



Policies That Address the Needs of High Property-Wealth School Districts with Low-Income Households

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INTRODUCTION

During Lawrence O. Picus and Associates' initial review of Maine's Essential Programs and Services (EPS) school funding system we conducted interviews and forums with policymakers, education stakeholders and members of the community. These interviews were designed to elicit opinions, ideas and recommendations about the operation of the current school funding system and to seek opinions about what might be done to improve that system. A major concern that emerged – described to us as a “tax equity” issue – was a sense that in a number of high property-wealth districts, there are large numbers of low-income households that face significant challenges meeting their property tax obligation for schools. This situation appears to occur most frequently in vacation and tourist communities along Maine's coast and near Moosehead Lake. To fully understand the implications of this issue, and provide the Joint Standing Committee on Education and Cultural Affairs with an analysis of the issue and potential solutions, this paper:

- Identifies the issues faced by high property-wealth, low-household income (HPW/LHI) districts
- Outlines possible policy solutions, and
- Illustrates how other states currently address these important issues

In preparing this paper, we studied Maine's current and past school funding policies as well as relevant data from national and state educational organizations and various peer reviewed academic sources. We also considered the approaches used in other states to deal with similar school finance issues.

The paper begins with a brief description of Maine's current funding system and offers a brief historical context for this discussion. The second section identifies possible solutions to the problem of establishing a school funding system that fairly treats low-income households in high property wealth districts and describes programs used in other states. The third section provides a more detailed analysis of how alternative measures of fiscal capacity might be implemented in Maine, and considers solutions that are both part of, and outside of, the school funding system. This paper was written to support the development of a funding “distribution model” that Lawrence O. Picus and Associates has developed to help the Legislature assess the potential impact of alternative

approaches to measuring fiscal capacity in the funding system,

MAINE'S CURRENT FUNDING SYSTEM

Maine's Essential Program and Services Funding Act (EPS) identifies the level of resources available to each school district (School Administrative Unit or SAU) and then establishes a process whereby that amount is funded through a combination of state and local revenues. The state share is appropriated by the Legislature through its budget process, while the local required contribution is collected on the basis of an established property tax rate designed to collect the balance of revenues needed to fund the EPS.

Each SAU's required local contribution is determined by applying the required tax rate to the property value of the SAU. The state effectively makes up the balance of funding. If an SAU is able to raise all (or more) of its EPS allocation through local property taxes, it then qualifies for a minimum state payment. At the present time, Maine's school funding formula only measures a district's ability to pay based on its property values and does not take the income of a district's residents into account.

Issues Faced by HPW/LHI Districts

Maine's school funding system, like that of 48 other states,¹ shares the cost of education between the state and local districts on the basis of each district's ability to pay. Districts that are deemed to have a greater ability to pay receive a smaller proportion of their education funding from state sources, while districts with lesser ability to pay receive a greater share of total funding from the state. Maine is one of 41 states that use school district property value as the only measure of a district's ability to pay. Using property values as the only measure for a district's ability to pay can be problematic because property values alone "... (do) not accurately measure the current ability of a property owner to pay the tax imposed."² This argument is based on the fact that there is not necessarily a correlation between property values and a property owner's ability to pay taxes. Individuals with highly valued homes may have a low current income whereas individuals with high incomes may have homes valued at a lower level.

The Impact of Excluding Income

A school funding model that does not take income into account in determining a school district's ability to fund educational services, is more likely to result in low-income, high property wealth districts being treated as if they have a greater tax capacity than the local community believes it can afford. Odden points out that "*It makes little sense to impute a*

¹ Hawaii is the only state that does not share the costs of education between the state and local districts due to the fact that the state operates as a single school district.

² Brennan, Michael and Orlando Delogu, "The Argument For: Retaining Income as One of Two Factors in Maine's School Aid Funding Formula", Maine Policy Review Volume 9, Issue 1, 2000. Page 78.

*high tax capacity to a jurisdiction whose residents lack the ability to pay the tax*³.
HPW/LHI districts experience two potential funding dilemmas:

1. High or excessive tax burdens as a result of paying a greater proportion of their income in local school taxes
2. Decreases in school funding because residents are unwilling to vote for higher property taxes to pay for educational programs

Moreover, in those cases where individuals live on a fixed income, high property values create a risk they will be forced out of their home.

Historical Context

Maine has not always relied only on property wealth to measure a SAU's fiscal capacity. The 1995 Rosser Commission recommended that the state school aid formula include both income and property wealth as measures of a district's ability to pay. In 1996 the state adopted changes to the school funding system that included income as a measure of a district's fiscal capacity.⁴ This new fiscal capacity measure factor was based 85% on district per pupil property value and 15% on district median household income.⁵ However, in less than a decade the state had discontinued the use of income as a measure of wealth and implemented the current system that makes use of property value as the only measure of a district's fiscal capacity.

One reason the state moved away from this "additive" approach for including income in the fiscal capacity measure is that the approach had unexpected results. Some high-income high property wealth districts ended up with larger amounts of state aid and some lower income and property wealth districts received less state aid, which was counter to the intent of the change in measure of fiscal capacity. .

Today, there is considerable debate over the best way to address the concerns of low-income families in SAUs with high property wealth who feel their property tax bills are excessive. The next section identifies possible solutions for this problem.

³ Odden, Allan, "Alternative Measures of School District Wealth", *Journal of Education Finance*, Vol. 2, Winter, 1977. Pages 356-379.

⁴ Brennan, Michael F. and Orlando E. Delogu. "The Argument For: Retaining Income as One of Two Factors in Maine's School Aid Formula", *Maine Policy Review* 9.1 (2000). Page 80.

⁵ Anonymous, "Reforming School Funding", Augusta, Maine, Maine Center for Economic Policy, 2003. Page 12.

STATE REMEDIES

There are several policy options available to states to mitigate the issues facing HPW/LHI districts. They fall generally into two categories, assistance to school districts, and assistance to individuals. The most common approaches are:

- Provide assistance to school districts
 - **Establish minimum school funding payments** – Minimum payments allow for schools regardless of their wealth to receive some funding from the state
 - **Use income as a wealth measure** – States can use some form of income as a measure to better define a district’s ability to pay
- Provide direct assistance to property taxpayers
 - **Property tax “circuit breakers”** – these are designed to reduce the property tax liability for individuals whose property tax payments represent a large portion of their household income by providing them with an income tax credit
 - **Homestead exemptions** - this program allows for homeowners to exempt a certain portion of their home’s value from property tax levies

States often use multiple programs to help address the issues faced by HPW/LHI districts and Maine is no exception. Maine makes use of the following policies to address the issues faced by HPW/LHI districts:

- **Minimum Payments:** For the 2012-13 school year the minimum payment to districts was the greater of three percent of the SAU’s minimum adjustment or 30% of the SAUs special education adjustment (For greater detail see Table 1).
- **Property Tax Circuit Breaker:** Property owners whose property taxes exceed 4% of total household income and have household incomes that do not exceed \$64,950 (single) or \$86,600 (multiple members) can qualify for this credit. The credit ranges from 25% to 100% of property taxes paid based on income. The maximum credit is \$400. The credit is applied to the taxpayer’s income tax liability following payment of the property tax.
- **Homestead Exemption:** Homeowners who have lived in Maine for at least twelve months and make the property they occupy on April 1 their permanent residence qualify for a homestead exemption. These homeowners can exempt the first \$10,000 a home’s value from property taxes.

Direct aid to School Districts

Minimum School Funding Payments

Some states establish a minimum payment amount within their primary funding formula. States establish minimum payment programs for a variety of reasons including political expediency, but the result is that it ensures all districts receive some state funds regardless of where they rank in the state's measure of fiscal capacity

The benefit of a minimum payment system is that it ensures all districts receive some state funding, regardless of their fiscal capacity. The downside to such systems is that it provides additional funding to the wealthiest districts (as measured by the state's fiscal capacity measure) regardless of the median household income of the residents of those districts. Additionally, in a funding system with finite resources, to the extent the minimum payment shifts resources to districts with high fiscal capacity, low fiscal capacity districts will receive fewer state dollars and either have to make up the difference from their own resources, or reduce spending.

Our analysis identified eight other states that provide school districts with some form of minimum payments regardless of their wealth (For a complete description see Table 1):

- **Minimum funding per student:** Five states (California, Illinois, Iowa, New York and Texas) provide a minimum funding amount per student regardless of their wealth. This type of minimum funding is easy for the state to administer and provides districts with a predictable amount of funding each year. The amount that states provide ranges from \$218 in Illinois to \$500 in New York.
- **Guaranteed percentage of funding:** Two states (Florida and Pennsylvania) provide a guaranteed percentage amount of funding to districts. Florida and guarantee that districts will receive at least 10% of their base-funding amount from state sources and Pennsylvania guarantees 15%.
- **Minimum funding per school/grade:** Montana provides districts with a guaranteed amount of funding per grade in elementary school (\$23,593), junior high (\$66,816) and a minimum amount of funding for any high-school (\$262,224). This funding approach is designed to mitigate issues of small school size more than to address differences in district wealth.

Table 1: States That Provide for Minimum School Funding Payments

	Minimum Funding Amount	Notes
California	\$120 per student in Average Daily Attendance, or \$1,200 per district whichever is greater	
Florida	Districts receive at least 10% of base funding amount from the state	Districts must use this minimum state funding payment to lower their local property tax rates.
Illinois	\$218 per student	
Iowa	\$300 per student	
Maine	The greater of 3% of the SAU's minimum subsidy adjustment or 30% of the SAUs special education adjustment.	An SAU's minimum subsidy adjustment applies to the operating allocation but does not include other subsidizable costs or debt services. In addition, it only includes 2% of the economically disadvantaged adjustment.
Montana	Between \$23,593 or \$66,816 per grade or \$262,224 per school	Districts with elementary schools receive a minimum of \$23,593 per grade for K-6 programs plus \$66,816 per grade for 7 th & 8 th grade. A district receives a minimum of \$262,224 to operate a high school
New York	\$500 per student	
Pennsylvania	Districts receive at least 15% of base funding amount from the state	While the minimum funding amount exists in legislation the state has not used the formula to distribute funds to districts over the past 2 years.
Texas	\$247 per student	The state's Available School Fund (ASF) provides a minimum funding amount to all districts. The ASF is primarily made up of revenue generated by the state's fuel tax and the Permanent School Fund. This minimum funding amount varies each year depending on funding levels and student enrollment numbers.

All data are derived from state sources.

Alternative Measures of Fiscal Capacity (Income)

As noted above, we found that 42 states – including Maine - use property values as the only measure of a district's fiscal capacity or ability to pay for schools from local sources. In an attempt to better measure a district's ability to pay for schools, eight states have adopted additional fiscal capacity measures to supplement to property values. These typically rely on some measure of income to be included (along with property wealth) in the measure of fiscal capacity.

Using income as part of the fiscal capacity measure provides a more comprehensive measure of a district's fiscal capacity, and can likely redirect state funding to districts with low median household income.

The problems with using household income as part of a fiscal capacity measure focus on the fact that many states do not collect school district residency on their state income tax forms making it hard to measure household income by district – and of course nine states do not have an income tax making collection of such data by district even more difficult. Further, states that have used measures of income have not always seen net funding distribution changes – meaning the problem they sought to solve did not go away. Finally, if not incorporated correctly into the formula the results could be counter to expectations, as Maine experienced in the 1990s, reducing state aid to districts with low median household incomes.

How income is incorporated as a measure of a school district's wealth is just as important as whether it is included at all. Simply adding income to property values often results in unintended consequences such as funding decreases for low-income districts and funding increases for high-income districts. To ensure that an income factor benefits low-income districts it needs to be used as a multiplier to property values. If a district's income is turned into a ratio of the district's income to the state average, a high income district would have a ratio larger than 1.0 and lower income district would have a ratio less than 1.0. Then when this income factor is multiplied by the district's property wealth per pupil to determine that district's local funding capacity, it would raise the relative fiscal capacity for a high income district but decrease the fiscal capacity of a low income district. In the case of a district with median household income below the state average, the impact would be to lower the fiscal capacity measure and increase the share of total funding provided by the state

To illustrate how a multiplicative income factor might work consider how two different districts would fare using income as both an additive factor and as a multiplicative factor.

- District #1 has an average property value per pupil that is equal to the state's average thus it would be given a property wealth factor of 1.0. The district's per pupil income is 10% above the state average – thus its income factor would be 1.10
- District #2 also has an average property value per pupil that is equal to the state's average so it too would be given a property wealth factor of 1.0. This district's

per pupil income is 10% below the state average – thus its income factor would be 0.90

Under this example if the state simply used property value as its measure of a district’s fiscal capacity in its formula then both of districts would be viewed as having perfectly average fiscal capacity and would receive the same amount of state funding. But under a system where property wealth and income wealth factors both are given a weight of 50% and simply added together, it would look like this:

Table 2: Income as an Additive – Districts with Equal Property Wealth

	Property Value per Pupil		Income factor		Adjusted District Fiscal Capacity
District #1	$(1.0 \times 50\%) = 0.50$	+	$(1.10 \times 50\%) = 0.55$	=	1.05
District # 2	$(1.0 \times 50\%) = 0.50$	+	$(0.90 \times 50\%) = 0.45$	=	0.95

Table 2 shows that under a system where a district’s property values are *added* to an income factor District #1 has an adjusted district wealth that is 5% above the state average and district #2 is 5% below the state average. However, if the state used a multiplicative income factor then each district’s fiscal capacity calculation would be as follows:

Table 3: Using Income as a Multiplier – Districts with Equal Property Wealth

	Property Value per Pupil		Income factor		Adjusted District Fiscal Capacity
District #1	1.0	X	1.10	=	1.10
District # 2	1.0	X	0.90	=	0.90

Under a system where a district’s property values are *multiplied* by an income factor, District #1 has an adjusted district fiscal capacity that is 10% above the state average and district #2 is 10% below the state average. Table 3 shows that the higher income district would receive less state aid (a fiscal capacity number of 1.10 vs. 1.05) using the multiplicative factor and the lower income district would receive more state aid (with a fiscal capacity number of 0.90 vs. 0.95).

The following is an example of how using income as a multiplier can impact high property wealth/low-income wealth districts:

- District #3 has an average property value per pupil that is twice the state’s average so it would be given a property wealth factor of 2.0. This district’s per pupil income is 50% below the state average – thus its income factor would be 0.50

Table 4: Using Income as an Additive – High Property Wealthy/Low-Income District

	Property Value per Pupil		Income factor		Adjusted District Fiscal Capacity
District # 3	$(2.0 \times 50\%) = 1.0$	+	$(0.50 \times 50\%) = 0.25$	=	1.25

Table 5: Using Income as a Multiplier – High Property Wealthy/Low-Income District

	Property Value per Pupil		Income factor		Adjusted District Fiscal Capacity
District # 3	2.0	X	0.5	=	1.00

Under this example a district with property values that are twice that of the average district and average income that is half the state average (District #2) would receive a fiscal capacity amount twice that of the average district if only property values were taken into account. However, if income is taken into account and used as an additive then District #2 fiscal capacity number would drop to 1.25 (Table 4). If income were used as a multiplier then the fiscal capacity number for District #2 would decrease to 1.00.

How An Income Factor Would Work in Maine

The idea that a multiplicative income factor benefits more low-income districts is born out in a 2010 study from David Silvernail and James Sloan of the University of Southern Maine. They studied how including income as a measure of fiscal capacity would impact Maine’s school funding system⁶. They reviewed three different scenarios for including income as a wealth measure, these were:

1. Property valuation and income index – This system creates indices for property values and average income amounts and adds those numbers together.
2. Property valuation and income rates – This system defines a district’s ability-to-pay as “a percentage of property value plus a percentage of income”⁷
3. Income modified valuations – This system multiplies property values by an income factor.

They simulated how each of these scenarios would impact Maine’s SAUs. Under the first option 45% of low-income/low-property wealth SAUs would actually see decreases in school funding. Under the second scenario 76% of low-income/low-property wealth SAUs would see funding decreases. This study showed that the third scenario - where income was used as a multiplier - 100% of low-income/low-property wealth SAUs in Maine would see increases in funding.

⁶ Silvernail, David and James Sloan “An Analysis of the Impacts of Including Income in Determining Community Wealth in the Maine K-12 School Funding Formula”, Maine Education Policy Research Institute at the University of Southern Maine, Portland, Maine. 2010.

⁷ Ibid, page 8.

Alternative Measures of Fiscal Capacity (Retail Sales Base)

In an attempt to determine a district's ability-to-pay some states take into account a district's sales tax base. Only two states – Tennessee and Virginia – currently use a district's sales tax base as a measure of their fiscal capacity. Both of these states provide for a local option sales taxes that can be used to fund schools. However, this system would make much less sense in a state, like Maine, where a local option sales tax is not an option for districts.

States With Alternative Fiscal Capacity Measures in the School Funding System

Our study found that eight states make use of a fiscal capacity factor in addition to property values. Among the alternative fiscal capacity measures used by states, we identified the following:

- **Income:** Four states (Connecticut, Massachusetts, New Jersey & New York) measure a district's ability to pay based 50% on property values and 50% on income
- **Retail Sales:** Tennessee uses a district's property tax base as 50% of their fiscal capacity measure and 50% based on their sales tax base
- **Income & Retail Sales:** Virginia makes use of three measures, they are: property tax base (50%), income tax base (40%) and sales tax base (10%)
- **Low-Income Students:** Rhode Island uses a combination of property values (50%) and the relative percentage of students eligible for free/reduced lunch in grades Pre-K to 6th (50%)⁸
- **Multiple Measures:** Maryland uses a combination of real and personal property values, taxable income and the public utilities assessable base

Our study found that seven states (Connecticut, Massachusetts, Maryland, New Jersey, New York, Rhode Island and Virginia) use some form of income as a measure of a district's fiscal capacity. None of these seven states made use of a multiplicative income factor – in each case an income factor is simply added to the property values. Table 6 summarizes the alternative fiscal capacity measures used by other states.

⁸ Using low-income students as part of the fiscal capacity measure is essentially an income based measure.

Table 6: States that Measure Fiscal Capacity with Factors In Addition to Property Wealth

	Property	Income	Other
Connecticut	Property Value 90%	Median Income 10%	
Maryland ⁹	Real Property Personal Property	Total taxable Income	Public Utilities Assessable Base
Massachusetts	Property Value 50%	Aggregate personal income 50%	
New Jersey	Based on both property values and property tax rates 50%	Based on Aggregate income and income tax rates 50%	
New York	Property Value 50%	Adjusted Gross Income 50%	
Rhode Island	Property Value 50%		Percentage of students eligible for Free/Reduced lunch in grades PK-6 compared to the state average 50%
Tennessee	Property Tax Base 50%		Sales Tax Base 50%
Virginia	Property Tax Base 50%	Income Tax Base 40%	Sales Tax Base 10%

All data are derived from state sources.

⁹ Maryland uses the following formula to determine a districts relative wealth: (Total real property values x 40%) + (total personal property x 50%) + (100% of public utilities' assessable base) + (100% of net taxable income) = total district wealth.

Direct Aid to Property Tax Payers

One way to address the unique needs of HPW/LHI districts, especially for families with lower incomes is to provide relief through assistance targeted directly to tax payers. Two approaches for providing direct assistance to property tax payers are circuit breaker programs and homestead exemptions. This section of the paper addresses both of these issues.

Circuit Breakers

Studies have found that property taxes tend to be regressive in nature – in fact, a report from the Institute on Taxation and Economic Policy found that in 2007 low-income households paid 3.7% of their income in property taxes while middle-income households paid 2.9% and the wealthiest taxpayers paid just 1.4%.¹⁰ To help offset the regressive nature of property taxes, some states have established circuit breaker programs. Circuit breakers are designed to reduce the property tax liability for individuals whose property tax payments represent a large portion of their household income by providing them with an income tax credit.

The strength of circuit breaker programs is that they provide relief to low and middle-income families and can easily be targeted to specific populations or groups of taxpayers. In addition, the amount of the circuit breaker, or the qualification levels for receiving assistance can be adjusted to reflect changing economic circumstances relatively easily and quickly.

On the other hand it is possible that with a circuit breaker program, the state will end up paying for local decisions as local voters may be willing to approve higher property taxes knowing that the state will pay a portion of the new tax levy. Many state programs have a narrow focus, such as for elderly or disabled taxpayers, and end up providing little or no assistance to other low-income families who might benefit from the tax relief. Finally, many circuit breaker programs have funding caps that limit the assistance available to low income households.

Thirty-five states provide some form of circuit breaker relief. However, most of these state programs are only available to taxpayers who are senior citizens, disabled or both. Only 14 states and the District of Columbia make this program available to taxpayers regardless of age or disability status. Some of the details of these 15 circuit breaker programs include:

- 14 of the 15 circuit breaker programs have some form of income requirement – West Virginia is the only exception.
- All 15 states have maximum household income requirements which range from \$18,000 (New York) to \$190,500 (Connecticut)
- Four states have maximum property value requirements ranging from \$85,000 (New York) to \$500,000 (Vermont)

¹⁰ Institute on Taxation and Economic Policy, “*The ITEP Guide to Fair State and Local Taxes*”, Washington, D.C., 2011. Page 26.

- Maryland is the only state that has a maximum net worth requirement which is currently set at \$200,000
- The maximum credit for these circuit breaker programs ranges greatly from a low of \$75 (New York) to a high of \$8,0000 (Vermont)

For more complete description of each of these 15 circuit breaker programs see Appendix II.

Minnesota and Montana have special circuit breaker programs that are only available to taxpayers who have experienced dramatic increases in their property values – these special credits are in addition to the states’ traditional circuit breaker credits. Minnesota taxpayers whose property taxes increased by more than 12% from 2012 to 2013 are entitled to an additional tax credit of up to \$1,000. Montana has a special circuit breaker program that is available to individuals who have owned their home since 2008. If the home’s value increased by at least 24% between 2008 and 2014 the homeowner is entitled to a reduction in their taxes of between 30% and 80%

HOMESTEAD EXEMPTIONS

Some states provide tax relief to homeowners by removing part of the value of their property from taxation – this is commonly referred to as a homestead exemption. The homestead exemption is intended to both lower tax rates and to make property taxes more progressive.

Homestead exemptions reduce the tax liability of homeowners for any given tax rate by lowering the assessed value on which the tax is levied. On the other hand, such exemptions may shift the property tax burden to non-homestead property. In addition, homestead exemptions are generally available to all qualifying property regardless of the owner’s income, providing assistance to those who need less assistance. Finally, homestead exemptions reduce the overall assessed value of a taxing jurisdiction, effectively lowering local tax capacity. This is not a problem in a foundation based school finance system where the state makes up the difference, but it can have negative impacts on other governments that rely on property tax revenue.

Our study found that twelve states other than Maine, and the District of Columbia provide a homestead exemption to all taxpayers regardless of age or disability status. Maine provides a homestead exemption to individuals who have owned their home for at least twelve months. Qualified property owners receive an exemption of \$10,000 on the value of their property. The following are some of the details of the other 13 homestead exemption programs (For a full description see Appendix II):

- Only Wyoming and the District of Columbia have income qualifications for their homestead exemptions
- Minnesota is the only state that has a qualification on the home’s value
- Kansas only provides the homestead exemption to homes that have experienced home valuation increases of over 7%

- In seven states and the District of Columbia the homestead exemption reduces a taxpayers property taxes
- In six states the homestead exemption is designed to reduce a taxpayers income tax

CONCLUSION

As stated earlier in this paper there are several policy options available to Maine to mitigate the issues facing HPW/LHI districts. These options fall generally into two categories, assistance to school districts, and assistance to individuals. With this in mind we have two separate recommendations:

Assistance to School Districts:

If Maine would like to use the school funding system to provide more aid to HPW/LHI districts, we recommend the state use a multiplicative income factor in the formula for measuring a district's relative wealth. The factor would be the ratio of the district's income measure to the state average of that measure. The "property fiscal capacity of the municipality" figure currently used in the school aid formula ($\$15688 (3-A)(B)$) would then be multiplied by this ratio. The result would be that HPW/LHI districts would have a lower fiscal capacity measure, and qualify for more state aid. This factor would reduce aid for districts with median household incomes above the state average, regardless of their relative property wealth. There is a substantial body of research showing that, all things equal, districts with lower (higher) median household incomes have lower (greater) preferences for education and consequently spend below (above) average levels. A multiplicative income factor helps ameliorate these tendencies making access to education services more equitable across all districts.

Assistance to Individual Taxpayers:

If Maine chooses to resolve the problems of HPW/LHI districts through the use of individually targeted approach to taxpayers, we would recommend that the state expand its current circuit breaker to provide a larger amount of property tax relief. An expanded program could establish tiered levels of assistance, and include limits such as a maximum household income to qualify or restricting the assistance to some maximum property value, or possibly some maximum net worth. To fully protect lower income families from excessive property tax burdens, the relief could be pegged to insuring that school property (or total property) taxes do not exceed a certain percentage of family/household income. This later approach is used in Vermont. Appendix III includes a summary of Vermont's school funding system.

**APPENDIX I
STATE CIRCUIT BREAKER PROGRAMS**

	Income and Other Qualifications	Benefit
Connecticut	The maximum income is \$146,500 for a single filer; \$168,500 for head of household and \$190,500 for filing jointly.	The maximum credit is \$500. The credit is reduced by 10%, for each \$10,000 or fraction thereof in adjusted gross income above \$56,500 for unmarried individuals; \$78,500 for heads of household; and \$100,500 for married households.
District of Columbia	Household gross income must be less than \$20,000.	For household income of \$0-\$2,999, the tax credit equals 95% of property tax exceeding 1.5% of household gross income. For the highest bracket, household income of \$15,000-\$20,000, the tax credit equals 75% of property tax exceeding 4% of household gross income. The maximum credit is \$750.
Maryland	An applicant's income cannot exceed \$60,000. The maximum property tax considered is on first \$300,000 in property value. The maximum net worth is \$200,000, which excludes the residence, IRAs, and other retirement accounts.	For the first \$8,000 of income, tax relief is 100% of property taxes paid. For the next \$4,000 of income, relief is taxes in excess of 4% of income; 6.5% for the next \$4,000 income and 9% for all income above \$16,000.
Maine	Household income cannot exceed \$64,950 (single) or \$86,600 (multiple members). Property taxes must exceed 4% of total household income.	Sliding scale - between 25% and 100% of property tax based on income. The maximum credit is \$400. Senior claimants will receive the greater of the Senior Refund or this, the General Refund.
Michigan	Household income must be \$50,000 or less. Household property value of \$135,000 or less. A taxpayer does not qualify for the credit if their household income comes 100% from the Department of Human Services.	Taxpayers receive a 60% credit for property tax paid above 3.5% of household income. The maximum credit is \$750.
Minnesota	Household income must be \$103,730 or less.	The benefit is determined by 23 brackets and thresholds ranging from 1% for income up to \$1,519 to 3.5% for incomes between \$68,850 and \$99,239. The benefit is 95% of taxes for the lowest brackets to 50% for incomes between \$68,850 and \$99,239. The maximum benefit is \$2,530.
Montana	For single filers the cap is \$20,890, for multiple applicants/head of household the cap is \$27,745. The reduction applies to the first \$100,000 of taxable market value after applying the homestead exemption.	The benefit is determined by a sliding scale of relief with 3 brackets with tax relief percentages ranging from 80% for claimants with income up to \$8,118 (single) or \$10,825 (married), to 30% for claimants with income from \$12,449 to \$20,296 (single) or \$18,944 to \$27,061 (married).

New Hampshire	Income must be below \$20,000 for an individual or \$40,000 for a married person or head of household.	Refund is calculated on statewide property taxes for education on \$100,000 assessed value adjusted by each town's equalized ratio. The percent of taxes refunded range from 100% for those with income below \$12,500 (single person) or \$25,000 (head of household or married person) to 20% for those with the highest eligible income.
New Jersey	Household income must be \$75,000 or less.	For income of under \$50,000 – the credit equals 10% of taxes paid (up to \$10,000). For income between \$50,000 to \$75,000 the credit equals 6.67% of taxes paid (up to \$10,000). The maximum credit is \$1,000.
New Mexico	No tax rebate shall be allowed any taxpayer whose modified gross income exceeds \$24,000. Claimant is eligible if they were not an inmate of a public institution for more than 6 months during the taxable year.	The amount of the benefit varies with income and is based on 9 income brackets. The benefit ranges from 75% of property tax liability for income below \$8,000 to 35% of property tax liability for income between \$22,000 and \$24,000. The maximum rebate is \$350.
New York	Income for individuals cannot exceed \$18,000. Maximum property value considered is \$85,000 (includes all real estate owned).	The benefit is determined by sliding scale of relief with 7 brackets and thresholds ranging from 3.5% if income is under \$3,000 to 6.5% if income is \$14,001 to 18,000. The maximum benefit ranges from \$75 if income under \$1,000 to \$41 if income \$17,000-\$18,000.
Rhode Island	Income ceiling is \$30,000.	There are 5 income brackets for all filers. For those with income less than \$6,000, the credit is the taxes in excess of 3% of income. For those in the top bracket, \$15,001 to \$30,000, the credit is the taxes in excess of 6% of income. The maximum credit is \$300.
Vermont	Household incomes below \$90,000 receive the full adjustment. The adjustment for incomes above \$90,000 is reduced until household income reaches \$97,000 at which point no adjustment is available. The adjustment only applies to the first \$500,000 of homesite market value. Any value above \$500,000 is subject to the homestead property tax rate of the school district.	The benefit is a credit on property tax bill for school taxes. The credit is the amount that taxes exceed the applicable percentage threshold, which is a specific percentage of income set by the state. The maximum benefit is \$8,000. <u>For a full description of Vermont's circuit breaker program see Appendix III</u>
West Virginia	All homeowners are eligible if property taxes exceed 4% of their gross household income.	This program provides a refundable credit for property taxes paid in excess of 4% of gross household income. The maximum credit is \$1,000.

Wisconsin	Income ceiling is \$24,680 plus \$500 per dependent.	The credit is equal to 80% of the taxes paid above 8.788% of income. The maximum credit is \$1,168.
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Source: *Significant Features of the Property Tax*. Lincoln Institute of Land Policy and George Washington Institute of Public Policy. (Residential Property Tax Relief Programs; accessed: 6/10/2013). Additional information provided from state sources.

**APPENDIX II
HOMESTEAD PROPERTY TAX EXEMPTIONS**

	Special Qualifications	Type of Credit	Taxpayer Benefit
Arizona	None	Property Tax	The state pays 40% of the homeowner's school district primary tax, up to \$600.
Arkansas	None	Property Tax	\$350 reduction in the property taxes assessed on the homestead.
District of Columbia	Income of the household shall not exceed 120% of the lower income guidelines for the Washington Standard Metropolitan Statistical Area.	Property Tax	For a period of 5 years, eligible applicants may receive a tax abatement.
Georgia	None	Income Tax	Homeowners receive an income tax credit equal to the county, state, school, and city taxes on \$8,000 of property value.
Iowa	None	Income Tax	Homeowners receive an income tax credit equal to the county, state, school, and city taxes on \$4,850 of property value. The minimum credit is \$62.50.
Illinois	None	Income Tax	A credit of 5% of real property taxes paid on taxpayer's principal residence is provided on the taxpayer's income tax. The credit is non-refundable.
Kansas	The homes appraised value must have increased by more than 75%.	Property Tax	If the appraised value increases by 75% or more, 80% of the tax attributed to the increase shall be refunded in the first year, reduced to 50% the next year and 25% in the third year.
Maine	None	Property Tax	The first \$10,000 of the homestead's property value is exempted from property taxes.
Maryland	None	Property Tax	A municipality may grant a property tax credit against the county or municipal corporation property tax imposed on a homestead.
Minnesota	The value of the home must be less than \$414,000 to qualify.	Property Tax	Homeowners receive a credit equal to .4% of the first \$76,000 of the qualifying property's market value, minus .09% of the market value in excess of \$76,000. The benefit is phased out at about \$414,000 market value.
Ohio	None	Property Tax	Taxpayers receive a 2.5% reduction on their real property tax bill for owner-occupied residential property.

Wisconsin	None	Income Tax	This non-refundable state income tax credit is 12% of the first \$2,500 of property taxes paid or rent, deemed to be property taxes.
Wyoming	<p>Must be a resident of Wyoming for the past 5 years.</p> <p>The household's gross income may not exceed the 75% of the median gross household income for the applicant's county of residence or the state (\$41,205 in 2010). Household assets cannot exceed \$101,900 per adult member of the household.</p>	Income Tax	The benefit is a refund of up to one-half of the applicant's prior year's property tax, not to exceed one-half of the median residential property tax liability for the applicant's county of residence as determined annually by the department of revenue.

Source: *Significant Features of the Property Tax*. Lincoln Institute of Land Policy and George Washington Institute of Public Policy. (Residential Property Tax Relief Programs; accessed: 6/10/2013). Additional information provided from state sources.

APPENDIX III VERMONT'S SCHOOL FUNDING SYSTEM¹¹

In fiscal year 2012 (FY 2012)¹² Vermont raised an estimated \$1.4961 billion to educate 89,115 students in 307 schools operated by 277 districts through 46 supervisory unions, 12 supervisory districts, and 2 interstate districts.¹³ This spending amounted to approximately \$16,788 per pupil. Vermont's system for allocating revenue to school districts is unique among the 50 states in that local towns and districts annually determine the spending level for their schools, and the state – through a complex system of property and income taxes and other state sources of revenue – funds the schools in a manner designed to treat taxpayers choosing the same level of spending for the students in their schools equally regardless of their location across the state.

The funding system in use today emerged in response to the 1997 Vermont Supreme Court ruling in *Brigham v. State* and was implemented through Act 60 in 1997 and Act 68 in 2004. This appendix provides a brief historical description of Vermont's school funding system and offers a description of its current operation. As in other states, the actual operation of the school finance system is highly technical. This description is designed to provide the reader with an understanding of how it works, but does not include many of the technical details that can lead to confusion in understanding the overall operation of the system.

HISTORICAL CONTEXT

Prior to the *Brigham* decision, Vermont relied on a foundation program to fund its public schools. A foundation program is the most common approach to school finance today and relies on a base – or foundation – level of revenue for each school district. To ensure that all school districts have equal access to this level of resources, a fixed tax rate is established, and state aid is provided to districts that are not able to raise the full foundation amount from the fixed tax rate.

Under the system in place at that time, the foundation level was legislatively determined on an annual basis and expressed in terms of funding per weighted ADM (Average Daily Membership). Weighted ADM was determined by assigning weights of 1.25 to secondary students and to students from families receiving food stamps. In addition a variable weight was assigned for pupil transportation (Mathis, 1995). Downes

¹¹ This Appendix is adopted from our report to the Vermont Legislature, Picus, L.O., Odden, A., Glenn, W., Griffith, M., and Wolkoff, M. (2012). *An Evaluation of Vermont's Education Finance System*. North Hollywood, CA: Lawrence O. Picus and Associates. Available at www.lpicus.com.

¹² Fiscal years run from July 1 of one year through June 30, of the following year. As used throughout this document when we use the term FY 2012 we are referring to the period of time from July 1, 2011 through June 30, 2012, thus the current fiscal year as of the date of this study is FY 2012.

¹³ *2011 Report on Act 3 Section 56, An Act Relating to Fiscal Year 2011 Budget Adjustment*, Report/Recommendations to the House and Senate Committees on Appropriations, Submitted by: Vermont Department of Education, School of Finance Division. April 6, 2011.
<http://www.leg.state.vt.us/reports/2011ExternalReports/268662.pdf>

(2004) points out that fluctuations in the state's fiscal status led to Legislative adjustments to the foundation tax rate to reduce the state's liability and the state share of education expenditures fluctuated between 20% and 37% of education expenditures. In the period immediately prior to the *Brigham* ruling and passage of Act 60, the state share had been declining.

In addition, prior to Act 60, property wealthy districts were able to increase spending above the foundation level with a lower incremental tax rate than property poor districts, and thus benefited from both lower property taxes and higher per pupil revenues. Despite efforts – to that time unsuccessful – by the legislature to modify the system, the combination of reduced state share plus property tax rate inequities led to the filing of the *Brigham* suit. The ruling by the state's highest court required that local tax efforts for equal levels of school spending be substantially equal, and that the wealth of the state, not of local school districts, be the determinant of how much was spent to educate Vermont's school children. As described below, the Legislature responded with a system designed to both equalize property tax burdens and individual taxpayer liability on the basis of their household income.

ACT 60

Passed just four and a half months after the *Brigham* ruling, Act 60 dramatically changed the way Vermont's schools were financed. Act 60 established a two tier funding system and added an income adjustment to limit the amount individual taxpayers would pay for schools. The first component of the new system was a basic level¹⁴ of spending for all districts, financed in part by a statewide property tax. Districts choosing to spend more than the basic level participated in a power-equalized system that included a recapture provision. A unique aspect of this second tier of the funding system was that it was funded by an additional property tax rate assessed in proportion to the level of spending a town chose. The property wealth of all districts that wanted to spend above the base spending level was pooled, and a tax rate based on the district's desired spending level set to produce the additional funds desired, with each district receiving from the "sharing pool" of revenue the amount it wanted to spend above the base spending level.

What made the second tier unique was that it did not rely on any revenue sources other than property taxes beyond the base level. Towns that chose to spend above the base level informed the state what their spending level would be. The total additional revenues for all towns that went above the base level would come from the "sharing pool" that was funded by additional property taxes on those towns that chose to raise additional funds. Town tax rates above the base rate were determined on the basis of

¹⁴ Students of school finance will want to call this a foundation amount. Vermont does not use that term and points out that since the passage of Act 60 and as part of Act 68, the basic amount is determined annually as part of the appropriation process for education. Generally in school finance, the foundation level is determined on the basis of some minimum amount needed for all schools; this is not part of the discussion in determining the annual basic amount in Vermont. Maine's equivalent today is the EPS funding level, the major difference being that the per pupil funding level in most foundation programs is the same for all districts, while Maine's adequacy based EPS system generates a different per pupil funding level for each district.

how much their per-pupil funding proportionally exceeded the base level (that is if per pupil spending above the base level was twice as high as another district, the tax rate beyond the base rate was twice as high as well) and how much money was needed to be raised to fund fully the sharing pool from these revenues. Property tax revenues were then placed in the “sharing pool” by the state and redistributed to school districts.

Setting proportionate tax rates for the same spending levels meant that property rich districts would raise more money at the same tax rate than property poor districts. The effect of the sharing pool process was to fully recapture any property tax revenues generated by property wealthy districts as all districts making the same spending level choice paid the same tax rate. Therefore, property wealthy district funded a disproportionate percentage of the sharing pool even when taxed at the same rate as poorer districts. This feature of the sharing pool led a number of wealthy districts to limit their participation in the sharing pool to minimize the amount of property tax funding that was recaptured. While some districts were able to fund all expenditures above the basic amount through private donations, many relied on a combination of private funding and the sharing pool. At its height, wealthy districts raised about \$13.9 million total privately out of a system with total spending in the range of \$1 billion. As described below, Act 68 eliminated the sharing pool and the incentive to raise such large amounts of private funds.

In addition, an income adjustment was enacted to impact individual tax liability for schools. In districts that only spent the basic amount, school taxes for taxpayers with household incomes below \$75,000 were limited to the lesser of the homestead property tax (the tax liability on their homestead which is their house and up to two surrounding acres) or two percent of their income. For spending above the base amount, the percent of income was increased proportionally along with the property tax rate. This income adjustment was the result of many legislators wanting to move the state to an income based tax system for schools, and represented a compromise between those who wanted to rely solely on income taxes and those who felt residential property taxes should be part of the funding scheme as well. Although Downes (2004) suggests the income adjustment was primarily developed to limit the tax liability of low-income families living in high wealth or “gold town” school districts, interviews with officials who participated in the development of the system suggest this was not the primary goal. Rather the primary goal was an income tax based school funding system.

Act 60 succeeded in eliminating the relationship between property wealth and school district spending. However it was widely unpopular in the gold towns, many of which elected to limit participation in the sharing pool and instead raised funds through private donations as described above. The state also took on additional funding responsibility for schools – and began the process whereby all property tax collections for schools are considered state, not local, revenue sources. In response to the many concerns about Act 60 and the complexities of the “sharing pool,” the state enacted Act 68 in 2004.

ACT 68¹⁵

Act 68 as it modified Act 60, remains the basis for Vermont’s school funding system today. Act 68 eliminated the two tier funding system placing all education funds for schools in one large pot, not two. It also ended the “sharing pool” and split the property tax base between residential and non-residential property. The non-residential property tax rate is determined by the state and is uniform across all towns but adjusted for the common level of appraisal or CLA as described below. Changes since that time have increased the income level at which the income adjustment to homestead property taxes can be used and made other small alterations to the operation of the system. According to the Vermont Department of Education (2011), today, regardless of the level of per pupil spending approved by the voters of each town, taxpayers with homesteads of the same market value or the same household income, in districts with the same per pupil spending, should have the equal tax bills for education. School funding under this system is outlined below.

Education Spending

Under Act 68, total funding for education has two components, categorical grants and education spending. Categorical grants are separate revenue sources provided by the state to school districts for specific purposes. In FY 2012 these grants amounted to \$205.7 million as displayed in Table 2.1. Education spending is essentially all other expenditures for education and is determined by totaling all budgeted expenditures of all school districts (including any district carryover deficits if they exist) and subtracting the categorical grants. For FY 2012 education spending was estimated to be \$1.125 billion, which amounts to 78% of total PK-12 resources.

In addition to these two components, an estimate of total estimated revenue for FY 2012 includes the state appropriation for school employee pensions (\$57.3 million) as well as Federal funding (estimated at \$108 million) for a total of \$1.496 billion or \$16,788 per ADM.

Table 2.1: Vermont Categorical Grants, FY 2012

Categorical Grant	Amount (\$)
Special Education Aid (about 60% of eligible special education)	148,587,443
Transportation Aid (about 44% of transportation expenditures)	16,313,885
Small School Grants	7,100,000
Aid for State-placed Students	15,000,000
Technical Education Aid	12,872,274
Essential Early Education Aid	5,782,900
Total	205,656,502

Source: Vermont Department of Education, 2011

¹⁵ This section draws heavily from the Vermont Department of Education’s document, *Vermont’s Education Funding System, June 2011*.

Property taxes are split into two components, a non-residential component and the homestead property tax. The tax rate for non-residential property is set annually by the state as part of the process of determining how much revenue will be needed to fund schools. The residential component – which is subject to both the income adjustment and a circuit breaker relief program for households with incomes below \$47,000 – is the most complex part of the formula. Act 68 establishes tax rates of \$1.59 per \$100 of fair market value for non-residential property taxes and a base rate of \$1.10 for homestead property although both are adjusted annually by the Legislature upon recommendation by the Tax Commissioner based on projections of the amount of money in the education fund reserve and the stipulation that the non-residential property tax revenues must fund at least 34% of education spending (total minus categoricals). For FY 2012, the non-residential property tax rate was \$1.36 and the base homestead rate was \$0.87.

Determining the actual tax payments for individuals in local school districts is relatively complex and based on a number of factors. The state does not limit how much a local district can spend on education although as described below there is a disincentive to spend at very high levels.

To determine homestead tax rates, the first step occurs when the Legislature establishes the base homestead tax rate (\$0.87 for FY 2012) and the base education-spending amount per pupil (\$8,544 in FY 2012). A district's education budget, which can be larger than the base spending, is then divided by its equalized pupil count.¹⁶ This yields an education spending per equalized pupil figure for each district in the state. That amount is compared to the base education-spending amount per pupil to determine the percentage variance from that amount. If a district's equalized per pupil spending amount is less than or equal to the base education spending level (\$8,544), its tax rate is the base homestead rate (\$0.87). If the district's per pupil spending exceeds the basic education per pupil amount, the base education homestead tax rate is increased by the percentage by which its per pupil spending amount exceeds the base amount. In addition, there is a threshold beyond which increases are funded at rates double the proportional increase (see below). The following describes how the education homestead tax rate is first determined for each town and then for each individual resident's property in the town.

First, a district's base homestead tax rate cannot be lower than the state determined base rate (\$0.87 in FY 2012). Districts spending less than the base spending level therefore pay the same homestead tax rate as districts spending at the base spending level.

Second, when a town decides to spend above the base spending level, the education homestead tax rate of \$0.87 is increased proportionally, i.e., by the same percentage.

¹⁶ The equalized pupil count is determined by the Vermont Department of Education based on a specific formula and differs from enrollment, ADM and weighted ADM.

Third, there is a built in disincentive to spend above a certain point, called the High Spending Threshold. The High Spending Threshold is determined statutorily to be 25% above the state average education spending per pupil for the prior year. In FY 2012, this threshold is \$14,733 per pupil. For districts choosing to spend above this level (after adjustments for approved capital construction debt services, certain special education costs, and deficit repayments in some cases) the marginal homestead tax rate increases at twice the rate it increases below the threshold. The marginal percentage of income paid under the income adjustment also doubles above this threshold.

Fourth, an individual taxpayer's tax payment is subject to an income-based adjustment if their household income is below \$90,000 (with a smaller adjustment between \$90,000 and \$97,000). In 2012, for school districts with per pupil spending equal to the base spending level (\$8,544), the homestead property tax is the lower of the property tax assessment or 1.8% of household income. As equalized spending per pupil exceeds the base spending level, the percentage of household income used to determine tax liability increases by the same percentage that spending exceeds the base amount. This too is subject to the High Spending Threshold so the additional proportion of income to be paid in school taxes doubles for amounts above the threshold. Above incomes of \$90,000 this adjustment is reduced until household income reaches \$97,000 at which point no adjustment is available.

Fifth, the income adjustment to property taxes only applies to the first \$500,000 of homesite market value. Any value above \$500,000 is subject to the homestead property tax rate of the school district.

Sixth, Vermont has a circuit breaker property tax relief program for households with incomes below \$47,000. This provides further income based property tax relief for some households. The important consideration related to the circuit breaker is that once a taxpayer qualifies for circuit breaker assistance, they do not pay for additional homestead property taxes even if their school district's spending increases. This adjustment has been in place since the 1970s, but after Act 60's passage, the income adjustment reduced tax liabilities of many households and reduced the number of households that qualify for the circuit breaker, which is applied after the income adjustment is computed.¹⁷

Seventh, there is one more adjustment that has caused a great deal of confusion about the system. The common level of appraisal or CLA is designed to adjust property tax rates to accommodate differences in assessment practices across the state. The CLA is computed by the Vermont Tax Department based on actual sales data over the past three years and additional statistical analysis. The CLA compares the town's education grand list with what the grand list would be if all properties were listed at 100% of fair market value as determined through this analysis. The CLA is then expressed as a percentage such that a town that has under assessed its property would have a value less than 100% and a town that over assessed its property would have a value exceeding

¹⁷ It should also be noted that Vermont has a \$15,000 homestead exemption for property taxes. Property worth less than \$15,000 is not subject to taxation, and tax rates are applied to homestead property values minus the \$15,000 exemption.

100%. The CLA is then applied to the town's education tax rate by dividing the homestead and non-residential tax rates by the CLA. For example in a town with an education tax rate of \$1.22 and a CLA of 80%, the tax rate would be divided by 0.8 and the actual tax rate shown on tax bills would be \$1.53 ($\$1.22/0.8$). Similarly, a town with a CLA of 120% would find a tax rate of \$1.22 adjusted downward to \$1.02 ($\$1.22/1.20$). Again, this important adjustment, which is made in most other states as well, is to ensure that property tax rate calculations are made on the basis of comparable valuing of property.

Eighth, another confusing aspect of the system is the annual determination of the base amount as well as the non-residential property tax rate and the homestead base tax rate. Because these are determined by the Legislature and likely to be impacted by the level of other state revenue available for education, if a district's education spending were to remain constant from one year to the next, but the Legislature were to reduce the funding from other state sources, homestead and/or non-residential property tax rates could increase. Similarly, it is possible for a town to hold spending constant while others increase spending and similarly see tax rate increases.

While this system appears quite complex, the intent is to ensure that property tax payments, whether based on the value of the property or household income should be equal for individuals in school districts with the same per pupil spending level and equal property values or household incomes. In short, the property wealth of individual school districts and the income of district residents should not impact the amount of money a district spends for education.