

Funding K-12 Public Education in Nebraska

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

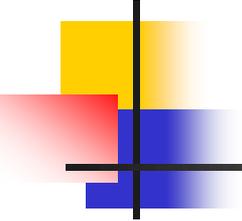
Lincoln, Nebraska, August 28, 2015

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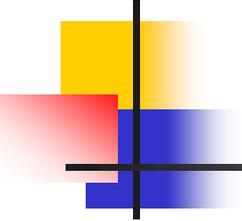
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Presentation Outline

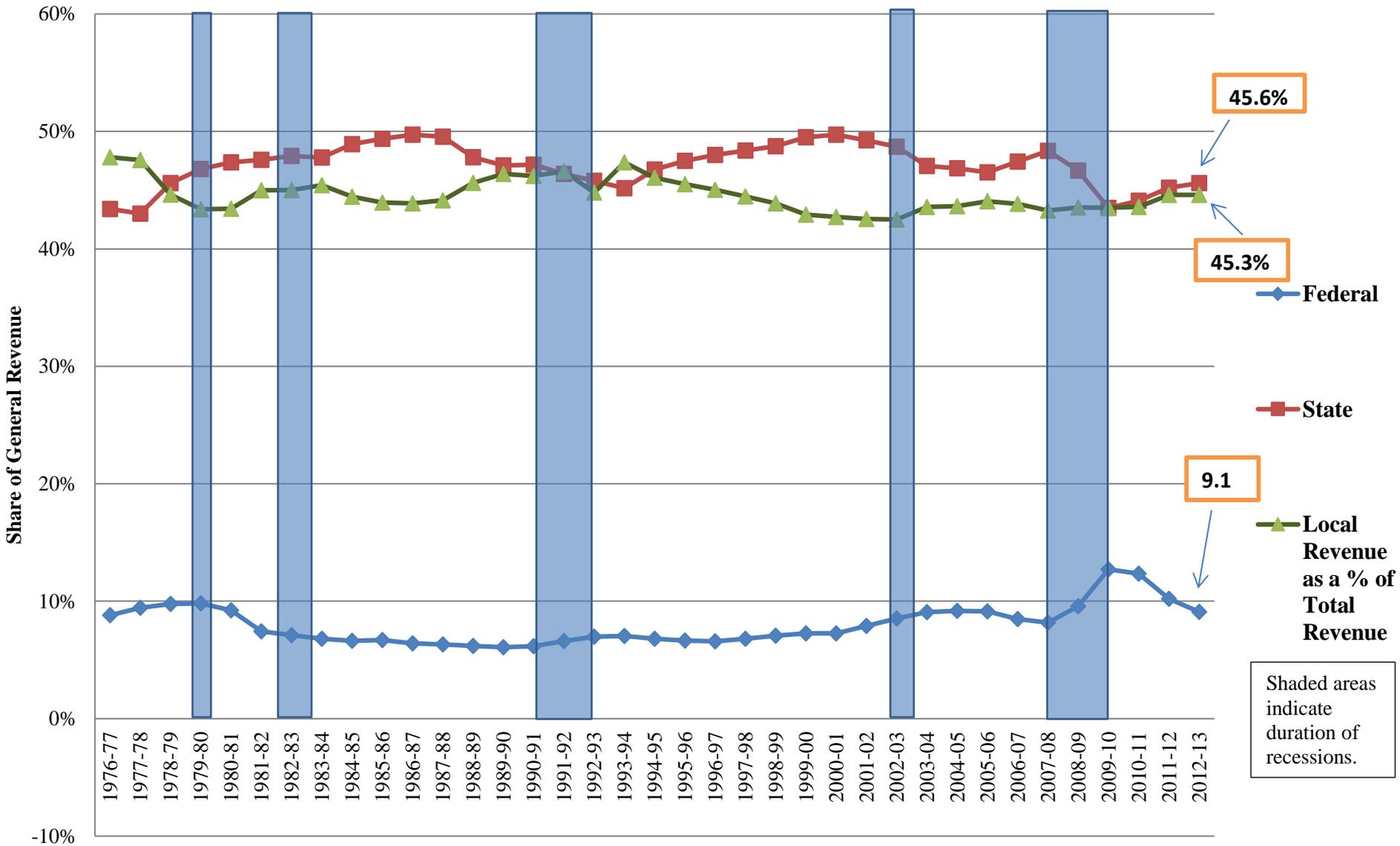
- Policy issues
 - Heavy reliance on the property tax for funding K-12 public education
 - Rapidly rising property taxes on agricultural property
- Policy responses
 - Funding increases in state aid to education
 - Responding to the rise in property taxes on agricultural land



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

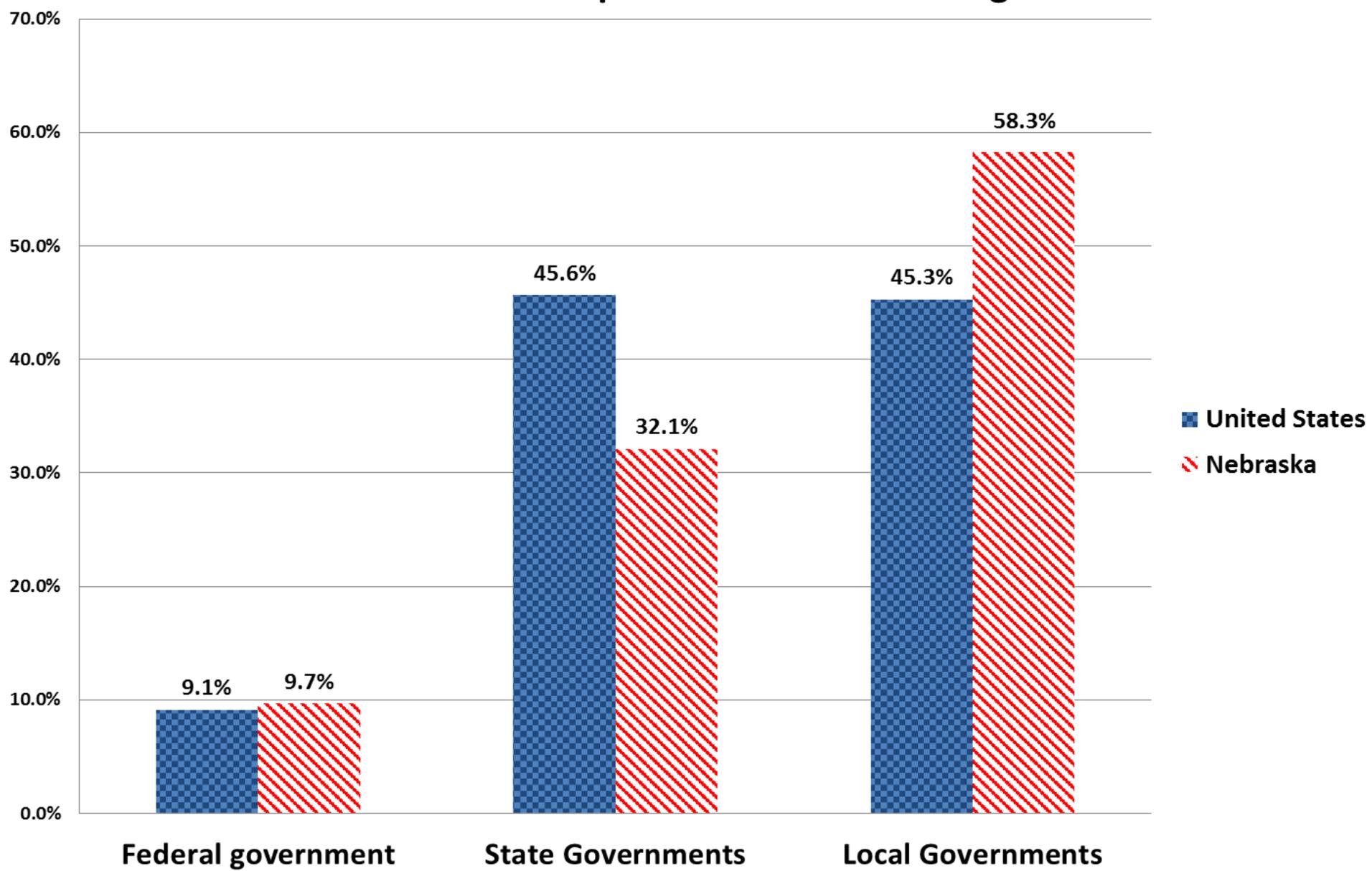
General Revenue for Public Education

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



Revenue Sources for Public Education, 2012-13

Nebraska Compared to the U.S. Average



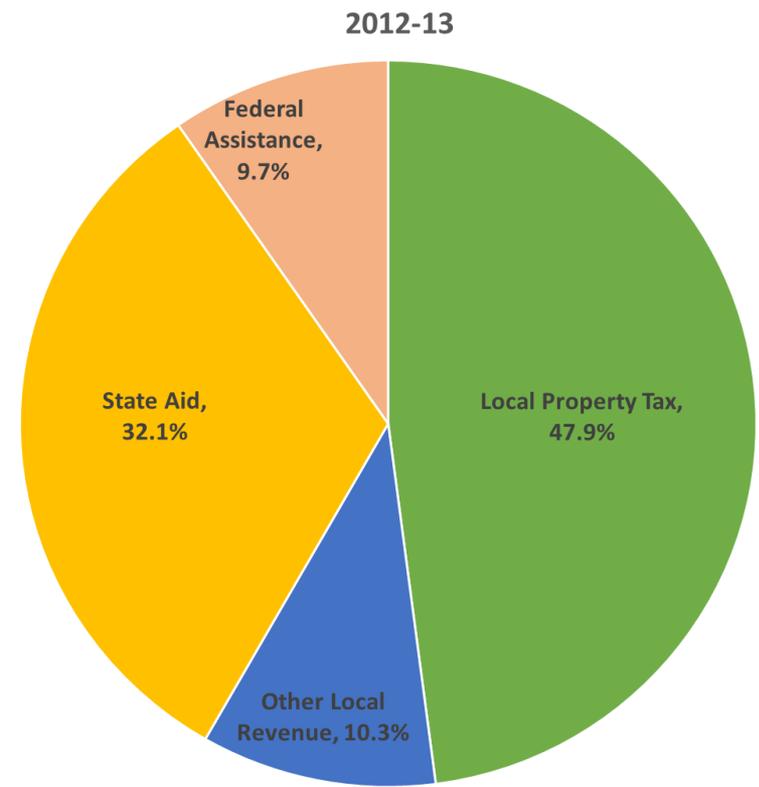
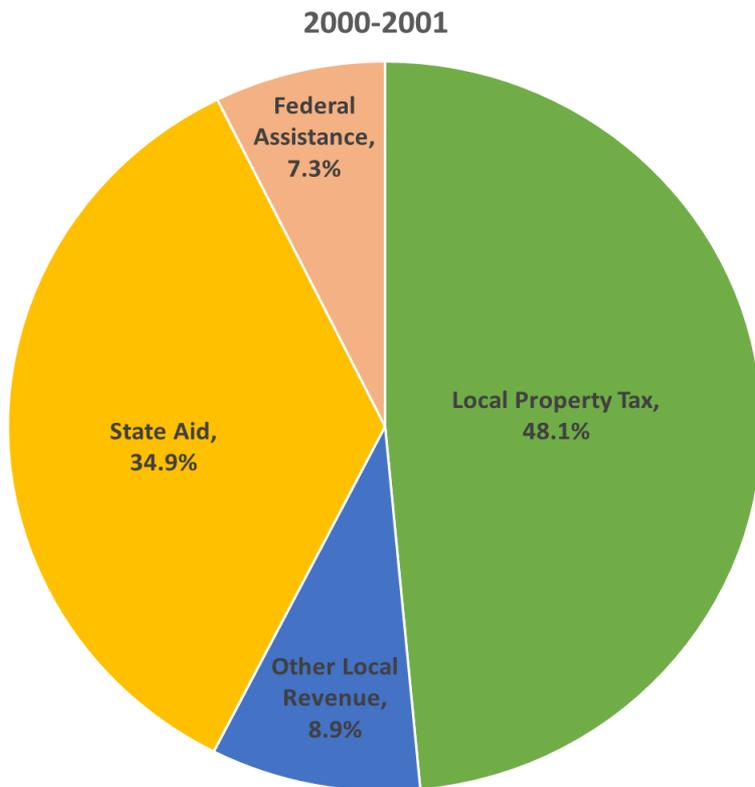
Source: National Center for Education Statistics, *Public Elementary-Secondary Education Finances, Fiscal Year 2013*.

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

	Property Tax as a % of Local Revenue	Local Revenue as a % of Total Revenue	Local Property Tax as a % of Total Total Revenue
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%
Nebraska	85.2% (14)	59.6% (1)	50.8%
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%

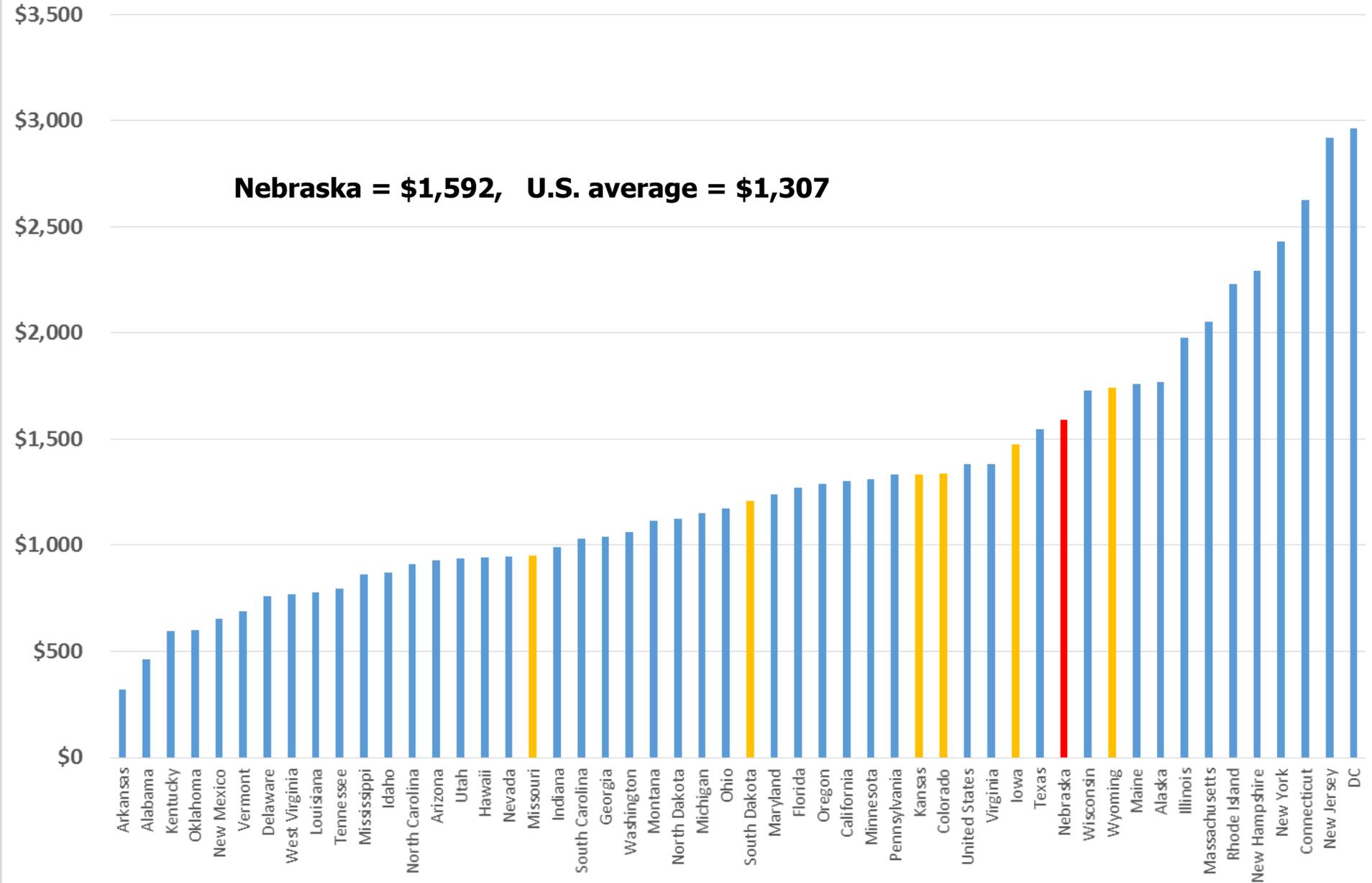
Source: Calculations using data from the National Center for Education Statistics, *National Public Education Financial Survey* Data, 2015. Available at nces.ed.gov/ccd/stfis.asp.

Sources of Nebraska Education Revenue



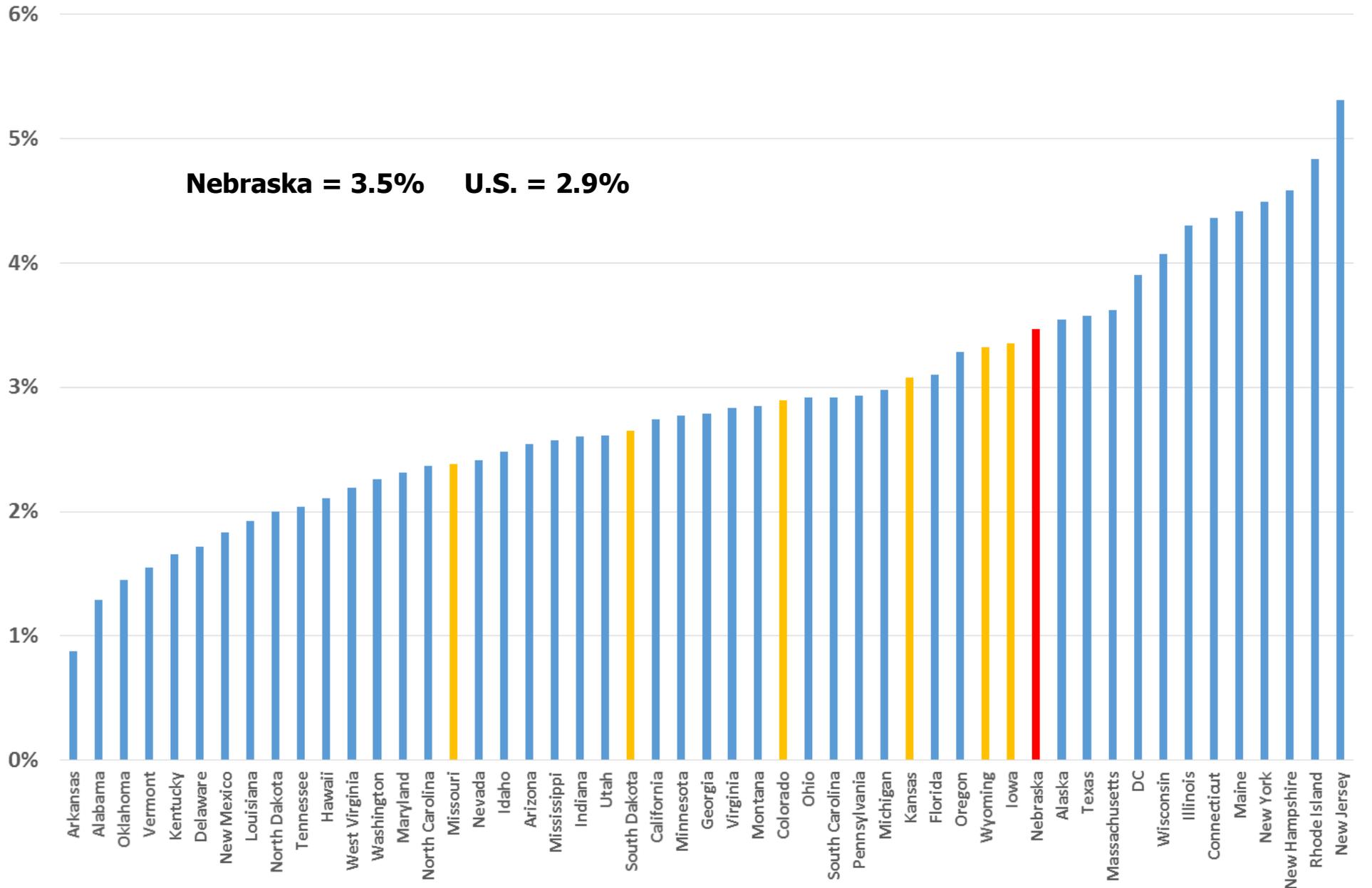
Local Property Tax Revenue Per Capita, 2012

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



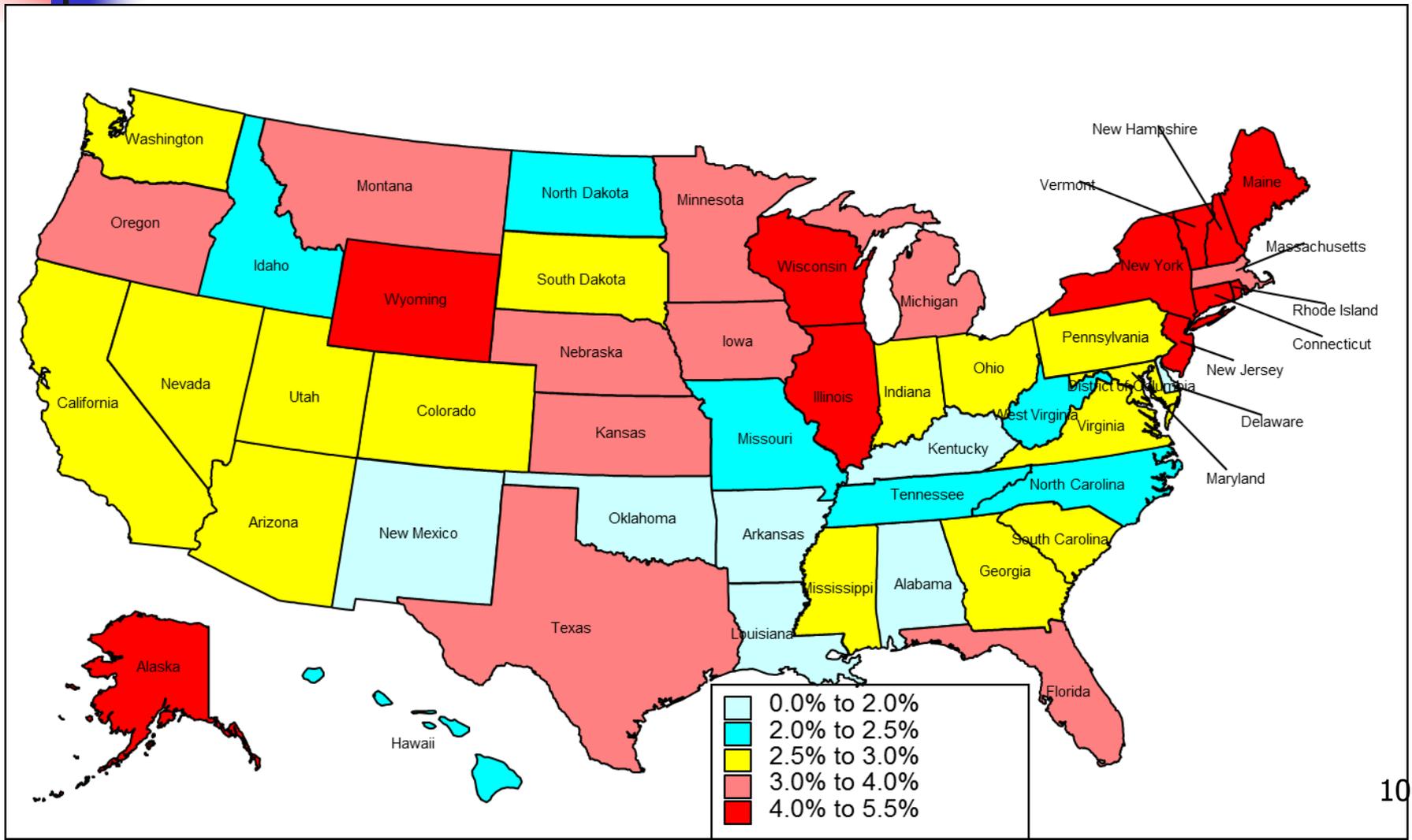
Source: U.S. Census Bureau, *State and Local Government Finances*

Local Property Tax Revenue as a % of Income, 2012

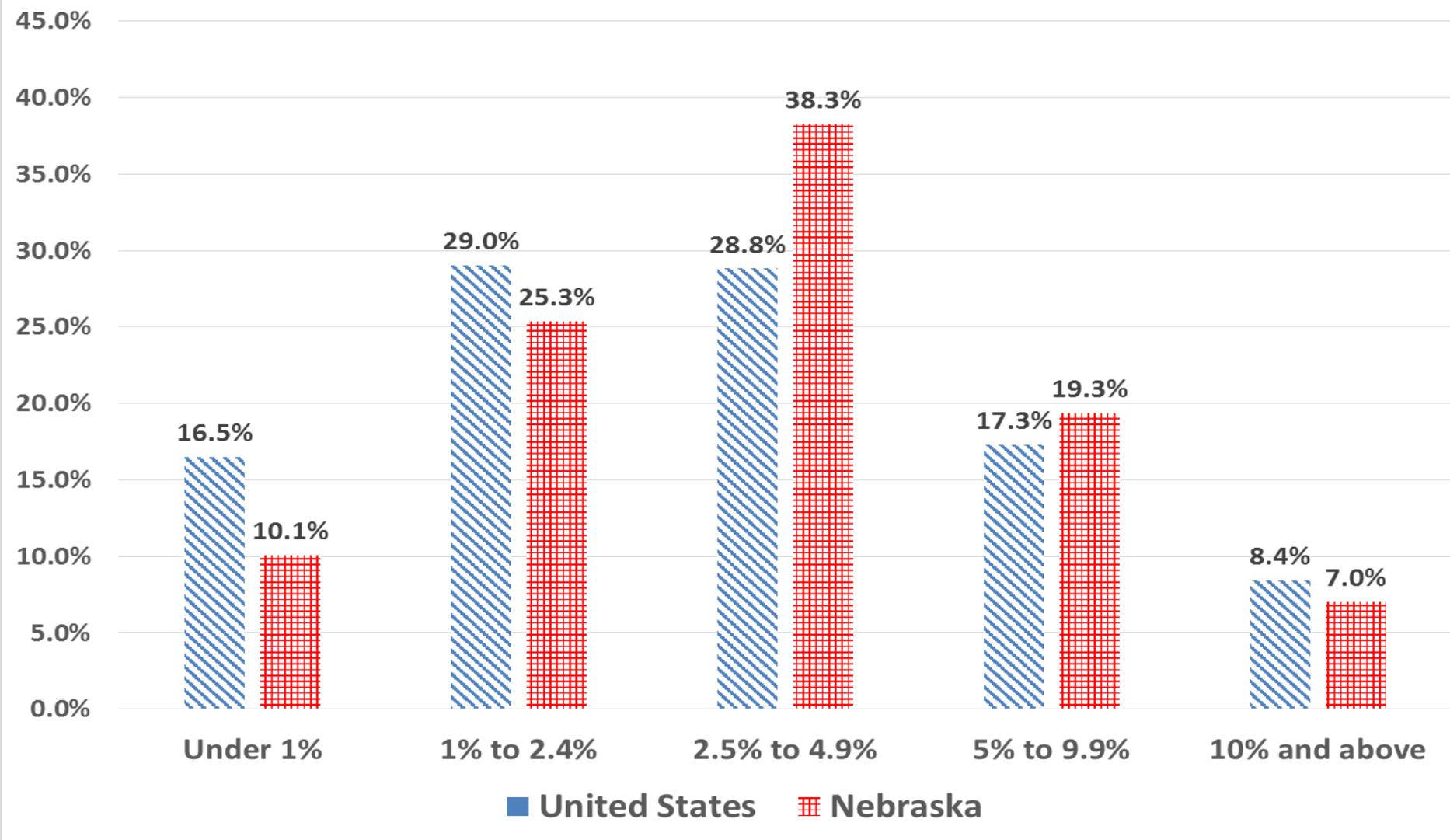


Source: U.S. Census Bureau, *State and Local Government Finances*

Property Tax Revenue as a % of Personal Income, 2012



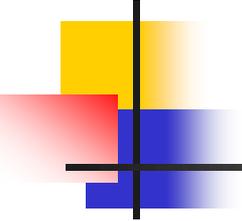
Homeowner Property Taxes as a Percent of Income, 2010 Nebraska Compared to United States Average



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

Nebraska = 4.3%

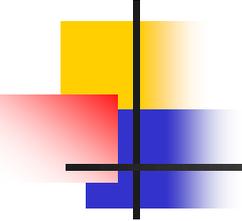
Source: U.S. Census Bureau, *American Community Survey, 2008-2012*



Current Spending Per Pupil, Fiscal Year 2013

Public Elementary and Secondary Education

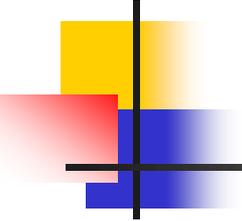
New York	\$19,818
Alaska	\$18,175
District of Columbia	\$17,953
Hawaii	\$11,823
Nebraska	\$11,579
Ohio	\$11,197
National Average	\$10,700
Arizona	\$7,208
Idaho	\$6,791
Utah	\$6,555



Nebraska's High Quality Public Schools

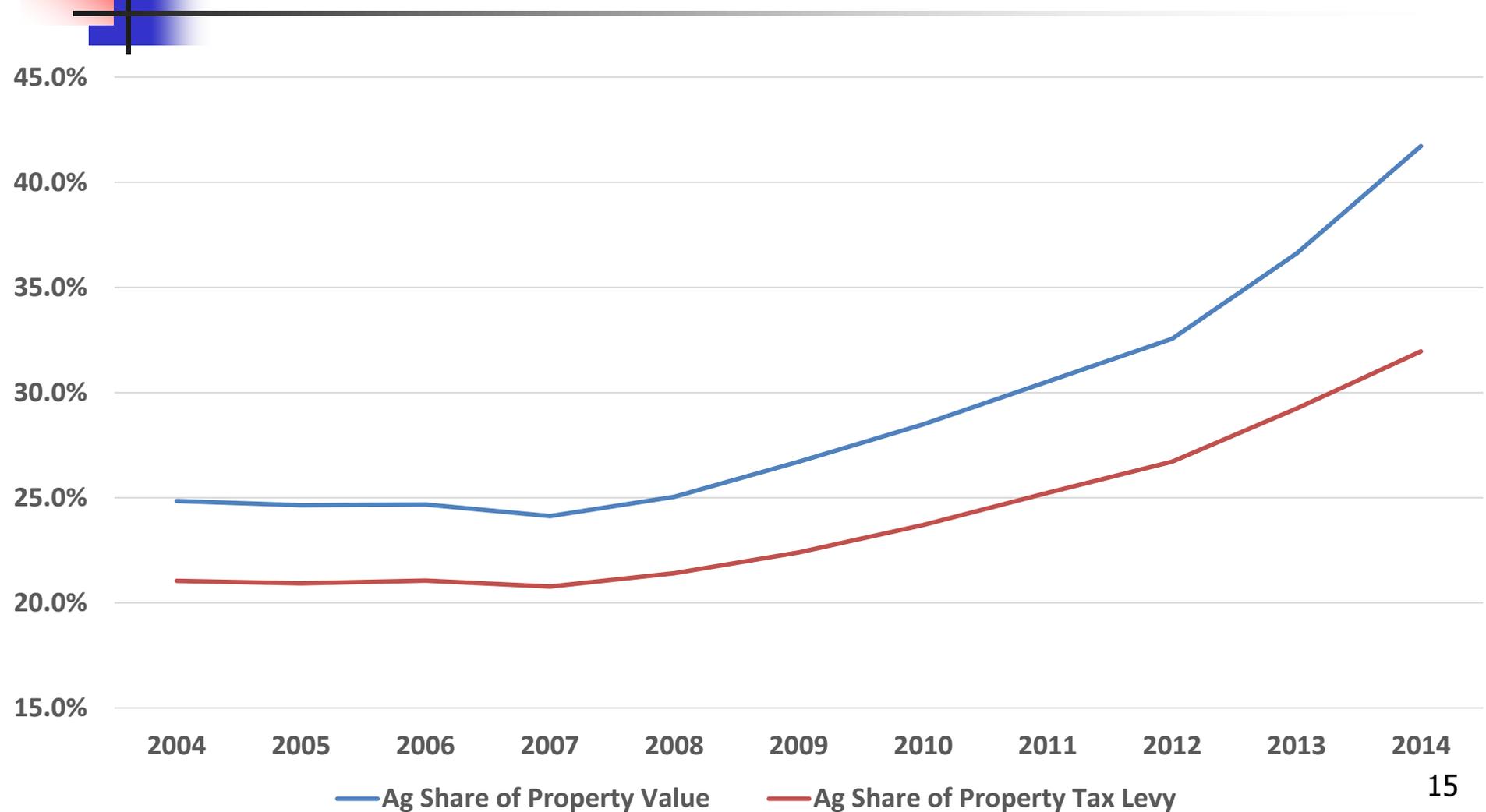
- Public schools are generally considered to be of high quality
- Student performance on National Assessment of Education Progress (NAEP) above national averages

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

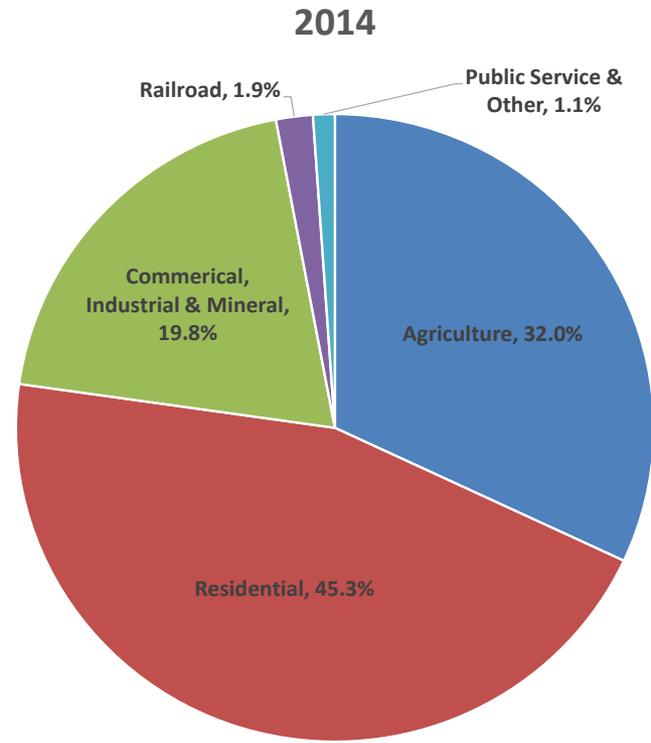
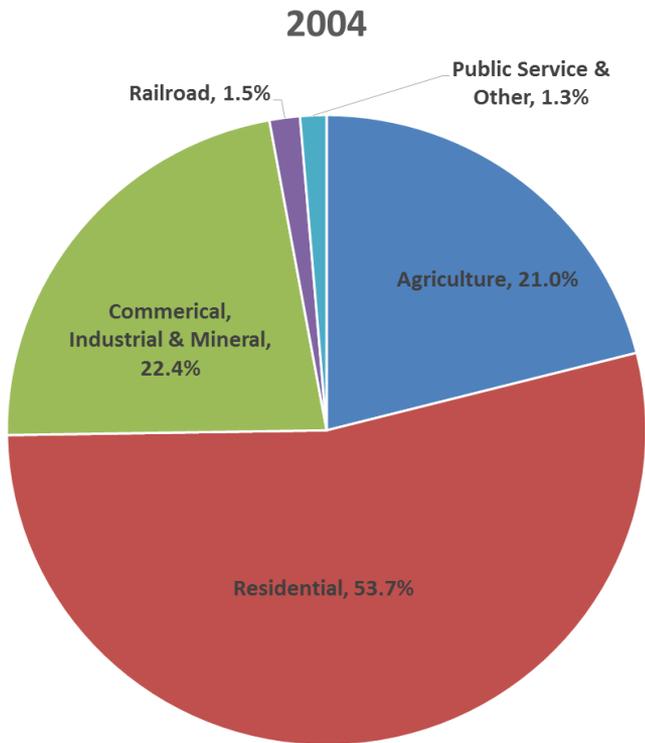


Policy Issue: Rapidly Rising Property Taxes on Agricultural Property

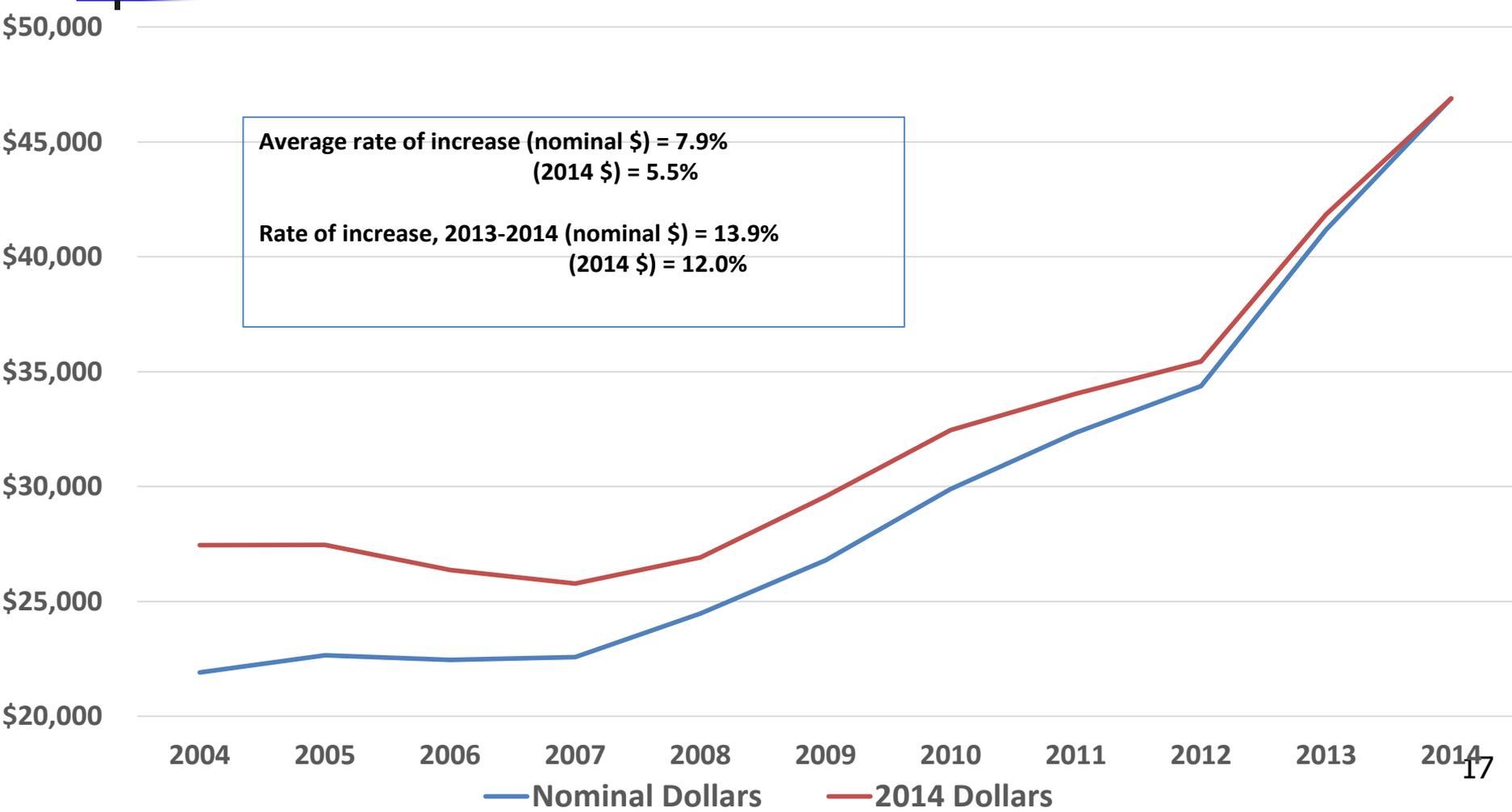
Growth in Agriculture's Share of Total Property Values and Total Property Tax Levies, 2004-2014



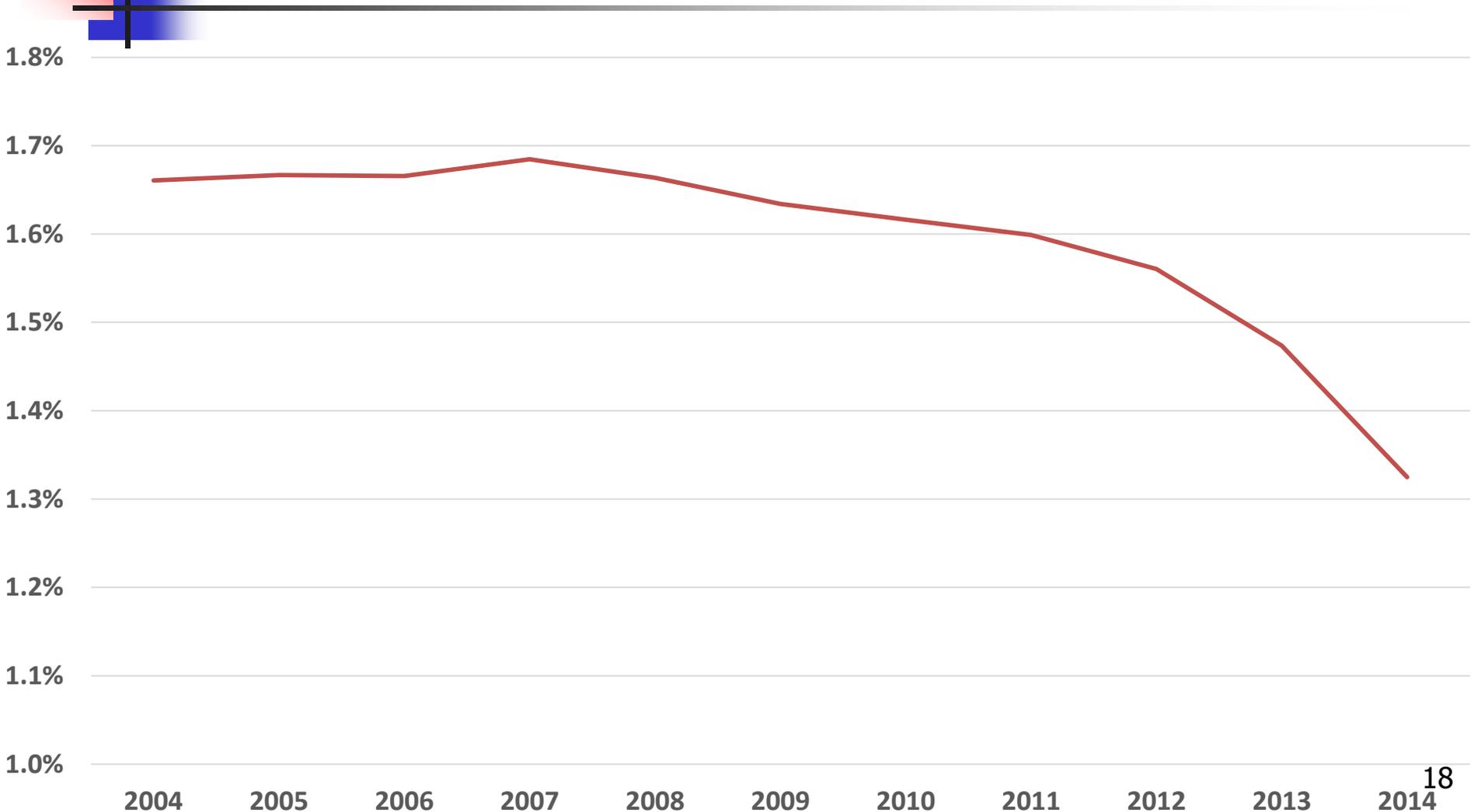
Property Tax Levy by Type of Property 2004 and 2014

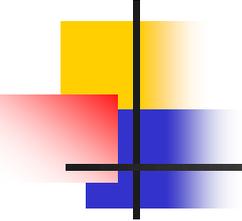


Growth in Agriculture Property Tax Levies per Farmer & Rancher Income Tax Return, 2004-2014



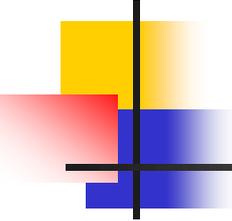
Average Agriculture Property Tax Levy Rate 2004-2014





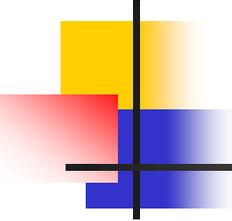
Despite Rising Property Tax Payments, Farmers are Taxed at a Lower Rate than Other Property Owners

- 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



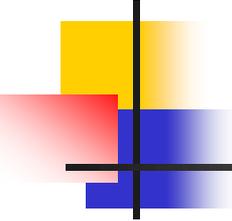
Why Are Agricultural Property Tax Levies Rising?

- 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?

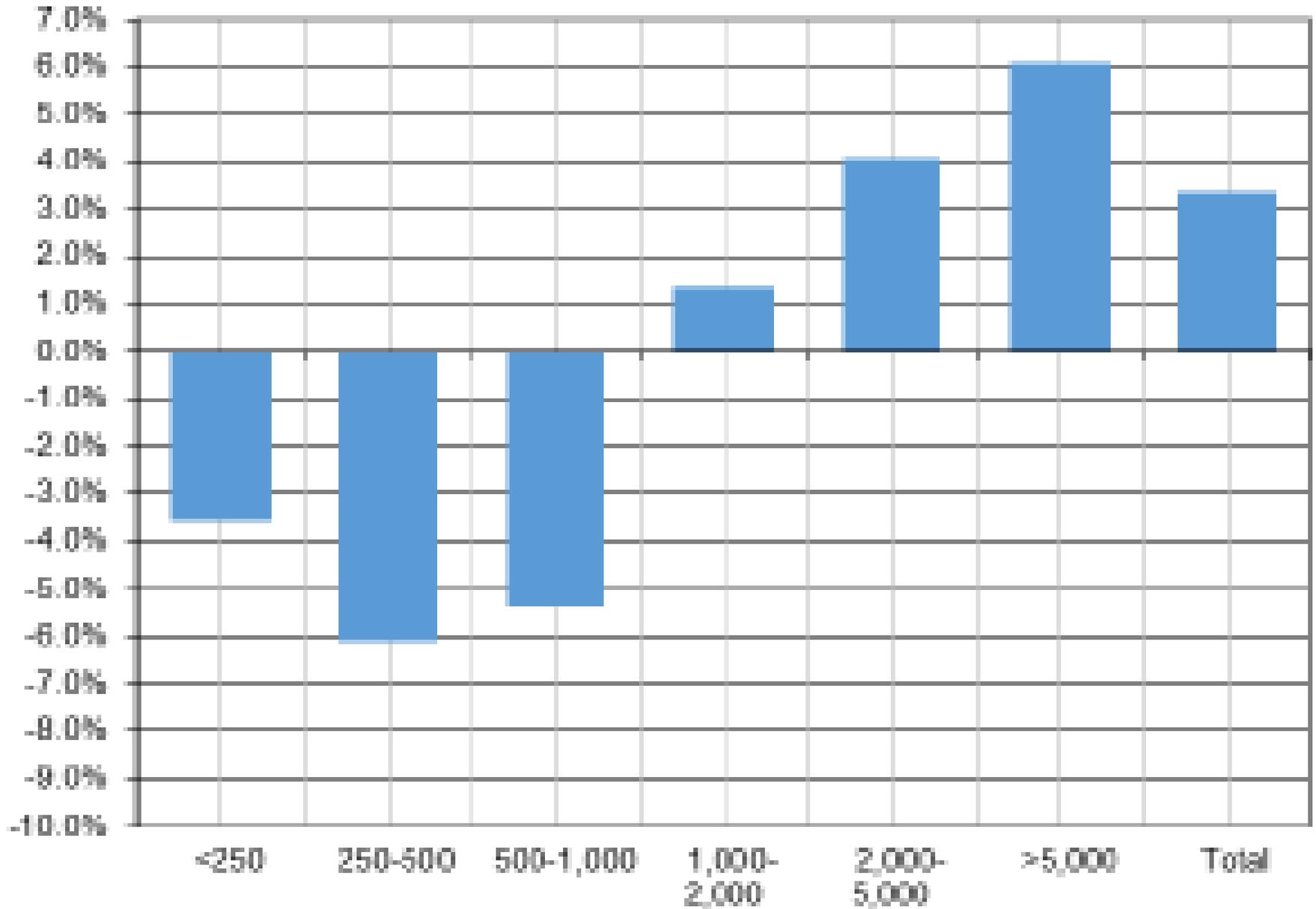
- The rising costs of education, especially in small school districts
 - Spending per student is >50% higher than average in small (<250 students) districts
 - Average annual growth in per pupil spending 2004 to 2014 was 6.2% in small districts compared to 3.1% in large districts (>5,000 students)
 - 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

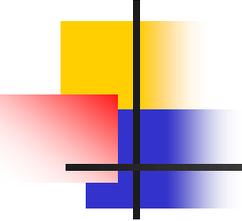


Why Are Agricultural Property Tax Levies Rising?

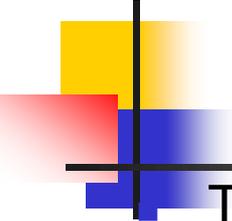
- The combination of rising valuations and falling enrollment leads to reductions in equalization aid
 - Between 2007-08 & 2012-13, 60 districts lost all their equalization aid, and 30 districts lost more than ½ their aid
 - These districts were almost all rural
 - Over past decade, largest percentage 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





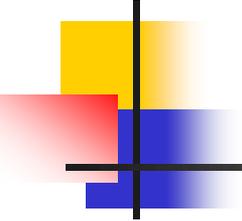
Revenue Options for Funding Increased State Aid for K-12 Education



Tax Analysis Criteria

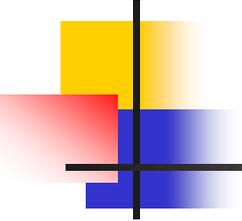
The *efficiency* of the tax

- 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

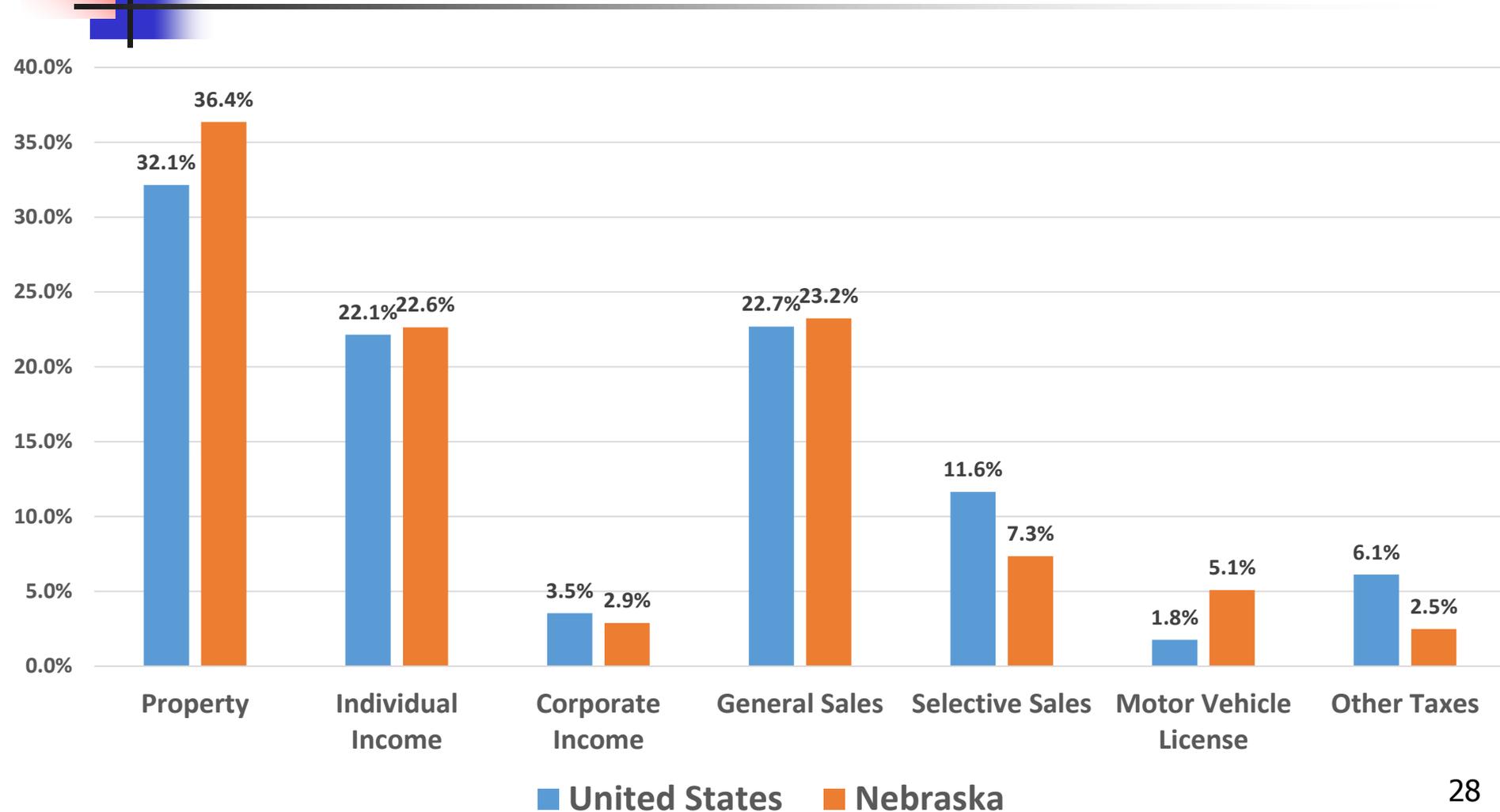
- All tax policy decisions require making trade-offs
 - Tax credits to enhance competitiveness will reduce simplicity
 - Highly progressive tax systems may hurt tax competitiveness
 - Reduced revenue volatility often leads to a more regressive tax system
- A well-balanced tax system can do a reasonably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



Characteristics of Nebraska's Tax System

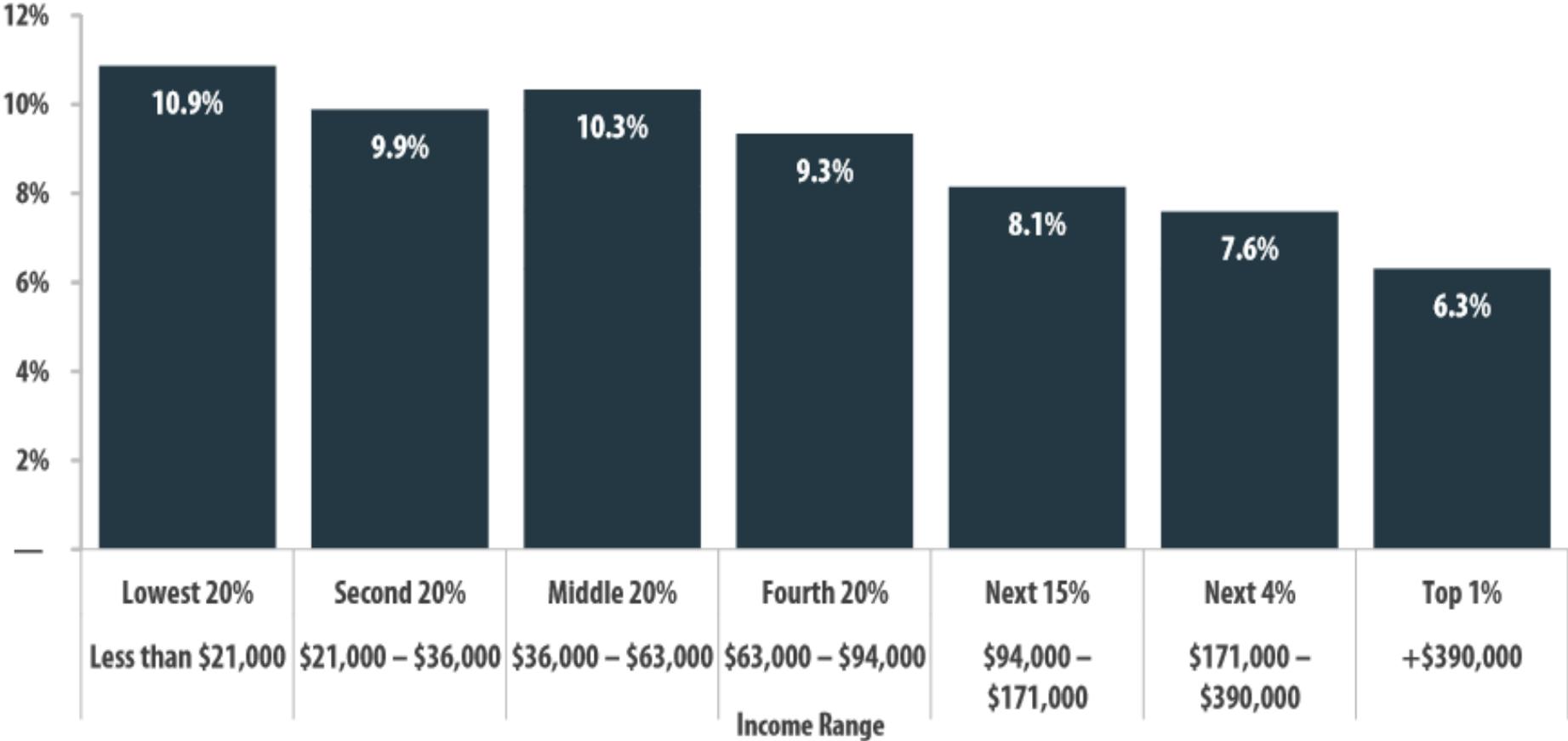
Mix of State and Local Taxes, 2012

Nebraska Compared to the United States



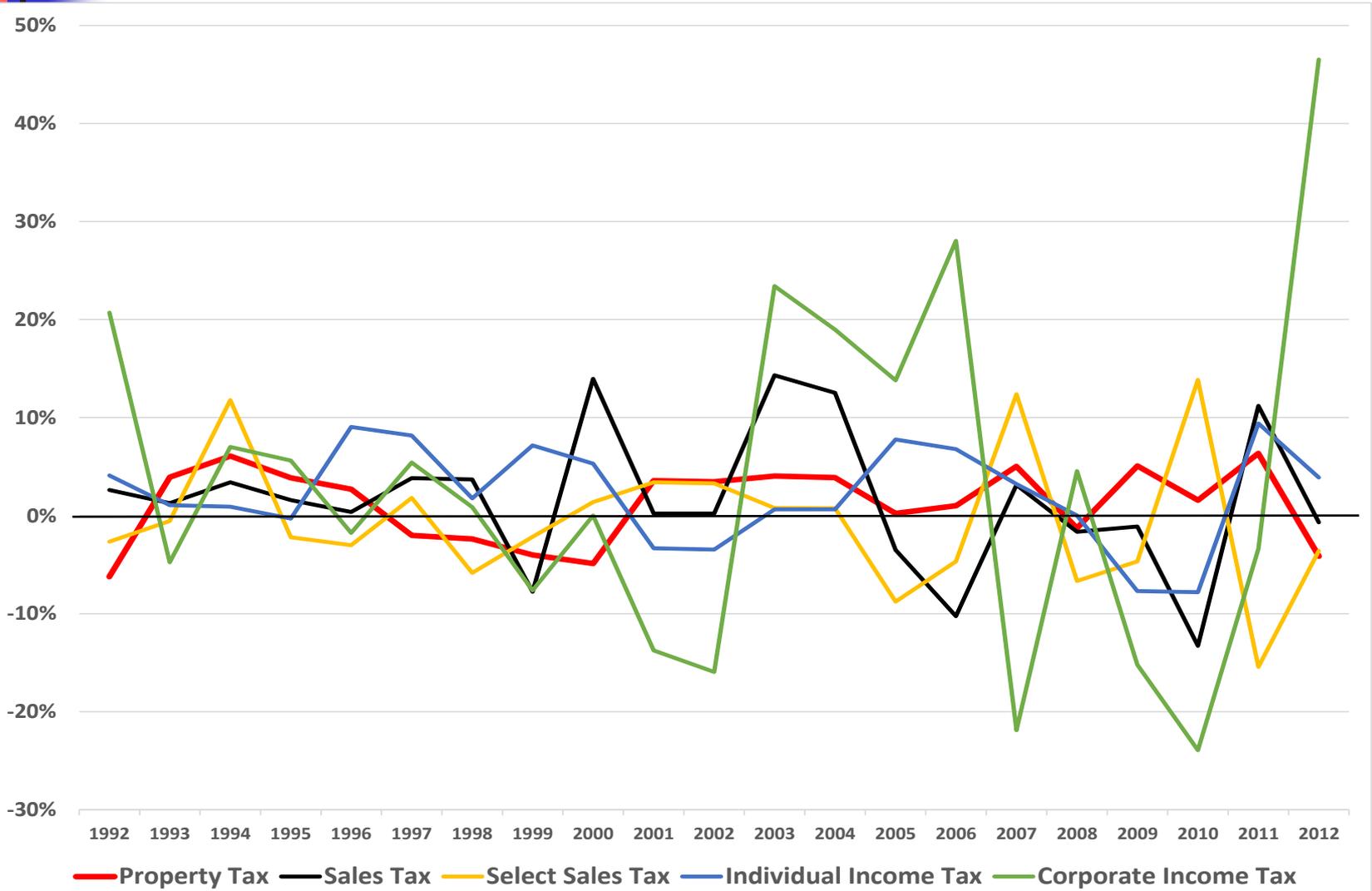
Nebraska State & Local Taxes in 2015

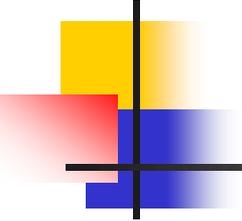
Shares of family income for non-elderly taxpayers



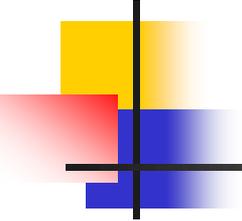
Source: ITEP, *Who Pays? A Distributional Analysis of the Tax Systems in all 50 States, 2015.*

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



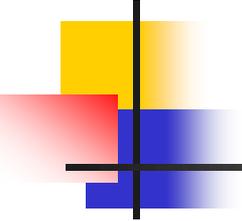


Increasing Individual Income Taxes to Fund Additional State Aid to Education



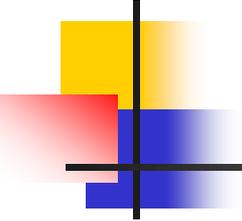
Income Tax Policy

- 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



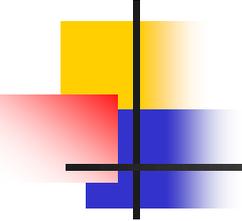
Income Tax Policy Considerations

- 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



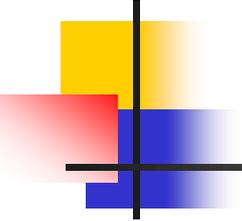
Income Tax Policy Considerations

- 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

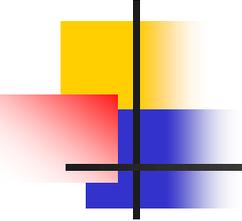


Income Tax Policy Considerations

- 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

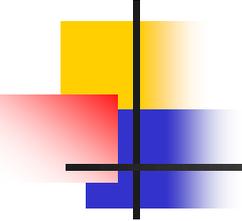


Increasing Sales Taxes to Fund Additional State Aid to Education



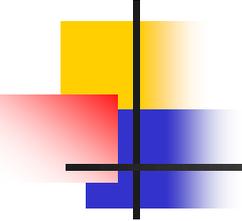
Sales Tax Policy

- 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



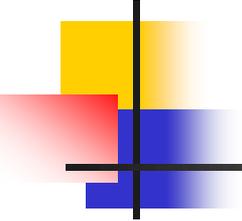
Sales Tax Policy

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

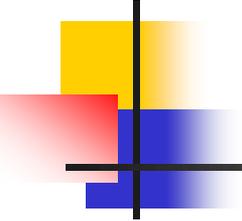


Sales Tax Policy

- 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

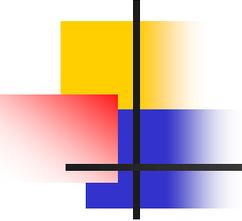


Increasing Corporate Income Taxes to Fund Additional State Aid to Education

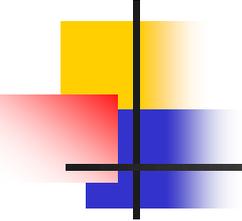


Corporate Income Tax Policy

- 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



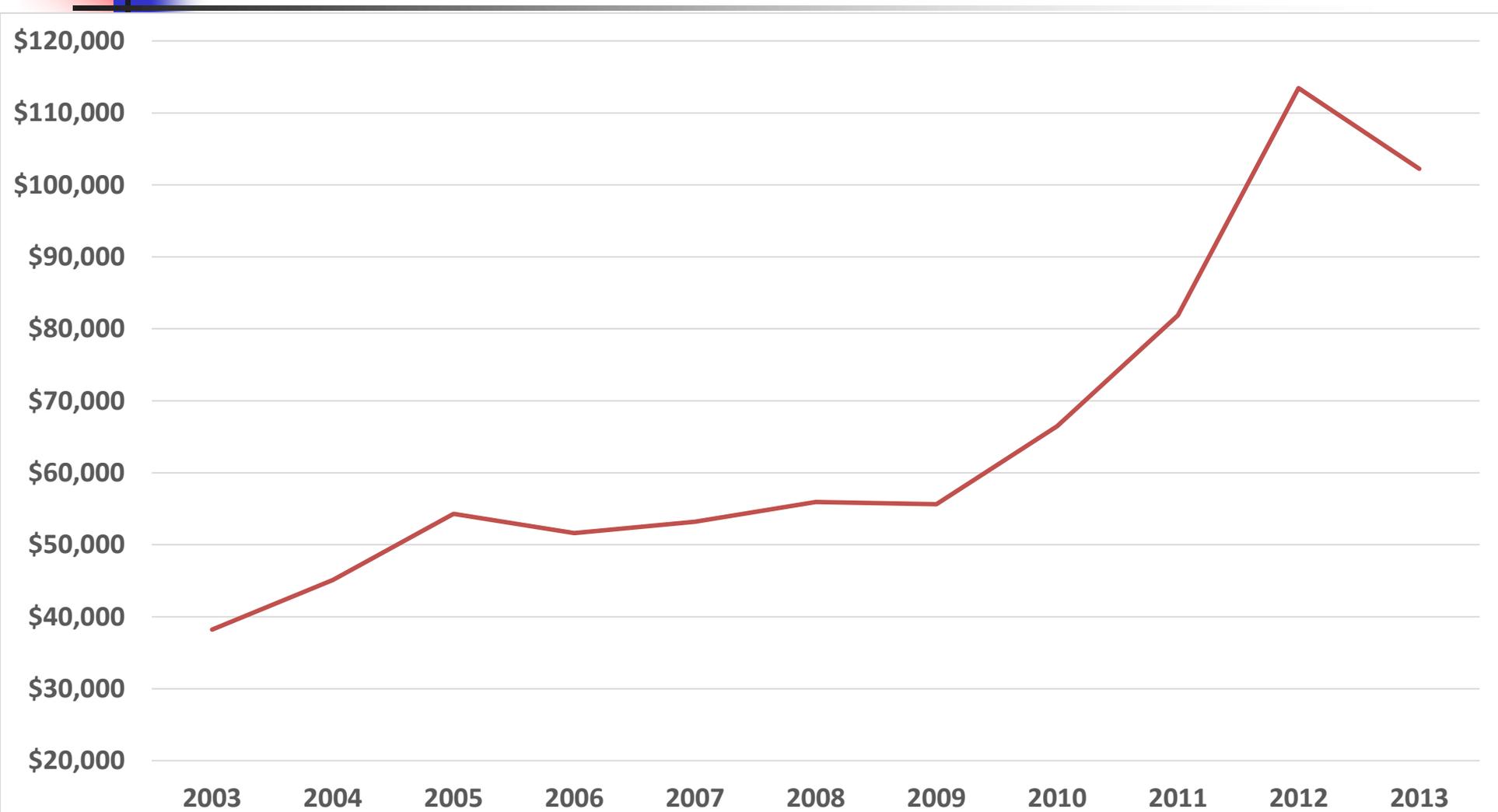
Policies to Address Rising Agriculture Property Taxes

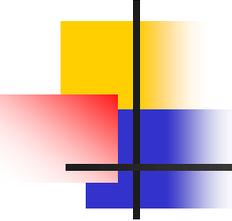


Value Ag Property at 65% of Use Value

- 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

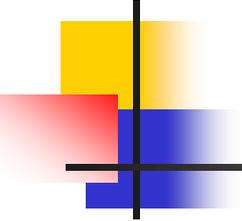
Average Income (Federal AGI) of Nebraska Farmers and Ranchers, 2003 to 2013





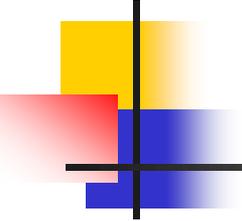
What About Farmers/Ranchers Who Face Rising Property Taxes, but Have Low Incomes?

- 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



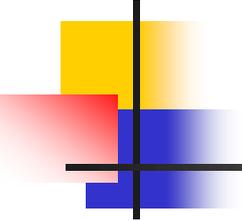
Two Property Tax Policies that Could Help Farmers (and others) Facing Large Property Tax Bills Relative to their Incomes

- 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

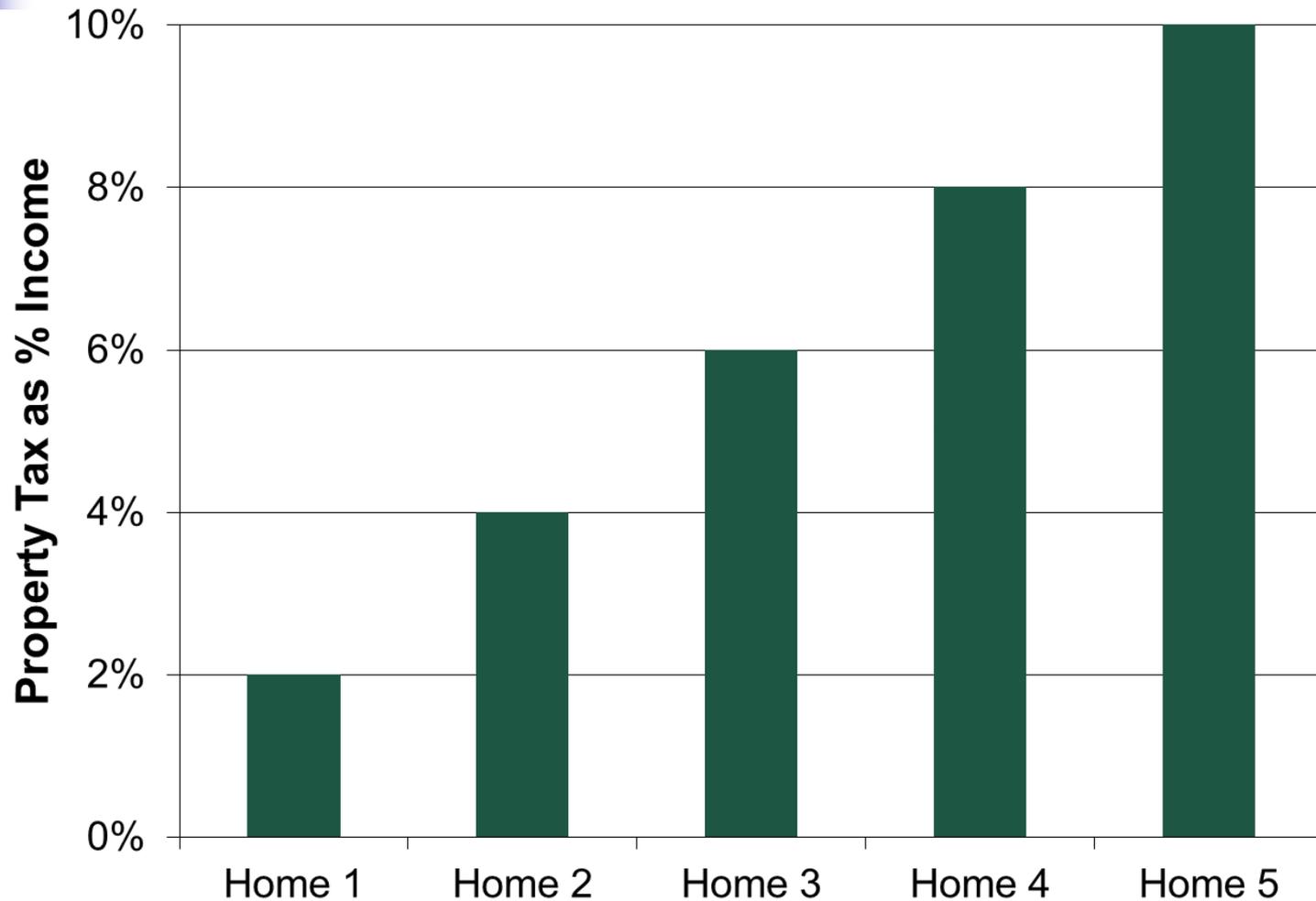
- Similar to a reverse equity mortgage
- Local government lends taxpayer money to pay a portion of property tax, with loan paid back in future or when property sold
- Can be triggered when tax is above a threshold % of income, or when tax increases at a very rapid rate
- Could be an “opt out” program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



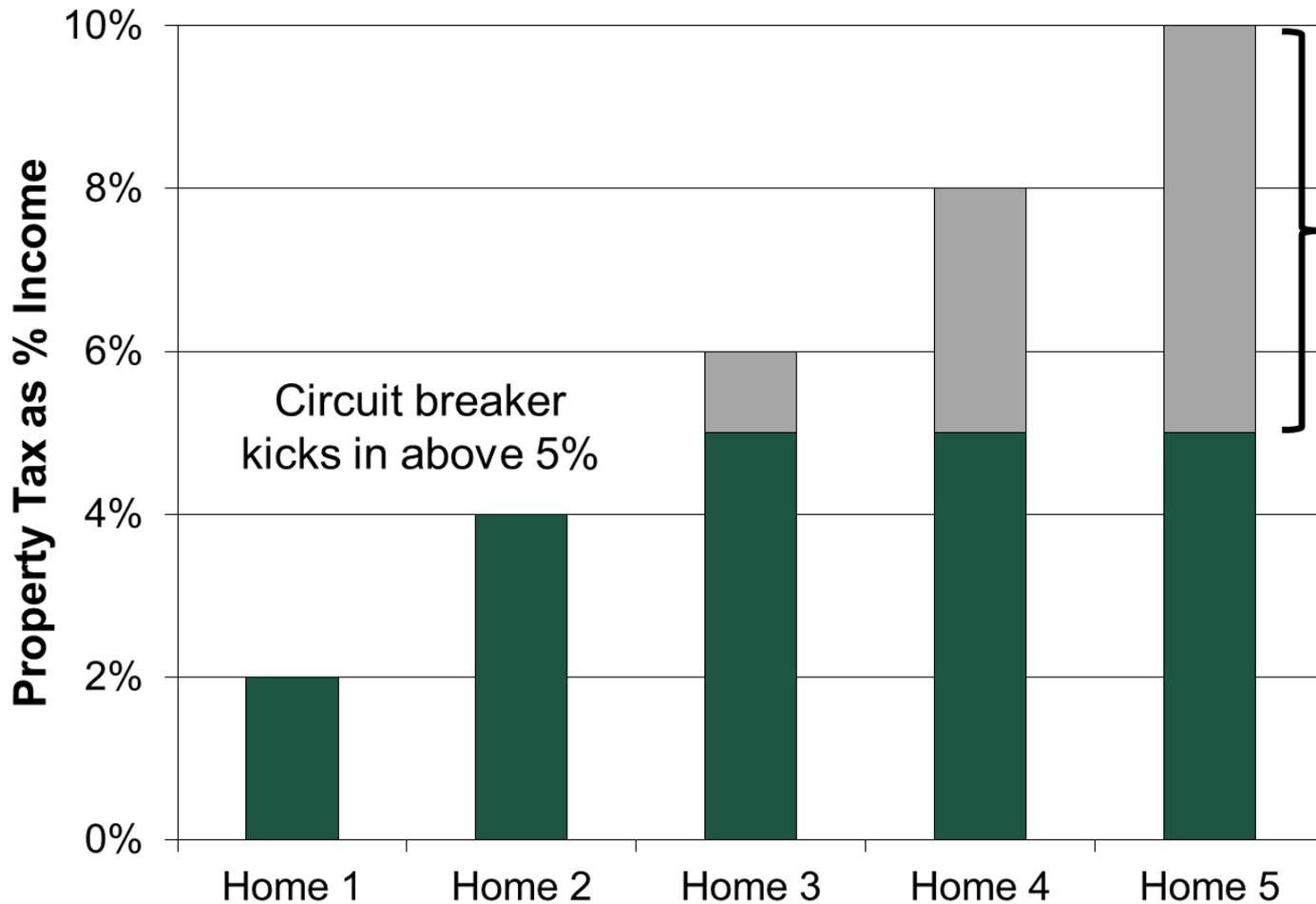
Circuit Breaker Programs

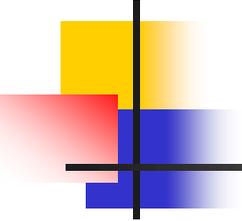
- Circuit breakers target property tax relief to those taxpayers who face particularly high property tax burdens (property tax as a % of their income)

Property Taxes as a Percentage of Income Without a Circuit Breaker



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

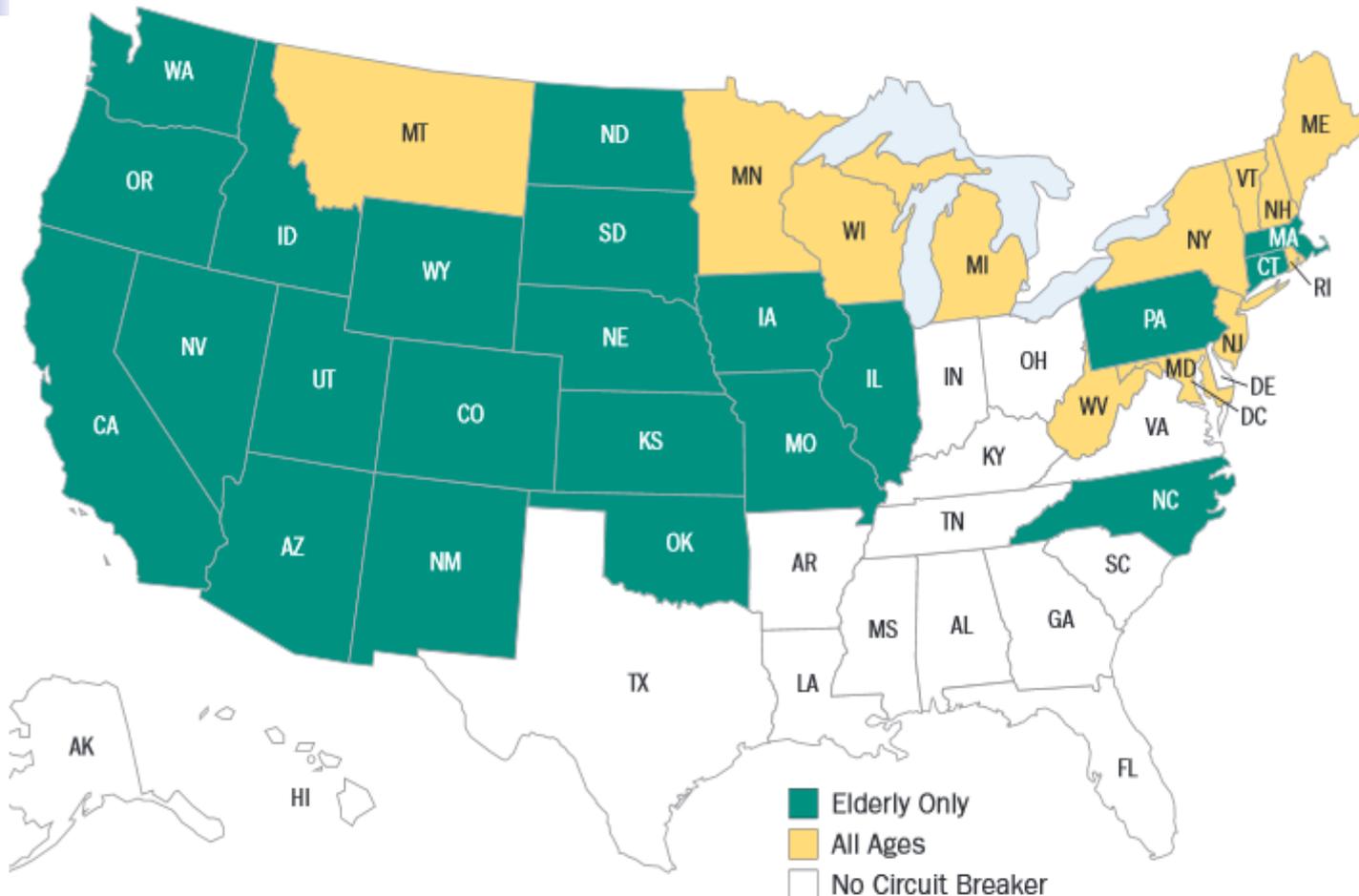


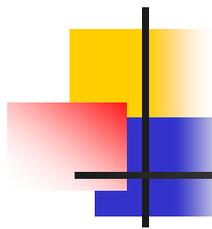


Circuit Breaker Programs

- 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

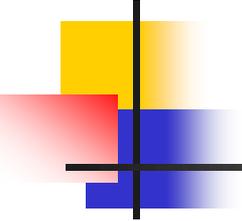
State-Funded Circuit Breaker Programs, 2009





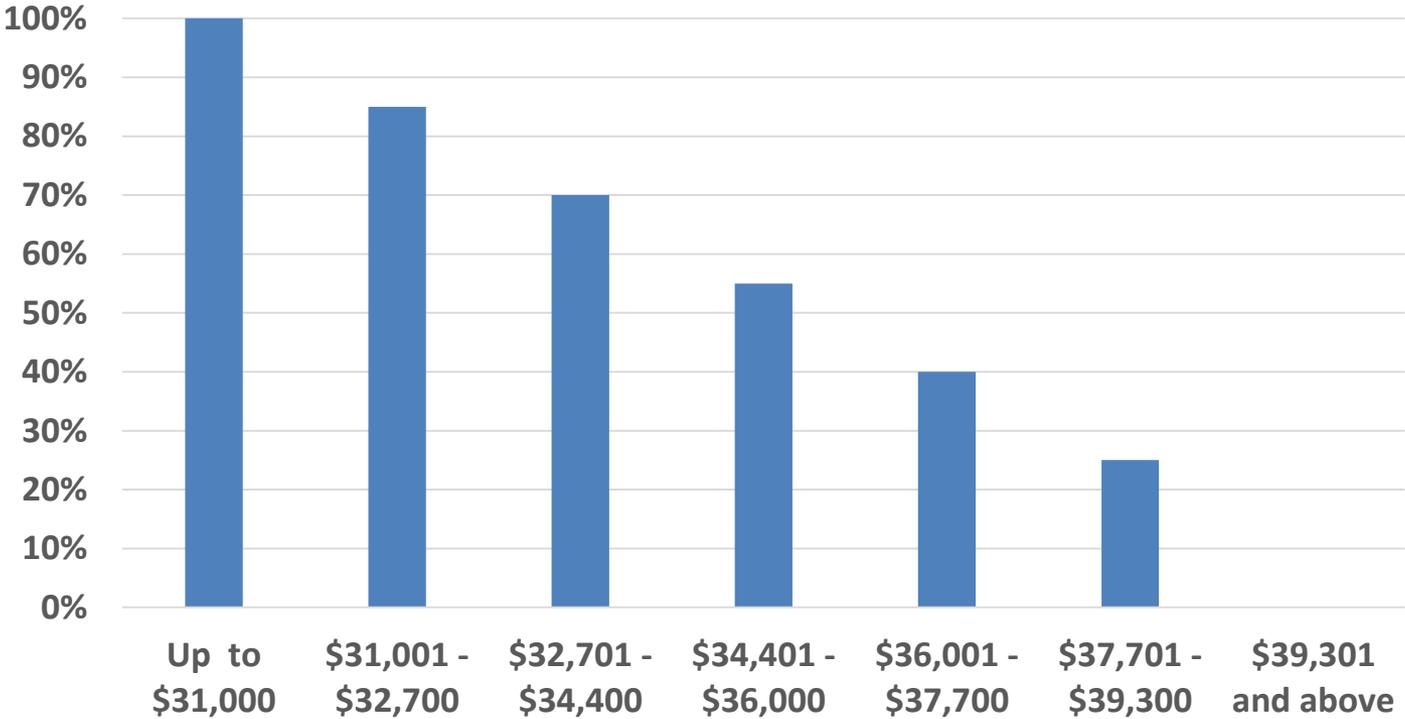
Circuit Breaker Parameters for Selected States, 2012

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

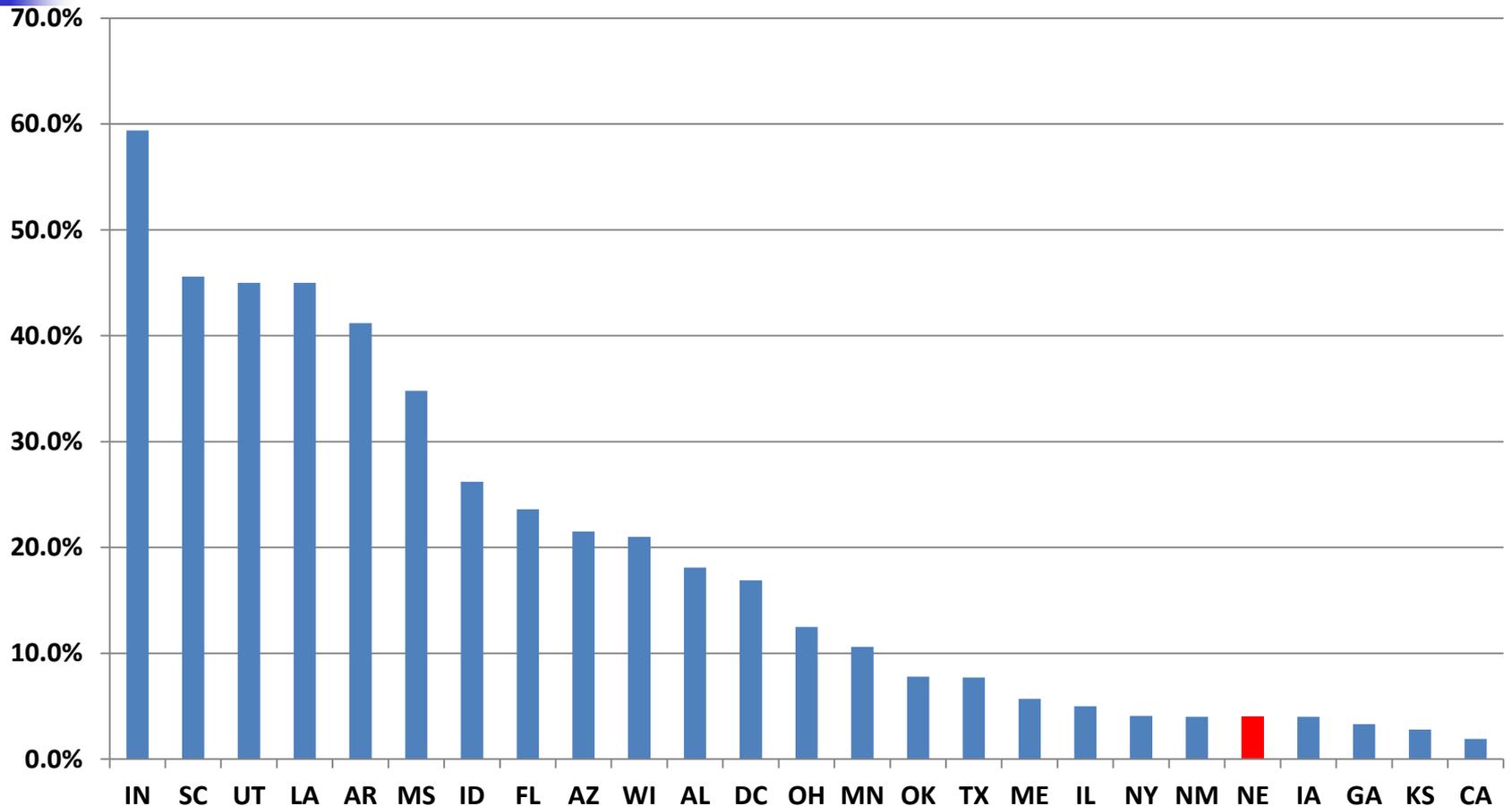


Nebraska's Property Tax Relief Programs

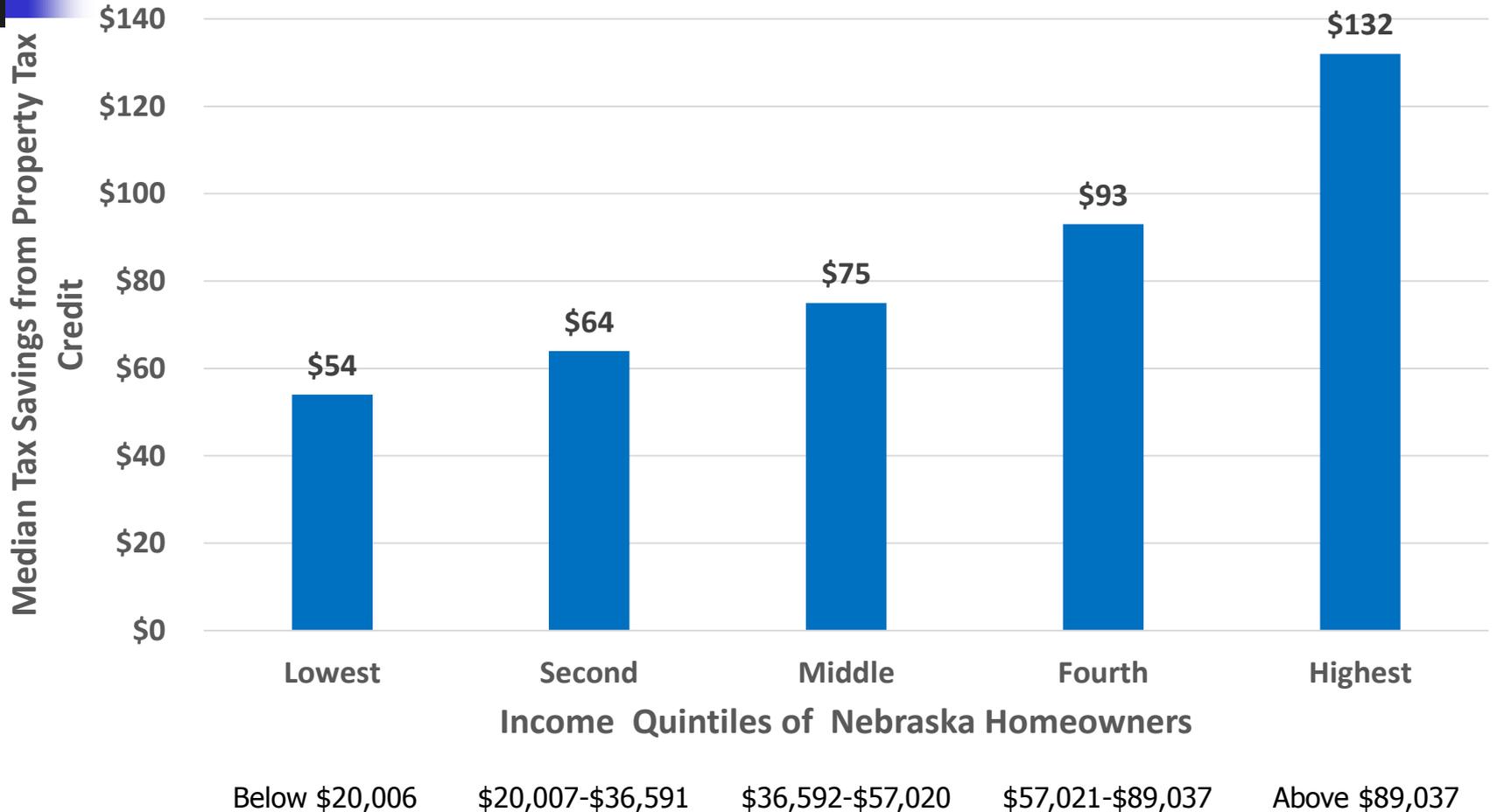
Percentage Reduction in Property Tax from
Nebraska Elderly Homestead Exemption
(For below average assessed values in a county with
average assessed value equal to \$100,000)

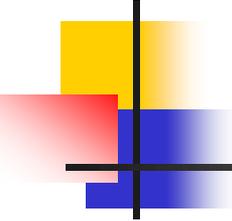


Percentage Property Tax Savings of Median Homeowner from Property Tax Exemption and Credit Programs (available to all property owners)



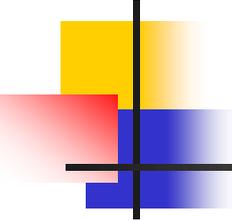
Median Tax Savings for Homeowners from Nebraska's Property Tax Credit, 2012





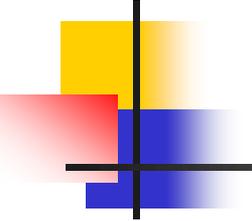
What About Farmers/Ranchers Who Face Rising Property Taxes, but Have Low Incomes?

- 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



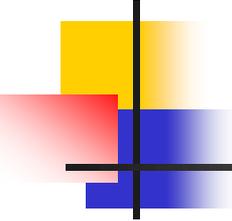
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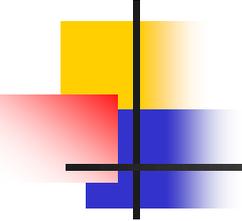
Increasing State Aid to Small, Rural Districts

- 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



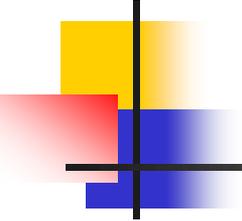
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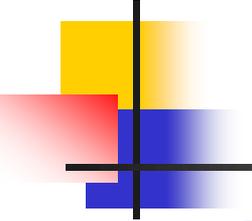


Education Policies to Reduce Costs of Rural Education

- 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

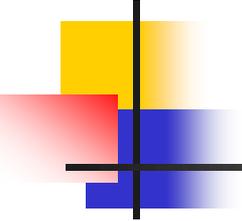


In Defense of the Property Tax



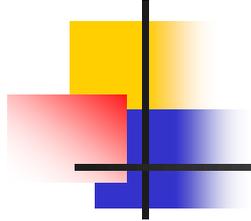
The Strengths of the Property Tax

- 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

- 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



Thank You.

Questions and Comments?