



## DIGGING A HOLE

### Special Session Tax and School-Finance Package Creates \$10.5 Billion Deficit in 2008-09 Budget

The fiscal notes for the tax and school-finance bills passed during the special session reveal a gap of \$10.5 billion between the expected costs of HB 1 and anticipated revenues from HB 3, 4, and 5 in 2008-09. This deficit will place tremendous pressure on the next state budget, which could cause severe budget cutbacks, an increase in the state sales tax or other state taxes, an expansion of gambling as a source of revenue, or all of the above.

#### **What is the cost of the property tax cut and new school spending?**

HB 1 will reduce school maintenance-and-operations (M&O) property taxes by up to 17 cents in 2007 and by one-third in 2008. The fiscal note assumes that the one-third reduction will be maintained in future years.

The initial property tax cut will require the state to put up \$2.15 billion in 2007 to replace property tax revenue lost to school districts. The deeper cut in 2008 will cost \$6.59 billion in the first year; the cost will increase by 4% to 5% each year thereafter.

In addition, HB 1 spends \$802 million to fund a salary increase for teachers, counselors, librarians, and school nurses in 2007 and \$319 million for an allotment to school districts of \$275 for each high school student. If all school districts were to raise their local tax rates by four cents for 2007, to take advantage of the new higher yields offered on those pennies, the cost to the state would increase by \$478 million.

Recapture payments statewide will drop from the current \$1.8 billion to less than \$1.1 billion in 2007. The lost \$700 million is

currently used to support property-poor school districts.

#### **How much revenue will be generated by the tax bills?**

HB 3, the new business tax that will replace the corporate franchise tax, will generate a net increase of \$3.38 billion in 2008. The fiscal note assumes that, once the tax is fully operational, it will grow by 6% to 7% per year.

Although the business tax is assumed to grow faster than the property taxes it partially replaces, that does not mean that the gap between spending and revenue will shrink. Remember that the business tax will grow from a base of roughly \$3.5 billion, while the property taxes that are being cut would have generated more than \$6.5 billion. Business tax revenue will increase by about \$250 million a year, but foregone property tax revenue would have grown by about \$350 million a year.

The new cigarette tax generated by HB 5 will decline from biennium to biennium, dropping from \$1.42 billion in 2008-09 to \$1.31 billion in 2010-11.

All new revenue from HB 3, 4, and 5 is dedicated by HB 2 to reducing school property taxes. If the average tax rate were to drop below \$1.00, two-thirds of the new revenue would continue to go to cut property taxes and one-third would go to increase equalization of school taxes “to the extent that limits reliance by school districts on local property tax effort and decreases the enrichment tax rates of districts,” i.e. to cut property taxes.

**What is the net result?**

Combining the estimated costs of HB 1 with the estimated revenue from HB 3, 4, and 5 reveals a potentially disastrous gap in future budgets. As the table below shows, the expected deficit in 2008-09 is \$10.48 billion, growing to \$11.12 billion in 2010-11. This deficit will place tremendous pressure on the next state budget, which could cause severe budget cutbacks, an increase in the state sales tax or other state taxes, an expansion of gambling as a source of revenue, or all of the above.

|              | COSTS   |  | REVENUE |        |        | Total Revenue | NET DEFICIT |
|--------------|---------|--|---------|--------|--------|---------------|-------------|
|              | HB 1    |  | HB 3    | HB 4   | HB 5   |               |             |
| 2007         | \$3.92  |  | \$0     | \$0.03 | \$0.43 | \$0.46        | \$3.53      |
| 2008         | 8.69    |  | 3.38    | 0.04   | 0.69   | 4.12          | 4.58        |
| 2009         | 10.13   |  | 3.45    | 0.04   | 0.73   | 4.22          | 5.91        |
| 2010         | 9.85    |  | 3.72    | 0.04   | 0.63   | 4.40          | 5.46        |
| 2011         | 10.35   |  | 3.96    | 0.04   | 0.68   | 4.68          | 5.67        |
| 2008-09      | 18.83   |  | 6.83    | 0.09   | 1.42   | 8.34          | 10.48       |
| 2010-11      | 20.20   |  | 7.68    | 0.09   | 1.31   | 9.08          | 11.12       |
| 5 year total | \$43.02 |  | \$14.51 | \$0.20 | \$3.16 | \$17.88       | \$25.14     |

All numbers in billions of dollars. Source: LBB Fiscal Notes – HB 1 (May 11); HB 3 (April 27); HB 4 (April 29); HB 5 (May 5).

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