THE POLICY PAGE
An Update on State and Federal Action

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SENATE FINANCE COMMITTEE TINKERS WITH SJR 38, THE STATE PROPERTY TAX CONSTITUTIONAL AMENDMENT, BUT DOESN'T IMPROVE IT. STILL CONTAINS DANGEROUS LIMITS ON REVENUE GROWTH, SCHOOL ENRICHMENT

The Senate Finance Committee has made small changes to SJR 38, the constitutional amendment that would permit a state property tax, but did little to fix its fatal flaws before sending it to the full Senate for debate, expected Tuesday. A state property tax could provide an equitable and growing source of funding for public education. However, the committee substitute still contains several dangerous provisions that would cap growth of revenue from the state property tax and would require a new constitutional amendment to expand school enrichment taxes. With these provisions, a state property tax would no longer offer an acceptable source of funding for public education.

A STATE PROPERTY TAX COULD OFFER IMPORTANT BENEFITS

There are two main advantages to relying on a state property tax to provide a large share of funding for public education:

A state property tax is automatically equalizing. Under the current school-finance system, local school districts collect all school property taxes. The recapture provisions of the school-finance system require the wealthiest districts to then share some of their local revenue with less-wealthy districts or write a check to the state, which then uses the money to aid other districts. With a state property tax, the state would collect property taxes statewide and distribute the revenue to local districts according to school-finance formulas -- just as the state sales tax is spent statewide, without regard to where it is collected, according to the needs of the state. Districts could, with voter approval, raise additional local property taxes to supplement state funding.

Revenue from a state property tax should grow over time, as property values throughout the state increase. This would help provide a growing source of revenue to meet the growing needs of public education.

THE COMMITTEE SUBSTITUTE WOULD SEVERELY LIMIT REVENUE GROWTH

Instead of harnessing the natural growth in property values statewide to support the growing demands on our public education system, the committee substitute for SJR 38 would impose a tight cap on the amount of revenue that the state property tax could generate. The limit would be to -- but much more restrictive than -- the caps on city and county revenue currently being debated. This restriction would eliminate one of the main advantages of a state property tax.

The Legislature would, every two years, set a tax rate for the state property tax for the next biennium. The proposed committee substitute would prohibit the Legislature from setting a rate that was more than 8% greater than the effective tax rate for the prior biennium. The effective rate is the rate that would raise the same amount of tax as was raised in the prior biennium, taking into account the increase in property values (but not counting new construction). In other words, revenue from the state property tax could increase by only 8% a biennium, plus whatever revenue is raised by taxing new property.

The debate over limits on local government revenue growth involves an <u>annual</u> cap of 5%. CSSJR 38 would impose a <u>biennial</u> cap of 8% -- equivalent to an <u>annual cap of less than 4%</u>, due to compounding.

Cities and counties would be able to exceed the proposed lower annual 5% cap if necessary, subject to the possibility of a rollback election. The state would be constitutionally forbidden to increase state property tax revenue by more than 8% per biennium, not including new property. There would be no provision for an override of the cap in order to meet greater needs by our schools.

Eight percent revenue growth over two years could easily be less than the amount needed just to keep up with inflation in the goods and services required by schools. In addition, there is no assurance that taxes collected on new construction would be adequate to meet the costs of increased enrollment. Therefore, with these limits, the state property tax would be unable to keep up with the simple growth in revenue needs from inflation and enrollment, to say nothing of actually increasing real (inflation-adjusted) per student spending to meet higher expectations. This would put pressure back on local school district taxes, which led us to the current school-finance dilemma, or on other state taxes, or on other state services that would have to be cut to finance basic public education needs.

THE COMMITTEE SUBSTITUTE WOULD CAP LOCAL ENRICHMENT TAXES

The committee substitute would also insert in the Constitution a 15-cent limit on the tax rate for local enrichment – money used by school districts to provide revenue above the minimum level of state support. This limit could be changed only by another constitutional amendment.

An earlier version of the SJR would have permitted the Legislature to raise the limit by a two-thirds vote. The committee substitute removed this option, so that the limit could be raised only through the amendment process, which requires not only a two-thirds vote of the Legislature, but also approval by the voters . This additional step could probably not be completed until another school year had begun -- without further enrichment funds.

Although the 15-cent limit is currently an acceptable provision of the proposed school-finance bill, it would be improper to enshrine the limit as a constitutional provision. The Legislature must maintain the flexibility to change the school-finance system to meet future needs. Such changes in major state programs are a routine responsibility of the Legislature, and can be expected to occur.

A RECIPE FOR DISASTER

The combination of a state property tax that cannot grow fully with property values, plus a constitutionally limited local enrichment tax, is a recipe for disaster. A major cause of the current school-finance crisis is inadequate state support for public education, coupled with the inability of local districts to generate enough additional revenue to meet increasing expectations for student achievement. CSSJR 38 would set up a system under which this repetition of this scenario is far too likely.

THE OPTIONAL PERCENTAGE HOMESTEAD EXEMPTION LIVES ON

School districts are currently permitted to exempt up to 20% of the value of residential homesteads from property taxes. Because elimination of this exemption by a state property tax could counteract the effects of a lower property tax rate, the Senate Finance Committee added an unusual provision to CSSJR 38 – the Legislature could permit school districts to use their own money to pay a portion of a homeowner's state property tax!

Fewer than one-quarter of school districts offer this exemption, which was enacted in 1981 to ease the "sticker shock" experienced by homeowner facing taxation on full market value for the first time as a result of property tax reform. Houston ISD, which offers the full 20% exemption, accounts for one-quarter of the total value exempted in the state. Just five districts (Houston, Cypress-Fairbanks, Dallas, Spring Branch, and Highland Park) account for nearly 60% of total exempted value.

The optional percentage homestead exemption is one of the most regressive exemptions in the Tax Code; more than half of the benefits received by Texas homeowners goes to the one-fifth of Texas households with an annual income of more than $97,000, while only 18% of the benefit of the exemption goes to the one-half of families with an income of less than $50,000.

Since the optional exemption applies to a percentage of the value of a homestead, it reduces the taxable value of a higher-priced home more than the value of a lower-priced home. In contrast, the mandatory statewide exemption of the first $15,000 of a homestead's value (which would be continued under a state property tax) is progressive, since it has a higher impact on a lower-value home than on a higher-value home.

HB 3, which would implement this provision, could be improved by permitting school districts to pay a certain dollar amount of each homeowner's state property tax, rather than a percentage of the homeowner's tax bill.

For more information, see *Where Did All the Money Go?: The Case of the Optional Homestead Exemption,* http://www.cppp.org/research.php?aid=105&cid=5
