



TTARA

Texas Taxpayers and Research Association

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A State Property Tax for Schools — Fix or Nix?

Once again the state's school finance system is under challenge in the courts. Among the contentions is that the local school property tax has become a de facto state property tax—a tax which is prohibited under Article 8, Section 1-e of the Texas Constitution. Over the years some have advocated addressing this challenge by amending the state Constitution to impose, rather than prohibit, a state property tax to finance schools. But in truth, such a proposal would be only a partial “fix” for the legal challenges to our school finance system. Inequities in school funding that are a key part of the lawsuits would remain unless lawmakers rewrote school funding formulas—something that could be done independently of a state property tax. And because some districts offer local exemptions that others do not, a “revenue neutral” state property tax would mean higher taxes for some, and lower taxes for others—an especially controversial result given voters would have to approve the amendment.

School districts currently levy property taxes totaling \$22 billion — \$17.6 billion for maintenance and operations and \$4.4 billion for debt service. State law places a “cap” on local tax rates. Twice the Supreme Court has ruled that because so many school districts were at the rate cap, the local tax was for all intents and purposes a state property tax, and violated the Constitution. The first of these rulings was in 1992 when the Supreme Court ruled that the tax levied by the 188 County Education Districts, created by the Legislature in 1991, constituted a state property tax. The second and most recent ruling was in 2005 in *West Orange Cove ISD et al vs. Neeley* when the Court held that school districts taxing at the \$1.50 M&O rate cap no longer had “meaningful discretion” over their tax rates, and therefore the school district tax had become a de facto unconstitutional state property tax.

In response to the *West Orange Cove* ruling, the Legislature passed legislation in 2006 that “compressed” school district maintenance and operations tax rates to two-thirds of the rate imposed by each district in 2005, and replaced the forgone property tax revenue with state aid. Therefore, all school districts that imposed an M&O tax rate of \$1.50 per \$100 valuation saw that rate compressed to \$1.00. Districts were given access to an additional \$0.17 that they could access for enrichment purposes, thereby giving them “meaningful discretion” over their rates. The first four pennies can be levied with only school board approval, but voter approval must be obtained to levy the remaining 13 pennies.

The de facto state property tax question has risen again in a new series of lawsuits, along with constitutional challenges related to funding equity and adequacy (see Table 1). Over one-half of the state's school districts, educating over two-thirds of the state's students are now joined in a consolidated case before Travis County District Court Judge John Dietz.

The plaintiffs argue that over 200 school districts are at the \$1.17 M&O rate cap (see Table 2), and that the revenue per weighted student raised by over 80% of these districts is still less than the average amount of revenue available to districts not at the \$1.17 cap. Faced with a reduction in state funding imposed by the Legislature in 2011, these districts cannot raise their rates to recoup the lost revenue. Therefore, they argue, they do not have “meaningful discretion” over their rates, and the system has evolved into a de facto state property tax.

Over the years a number of Texas politicians have advocated revamping the Texas Constitution to abolish

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Table 1—School Finance Lawsuits

	PLAINTIFFS				
	Texas Taxpayer Fairness Coalition Filed 10/11/11	Texas School Coalition Filed 12/9/11	Mexican American Legal Defense and Educational Fund (MALDEF) Filed 12/13/11	Fort Bend ISD et al Filed 12/23/11	Intervenors Texans for Real Efficiency and Equity in Edu- cation (TREE) Texas Associa- tion of Business (TAB) Filed 2/24/12
State Property Tax The \$1.17 statutory M&O rate cap prevents districts from exercising “meaningful discretion” in setting their tax rates, and therefore constitutes a state property tax. [Article 8, Section 1-e]	✓	✓	✓	✓	
Adequacy - Districts don’t have access to the resources necessary to provide “a general diffusion of knowledge.” [Article 7, Section 1]	✓	✓	✓	✓	
Equity - The system is inefficient and arbitrarily funds districts at different levels, even at the same tax rate. [Article 7, Section 1]	✓		✓	✓	
Efficiency - The system is inefficient because there is no competition for school districts and there is gross waste in the bureaucratic administration of the system. [Article 7, Section 1]					✓
Equal Protection - The system fails to provide equal protection to students in low-wealth districts because their districts have access to less revenue than high-wealth districts at the same tax rate. [Article 1, Section 3]	✓				
Equal and Uniform Tax - Taxes levied to support schools are not equal and uniform because districts that levy the same tax rate have access to different amounts of revenue per student. [Article 8, Section 1(a)]	✓				

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ish the local tax for maintenance and operations and replace it with a uniform state property tax (a modest local tax for “enrichment” would be allowed). During the last 20 years, many influential people such as former Governor Ann Richards, Governor Rick Perry, Lt. Governor Bob Bullock, Senate Education Committee Chair Carl Parker, House Public Education Committee Chair Paul Sadler, Senate Finance Committee Chair Steve Ogden, Senate State Affairs Committee Chair Robert Duncan and Dallas attorney and education advocate Tom Luce have advanced various versions of a proposed state property tax (Table 3) in an attempt to bring an end to the seemingly never-ending litany of school finance lawsuits.

But in truth, the litigation is much more complex. The state property tax is only one contention of several in the lawsuits. Unless lawmakers revise how state aid is distributed to districts, the issue of funding equity would remain unaddressed. Lawmakers could “fix” the funding disparities by simply rewriting current statutory formulas — something that would not require amending the Constitution.

Even so, the option of a state property tax for school finance purposes appears to continue to have a certain appeal, and it is likely to be considered in the next legislative session, along with a number of proposals to eliminate the property tax entirely. But what seems to be a simple trade of local property taxes for a state tax is, quite frankly, not that simple. Major policy hurdles would have to be overcome.

“Local Control” Equals Local Enrichment. The ability to adopt tax rates to pay for approved school budgets is the essence of “local control.” Therefore, school officials are very protective of this authority and more than reluctant to relinquish it entirely to the state. Legislators often address these concerns by giving districts control over an “enrichment tax” to enable them to enhance the basic program financed through state formulas. This raises the distasteful prospect that the local school tax will continue to increase, even though it was “replaced” by a state tax. And if the local enrichment tax is “capped” to prevent this from happening, it could become the focus of future lawsuits contending that it, too, had in effect become a state property tax. Regardless, to ensure some degree of local control and discretion, a state property tax would most cer-

Table 2
2011 ISD Maintenance and Operations Tax Rates

M&O Rate	# Districts	# Granting Optional Homestead Exemption	# ADA	% of Total Statewide ADA
\$1.25 - \$1.29	1	0	823	
\$1.18 - \$1.24	2	2	20,193	0.5%
\$1.17	249	37	569,217	12.9%
\$1.05—\$1.16	53	15	499,090	11.3%
\$1.04	634	140	2,838,457	64.1%
\$1.01—\$1.03	30	6	386,603	8.7%
\$1.00 and below	55	18	110,245	2.5%
	1,024	218	4,424,628	

Table 3 — State Property Tax Proposals 1991-2011

- 1991 **SB 49 and SJR 1 filed by Senate Education Committee Chair Carl Parker.** Would have created a state property tax of **\$1.00** per \$100 valuation on all property which would have been levied and collected by school districts on behalf of the state. Revenue collected in excess of a district's entitlement (determined by the formulas) would have been remitted to the Comptroller for deposit into the Foundation School Fund. School districts would have been authorized to levy an additional **\$0.25** local enrichment tax. Revenue generated in excess of the guaranteed yield limit would have been remitted to the Comptroller. The state would have assumed all school district debt liability. The bills did not make it out of Senate Committee.
- 1992 **“Good Schools Plan” proposed by Governor Ann Richards.** The concept for this plan was initially proposed by Dallas attorney and education advocate Tom Luce. A state property tax on business property would be levied and collected by the state at a rate set by the Legislature. Local school districts would continue to tax residential and agricultural property at a rate set by the local school board subject to limitations in state law. A minimum local tax rate would be determined by the Legislature that would have to be imposed by a school district in order to receive state funds. The state rate on business property and the minimum local rate would be linked so that if the Legislature increased the rate on business property, the rate on residential property would also increase. School districts would continue to tax business property for debt service. The plan was never put into a bill draft.
- 1992 **“Fair Share Plan” proposed by Governor Ann Richards, Lt. Governor Bob Bullock, and Speaker Gib Lewis.** Governor Richards' “Good Schools Plan” was the basis of a new plan endorsed by the state's leadership. The plan had two options — (1) continue with the County Education Districts by holding an election to allow voters to authorize the tax they levied, or (2) create a state property tax as was proposed by Governor Richards. An unsuccessful election was held to authorize the CED tax.
- 1997 **HB 4 by Rep. Paul Sadler, Chairman of the Select Committee on Revenue and Public Education Funding.** Removed business property from the local tax base and taxed it at the state level at a rate of **\$1.05** per \$100 valuation. The tax would have been collected by the county assessor-collectors and remitted to the Comptroller for deposit into the Foundation School Fund. School districts would tax residential property at a rate of **\$0.75** per \$100 valuation. A district could add up to \$0.10 for enrichment purposes with voter approval. School districts would continue to tax business property for debt service. The bill passed the House but was not voted out of Senate Committee.
- 2004 **“Educational Excellence & Property Tax Relief Plan” by Governor Rick Perry.** Business property was removed from the local school district tax base and taxed by the state at a rate of **\$1.40** per \$100 valuation. The rate could be increased only with a 2/3 vote of both houses of the Legislature and a statewide vote of the people. School districts would continue to tax residential property at an M&O rate \$0.25 less than the rate the district currently imposed, and the local \$1.50 M&O rate cap would have been reduced to **\$1.25**. The state would reimburse school districts for the lost property tax revenue due to the rate reductions. School districts were allowed to increase their rates \$0.05 per biennium for enrichment up to a maximum of \$0.15, and would continue to tax business property for debt service. The plan reduced the 10% cap on annual appraised residential value increases to 3%. The plan was not introduced in bill form.
- 2005 **SJR 38 by Senate Finance Committee Chair Steve Ogden.** Authorized a state property tax not to exceed **\$1.10** per \$100 valuation. The Legislature would set the rate which had to be the same for each year of the biennium and could not increase revenue by more than 8% over the previous biennium. School districts could impose a tax rate of up to \$0.15 for enrichment with voter approval, and would continue to levy taxes for debt service. The bill was voted out of Senate committee, but was not heard by the full Senate.
- 2011 **SB 1858 and SJR 51 by Senator Robert Duncan.** Phased in a state property tax of **\$1.00** per \$100 valuation over five years at 20% per year to replace school district M&O taxes. School districts would be authorized to levy an enrichment tax of up to **\$0.17** per \$100 valuation with voter approval and would continue to impose tax rates for debt service. Increases in the appraised value of a resident homestead could not exceed 105% of the previous year's value. The bills were not voted out of Senate committee.

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tainly be coupled with optional local enrichment taxes.

Equity. Some claim that a state property tax would achieve equity. While taxing all property at a single state rate achieves “tax rate” equity, it does not guarantee that the revenue will actually be distributed to school districts in an equitable manner. If individual district revenue targets and “hold harmless” provisions that override the school finance formulas are not repealed, school districts will continue to receive widely varying amounts of revenue per student.

Varying Local Tax Rates. Currently 49 school districts impose a maintenance and operations tax rate of less than \$1.00 per \$100 valuation. If a state property tax of \$1.00 is approved to replace the local property tax, taxpayers in these school districts would be subjected to a large tax increase. At the same time, taxpayers in the 975 school districts that currently impose an M&O tax rate higher than \$1.00 would receive a *reduction* in the amount of taxes they pay, resulting in a geographical shifting of the school tax burden.

Optional Homestead Exemptions. There are 218 school districts that grant an optional homestead exemption to homeowners in the district, most of which are for 20% of the market value of the home. If the local property tax is replaced with a state property tax, these homeowners theoretically would lose this preferential exemption absent legislative action. Legislators may propose to extend the 20% exemption to all homeowners in order to garner support for the new tax, as they did when the 188 CED’s were created in 1991. That means the state property tax rate would have to be higher than current rates to raise the same amount of money. The net result is that some homeowners would enjoy a new exemption, while other homeowners and all business owners could see their taxes go up.

Appraisal Caps and Homestead Exemptions. Because voters find the property tax so objectionable, legislators almost always couple a proposal for a state property tax with either a limitation on the

permissible amount that residential values can increase from year to year — usually either 3% or 5% — or an increase in the state homestead exemption. Both of these proposals benefit homeowners by shifting the tax burden to owners of rental homes and business properties. Not surprisingly, owners of these types of property often find these proposals objectionable, since they are almost assured their taxes will increase.

Tax Rates and Tax Increases. If a state property tax is considered, the first order of business for the Legislature would be to set the rate of the tax. Ninety-four percent of the school districts in the state impose an M&O tax rate greater than \$1.00 per \$100 valuation, and approximately 25% of all school districts are at the statutory cap of \$1.17. This calls into question whether or not a state rate of \$1.00 will generate sufficient revenue to support school districts at current funding levels, even if it is coupled with a local enrichment tax. The state tax rate might have to be greater than \$1.00 — say \$1.10 or \$1.20 — to ensure that districts don’t immediately levy high local enrichment taxes simply to generate the same amount of revenue that they currently receive. The Legislature would also have to decide whether to cap enrichment taxes, and if so, decide what level would ensure that districts maintain “meaningful discretion” over their tax rates. The Legislature would also be tasked with setting the parameters that govern any possible rate increases. Should the state tax rate be stated in the Constitution so that it can only be increased by constitutional amendment, or should the Legislature be given the authority, with or without limitations, to raise the rate? Should an overall limit be placed on the amount of revenue the tax can generate? What, if any, limitations should be placed on the levy of local enrichment taxes if allowed? Legislators would also have to determine if other safeguards should be put into law to prevent them from looking to the state property tax as a financing mechanism for other parts of the state budget in addition to schools.

Debt Service. School districts currently carry approximately \$64 billion of bonded debt, with annual debt service payments totaling approximately \$4.4

billion. This debt was approved by the districts' voters and is guaranteed by the imposition of an interest and sinking tax rate to pay for it. To avoid violating existing bond covenants, most state property tax proposals allow school districts to continue to levy a local property tax to pay for debt service, creating a confusing patchwork system in which voters may not understand who is taxing them for what.

“Split Roll.” One variant of a state property tax is to remove only business property from the local tax base and tax it at the state level. Quite often the proposed state tax rate on business property is higher than the rate local school districts are authorized to impose on residential property, which again means that higher taxes for some, pay for lower taxes for homeowners. These proposals worsen a system that is already weighted against business property. Because residential homestead exemptions remove almost 20% of home values from the tax roll and a variety of exemptions remove only 5% of business value, businesses currently pay a higher *effective total school tax rate* than homeowners — \$1.23 vs. \$1.08. Virtually all split roll proposals also allow school districts to tax both residential and business property for debt service, resulting in business property owners possibly receiving multiple tax bills — one from the state and one or more from local school districts — in addition to paying a greater share of the overall tax burden. Another problematic result to split roll proposals is that they leave school districts that are comprised mostly of high dollar residential value — such as Highland Park and Alamo Heights — with a much higher local tax base than other districts, a result which could spark a new round of equity challenges.

Property Appraisals. Many administrative difficulties would need to be addressed in the implementation of a state property tax. Developing a state tax roll is at the top of the list. Article 8, Section 18 of the Texas Constitution requires a single appraisal of all property within a county which is used by all taxing jurisdictions (cities, counties, schools and special districts). Consequently, most of the plans for a statewide property tax put forth to date have envisioned that the state tax would also be levied on values determined by the existing 253 central appraisal

districts (CADs). In order for a statewide property tax levied on locally determined values to pass the Constitution's “equal and uniform” test, it would be essential that those values be determined in a standard, uniform manner. Currently, that may not be the case as evidenced by the results of the “Methods and Assistance Program” (MAP) review of all appraisal districts performed by the Comptroller's Property Tax Assistance Division which revealed that a significant number do not even have the necessary tools or procedures in place to determine market value in accordance with recognized professional standards. (See TTARA Newsletter, *Equal and Uniform...sort-of*, May 2012)

Without uniformly determined values, taxpayers in counties where property is correctly appraised would be subsidizing the lower tax burdens of those in counties where property is under appraised — a clearly unequal result. The necessity that property values be determined in the same manner statewide is only heightened by the prospect that they will be the basis on which the state will collect and redistribute \$17.6 billion for the maintenance and operation of school districts.

Valuation Appeals. New procedures for resolving property owners' valuation protests would have to be put in place. Article 8, Section 18 also requires that each central appraisal district have its own “equalization” board composed of local taxpayers to decide protests of value. Should the state take an active role in the appeals process, or should the state rely on local Appraisal Review Boards to settle valuation disputes? If so, what regulations might be needed to ensure that appeals are settled in a consistent manner? Would some positions on the CAD board have to be reserved for appointees of the state?

Tax Collections. Local property taxes, including school taxes, are now collected by many different taxing entities. However, over the years there has been considerable consolidation of this task. For example, the county tax assessor in some counties issues a single bill to each property owner that itemizes the amounts due to all taxing jurisdictions in the county. The assessor-collector then distributes the

appropriate portion of the amount paid to each jurisdiction. In contrast, a great many taxing jurisdictions — including school districts — continue to collect property taxes individually. So how would a state tax be billed and collected? Would the Comptroller or some other state agency send out a separate tax bill to property owners, or would the collection job be assigned to some local authority such as the county tax assessor-collector? The same questions would also apply to the collection of delinquent taxes. In order to simplify tax payments and avoid taxpayer confusion, a requirement for the consolidation of the collection of all property taxes by a single local entity should accompany the adoption of a state property tax if it comes to pass.

Collection Rates. Another issue to be resolved is how to deal with differing tax collection rates. If taxpayers residing in one school district pay 99% of total state taxes owed, and taxpayers of another district pay only 96% of taxes owed, should the state's school funding formulas be amended so that the lower-collecting district would be penalized by a compensating reduction in its state aid distribution?

Two-thirds Approval of the Legislature Required. In addition to substantial policy issues, there are strong political barriers to imposing a state property tax. A proposed amendment to the Texas Constitution must first receive the approval of two-thirds of the House and Senate, a difficult proposition on any issue, much less one related to taxes. If the Legislature is successful in passing the constitutional amendment, it must then be approved by a majority of the voters. The citizens of Texas are very leery of any changes to our tax system, and are very distrustful of those involving the property tax in particular. Convincing them to approve a new property tax at the state level, while keeping a portion of the existing local school property tax will be a monumental task.

All of these issues should be addressed before a state property tax proposal is seriously considered. Even then, a powerful public relations campaign will be needed to convince voters that it is acceptable to give the state such broad taxing authority at the expense of their local schools. And finally, voters will have to be persuaded that the end result for their schools is fair. If voters give their approval, the Legislature will have to be vigilant in maintaining an equitable system of funding, or the "reform" effort will have been a futile one.

Constitutional Provisions Allegedly Violated by Current School Finance System

Article 8, Section 1-e. *"No State ad valorem taxes shall be levied upon any property within this State."*

Article 7, Section 1. *"A general diffusion of knowledge being essential to the preservation of the liberties and rights of the people, it shall be the duty of the Legislature of the State to establish and make suitable provision for the support and maintenance of an efficient system of public free schools."*

Article 1, Section 3. *"EQUAL RIGHTS. All free men, when they form a social compact, have equal rights, and no man, or set of men, is entitled to exclusive separate public emoluments, or privileges, but in consideration of public services."*

Article 8, Section 1(a). *"Taxation shall be equal and uniform."*

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