44} The equalization rate is calculated by the State Board pursuant to articles 12, 12-A and 12-B of the Real Property Tax Law. N.Y. REAL PROP. TAX LAW arts. 12, 12-A, and 12-B (McKinney 1972 & Supp. 1980). Pursuant to § 1202, each year the State Board establishes equalization rates based upon the percentage of full value that assessments of taxable real estate represent in the jurisdiction for that year. At least once every five years, the State Board samples the ratio of assessments to market value, pursuant to § 1200. Special equalization rates for cities with populations of 125,000 or more are established under § 1252, using the last completed assessment roll and each of the four preceding rolls, with adjustments for estimated changes in market value between market value surveys. Id. A similar adjustment is used for city school districts in cities with populations of less than 125,000 inhabitants, under §§ 1260-1264.

\textsuperscript{45} Equalization rates have uses other than for the calculation of the debt and tax limits.
tionally mandated percentages are then applied to the full value to determine the limits of local taxing and borrowing powers.

Amendments to the local finance provisions of the state constitution in 1949 and 1951 changed the base for the calculation of the tax and debt limits from assessed values to full values. These amendments were intended to equalize local borrowing and taxing powers and free them from arbitrary restrictions imposed by local...
assessment ratios. By using the full value as a base, the limits would bear a more direct relationship to local property wealth. 47

These amendments were also intended to increase local borrowing and taxing powers where assessments were at levels significantly less than full value. 48 For example, where properties were typically assessed at half their full value, local borrowing and taxing powers would be half those of a jurisdiction where properties were assessed at full value. Therefore, where local assessments were close to full value, the modification of the base had little effect on local revenue-generating powers. 49 Concurrent with the change in the base, a number of percentage limits were amended. 50

Tax exempt property is excluded from full value in calculating the constitutional limitations. Although all real property in the state is subject to taxation unless specifically exempted by law, 61 article four of the Real Property Tax Law 52 and other laws 53 provide partial or full exemptions from property taxes for property owned by various levels of government, quasi-governmental authorities, organizations and individuals. 54 The value of these ex-

47. As a state committee recommending the modification of the tax limit reported:

Every municipality now has the power, and in fact is directed by law, to assess real estate at full value. Read together, the present constitutional tax limitation and the law requiring the assessment of property at full value, contemplate and intend that the tax limitation should be based on 2% of the five year average of full valuation of the real estate of the municipality.

Since the tax limitation is meant to restrain municipalities from levying taxes on real estate out of proportion to the value of the property, it is fiscally sound to base the limit on the full value of the real estate within the tax unit, rather than upon an artificial value resulting from a low rate of assessment.

COMPTROLLER’S COMMITTEE ON CONSTITUTIONAL TAX AND DEBT LIMITATION AND CITY SCHOOL FISCAL RELATIONS, FIRST REPORT 3-4 (Mar. 3, 1948) [hereinafter cited as COMPTROLLER’S COMMITTEE], quoted in TEMPORARY STATE COMMISSION ON THE REAL PROPERTY TAX, REPORT 88 (Mar. 27, 1979) [hereinafter cited as REPORT ON REAL PROPERTY TAX]. See also Constitutional History, supra note 11, at 158.

48. See Local Finance, supra note 23, at 101; Macchiarola, supra note 24, at 273.

49. Macchiarola, supra note 24, at 273.

50. Constitutional History, supra note 11, at 158-60.


52. Id. art. 4.


54. Most tax-exempt property is owned by various levels of state and local government or by quasi-governmental authorities. See NEW YORK STATE TEMPORARY STATE COMMISSION ON STATE AND LOCAL FINANCES, THE REAL PROPERTY TAX 89 (Mar. 15, 1975) [hereinafter cited as STATE AND LOCAL FINANCES].
emptions is continually rising.\textsuperscript{55}

The fact that the exempt value of property subject to certain partial exemptions is excluded in the calculation of the limitations may be based more on the application of sound fiscal practices\textsuperscript{56} than on legal decisions.\textsuperscript{67} At present, however, only the taxable value of property subject to partial exemption is included in the calculation of the limits.

III. Property Tax Assessment

The New York State Constitution\textsuperscript{58} was amended to require that measurements of tax and debt limits encompass the full value of local property because property had not been assessed according to uniform standards throughout the state.\textsuperscript{69} In this respect, New York has much in common with jurisdictions throughout the country.\textsuperscript{60} Measurements of assessment uniformity show that actual assessments often bear little relationship to legal assessment standards,\textsuperscript{61} and property tax burdens are rarely distributed uniformly
and according to value. This is despite the fact that the property tax is the most important source of revenue for local governments nationwide and therefore would presumably be subject to strict review.

In Hellerstein, the New York Court of Appeals noted that the legal assessment standard of full value was often ignored by assessors to such an extent that courts had determined that the standard meant nothing more than assessment at uniform percentages of full value. Even this standard has been proven to be rarely obtainable. Properties of like type, in similar locations, often show striking variations in assessments. As one state report described current assessment practices: "assessments of residential property are scattered with appalling randomness over a wide range of deviation from the simple mean. The status quo of residential assessment in most municipalities does not differ significantly in accuracy from what might be obtained by lottery." Local officials typically assess different types of property at differing percentages of full value. The percentage applied by the assessor depends upon such factors as how the property is used, how valuable it is, how long it has had the same ownership and where it is located.

Real Property Assessment 429 (1978).
63. Property taxes are the major source of revenue for local governments, raising $63 billion in 1979. They accounted for 78% of all locally collected taxes. N.Y. Times, Dec. 9, 1980, at A16, col. 4.
68. See, e.g., New York Public Interest Research Group, Inc., City of Unequal Neighbors: A Study of Residential Property Tax Assessments in New York City (1981); New York Public Interest Research Group, Inc., Assess Us As You Will: A Study of Residential Property Tax Assessments in the City of Syracuse (1980). NYPIRG found patterns of discrimination based upon neighborhood and value (with higher valued properties assessed at lower percentages of full value). Id. at 1, 9-13. See Report on Real Property Tax, supra note 47, at 27, with respect to discrimination by use. Assessment by duration of ownership is sometimes known as the "welcome stranger" method, whereby properties are reassessed as title transfers, subjecting the purchaser to assessments substan-
Properties assessed at the highest percentages of their value are owned generally by those who can most easily pass on the cost of the tax to others or for whom the property tax is a relatively insignificant factor in the cost of doing business. The lowest assessments are typically applied to property owned by those for whom the property tax is an important concern.  

Few jurisdictions in the state administer assessments in the same manner. Substantial differences exist as to which property types are favored, and to what extent. Within a single jurisdiction, for a single property type, there are often great differences in how properties are assessed. These large variations account for the great difficulty the legislature has faced in modifying the full value standard while minimizing local tax shifts.

A. De Jure Classification

The courts consistently have held that de jure classification systems do not violate the due process and equal protection clauses of the fourteenth amendment as long as they are based upon real distinctions. A number of states have enacted classified property tax systems that have been affirmed by the courts. In many states, the classification system was enacted as a result of a court decision, such as Hellerstein, requiring compliance with a state full value law. Most states that have enacted classification systems have

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72. See notes 106-09 infra and accompanying text.


Classification may involve the use of differential levels of assessment ("classified assessments") or the use of differential tax rates ("classified tax rates"). The former method is by far the most popular. The goal of both methods is the same: the granting of preferential tax treatment to the owners of certain types of properties. Both methods require the division of all properties into classes and the computation of the full value of all properties. In a classified assessment system, each class has its own assessment ratio, representing the percentage of full value subject to tax. A uniform tax rate is then applied to all non-exempt property. In a classified tax rate system, properties are assessed at full value and tax rates are applied according to the property class.

It is generally accepted that the legislature has the power to enact a classification system in New York. A recent decision summarized the relevant New York case law:

The power of taxation is plenary and rests exclusively in the Legislature.

... It may classify property for tax purposes in any manner it deems appropriate ... and what it determines in respect of policy, it is also competent to change. ... It may impose a heavy burden on one class of property and no burden at all upon others; the remedy for injudicious action being in

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76. ALA. CONST. § 217; ILL. CONST. art. 9, § 4; LA. CONST. art. 7, § 18(d); MINN. CONST. art. X, § 1; S.C. CONST. art. X, § 1; TENN. CONST. art. II, § 28; W. VA. CONST. art. 10, § 1b.
77. M. KUPFERMAN, CLASSIFIED REAL PROPERTY Tax SYSTEMS In THE UNITED STATES 1 (1980).
78. Id. at 2.
79. Id. at 2-7.
80. The point has been made that since article XVI, § 2 of the constitution provides: "The Legislature shall provide for the supervision, review, and equalization of assessments for purposes of taxation," then a classification system is contrary to the concept of equalization. Therefore, a constitutional amendment would be required to implement a classification system. See ECONOMIC DEVELOPMENT COUNCIL OF NEW YORK CITY, INC., REFORMING THE REAL PROPERTY TAX SYSTEM IN NEW YORK 23 (1979) [hereinafter cited as REFORMING THE PROPERTY TAX]. But see, e.g., LOCAL FINANCE, supra note 23, at 40: "[u]nder the present Constitution the Legislature could classify the types of property subject to the property tax and provide for differentials among tax rates for different classes."
the hands of the people, not the courts. . . . So long as the class subjected to taxation is determined by some reasonable policy of differentiation, and all in the same class have equality, the measure meets constitutional standards of equal protection. . . . That a 'fairer' taxing formula might have been adopted is of no moment. . . .

Uniformity clauses which require all property to be treated similarly for tax purposes are sometimes present in a state's constitution. A state with such a clause may be barred from enacting a classification scheme. Many state constitutions, however, including New York's, do not have uniformity clauses. The equal protection clause of the federal constitution does not prohibit classification.

B. De Facto Classification

Most state constitutions or property tax laws require property to be assessed at its full value or by some variant requiring uniformity, and for the same tax rate to be applied to all non-exempt property. The practice of fractional assessment where state stat-

82. 97 Misc. 2d at 643-44, 412 N.Y.S.2d at 297. As to the authority the legislature has in designing a classification system:

the Legislature has very nearly unconstrained authority in design of taxing impositions. . . . [F]airness and equity are not the principal criteria against which the validity of tax statutes is to be determined. . . . [I]t is often immaterial, in the resolution of tax controversies to demonstrate that in application a particular statute or regulation works even a flagrant unevenness. . . .

Long Island Lighting Co. v. State Tax Comm'n, 45 N.Y.2d 529, 535, 382 N.E.2d 1337, 1339-40, 410 N.Y.S.2d 561, 563-64 (1978). A local law providing for an excise tax or license fee applicable to businesses subject to supervision of the state public service commission was upheld as reasonable by the court of appeals because of the public service nature of the business and its protection against competition. New York Steam Corp. v. City of New York, 268 N.Y. 137, 197 N.E. 172 (1935).


It would be a narrow conception of jurisprudence to confine the notion of 'laws' to what is found written on the statute books, and to disregard the gloss which life has written upon it. . . . Deeply embedded traditional ways of carrying out state policy . . . are often tougher and truer law than the dead words of the written text. . . .

Fictions have played an important and sometimes fruitful part in the development of law; and the Equal Protection Clause is not a command of candor.

Id. at 369.

85. CENSUS OF GOVERNMENTS, supra note 55, at 281-83.
utes or constitutions require assessment at full value, however, has been sanctioned by the Supreme Court. In *Sioux City Bridge Co. v. Dakota County*, the Court ordered an assessment lowered to conform with the locally prevalent fractional assessment ratio, despite state law to the contrary, stating: "where it is impossible to secure both the standard of the true value, and the uniformity and equality required by law, the latter requirement is to be preferred as the just and ultimate purpose of the law." 87

The Supreme Court has also permitted de facto classification schemes where some property is fractionally assessed and other property is assessed at full value. In *Nashville, Chattanooga & St. Louis Railway v. Browning*, local officials valued ordinary property at less than the full value and state officials valued property owned by railroads and other public service corporations at full value. The Court held that this scheme did not violate the equal protection clause:

That the states may classify property for taxation; may set up different modes of assessment, valuation and collection; may tax some kinds of property at higher rates than others; and in making all these differentiations may treat railroads and other utilities with that separateness which their distinctive characteristics and functions in society make appropriate — these are among the commonplaces of taxation and of constitutional law. 88

86. 260 U.S. 441 (1923).
87. *Id.* at 446. The decision went on to require the local assessor to violate the law for the benefit of the taxpayer: "the right of the taxpayer . . . is to have his assessment reduced . . . even though this is a departure from the requirement of statute." *Id.*
88. 310 U.S. 362 (1940).
89. *Id.* at 368. Local governments derive a number of benefits from fractional assessment that explains its resilience despite laws requiring full-value assessment:
1) A low assessment ratio may delude a taxpayer into believing that the property tax rate is lower than it actually is.
2) An error in assessment is hidden better with a fractional assessment system: a 5% error where the assessment ratio is 30% and the value of the property is $100,000 is $1500, while the same error with full value assessments represents a $5000 difference in assessed value. The first error might be considered by the taxpayer to be too small to contest, while the latter might not be—although the tax effect is the same.
3) A taxpayer assessed at less than full value, but at a higher level than the prevalent assessment ratio, will have difficulty proving the inequality of the assessment, and may not want to upset the status quo.
4) The effective tax rate can be increased by raising assessments without increasing the tax rate itself, which might be unpalatable to local officials.
5) Assessments can be kept constant regardless of fluctuations in property value due to prevailing economic conditions, making localities depression- or recession-proof.
C. De Facto Classification in New York

Until its amendment in 1977, New York's assessment standard, section 306 of the Real Property Tax Law, read simply: "All real property in each assessing unit shall be assessed at the full value thereof." This standard had been law in New York since 1788.

As early as 1852, the court of appeals found assessors to be establishing their own standards: "[w]e are informed by the learned judge who delivered the opinion of the supreme court, that the usual method is to estimate property at less than half its value, under the obligation of an official oath, which requires its full value to be stated. . . ." Despite decisions requiring assessment at full value the practice of illegal fractional assessment did not disappear. The court of appeals found that fractional assessment was occurring as a matter of course in 1873 and with some regularity thereafter. A number of decisions held the practice to violate the law and ordered compliance; later decisions seemed to accept the fractional assessment standard on the theory that the legislature had acquiesced in this interpretation of the law. A 1964 supreme court decision affirmed by the court of appeals described the prevailing rule:

Section 306 provides that all real property shall be assessed at full value thereof. Although full value has been held to be synonymous with market value . . . the courts have uniformly held that this section does not mandate assessments at 100% of full or market value. It requires merely that the assessments be at a uniform rate or percentage of full or market value for every type of property in the assessing unit . . . The Legislature . . .

6) Some state governments, such as New York's, provide state aid in inverse proportion to local property value. Although the governments that provide aid mathematically equalize assessments before calculating state aid, local officials may attempt to underestimate property value on the theory that it would be harmless to try to deceive the state.

90. 1977 N.Y. Laws ch. 888 § 1.
91. 1788 N.Y. Laws ch. LXV. For the history of this standard in New York, see Hellerstein v. Assessor, Town of Islip 37 N.Y.2d at 4, 332 N.E.2d at 280, 371 N.Y.S.2d at 390.
93. People ex rel. Board of Supervisors v. Fowler, 55 N.Y. 252, 253-54 (1873).
95. Id. at 4-7, 332 N.E.2d at 281-82, 371 N.Y.S.2d at 391-92.
has acknowledged and apparently sanction [sic] this State-wide practice.97

The court of appeals' decision in Hellerstein in 1975 ended judicial acceptance of de facto classification in New York. The court responded to the Town of Islip's claim that the practical construction of the statute required only that property be assessed at a uniform fraction of value by noting that "'practical construction' is nothing more than a violation, which, no matter how persistent, widespread and uncorrected, cannot alter the meaning of the statute."98 The decision required the Town of Islip to reassess all property at full value by December 31, 1976.99

By implication, Hellerstein required all jurisdictions in the state to revalue properties at full value.100 Some jurisdictions were ordered by the courts to conduct revaluations as a result of subsequent decisions.101 Many jurisdictions in the state initiated revaluation programs voluntarily.102

The process of revaluation is time-consuming and costly.103 It is also politically unpopular, since it frequently shifts effective tax

97. 45 Misc. 2d at 192, 257 N.Y.S.2d at 38.
98. 37 N.Y.2d at 10, 332 N.E.2d at 284, 371 N.Y.S.2d at 395.
100. Matter of Colt Industries, N.Y.L.J. June 4, 1980, at 10, col. 2, held that New York City may enact a classified property tax system as described in this Comment by authority of the N.Y.C. ADMIN. CODE, § 166-1.0(b). The court recognized that the state legislature has traditionally treated New York City differently than other jurisdictions with respect to the assessment and taxation of real property. The court further noted that the real estate taxation provisions of the Administrative Code are special legislation that control the general statute, N.Y. REAL PROP. TAX LAW § 306. Therefore, the court held that the Administrative Code, which requires the taxpayer to prove inequality as against other property of like character in the same ward or section of the city, permits New York City to enact a classification system. Colt, if upheld, could eliminate for New York City problems engendered by the Hellerstein decision. Its effect on the constitutional tax and debt limits, the subject of this Comment, was not at issue in Colt. (Colt was ignored by a subsequent supreme court decision which considered an issue similar to that decided in Colt.) J.A. Green Constr. Corp. v. Finance Adm'r, No. 12468-71 (Sup. Ct. Sept. 15, 1980)).
102. See REPORT ON REFORMS, supra note 59, at 5.
103. The New York State Division of Equalization and Assessment estimates the cost of revaluations state-wide at $150 million. Id. at 7-8.
rates from commercial properties to residential properties and from over-assessed properties to under-assessed properties within the same class.104

In order to protect those jurisdictions not yet under court order to reassess, and to permit time to develop a replacement for the full value standard, the legislature amended section 306, creating a moratorium for compliance in jurisdictions making a good faith effort to revalue. This moratorium was recently extended to May 15, 1981.105

IV. Classification Legislation and the Tax and Debt Limits

The difficulty involved in developing an alternate assessment system that would minimize tax shifts prevented the legislature from coming to an agreement on a revision to section 306 during the 1980-1981 session.106 Substantially different bills passed each house during the session; in addition, a senate-approved bill significantly different from the other two was carried over from the prior session.

The bill that was passed by the senate in the 1979-1980 session ("Esposito-Padavan") would maintain the status quo of assessment administration. The bill would permit the continuation of assessments by "any of the same methods of assessment" used prior to 1975. In effect, this bill would delegate to local officials the determination of assessment ratios. A local option could be enacted to establish any other assessment standard, including full value.107

During the 1980 session, the senate passed the "Present-Good-hue Bill" which would leave the full value standard intact. It pro-

104. The greatest shifts have generally occurred within the same class. 1980 Revaluations, supra note 70; New York State Division of Equalization and Assessment, 1979 Revaluations Property Tax Shift Analysis (1979).

105. 1977 N.Y. Laws ch. 888 § 1 enacted a moratorium until December 31, 1980. This moratorium was extended to May 15, 1981 by the legislative session that was called toward the end of 1980. See 1980 N.Y. Laws ch. 880.


107. Critics have claimed that the bill (N.Y.S. 4130; N.Y.A. 6136 202d Sess. (1979)) has constitutional defects in its vagueness (permitting assessment by "any of the same methods" as existed previously provides no clear direction to administrators) and because it delegates the legislature's taxing and review powers. It is also questionable whether a rational basis for the classifications it protects is present. See, e.g., Senate Local Government Committee, Real Property Tax Reform in New York 3-4 (1981).
posed to establish a homestead exemption (to a maximum of twenty-five percent of assessed value as determined by the exercise of a local option) which would cushion the transition to full value for owner-occupied residences. It would also impose a "homestead tax" on the portion of residential property value subject to the homestead exemption.\(^\text{108}\)

A bill introduced in the assembly by Speaker Stanley Fink ("Fink Bill") would establish nine classes of property based upon use, with further subclassification subject to local option. To minimize tax shifts each class (and subclass) would be assessed as closely as possible to the current assessment ratio for that class of property. For owner-occupied residential property, no tax increase would become effective until title was transferred. The Fink Bill would also permit the establishment of a homestead exemption by local option.\(^\text{109}\)

The sponsors of both the Fink and Present-Goodhue Bills recognized that an interplay exists between the assessment standard and the constitutional tax and debt restrictions. At issue is whether the amount of property value that is exempt from assessment through the operation of a classification system is to be included in the value of taxable property in the jurisdiction for the calculation of the limits. This question has been considered by few courts, none of them in New York.

The 1977 Temporary State Commission on the Real Property Tax,\(^\text{110}\) which recommended that the legislature not enact a classification system,\(^\text{111}\) noted that the only sure way to avoid the possibility of classification operating to reduce the local debt and tax

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109. N.Y.A. 10,000-D, 203d Sess. (1980). The Fink Bill also permits an assessing unit to determine the value of property by a mathematical computation based upon average assessment ratios in the jurisdiction, without the necessity of on-site inspection. The classes that would be established are: residential (three or less dwelling units), apartment (more than three dwelling units), commercial, industrial, agricultural, vacant, railroad, utility and special franchise. Subclasses could be established for the residential and apartment classes of property. New York City would be permitted to establish four subclasses of property; other jurisdictions would be permitted to establish two subclasses. The subclasses could be based upon such considerations as use or potential use, form of ownership, value, age, geographic location and provisions of any applicable zoning ordinance or master plan.
111. REPORT ON REAL PROPERTY TAX, supra note 47, at 58-62.
limits would be to enact a constitutional amendment. The Commission reported that this problem had also been recognized by the Temporary State Commission on the 1967 Constitutional Convention. This point also has been made by other commentators.

A recent assembly committee report, however, which recommended the adoption of an early version of the Fink Bill decided that any ambiguity in the effect of classification on the limitations could be cured by legislation:

Another objection to classification lies in the assertion that it might adversely affect constitutional tax and debt limits. Some legal authorities believe that legalizing differential assessments would result in a redefinition of taxable value as that percentage of full value that is actually subject to taxation. This argument, however, overlooks the fact that the Constitution does not define taxable real estate. The legislature could obviate this concern by defining taxable property so as to ensure that such a reduction does not occur.

This approach of legislatively redefining a term in the constitutional limitation was attempted unsuccessfully by the Pennsylvania legislature in 1961.

Pennsylvania’s constitutional debt limit is based on the assessed value of local property. As in New York, the legal assessment standard is full value. However, the Pennsylvania Supreme Court found in Breslow v. School District that the practice was to assess at between fifteen and seventy percent of full value. In 1961,

112. Even though classification can be enacted, it does raise an ancillary legal question which should be resolved before any classification system is considered. It is possible that a municipality’s constitutional tax and debt limits would have to be reduced proportionately to the exemptions flowing from the classification system.

The issue has never been addressed by the courts or through administrative rulings, however, it does involve a risk and in municipalities which are at or near their tax limits, it poses a substantial fiscal question which could render classification unfeasible. The only sure method of resolution of this question would be an amendment to the Constitution.

Id. at 60 (emphasis added).

113. Id. at 89.


116. Id. at 10.


118. Id. at 125, 182 A.2d at 503.
in an attempt to increase local borrowing powers the legislature amended the Municipal Borrowing Law to define "assessed valuation" as "market valuation." The amendment would have raised the debt limit considerably. 119

Holding the amendment unconstitutional, the court reasoned that when the voters had adopted the constitution, the term "assessed valuation" had a common meaning to the voters: the percentage of market value at which property was assessed for tax purposes. 120 The court decided that the legislature could not redefine commonly understood terms: "all that any Legislature would have to do, in order to circumvent the Constitution, is to pass an Act defining or redefining any term or any language used in the Constitution to suit its purpose or objective." 121 Therefore, applying the same logic, a New York court would find the legislature powerless to redefine the term "full valuation of taxable real estate" in the constitutional limitation. 122

A different approach would be taken by the Present-Goodhue Bill. This proposal takes a position similar to that taken by the New York State Division of Equalization and Assessment, which assumes in a recent report 123 that the effect of classification would be to reduce taxing and debt-incurring powers. 124 This bill proposed that municipalities could apply a "homestead allocation" or homestead tax, to a portion of all residential property value, including value subject to the homestead exemption. The effect would be that the full value of homestead property would be taxed,

119. Id. at 126, 182 A.2d at 504.
120. Id.
121. Id. at 127, 182 A.2d at 505.
122. If a New York court were to find that classification operated as an exemption, removing a percentage of value from the calculation of the debt and tax limits, it is unlikely that a redefinition of terms could avoid the constitutional limit. As the court found in Hurd, the taxpayers have an important constitutional right not to be taxed in excess of the limits they believed they had established: "The citizens of the State of New York, in establishing a constitutional tax limit of 2% for operating expenses, presumably decided that this was the maximum tax which could be levied on real property without becoming oppressive, and it may not be circumvented by legislation." Hurd v. City of Buffalo, 41 A.D.2d at 405, 343 N.Y.S.2d at 953. But see Sigal, The Proposed Constitutional Amendments to the Local Finance Article: A Critical Analysis, 8 Fordham Urb. L.J. 29, 31 (1979) ("[T]he New York Court of Appeals has responded with great deference to legislative acts respecting fiscal matters when those acts have been challenged under the state constitution.").
124. Id. at 10-11.
albeit by two taxes at different rates.\textsuperscript{125}

An important question, however, is whether the courts would agree that classified assessments would affect the taxable value base, as the Division of Equalization and Assessment assumed.

Few states employ a system of constitutional tax and debt limitations combined with a statutory assessment standard. Therefore, courts rarely have considered the effect of a modification of the assessment standard on the constitutional limitations.\textsuperscript{126} Most of the eleven jurisdictions which have enacted classification systems did so by constitutional amendment.\textsuperscript{127} Other states with statutory classification systems do not have constitutional taxing or borrowing restrictions.\textsuperscript{128} In addition, New York's restrictions are relatively unique in that they are based upon the full value of taxable property in the jurisdiction, rather than upon the assessed value. Hence, clear precedents are difficult to find.

Where constitutional limitations are based upon assessed value, courts must consider whether the enactment of classification increases local borrowing or taxing powers. This is because the initial effect of classification is to increase fractional values to full value

\begin{itemize}
  \item[125.] "By continuing to levy a tax against the entire assessment roll, this device will produce the same mathematical effect as the application of an exemption, while avoiding the unintended potential fiscal problems associated with a reduced taxable value base." \textit{Id.} at 11. \textit{See also Senate Local Government Committee, Real Property Tax Reform in New York} 13-17 (1981).
  \item[126.] Eleven jurisdictions have legalized classified real property tax systems: Alabama, Arizona, Louisiana, Massachusetts, Minnesota, Montana, South Carolina, Tennessee, West Virginia and the District of Columbia. Illinois permits cities with populations of 200,000 or more to classify subject to a local option. \textit{See Kupferman, supra} note 77. All but Arizona, West Virginia and Montana adopted constitutional amendments in order to implement classification. \textit{International Association of Assessing Officers, Classified Property Tax Systems in the U.S.} 1 (1979).
  \item[127.] \textit{See note 76 supra.}
  \item[128.] B. Mann \& F. Bird, \textit{supra} note 8, at Table 2.
\end{itemize}
prior to reduction to taxable value. The courts are divided as to whether, under these circumstances, the taxable (fractional) values determine the base for the calculation of the limits, or the full values.\textsuperscript{129}

In \textit{Phelps v. City of Minneapolis}, for example, the Minnesota Supreme Court was asked to determine whether the limit of net indebtedness of "10 percent of the last assessed value of all taxable property" meant that the base was the full value or the value after the appropriate classification fractions were applied pursuant to the classification statute.\textsuperscript{130} The court held that the lower value, that is, the value after the classification fractions were applied, was appropriate for calculation of the debt limit because to do otherwise would have caused a substantial increase in local borrowing powers.\textsuperscript{131}

The Montana Supreme Court reached the opposite conclusion immediately after the enactment of Montana's classification law,\textsuperscript{132} holding that the term "assessed value" in the constitutional borrowing limit meant the full value prior to the reduction to the fractional assessment, since the language was "too plain to admit of doubt or to require the citation of authorities to support the conclusion. . . ."\textsuperscript{133} The court was unconcerned with the fact that the decision permitted the issuance of bonds at a level three times that which would have been possible prior to the enactment of the classification law.\textsuperscript{134}

Since classification operates in a manner similar to an exemption, the percentage of property value not taxed under a classification system could be treated as though it were exempt through more typical exemption measures. Most courts have held that ex-

\begin{itemize}
\item \textsuperscript{129} 174 Minn. 509, 219 N.W. 872 (1928).
\item \textsuperscript{130} \textit{Id.} at 511, 219 N.W. at 873.
\item \textsuperscript{131} \textit{Id.} at 512, 219 N.W. at 874.
\item \textsuperscript{132} 1919 Mont. Laws ch. 51.
\item \textsuperscript{133} \textit{State v. Board of Com'rs}, 56 Mont. 387, 389, 185 P. 456, 457-58 (1919).
\item \textsuperscript{134} The Montana legislature was concerned, however, and enacted a law limiting the base for the debt limit to the taxable value of property in the jurisdiction, defining the taxable value as the percentage of full value remaining after the classification fraction is applied. The substitution of the taxable value for the assessed value as a base was upheld by the Montana Supreme Court in \textit{Heckman v. Custer County}, 70 Mont. 84, 223 P. 916 (1924). The court reasoned that since the debt limit in the state constitution represented an outside limit, the legislature was free to reduce the constitutional limit as it saw fit. \textit{Id.} at 85, 223 P. at 918. \textit{See also} \textit{State v. Cooney}, 97 Mont. 75, 32 P.2d 851 (1934).
\end{itemize}
empt property is not included in the determination of the value of taxable property for calculation of the limits. With respect to borrowing limitations, the typical rationale of the decisions is that property that cannot be taxed to repay the bonds must not be permitted to increase borrowing powers.

For example, in Kentucky, property exempt from county taxation but subject to state taxation was not considered to be included in "value of taxable property in the county" for calculation of the county's debt limit:

the framers of our Constitution in limiting the amount of indebtedness the county might incur to not exceeding 2% of the value of taxable property in the county, intended that the taxable property would bear the obligation of satisfying the bonded indebtedness. . . . [As the exempt property] cannot be taxed for the purpose of maturing these bonds, it cannot be included in the 'value of taxable property' in the county.

Similarly, in Wyoming, it was held that the assessed value of property bought by a county after tax delinquency could not be used to support the local school debt. The Wyoming Supreme Court reasoned that taxes should be assessed to determine a price for redemption of the property by the prior owner, but since it was questionable whether the taxes would be paid, the value of the property should not increase the school district's borrowing powers.

135. "[T]he majority of the few cases on the subject have held or recognized that tax-exempt property is not to be included in determining the value of taxable property for debt limit purposes." Annot., 30 A.L.R.2d 903, 904 (1953). See, e.g., State v. City of Pompano, 136 Fla. 730, 188 So. 610 (1938); Campbell v. Red Bud Consol. School Dist., 186 Ga. 541, 198 S.E. 225 (1938); Thornburgh v. School Dist., 175 Mo. 12, 75 S.W. 81 (1903).

136. See notes 137-39 infra and accompanying text.

137. Monroe County v. County Debt Comm'n, 247 S.W.2d 507, 508 (Ky. 1952).


139. The court stated that it "cannot readily see how that particular property will 'eventually have to bear its proportion of the burden of retiring the bonded debt,'" Id. at 17, 102 P.2d at 53, and was concerned about the sufficiency of the tax base: "[n]either a school district nor a county can afford to have its credit impaired by the issuance of obligations likely to be defaulted in the not distant future." Id. at 18, 102 P.2d at 54. See also Thornburgh v. School Dist., 175 Mo. 12, 75 S.W. 81 (1903), where railroad property and merchants' stocks which were not taxable by the school district could not be included in calculating the debt limit. The court stated that "[t]he plain purpose of the Constitution is to forbid the incurring of a public debt beyond a certain per centum of the value of the property taxable for its payment." Id. at 30, 75 S.W. at 85.

Some courts, however, permit property not subject to taxation for the repayment of bonds
In New York, in determining whether the value of exempt property should be included in calculating the limitation, the consideration of whether or not the property will produce taxes may be less important than the fact that the local government retains the power to levy taxes if it so chooses. In *L.L.F. Realty Co. v. Fuchs*\(^\text{140}\) the appellate division held that the value of property subject to tax should be included for purposes of calculating the constitutional debt limit irrespective of whether or not a tax is actually extended against the property.\(^\text{141}\) In *L.L.F. Realty*, the City of Long Beach was prevented by its charter from levying taxes on property “bid in by the city treasurer at a tax sale or against which the city held or owned tax liens.”\(^\text{142}\) The court concluded that the property was still subject to taxation for purposes of calculating the limitations because the charter could have been amended at any time to extend taxes to these properties. Moreover, the court concluded that the properties were at least contingently liable for taxes which could be collected if the properties were redeemed by their owner or sold at a tax sale.\(^\text{143}\) This logic was followed in *Huntington v. State Board of Equalization and Assessment*,\(^\text{144}\) which permitted the full value of property subject to partial veterans' or clergy\(^\text{145}\) exemptions to be included in calculating the equalization rate despite the fact that only the non-exempt portion of the property value was taxed.\(^\text{146}\)

\(^{140}\) 273 A.D. 111, 75 N.Y.S.2d 356 (1st Dep't 1947).
\(^{141}\) *Id.* at 113, 75 N.Y.S.2d at 359.
\(^{142}\) *Id.* at 112-13, 75 N.Y.S.2d at 358.
\(^{143}\) *Id.* at 113, 75 N.Y.S.2d at 359. For practical reasons, the city was spared from futile attempts to collect taxes on the property or from preparing fictitious budgets assuming that the taxes would be paid. *Id.*
\(^{145}\) N.Y. REAL PROP. TAX LAW § 458 (McKinney 1972).
\(^{146}\) N.Y. REAL PROP. TAX LAW § 460 (McKinney 1972).
\(^{147}\) The court held that the veterans' or clergy exemption should have no effect on either the assessed or full values since they represented a "limited personal and transitory exemption" with relevance only in calculating the taxpayer's liability, 53 A.D.2d at 8, 385
Courts have paid particular attention to the wording of the limitation to determine the measure of property value that the legislature or the public intended to be used. In *Breslow*,\(^{148}\) the Pennsylvania Supreme Court determined that the constitutional limitations based upon assessed values meant assessments for taxation, which were commonly known to represent a fraction of market value.\(^{149}\) In California, however, because the legislature had established some limits based on assessed value of taxable property and other limits based upon the value of all property, the debt incurred by a utility district was held to be based on the total value of property in the district irrespective of whether the property was subject to taxation.\(^ {150}\)

In New York, the constitutional limitation is based upon the "full valuation of the taxable real estate" in the jurisdiction.\(^ {151}\) Prior to the 1949 and 1951 constitutional amendments, the limitation was based upon "the assessed valuation of the real estate subject to taxation."\(^ {152}\) The report of the committee,\(^ {153}\) which recommended the change from assessed valuation to full value as a base, does not discuss the change in wording from "subject to taxation"

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\(^{149}\) *Id.* at 126, 182 A.2d at 504.

"[The legislature] chose in the case of the cities, utility districts and certain subdivisions of the State, to limit bonding capacity to a percentage of the assessed value of all property within the taxing unit; it chose in the case of counties, schools, and certain other subdivisions of the State, to limit to a percentage of the assessed value of taxable property."

*Id.* at 469, 287 P.2d at 845-46. The court, therefore, decided to "assume that the Legislature knew what it was saying and meant what it said." *Id.* at 465, 287 P.2d at 844.

\(^{151}\) N.Y. Const. art. VIII, §§ 4, 10.
\(^{152}\) *See Constitutional History, supra* note 11, at 158-59.
\(^{153}\) *Comptroller's Committee, supra* note 47.
to "taxable real estate," and it is reasonable to infer that the change was not intended to have an effect on the measurement of the base. In such a case, the prior wording would imply that the value of property excluded from taxation by the operation of a classification system should be excluded from the calculation of the debt and tax limits.

V. Effect on Antecedent Debts

Some courts have considered the assessment standard to be part of the contract between the municipality and the purchaser of the bonds and have held that any change in the standard violates federal constitutional prohibitions against laws impairing contracts. This has been held to be so even where the classification system resulted in no change in assessed values. Thus, if a court were to hold that the enactment of classification legislation reduced the taxable value base for the calculation of debt-incurring powers, it could invalidate the statute as a possible impairment of the security of the bonds.

The Supreme Court has taken inconsistent positions with respect to how material a modification of a bondholder's security or a change in his remedies must be before it finds an unconstitutional impairment. In Von Hoffman v. City of Quincy, the Court held a law which limited the rate of the property tax and which

154. Id.
155. This was noted by the 1977 Temporary State Commission on the Real Property Tax. Report on Real Property Tax, supra note 47, at 88.
156. See also N.Y. Local Fin. Law, art. 1, § 2.00(7), (7-a) (McKinney 1968), where the distinction in wording is retained.
158. See, e.g., Town of Samson v. Perry, 17 F.2d 1 (5th Cir. 1927). Bonds were issued by the town when the legal assessment standard was full value. Subsequently the legislature amended the standard requiring assessment at 60% of full value. The court held the amendment void as to antecedent debts despite the fact that the amendment merely made the prior de facto standard legal.

We do not think it is material whether, after the enactment of that statute, 60 percent of the assessed value of property in the town of Samson actually was more or less than 100 percent of the value of the same property as it was assessed prior to that enactment.

Id. at 2. The court ordered the full value of property to be taxed until the antecedent debt was repaid. Id.
159. 71 U.S. 535 (1866).
repealed a special levy for the repayment of bonds unconstitutional. The decision in Von Hoffman emphasized the substantiality of the impairment created by the law and concluded that a legislature does have the right to modify the bondholders' remedies so long as "no substantial right secured by the contract is thereby impaired." This case lent support to a number of subsequent decisions which carefully weighed the materiality of the impairment.

Recently, the Supreme Court's decision in United States Trust Co. v. New Jersey may have signaled that the Court will take an absolute position with respect to laws affecting the security of bonds, to the extent of finding an impairment even where the marketability of the bonds is unaffected. In United States Trust, bondholders challenged legislation purporting to repeal retroactively a covenant which guaranteed purchasers of bonds of the Port Authority of New York and New Jersey that the Authority would refrain from acquiring certain mass transit facilities. The Court, however, did not determine that the impairment was material; rather, it determined that the covenant was "not superfluous" and the state had made no effort to compensate the bondholders for the repeal of the covenant. The Supreme Court did not consider significant the lower court's finding that the investment rating of the Authority's bonds showed no permanent reduction attributable to the passage of the law.

160. Id. at 553.
163. See Hurst, supra note 161, at 59.
165. Id. at 19.
166. Id.
167. The lower court found that the bonds retained their high ratings from the investment advisory services after the repeal of the covenant, and the market price of the bonds, although showing an initial decline, had risen to a level comparable to that existing prior to the passage of the legislation. United States Trust Co. v. State, 134 N.J. Super. 124, 179-82, 338 A.2d 833, 864-65 (1975), aff'd per curiam, 69 N.J. 253, 353 A.2d 514 (1976), rev'd, 431
Therefore, following *United States Trust*, a law reducing the amount of assessed value taxable to support the repayment of an antecedent debt could be voided as a violation of the contract clause if the assessment standard were to be considered "not superfluous" to the purchasers of the bonds.\(^\text{168}\) This could be held to be so even without proof that the law impairs the bondholders' security or otherwise impairs their contract.

Alternatively, a harsh result could arise if bonds were issued to a level based upon full value and a court were to subsequently decide that the limit should have been based upon the classified (fractional) value. Under similar circumstances, it has been held that a jurisdiction issuing bonds beyond the local borrowing power is not estopped from denying the validity of the bonds when they are presented for payment.

U.S. 1 (1977). Although the investment value of the covenant may have been minimal, one writer has noted that the attempted repeal of the covenant by the New Jersey legislature (and subsequently, the New York legislature) in 1975 carried with it "enormous psychological implications." K. Auletta, *supra* note 37, at 86. "Investors took this as a sign that the government's—or, more precisely, the politicians'—word was no good." *Id.* The result was that the municipal bond investment community subsequently took a much more jaundiced view of moral obligation bonds issued by the City of New York, which required "investor confidence" to sell. Later, that same investment community would take a much harder look at New York City's financial statements, leading to the fiscal collapse of 1975. The important point is that investor confidence may be at issue with respect to a modification of the assessment standard, and the marketability of municipal securities may be affected by these types of indirect forces. *See* note 175 *infra* and accompanying text.


A court could also develop a less drastic alternative to invalidation of a law which was held to impair the contract of the bondholders. When the Florida Constitution was amended to exempt homestead property from taxation, the Florida Supreme Court ordered property eligible for the exemption to continue to be taxed until the antecedent indebtedness was repaid, unless the legislature appropriated sufficient funds to replace the taxes that would have been obtained from the exempt property. *Long v. St. John*, 126 Fla. 1, 170 So. 317 (1936). *See also* Town of Samson v. Perry, 17 F.2d 1 (5th Cir. 1927); *People ex rel. Boyle v. Trustees, Village of Edgewater*, 51 N.Y. 280, 25 Barb. 16 (Sup. Ct. 1876) (where local power to levy taxes was decreased by the legislature, debts incurred by the village prior to the effective date of the legislation had to be paid from taxes levied outside the limit, if funds were unavailable to pay the debt inside the limit); *State v. Cooney*, 97 Mont. 75, 32 P.2d 851 (1934); Annot., 109 A.L.R. 817 (1937).
For example, in *Thornburgh v. School District No. 3*, the Missouri Supreme Court found that a school district had issued bonds based upon the assumption that railroad property and merchants' stocks were included in calculating the value of local property for determining the debt limit. Subsequent to the issuance of the bonds, railroad property and merchants' stocks were held not to be included. When the bonds were produced for payment the school district refused to redeem them. The bondholder sued, but the court agreed with the school district and found the bonds, including amounts issued within the debt limit, void.

Similarly, in *State v. Spring City*, the Utah Supreme Court held that certain municipal bonds were issued in an amount exceeding local revenues, violating taxpayer protections in the state constitution. The court held that the bonds were void, and the state, which had purchased the bonds, was denied restitution.

In light of the court's harsh position with respect to bonds issued beyond constitutional restrictions, it is important that potential purchasers be absolutely certain of the legality of bonds issued after a modification of the assessment statute. Any uncertainty involved could severely restrain the marketability of the bonds.

169. 175 Mo. 12, 75 S.W. 81 (1903).
170. Id. at 29, 75 S.W. at 85.
171. Id. at 31, 75 S.W. at 86.
172. Id.
174. The constitutional provisions were enacted as a protection for the taxpayers against an abuse of their credit. The protection is absolute in nature. If recovery is allowed against the municipality on a theory of money had and received, the entire purpose for which the provision exists is contravened. Although the legal theory is changed, the practical result would be payment by taxpayers of an obligation against which the Constitution specifically attempts to protect them. 

Id. at 476, 260 P.2d at 531. See also *Litchfield v. Ballou*, 114 U.S. 190 (1885); *Town of Belleair v. Olds*, 127 F.2d 838 (5th Cir. 1942); *State v. City of Pompano*, 136 Fla. 730, 188 So. 610 (1939); *Fairbanks Morse Co. v. City of Geary*, 59 Okla. 22, 157 P. 720 (1916).

175. New York Constitution article VIII, § 4 makes any indebtedness created in excess of the constitutional limit void. See *Bank for Sav. v. Grace*, 102 N.Y. 313, 7 N.E. 162 (1886). The bonding power is measured at the time of the issuance of the bonds. *Gibson v. Knapp*, 21 Misc. 499, 47 N.Y.S. 446 (Sup. Ct. 1897); 6 Or. N.Y. Comp. 167-68 (1950). Although the rating of bonds is not directly related to the proposed property tax legislation, uncertainties involving the security behind the bonds could reduce their marketability. The recent passage of Massachusetts' property tax limitation measure was solely responsible for the downgrading of the City of Boston's bonds, because it reduced the city's "financial flexibility." *N.Y. Times*, Dec. 3, 1980, at A20, col. 5. The passage of Proposition 13 in California caused
VI. Conclusion

Legislation directing local officials to assess and tax real property at less than full value is an attractive option to avoid precipitous tax increases for property owners now currently underassessed. However, New York's assessment standard does not stand alone; it is closely related to local government borrowing and taxing powers restricted by the state constitution. If these powers were held to be limited in any way by a modification of the assessment standard, the effect on local governments which rely heavily on borrowing, or which are taxing at levels close to the limits, would be calamitous.\textsuperscript{176} Reductions in local tax revenues could result in personnel layoffs and service cutbacks; reductions in borrowing powers could restrict funds sorely needed for the repair or replacement of capital improvements. Alternatively, a modification of the assessment standard could be set aside, as impairing the security of the bonds, thus violating federal constitutional guarantees against laws impairing contracts. A finding that the legislation reduced local borrowing powers after bonds were issued with the assumption that borrowing was unaffected could make the bonds void and irredeemable.

Whether bonds were issued in excess of the borrowing limits is perhaps the most important consideration. Uncertainty among bondholders results in higher interest rates to compensate for the investment risk. As was evident during New York City's fiscal crisis, any impairment in the marketability of municipal securities has a crippling effect on local government operations.\textsuperscript{177}

The possibility that a change in the assessment standard could

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\textsuperscript{176} The Temporary Commission on the 1967 Constitutional Convention found four cities in the State taxing at 99\% of the Constitutional limit: New York City, Rochester, Syracuse, and Yonkers. Most jurisdictions in the state were substantially below their limits. \textit{Local Finance}, supra note 23, at 47, 53-54. This may have been a transitory condition. Since 1967, New York City has taxed at approximately the limit in five years and significantly below it in eight years. T. \textsc{Boast} & J. \textsc{Vitullo-Martin}, supra note 69, at 8. As of June 30, 1980, New York City was borrowing at a level of approximately $1.5 billion below the debt limit. \textit{City of New York, Comprehensive Annual Report of the Comptroller for the Fiscal Year Ended June 30, 1980} 159 (1980). The city was also below the housing debt margin by over $200 million. \textit{Id.} at 160.

\textsuperscript{177} See Bond, supra note 161, at 24-25.
substantially impair the marketability of municipal securities is a compelling argument for modifying the assessment standard through a constitutional amendment. At the same time, a more comprehensive revision of the local finance article of the state constitution might now be appropriate. A number of writers have pointed out that New York's constitutional tax and debt limits are an inconsistent pattern of overlapping provisions, with important exceptions and exclusions which violate the intent of the limits.\textsuperscript{178} In fact, some writers have directly attributed New York City's fiscal crisis to tax limits which encourage borrowing over more realistic financing mechanisms.\textsuperscript{179}

An amendment of the constitutional debt and tax limits could resolve any uncertainty regarding the effect of a modification of New York's assessment standard. At the same time, an amendment could simplify the local finance provisions of the state constitution, and could encourage the application of sound fiscal practices.\textsuperscript{180} It is important, therefore, that the legislature consider a constitutional amendment when it addresses the full value assessment question.\textsuperscript{181}

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\textsuperscript{178} See, e.g., Gelfand, supra note 27, at 558-66; Macchiarola, supra note 24, at 285.

\textsuperscript{179} Constitutional History, supra note 11, at 175. Some commentators have also suggested that local property value is a poor standard to use to determine debt and tax limits. See Bar Association Proposal, supra note 37, in which a simplification of N.Y. Const. art. VIII, is proposed, including borrowing limits based upon local revenues instead of on local property values. See, e.g., Bowman, The Anachronism Called Debt Limitation, 52 Iowa L. Rev. 863 (1967); Constitutional History, supra note 11, at 169.

\textsuperscript{180} See Local Finance, supra note 23, at 56-64, 108-27, for recommendations proposed for the 1967 Constitutional Convention, and discussion of the proposals in Constitutional History, supra note 11, at 177-79. See also Bar Association Proposal, supra note 37, for a more recent proposal to amend article VIII of the constitution.

\textsuperscript{181} There are two ways the constitution may be amended: passage by the legislature, an intervening general election of members of the assembly, passage by the new legislature and approval by the voters; or adoption by a constitutional convention and approval by the voters. N.Y. Const. art. IX, §§ 1, 2.

* The student-writer is an employee of the Finance Department of the City of New York. The views expressed in this Comment are those of the writer and do not represent the City of New York's position on this issue.