

# Funding K-12 Public Education in Nebraska

## Presentation to the Revenue Committee and the Education Committee of the Nebraska Legislature

Lincoln, Nebraska, August 28, 2015

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# Presentation Outline

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- Policy issues
  - Heavy reliance on the property tax for funding K-12 public education
  - Rapidly rising property taxes on agricultural property
- Policy responses
  - Funding increases in state aid to education
  - Responding to the rise in property taxes on agricultural land

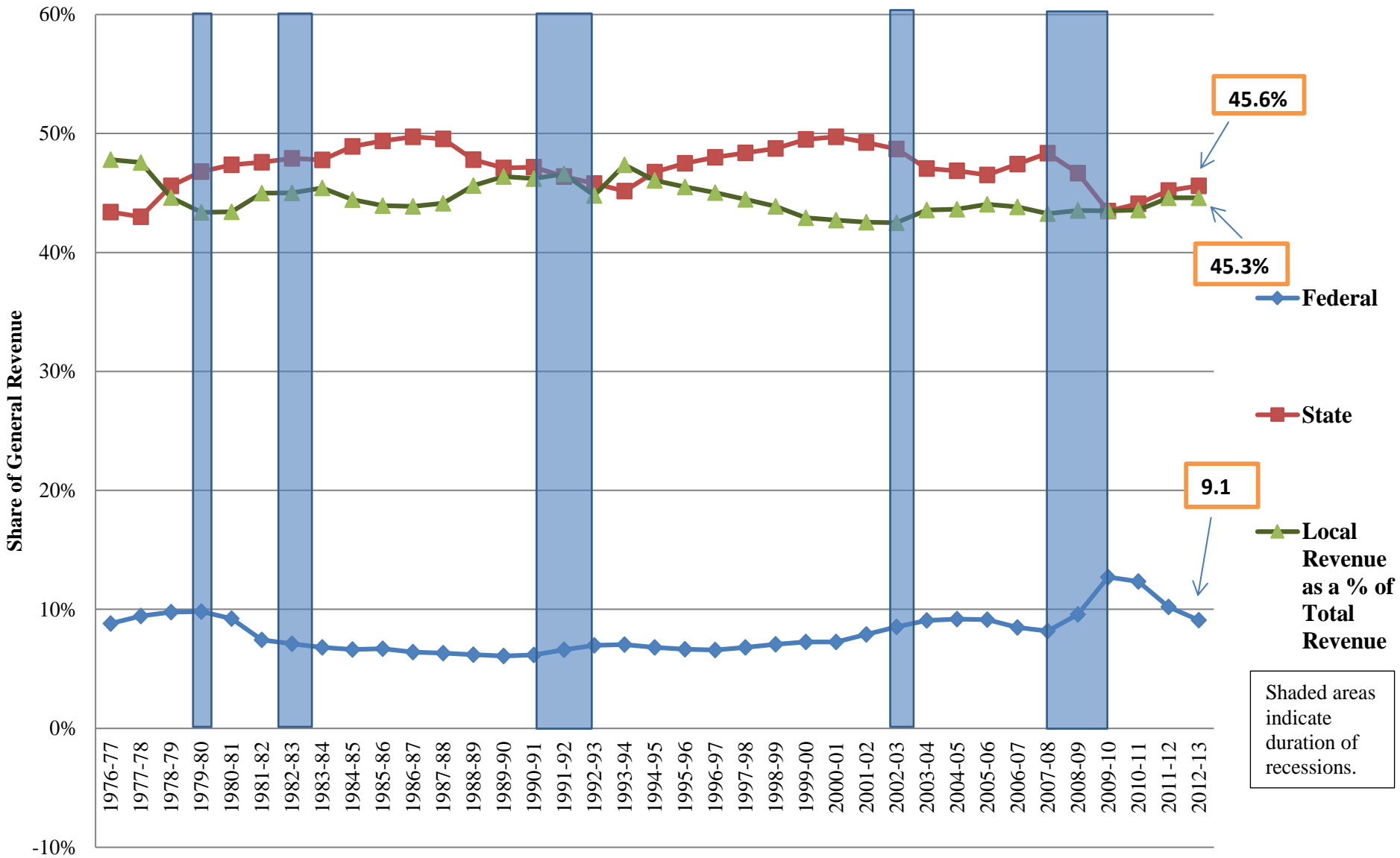


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## Policy Issue: Nebraska's Heavy Reliance on the Property Tax for the Funding of K-12 Education

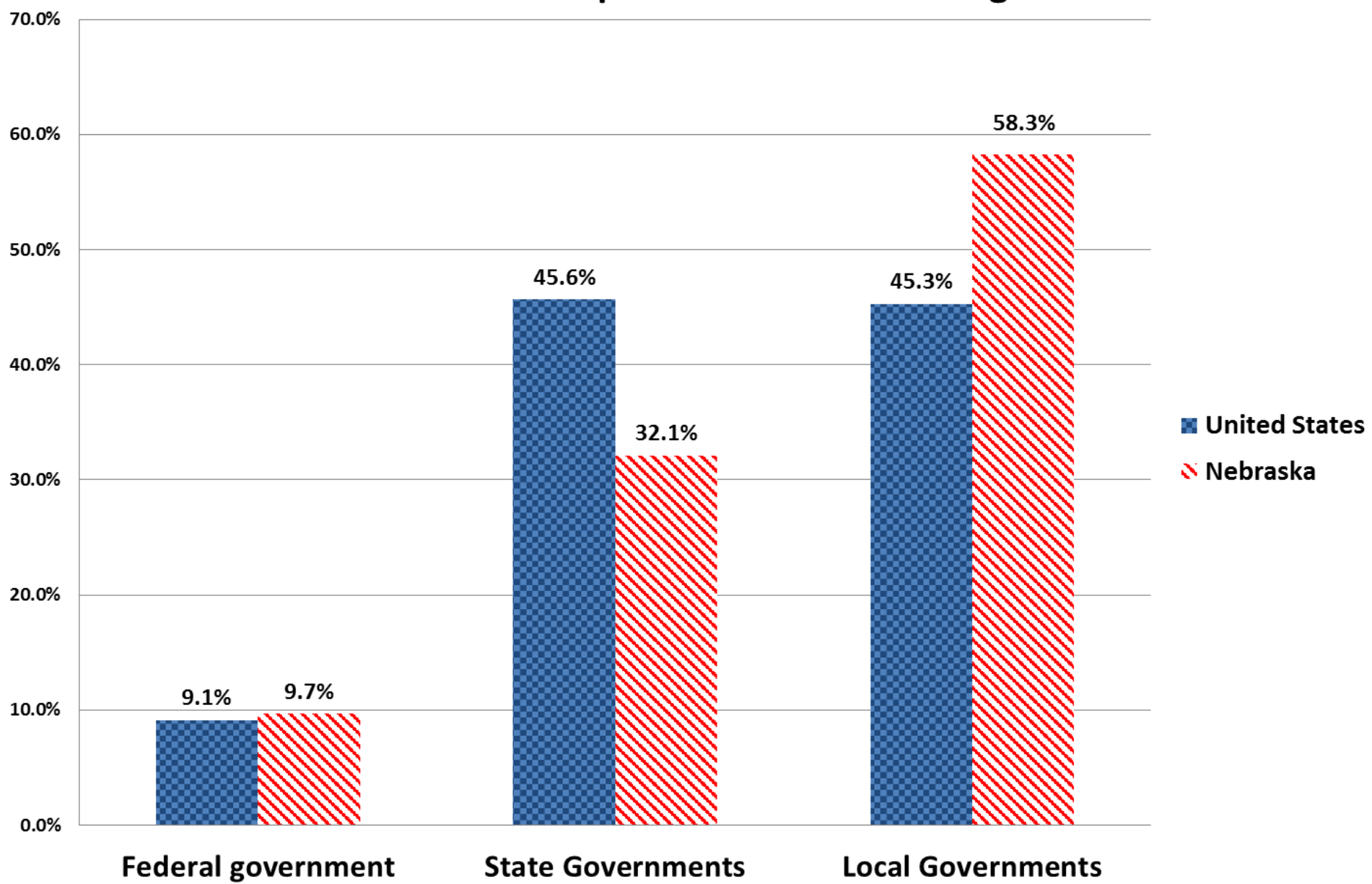
# General Revenue for Public Education

## Share by Level of Government, 1976-77 to 2012-13



# Revenue Sources for Public Education, 2012-13

## Nebraska Compared to the U.S. Average



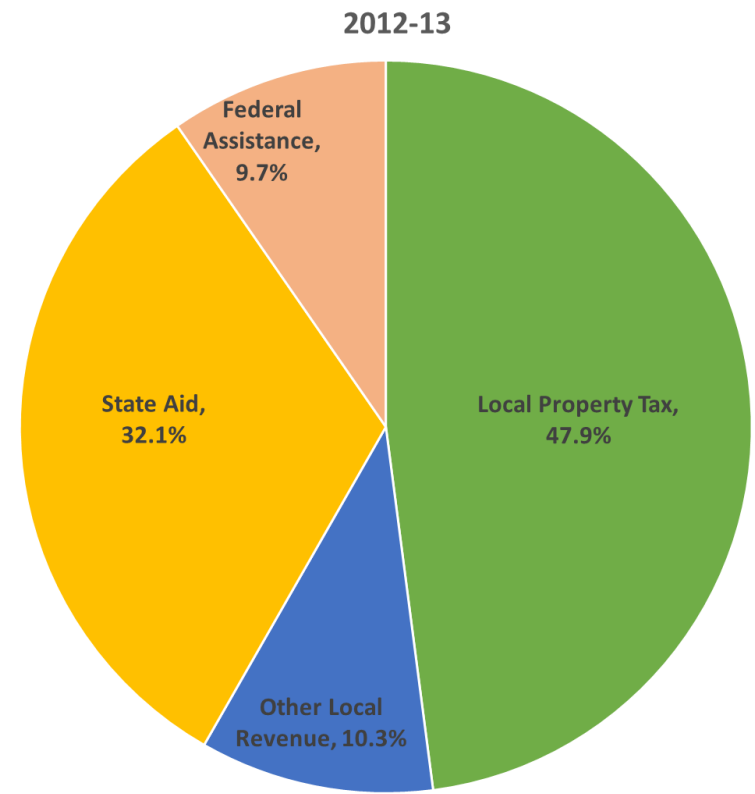
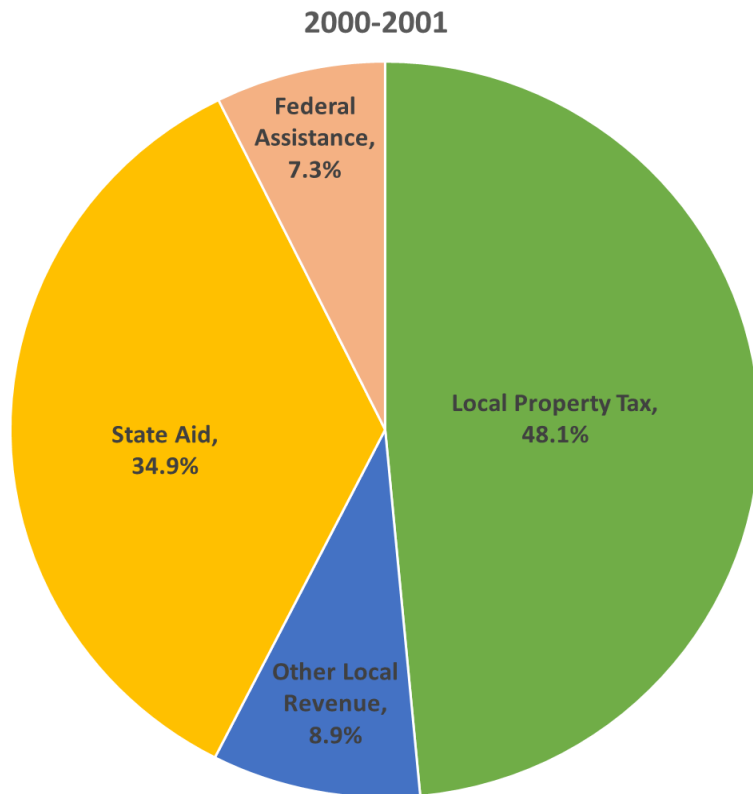
Source: National Center for Education Statistics, *Public Elementary-Secondary Education Finances, Fiscal Year 2013*.

## The Role of the Property Tax in Funding Public Education, 2011-12

	<b>Property Tax as a % of Local Revenue</b>	<b>Local Revenue as a % of Total Revenue</b>	<b>Local Property Tax as a % of Total Total Revenue</b>
New Hampshire	95.6%	57.4%	54.9%
Connecticut	97.3%	56.1%	54.6%
Illinois	88.3%	59.6%	52.6%
New Jersey	94.3%	55.1%	52.0%
Rhode Island	97.3%	53.3%	51.9%
Massachusetts	94.1%	54.1%	50.9%
<b>Nebraska</b>	<b>85.2% (14)</b>	<b>59.6% (1)</b>	<b>50.8%</b>
Average state	76.0%	41.7%	32.8%
Tennessee	47.9%	40.7%	19.5%
Idaho	83.3%	23.3%	19.4%
Minnesota	64.0%	28.6%	18.3%
Louisiana	41.9%	39.8%	16.7%
Alabama	46.8%	32.8%	15.3%
New Mexico	80.2%	17.0%	13.7%
Alaska	56.9%	21.0%	11.9%

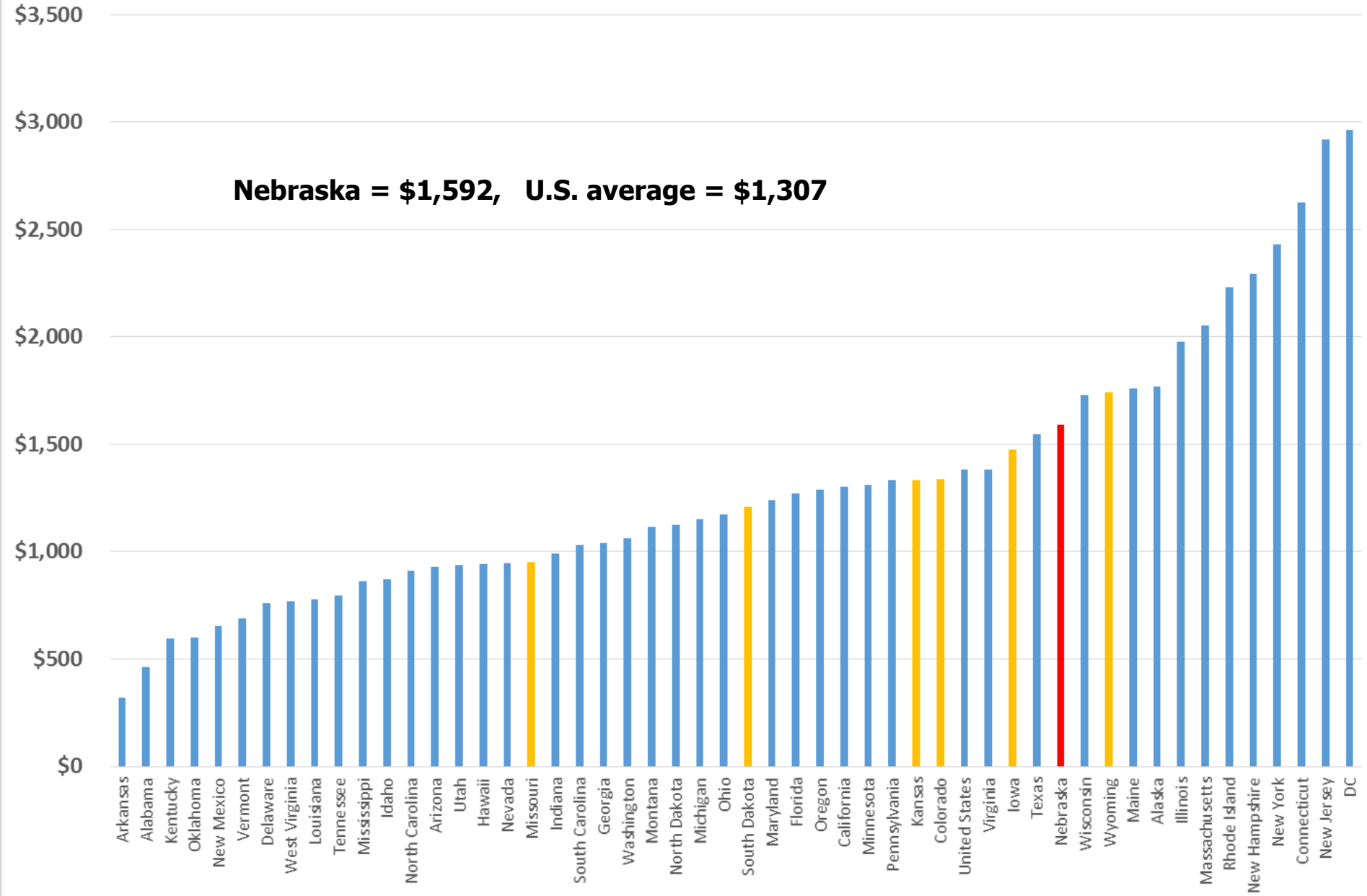
**Source:** Calculations using data from the National Center for Education Statistics, *National Public Education Financial Survey* Data, 2015. Available at [nces.ed.gov/ccd/stfis.asp](http://nces.ed.gov/ccd/stfis.asp).

# Sources of Nebraska Education Revenue



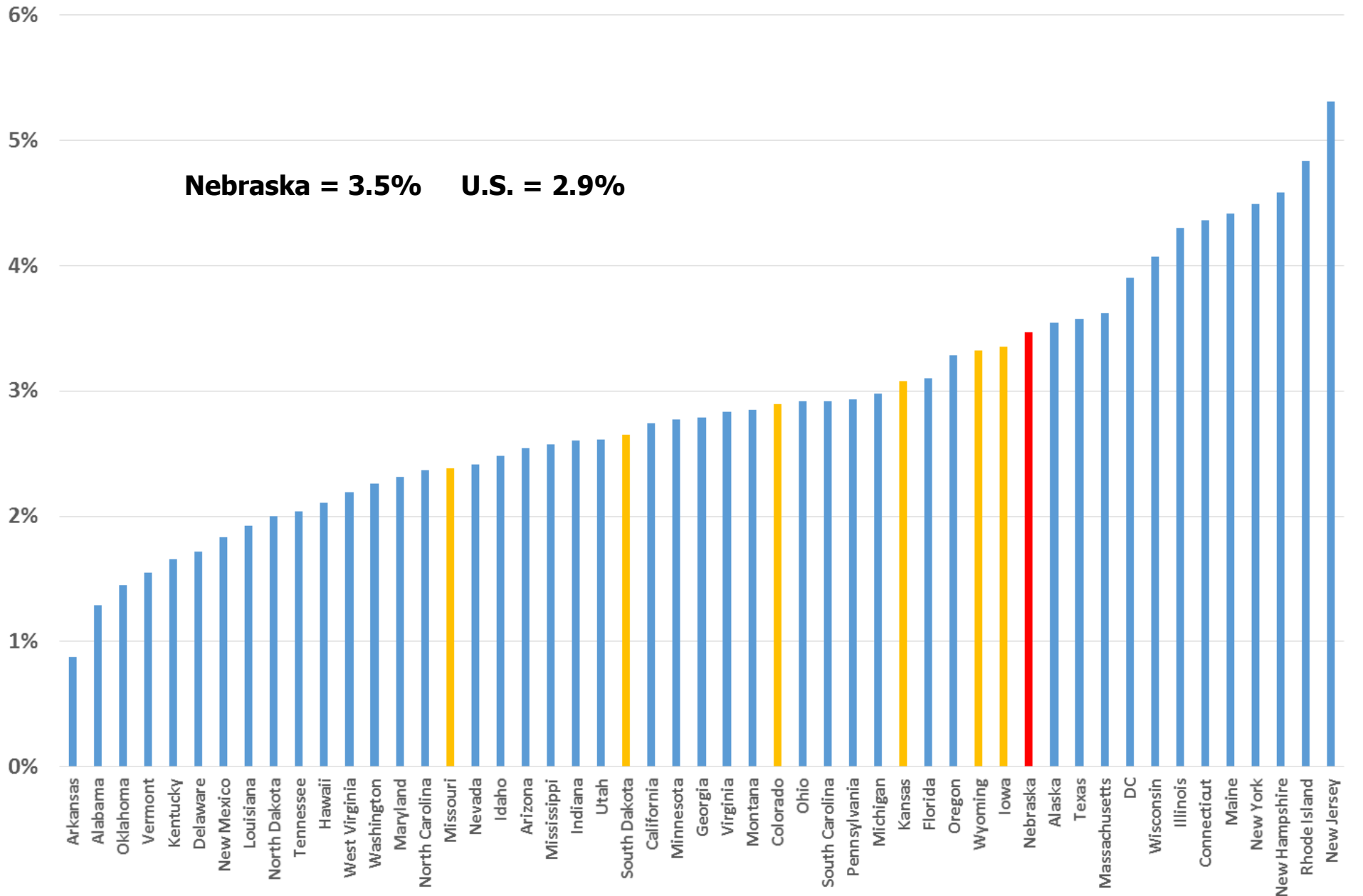
# Local Property Tax Revenue Per Capita, 2012

**Nebraska = \$1,592, U.S. average = \$1,307**



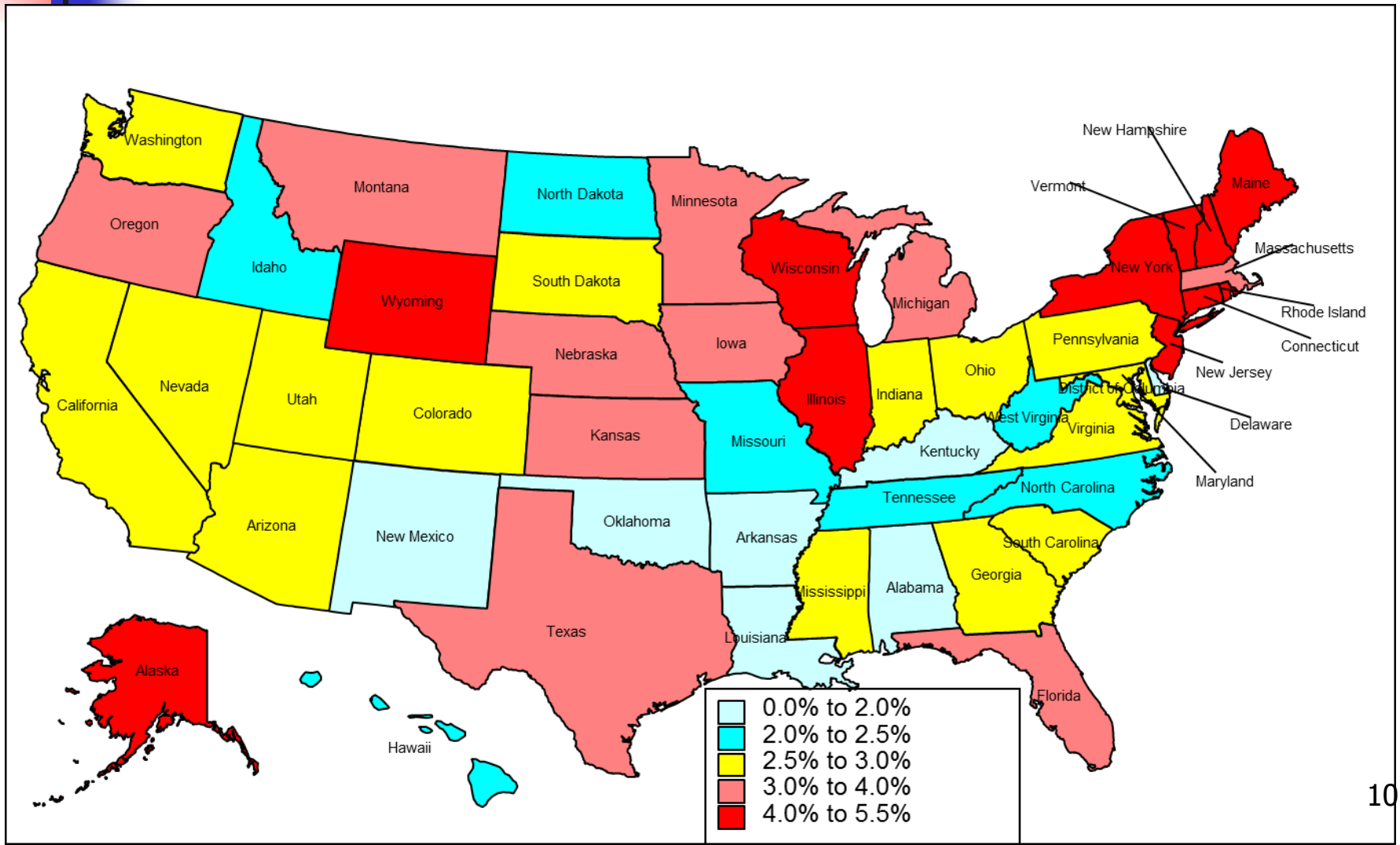


# Local Property Tax Revenue as a % of Income, 2012

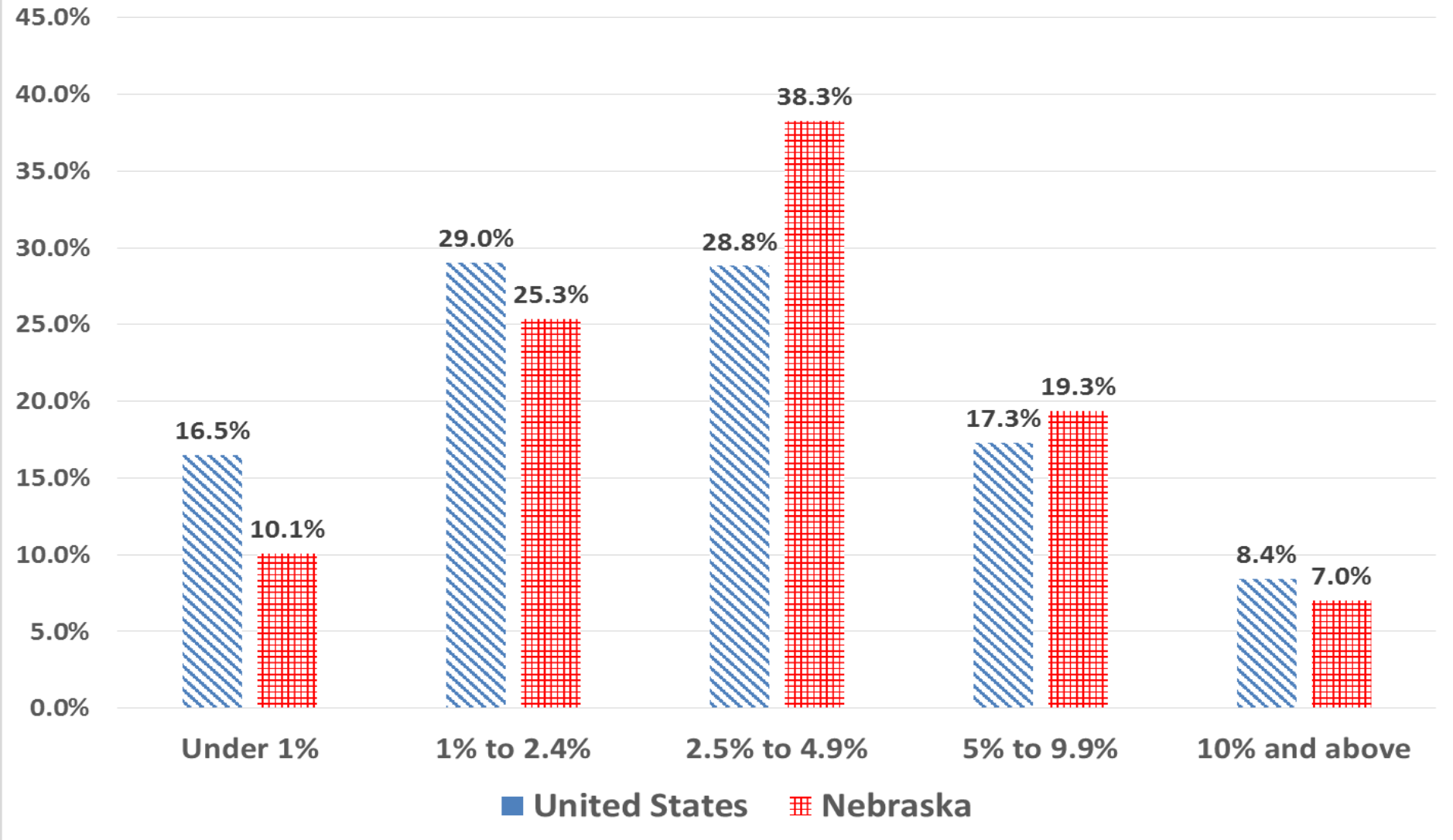


Source: U.S. Census Bureau, *State and Local Government Finances*

# Property Tax Revenue as a % of Personal Income, 2012



# Homeowner Property Taxes as a Percent of Income, 2010 Nebraska Compared to United States Average



Average property tax burden: U.S. = 4.3%

Nebraska = 4.3%

Source: U.S. Census Bureau, *American Community Survey, 2008-2012*



# Current Spending Per Pupil, Fiscal Year 2013

## Public Elementary and Secondary Education

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New York	\$19,818
Alaska	\$18,175
District of Columbia	\$17,953
Hawaii	\$11,823
Nebraska	\$11,579
Ohio	\$11,197
National Average	\$10,700
Arizona	\$7,208
Idaho	\$6,791
Utah	\$6,555



## Nebraska's High Quality Public Schools

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- Public schools are generally considered to be of high quality
- Student performance on National Assessment of Education Progress (NAEP) above national averages

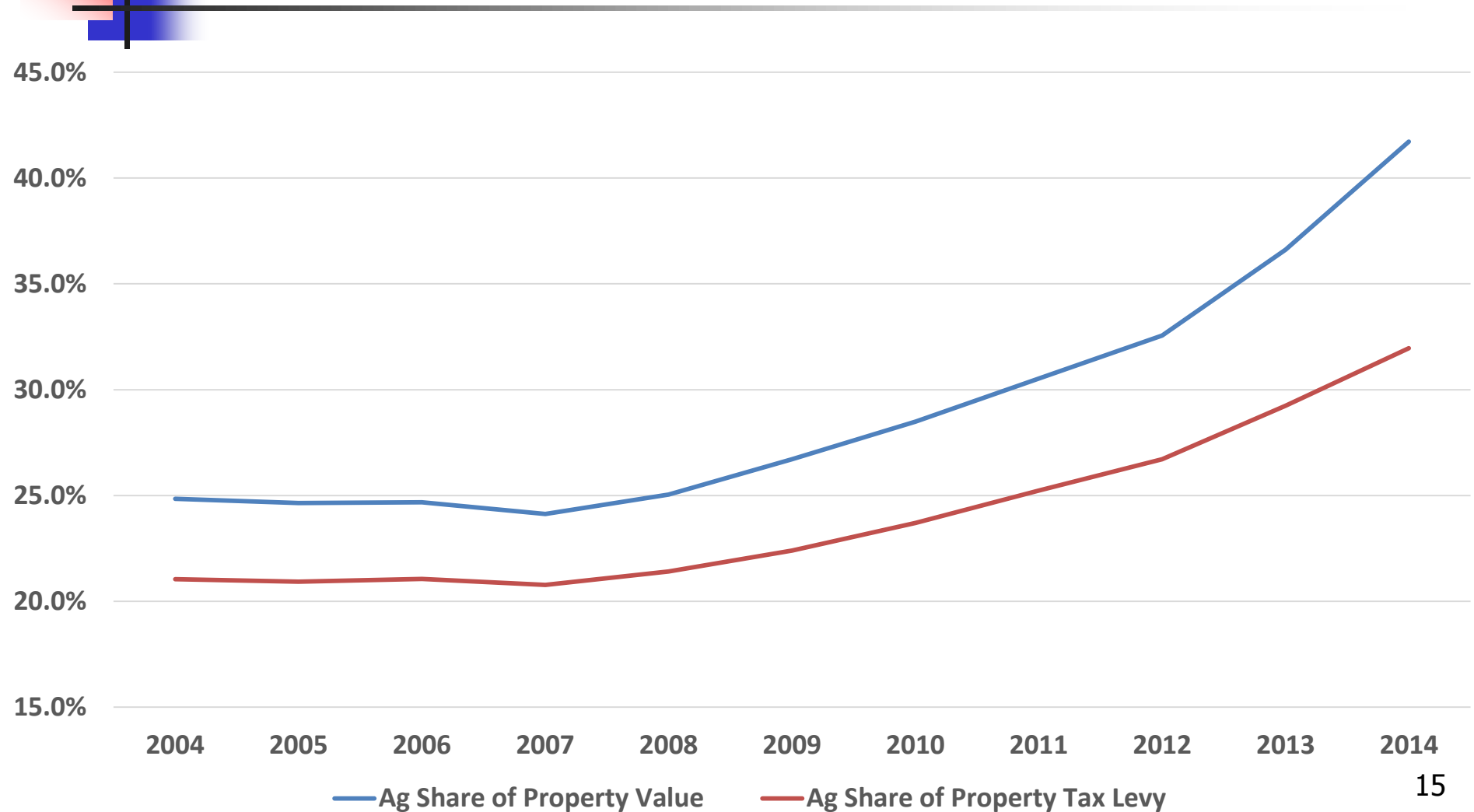
	Nebraska	U.S. Average
8th Grade Reading	285	284
8th Grade Mathematics	269	266



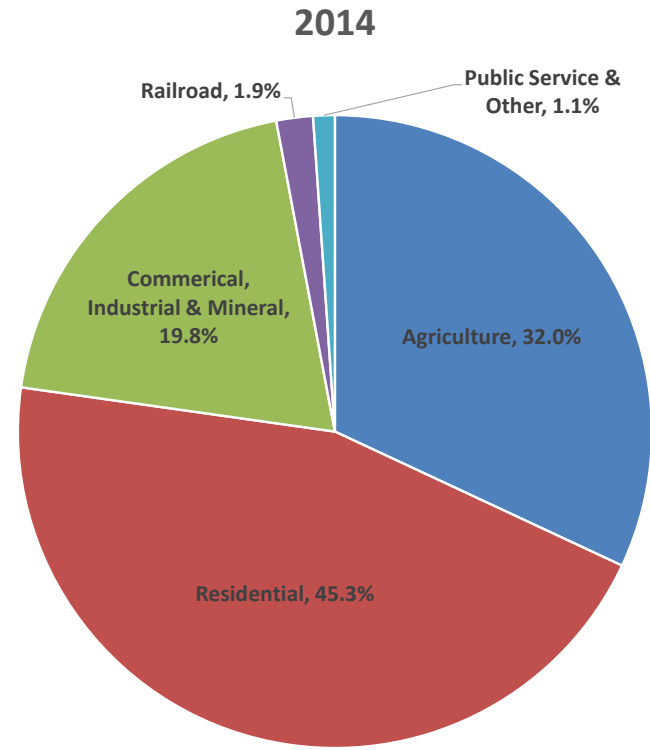
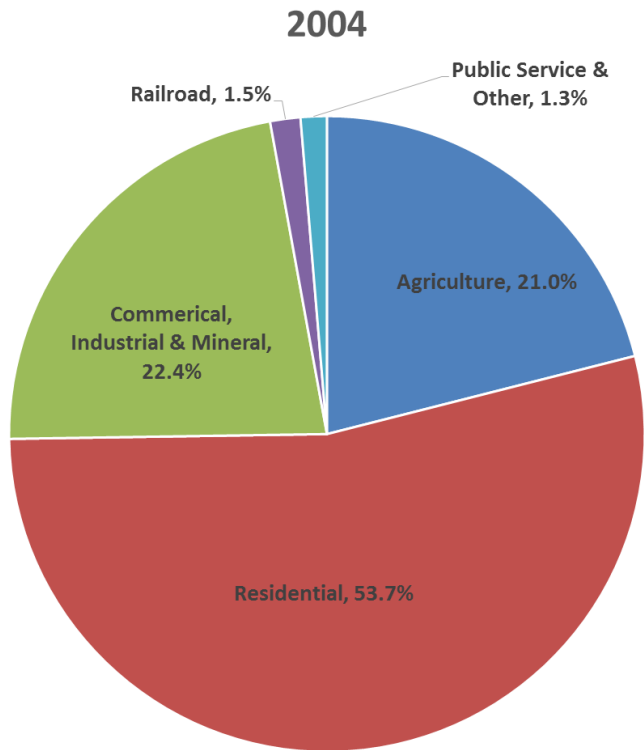
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## Policy Issue: Rapidly Rising Property Taxes on Agricultural Property

# Growth in Agriculture's Share of Total Property Values and Total Property Tax Levies, 2004-2014

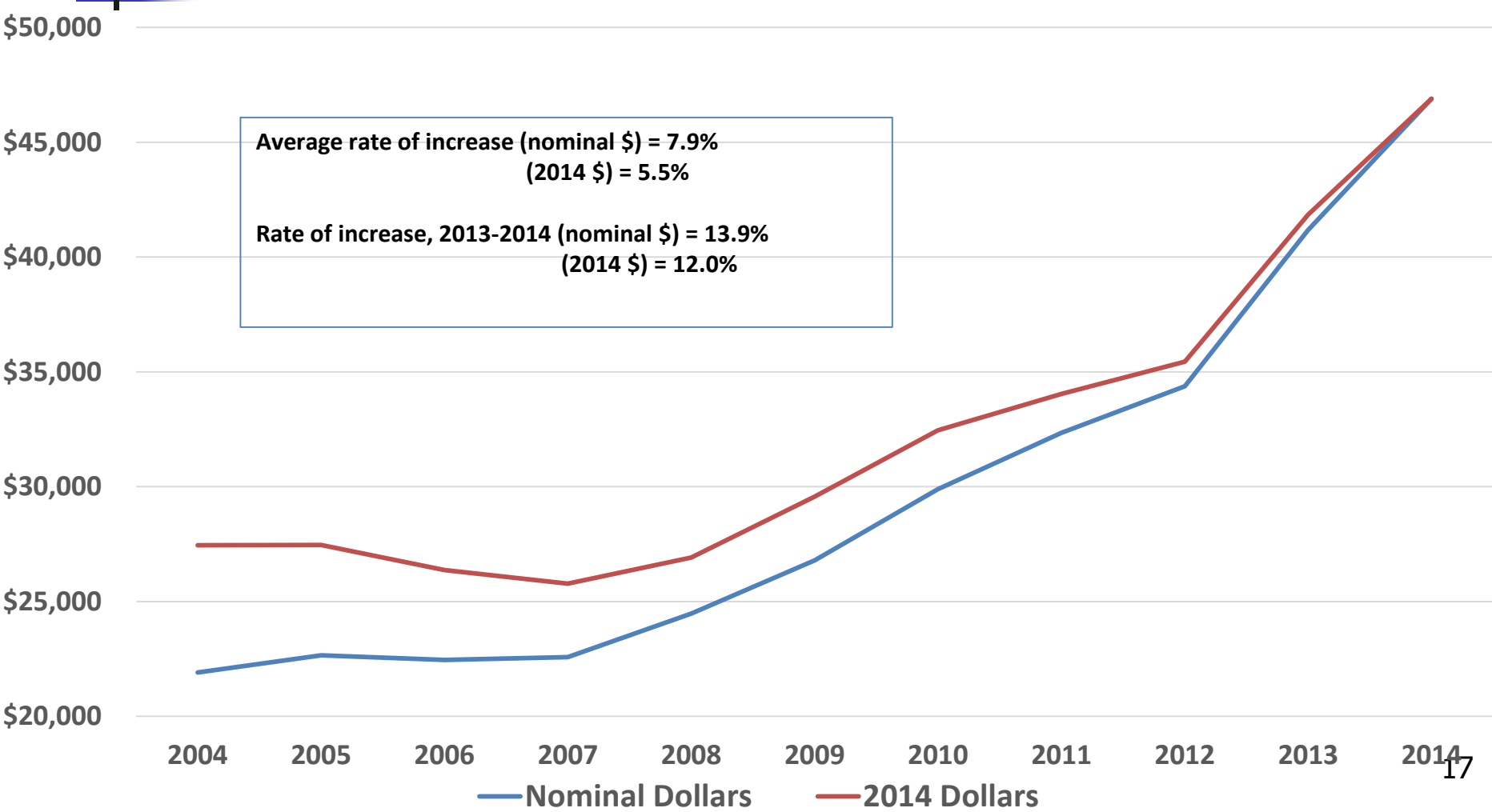


# Property Tax Levy by Type of Property 2004 and 2014

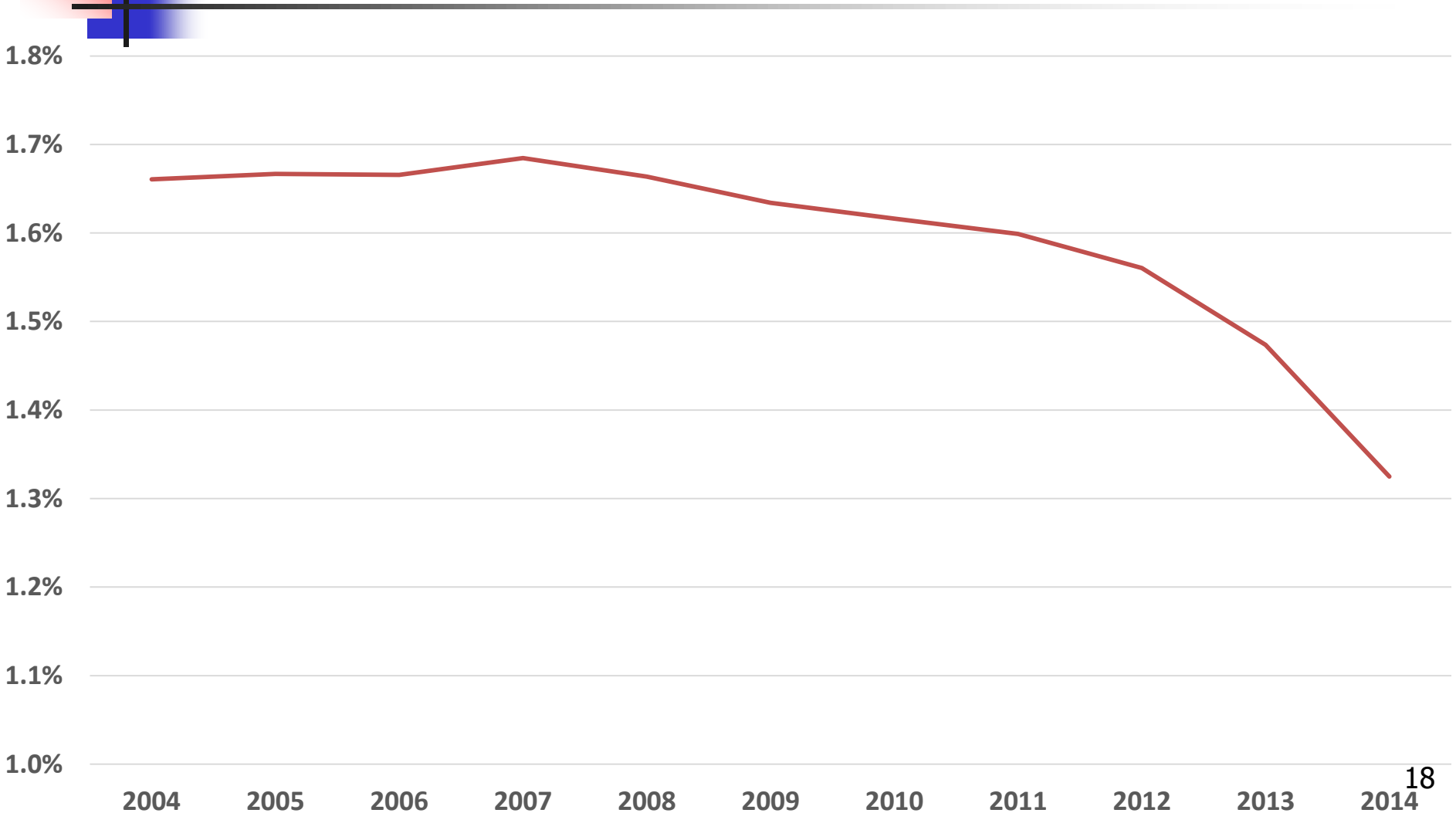




# Growth in Agriculture Property Tax Levies per Farmer & Rancher Income Tax Return, 2004-2014



# Average Agriculture Property Tax Levy Rate 2004-2014





## Despite Rising Property Tax Payments, Farmers are Taxed at a Lower Rate than Other Property Owners

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- Average tax rate on agricultural property is less than tax rate on residential property
  - In the average county the ag rate is 82% of the residential rate
  - In 33 counties ag rate is less than 80% of residential rate
  - In 48 counties ag rate is between 80% and 90% of residential rate



# Why Are Agricultural Property Tax Levies Rising?

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- Local officials may find it easier to raise total levies because they can do so while lowering tax rates
  - Evidence (Anderson and Thompson) shows that over past decade school districts increased their levies by about 8% for every 10% increase in valuation



# Why Are Agricultural Property Tax Levies Rising?

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- The rising costs of education, especially in small school districts
  - Spending per student is >50% higher than average in small (<250 students) districts
  - Average annual growth in per pupil spending 2004 to 2014 was 6.2% in small districts compared to 3.1% in large districts (>5,000 students)
  - School districts with <1,000 students have experienced declining enrollment in the past 10 years
    - About a 20% decline in enrollment in the smallest districts
  - Cutting spending in response to declining enrollment is very difficult

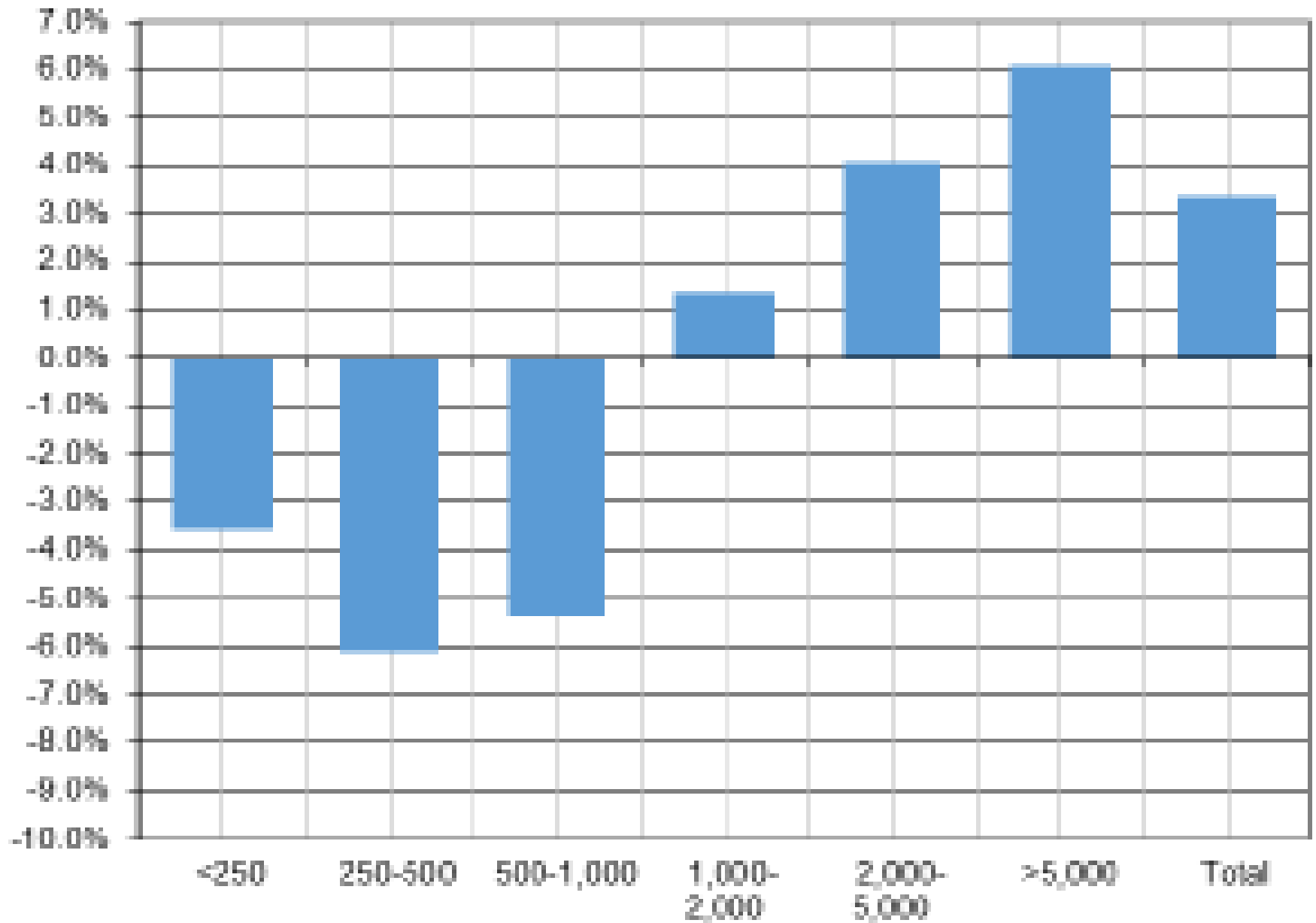


# Why Are Agricultural Property Tax Levies Rising?

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- The combination of rising valuations and falling enrollment leads to reductions in equalization aid
  - Between 2007-08 & 2012-13, 60 districts lost all their equalization aid, and 30 districts lost more than ½ their aid
    - These districts were almost all rural
  - Over past decade, largest percentage declines in TEEOSA aid in small school districts (between 250 and 500 students)
  - In small districts (<1,000 students), state support is less than 25% of total school district revenue
    - About 55% of total state support comes from TEEOSA aid

# Average Annual % Change FY06 to FY16 By Enrollment Size





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# Revenue Options for Funding Increased State Aid for K-12 Education





# Tax Analysis Criteria

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## The *efficiency* of the tax

- How does each tax effect the behavior/actions of individuals and businesses?
- Does a tax reduce the competitiveness of a state?
- Revenue growth and volatility
  - Will tax revenues grow as the economy grows?
  - How volatile is revenue over the course of a business cycle?
- Transparency and visibility
- Tax fairness
  - Two questions:
    - Who pays the tax? What is the incidence of the tax? (positive)
    - Is the distribution of tax burdens fair? (normative)
      - Consider *horizontal* and *vertical* equity
- Administrative feasibility
  - Is the tax simple to administer and to comply with?



# No Tax System or Tax Policy Will Meet All the Criteria

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- All tax policy decisions require making trade-offs
  - Tax credits to enhance competitiveness will reduce simplicity
  - Highly progressive tax systems may hurt tax competitiveness
  - Reduced revenue volatility often leads to a more regressive tax system
- A well-balanced tax system can do a reasonably good job in achieving all the criteria
  - Reason that the Tax Modernization Committee chose “Balance” as the first criteria of a good tax system

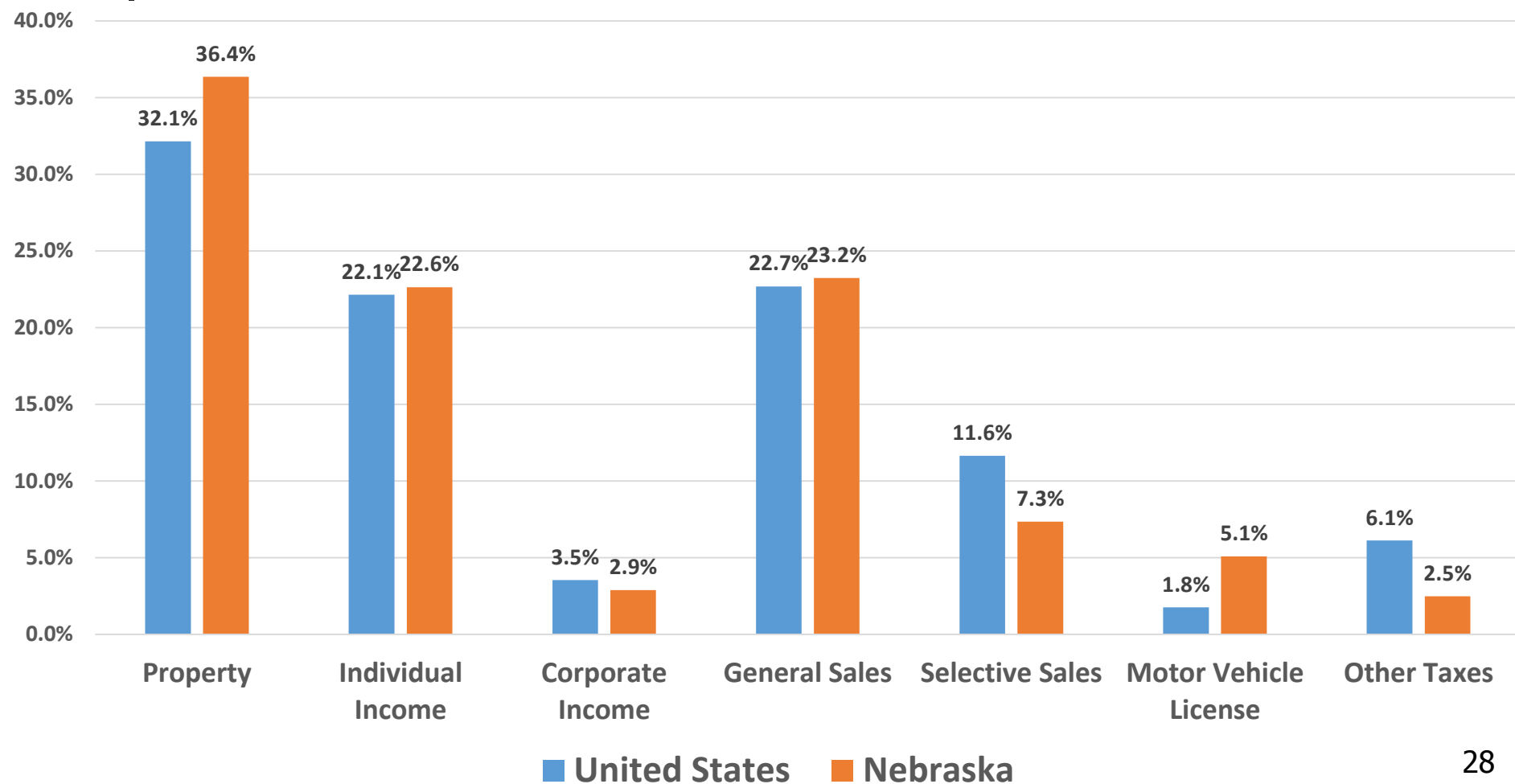


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# Characteristics of Nebraska's Tax System

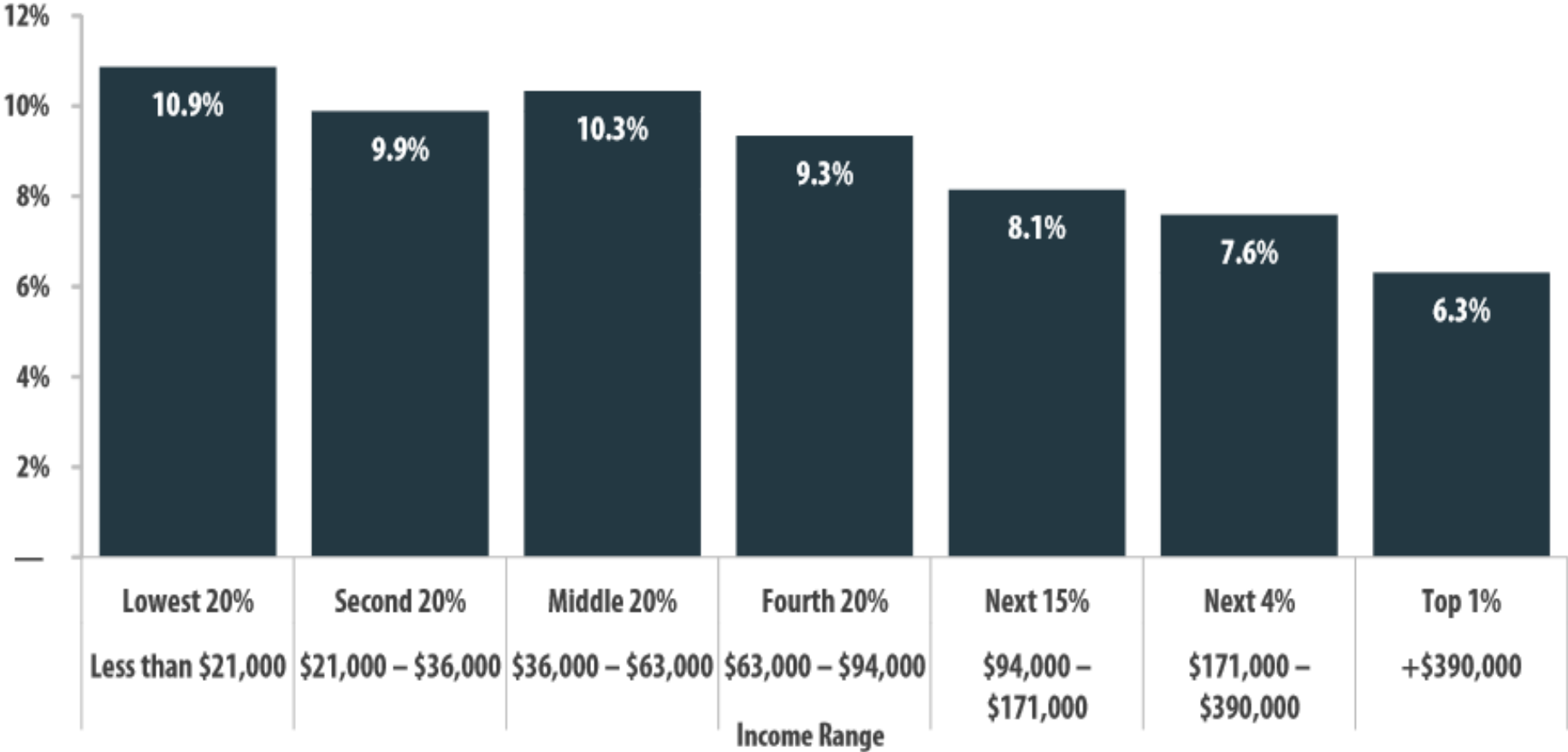
# Mix of State and Local Taxes, 2012

## Nebraska Compared to the United States



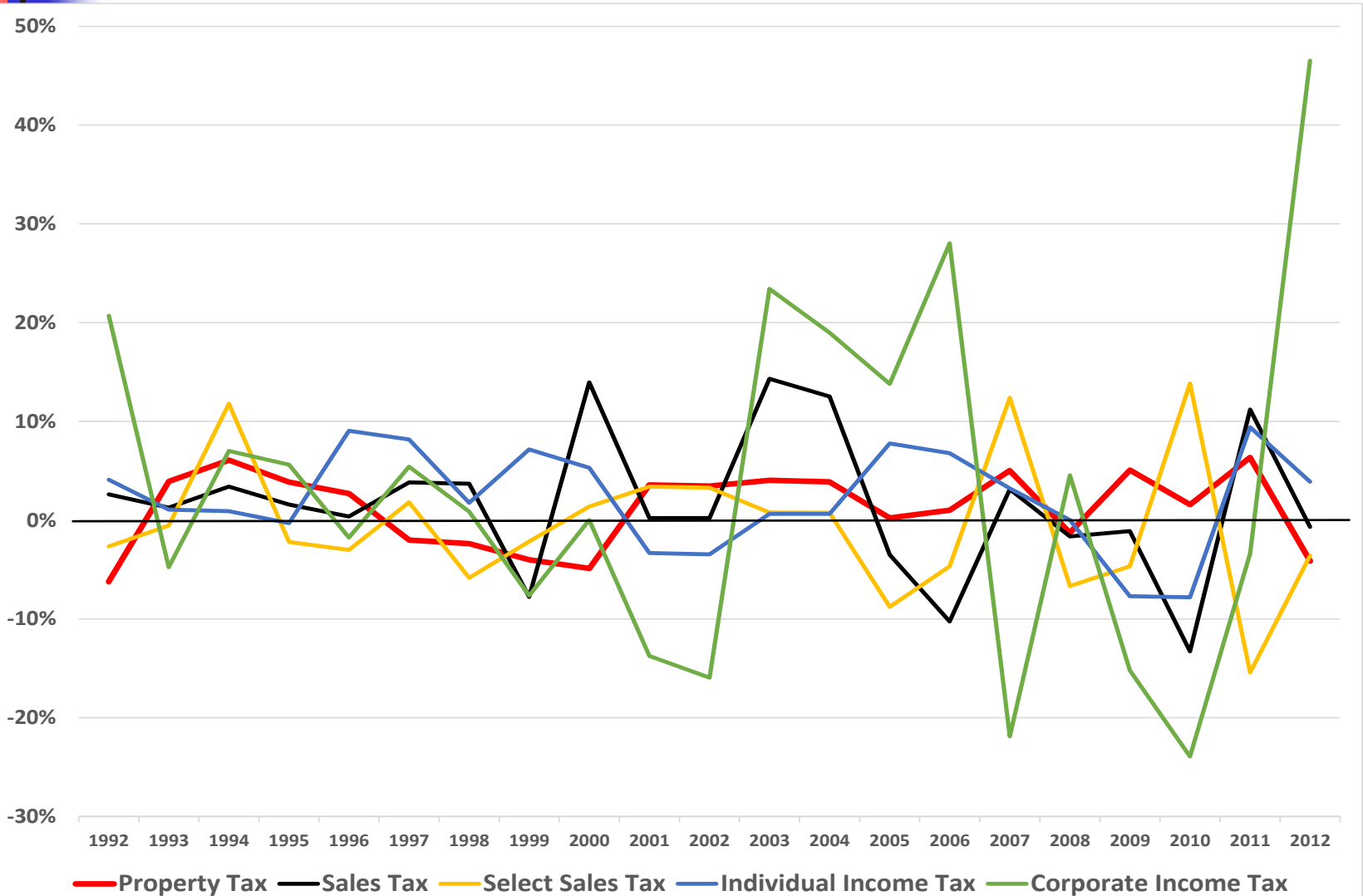
# Nebraska State & Local Taxes in 2015

Shares of family income for non-elderly taxpayers



Source: ITEP, *Who Pays? A Distributional Analysis of the Tax Systems in all 50 States, 2015.*

# Annual Percentage Change in Nebraska State and Local Tax Revenue, by Type of Tax, 1992-2012





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# Increasing Individual Income Taxes to Fund Additional State Aid to Education



## Income Tax Policy

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- Nebraska has a quite good income tax system
- Revenue could be increased by raising rates and/or adjusting brackets
- Revenue could also be raised by reducing use of exemptions or credits





## Income Tax Policy Considerations

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- Taxpayers can deduct state income tax payments on their federal income taxes (the federal offset)
  - Deductibility reduces the effective marginal tax rate difference between Nebraska and its neighbors



## Income Tax Policy Considerations

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- Resist the temptation to use the income tax to achieve non-fiscal goals
  - Credits are a way to subsidize some activity
  - It is preferable to provide direct subsidies—they have the same impact on the budget, but they are much easier to curtail when budgets are tight or priorities change



## Income Tax Policy Considerations

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- How to tax Social Security and pension income?
  - There are few economic justifications to treat these sources of income any different from other income
  - Favorable treatment of retirement income means that young families with children pay more
  - With the aging of the baby boom generation, the revenue costs of favorable treatment of retirement income will grow rapidly in the coming decades
- A broader income tax base will generate more revenue and/or allow lower marginal tax rates



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# Increasing Sales Taxes to Fund Additional State Aid to Education



## Sales Tax Policy

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- An “ideal” sales tax system taxes the final consumption of all goods and services, but exempts all purchases of goods and services by businesses
  - Taxing business inputs leads to pyramiding
  - Exemptions of some necessities are justified as a way of protecting the poor by reducing the regressivity of the tax
  - Note that services now make up 64% of total consumption expenditures



## Sales Tax Policy

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- To increase sales tax revenue Nebraska could:
  - Raise its rate
  - Abolish some of its existing exemptions
  - Expand the base to cover more consumer services



## Sales Tax Policy

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- An ever increasing share of consumer spending is being done over the internet
  - In addition to internet sales, “cloud” purchases, such as music streaming, are growing very rapidly and most are escaping sales taxation
  - Allowing states to tax internet commerce in the absence of nexus will require Congressional action
    - The Marketplace Fairness Act passed by the Senate or an alternative



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# Increasing Corporate Income Taxes to Fund Additional State Aid to Education





# Corporate Income Tax Policy

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- Reduce or eliminate existing credits and exemptions
  - States often enact credits and exemptions in order to help specific industries or reward particular activities
  - The effectiveness of these subsidies/incentives is rarely evaluated



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# Policies to Address Rising Agriculture Property Taxes

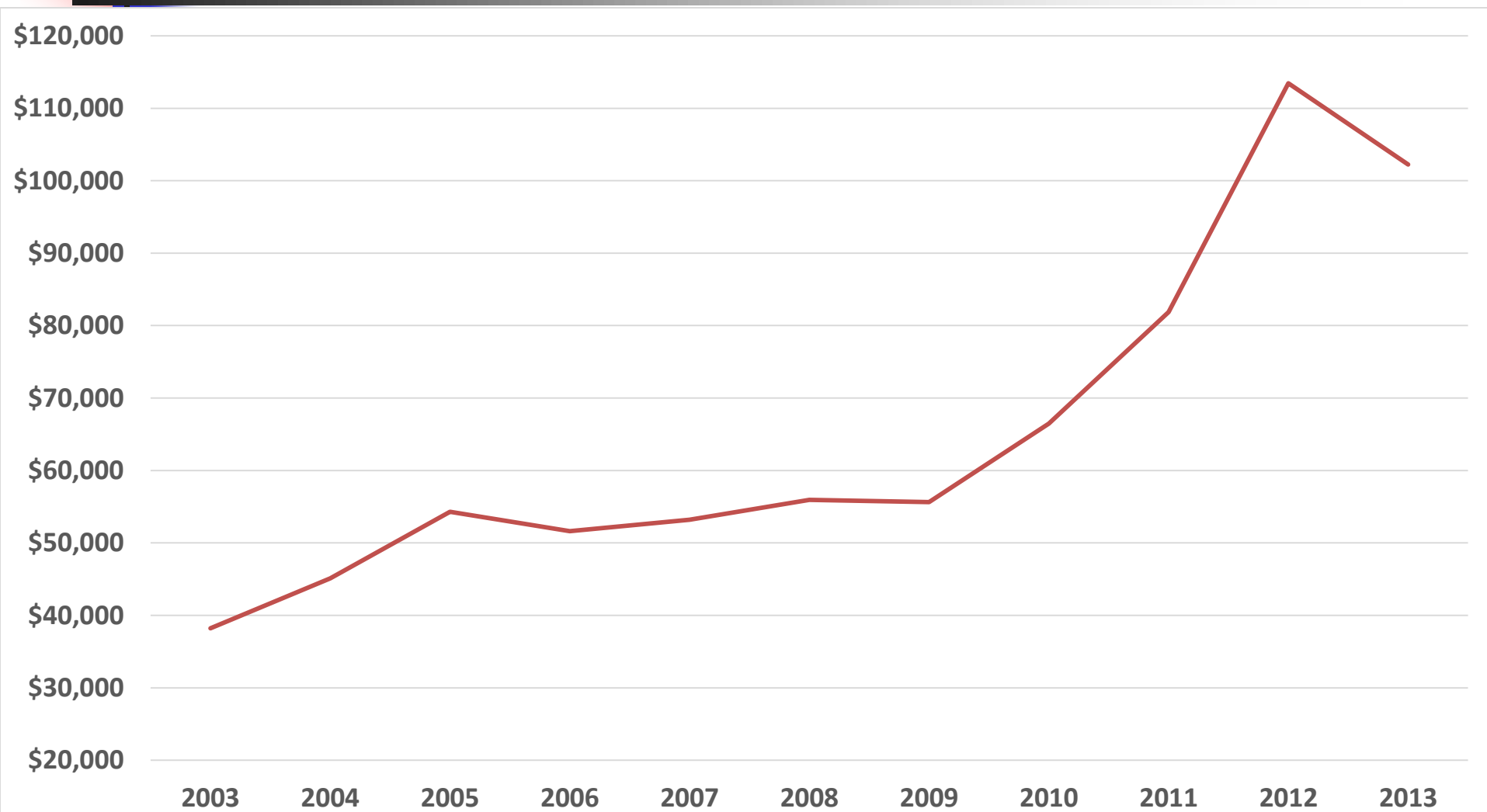


## Value Ag Property at 65% of Use Value

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- Down from 75%
- Won't reduce taxes in many communities, where ag property is a large % of total value
- Elsewhere, will shift tax burden from farmers to non-farmers and other property owners in the same community
  - When ag values fall, lower ag taxes will place an increased burden on owners of non-ag property
- On average, farmers have higher incomes than non-farmers

# Average Income (Federal AGI) of Nebraska Farmers and Ranchers, 2003 to 2013

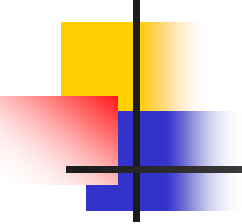




# What About Farmers/Ranchers Who Face Rising Property Taxes, but Have Low Incomes?

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- Four approaches:
  - Change property tax policy
  - Reduce reliance on the property tax by increasing state education aid
  - Change the school aid formulas in a way that benefits school districts with lots of ag property
  - Education policies designed to reduce costs in small, rural school districts



# Two Property Tax Policies that Could Help Farmers (and others) Facing Large Property Tax Bills Relative to their Incomes

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- Real problem is one of liquidity
  - Farmers have an asset (land) that is growing rapidly in value, but their current income is inadequate to pay the property tax
- Establish a tax deferral program
- Establish a circuit breaker program



## Tax Deferral Programs

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- Similar to a reverse equity mortgage
- Local government lends taxpayer money to pay a portion of property tax, with loan paid back in future or when property sold
- Can be triggered when tax is above a threshold % of income, or when tax increases at a very rapid rate
- Could be an “opt out” program
- Could be funded by state using bond funds



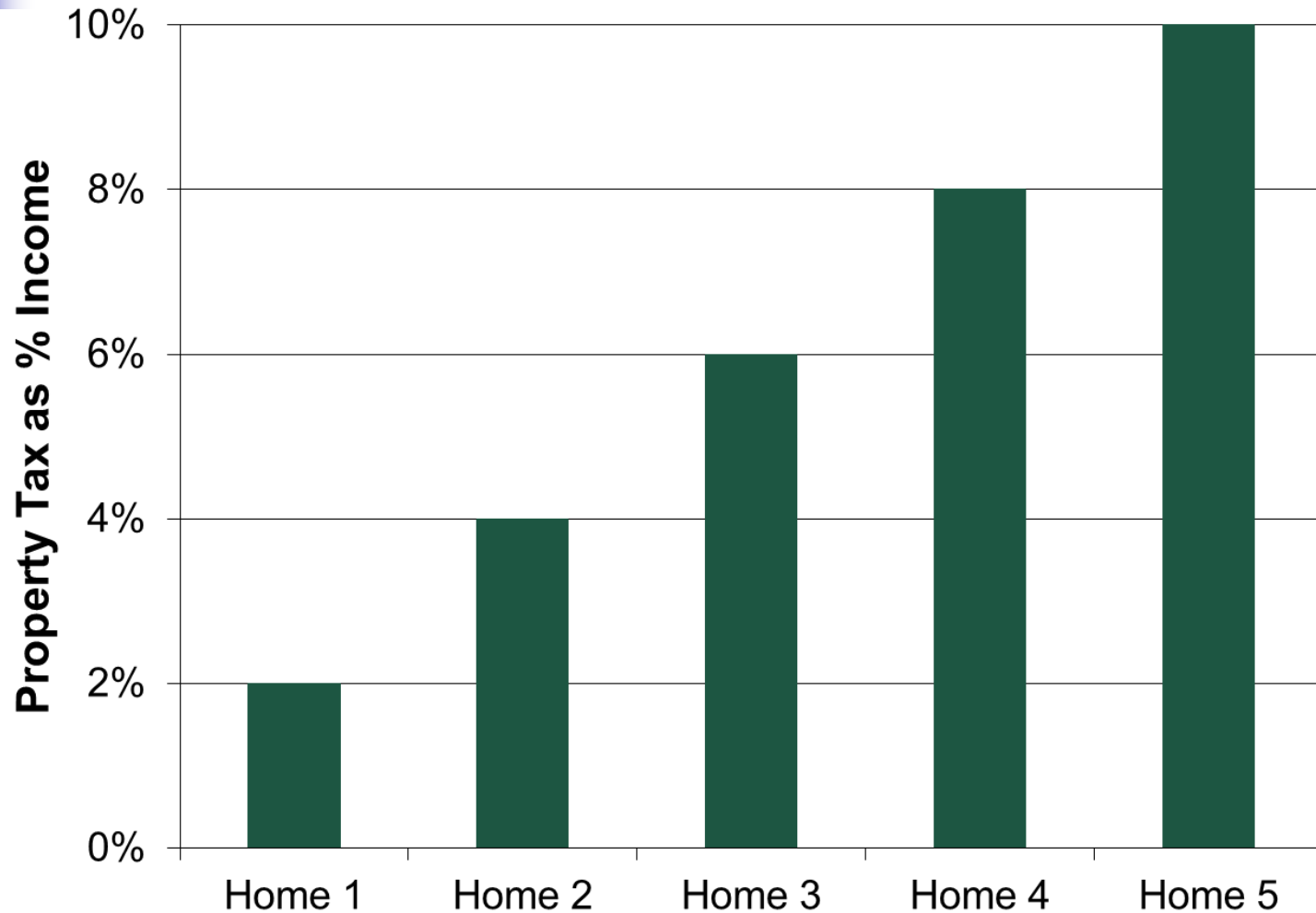
# Circuit Breaker Programs

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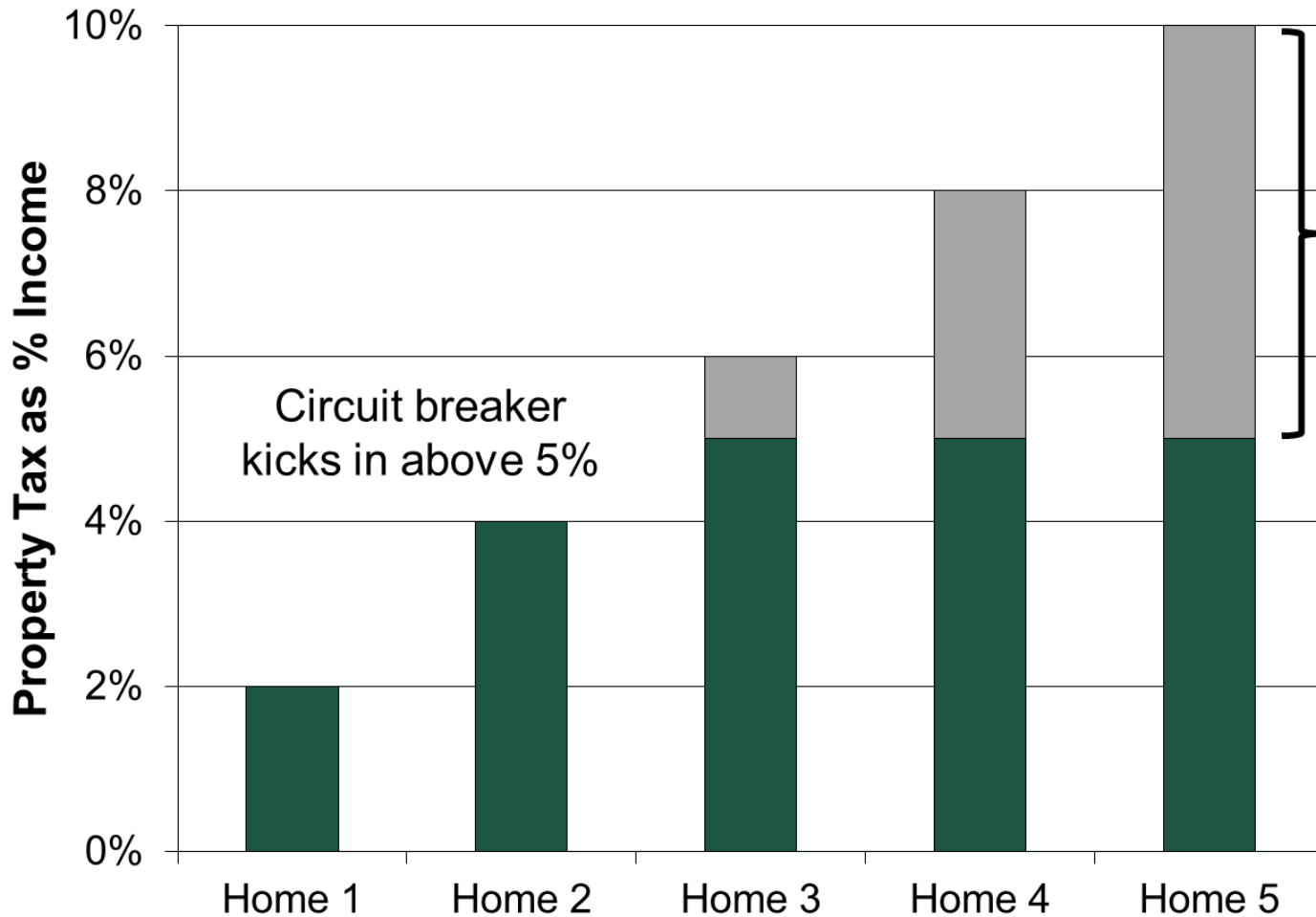
- Circuit breakers target property tax relief to those taxpayers who face particularly high property tax burdens (property tax as a % of their income)



## Property Taxes as a Percentage of Income Without a Circuit Breaker



# Property Taxes as a Percentage of Income With a 5% Threshold Circuit Breaker





# Circuit Breaker Programs

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- Renters are eligible for some programs by assuming that the property tax is equal to a fixed % of rent, e.g. 20% (lower if rent includes utilities)
- Often paid as a refundable income tax credit
- Many states limit circuit breakers to the elderly
- Programs generally have income eligibility limits and maximum benefit levels





# Circuit Breaker Parameters for Selected States, 2012

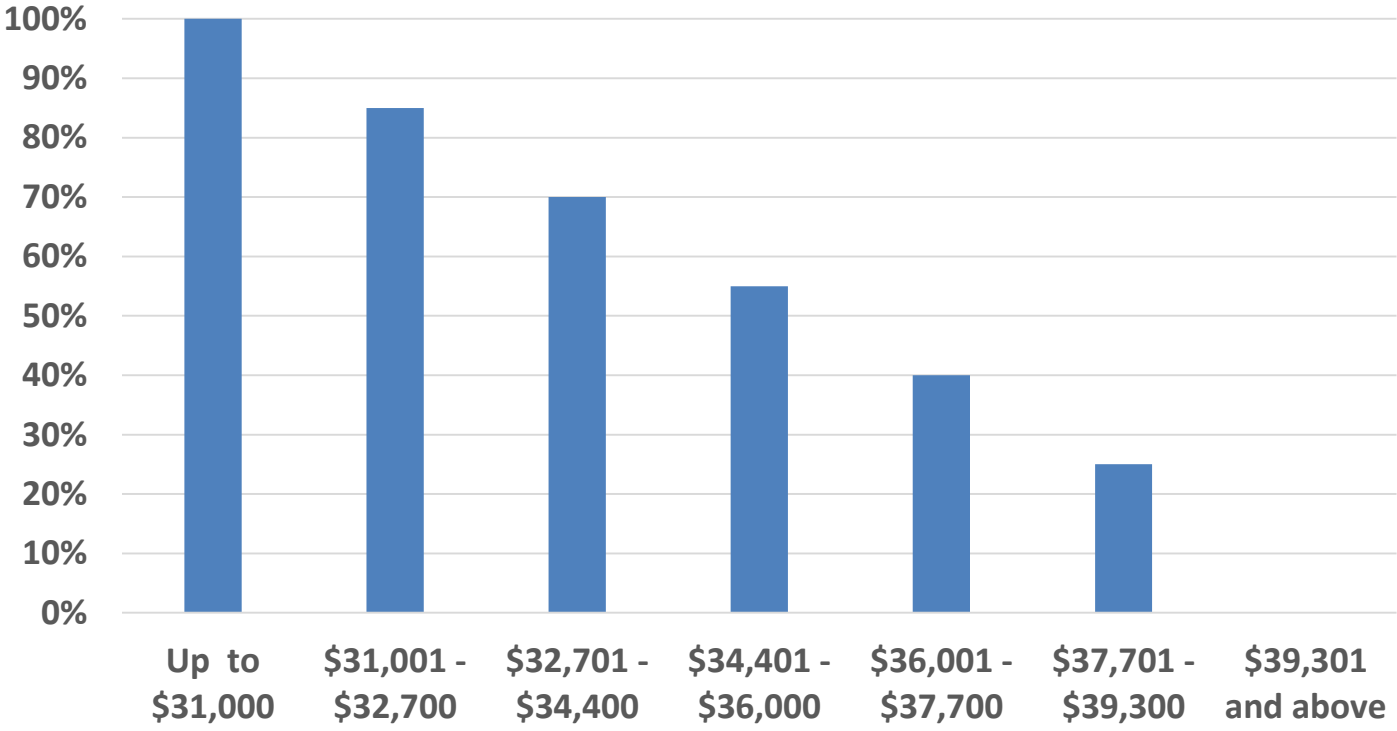
State	All ages or elderly only	Renters eligible (yes/no)	Income Ceiling	Maximum Benefit	Maximum Value
Iowa	Elderly	Yes	\$20,096	\$1,000	
Massachusetts	Elderly	Yes	\$80,000	\$1,000	\$705,000
New Jersey	All	Yes, elderly only	\$75,000 (<65) \$150,000 (>65)	formula determined	\$10,000 tax
Wisconsin	All	Yes	\$24,680	\$1,168	
Minnesota	All	Yes	\$100,780 (owners) \$54,620 (renters)	\$2,460 (owners) \$1,550 (renters)	
Kansas	Elderly	Yes	\$32,400	\$700	\$350,000



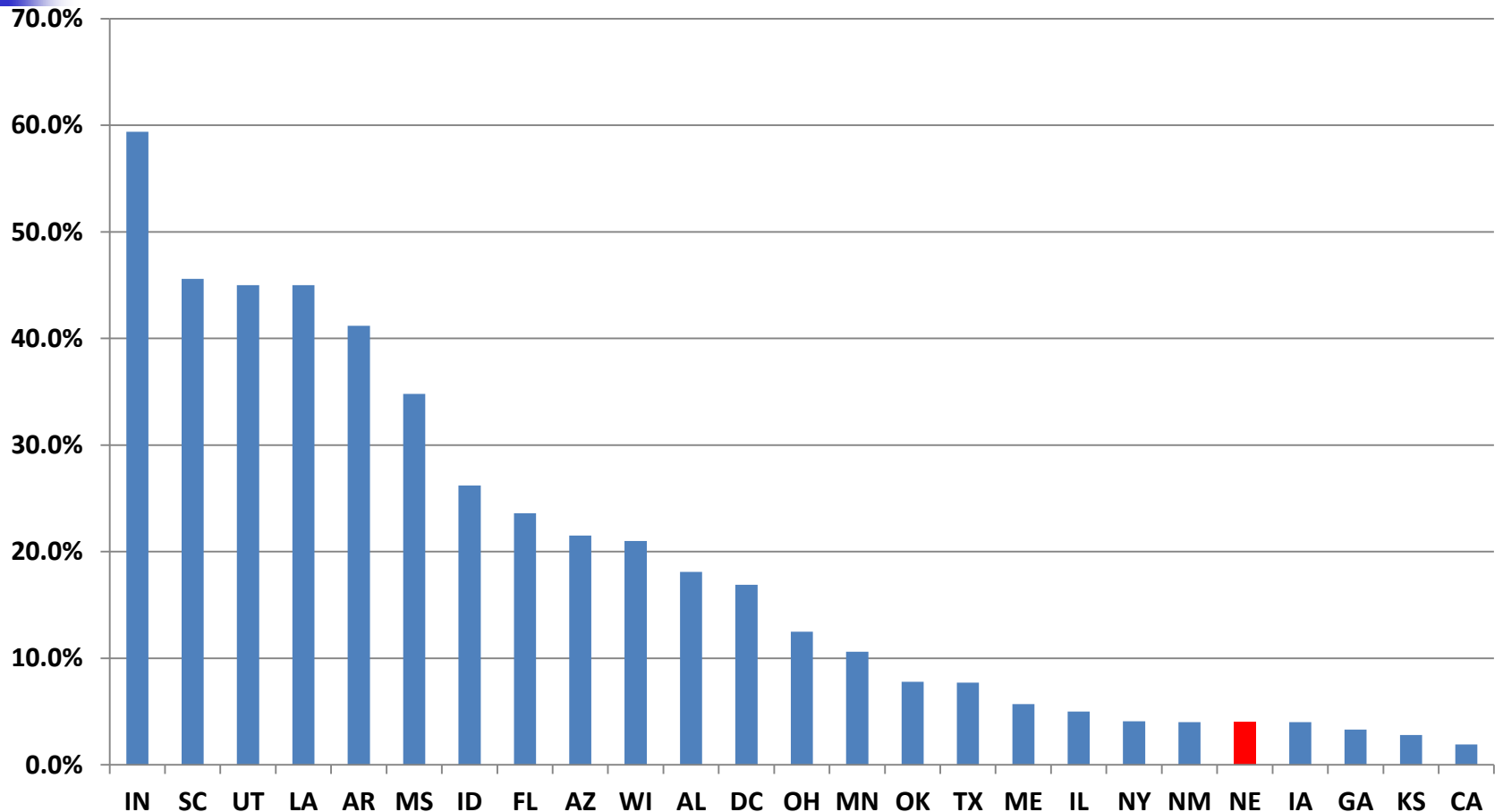
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# Nebraska's Property Tax Relief Programs

Percentage Reduction in Property Tax from  
Nebraska Elderly Homestead Exemption  
(For below average assessed values in a county with  
average assessed value equal to \$100,000)

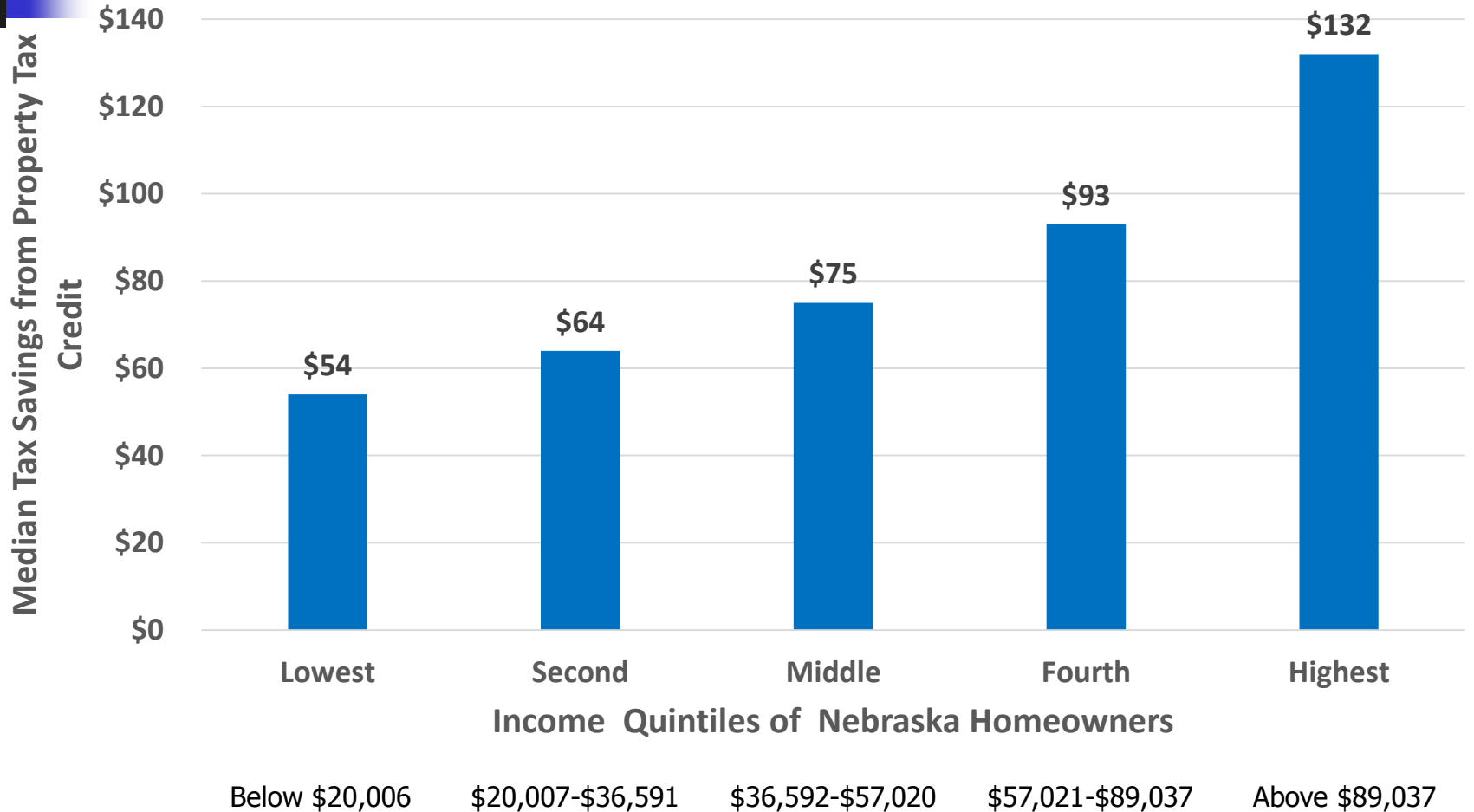


# Percentage Property Tax Savings of Median Homeowner from Property Tax Exemption and Credit Programs (available to all property owners)





# Median Tax Savings for Homeowners from Nebraska's Property Tax Credit, 2012





# What About Farmers/Ranchers Who Face Rising Property Taxes, but Have Low Incomes?

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- Four approaches:
  - Change property tax policy
  - ***Reduce reliance on the property tax by increasing state education aid***
  - Change the school aid formulas in a way that benefits school districts with lots of ag property
  - Education policies designed to reduce costs in small, rural school districts



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## Increasing State Aid to Small, Rural Districts

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- Rising property taxes on farm land reflect increases in school costs in rural district and reductions in state aid
- State aid formulas could be adjusted to account for higher costs in small school districts
- Some states have categorical “sparsity” aid



# What About Farmers/Ranchers Who Face Rising Property Taxes, but Have Low Incomes?

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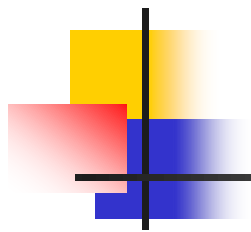
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# Education Policies to Reduce Costs of Rural Education

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- Further school consolidations are limited by large distances students would have to travel
- New two-way video communication technology can allow for multi-location classrooms
- Expanded distance education can reduce per pupil costs
- State may want to consider grants for needed capital expenditures to implement new technology



# In Defense of the Property Tax



# The Strengths of the Property Tax

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- Over time, the most **stable** source of revenue for public schools has been the property tax
  - During the past 2 recessions, state aid was cut in most states
  - Between 2009 and 2012, school property tax revenue per pupil **rose** modestly
- Heavily reliance on state funding effectively eliminates *local control* of public education
  - Lesson from California was substantial reduction in support for public education
- Alternative local sources of education funding are all problematic

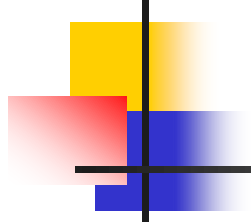




# The Strengths of the Property Tax

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- The fact that the property tax is highly visible is a political liability, but also a virtue
  - School board accountability to residents is enhanced when they see clearly the link between what they pay each year and public services received
  - Other taxes tend to be “hidden”; the result is less transparency and accountability
- A well-administered property tax system combined with a well-designed state aid system can deliver both educational excellence and tax relief



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Thank You.

Questions and Comments?