

Money Matters

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State Property Tax and Education Funding

Abstract: Some proposals for property tax restructuring include substituting a state property tax for some or all of the existing K-12 education property tax levies. That element of such proposals frequently has been characterized as a "new" tax. This paper argues that a state property tax would not be "new," because under current law most of the levies of the general education funding program already function as state property taxes. Under current law, the state pays roughly 86 percent of K-12 education costs (excluding federal funds), when both revenue from those general education levies and state aids are included in the definition of "state" funding.

Description of the General Education Formula

For the 1996-97 school year, each school district will receive a basic general education allowance of \$3,505 per weighted pupil unit. School districts will receive varying amounts of additional revenues depending on the amounts of their transportation sparsity, elementary and secondary sparsity, compensatory, and operating capital allowances. This paper will refer to those levies, allowances and revenues collectively as the general education levy or formula.¹

The funds each school district receives under the general education formula come from a combination of property tax revenues and state aids, or, for a small number of "off formula" districts, exclusively from property tax revenues. How much of the per pupil amount comes from property tax revenues and how much comes from state aid depends on two factors: the general education tax capacity rate determined by state law, and the relative property wealth of the school district. The general education tax capacity rate is determined by dividing the total amount of the general education levy, which is set in state law, by the total adjusted net tax capacity of all school districts in the state during the preceding year. For the 1996-97 school year, the general education tax capacity rate is 40.8 percent. The rate is the same for virtually all districts;² only the relative property wealth varies.

The General Education Levy Is a State Property Tax

Because the rate is the same in all school districts throughout the state, a property in one district will pay the same amount of tax under the general education formula as a property of the same class and taxable market value located

¹ The general education funding program also includes the supplemental, transition, and operating referenda levies/revenues, which are not included in this paper's definition of general education levy or formula.

² If the effect of adjusted net tax capacity is ignored, only one "off formula" school district, the Becker district, has a general education tax capacity rate that is less than the rate for all other school districts in the state.

in another district.³ If the state chose to direct the counties to pay the revenues from the general education levy to the state for deposit into the state general fund, rather than directing the counties to pay those revenues to the school districts, payers of property taxes would pay the same amount as they do under current law. If the state did deposit those revenues into the state general fund, it could then appropriate and pay to each school district an amount equal to the sum of property tax revenues and state aid each currently receives under the general education formula.

The general education levy is, in essence, a state property tax for two reasons. First, the state sets the rate. Second, taxpayers would pay the same amounts and school districts would receive the same amounts regardless of whether the property tax revenues were paid directly to the school districts or instead were paid into the state general fund and then distributed to the school districts.

The state has “taken” a large share of the potential property tax revenue—revenue that otherwise would be available for counties, cities, towns, and school districts to capture—to pay for part of the cost of a high state priority, K-12 education. School districts with high property wealth, which usually have high concentrations of valuable commercial, industrial, public utility or lake shore properties, pay a larger share of this source of state support for education than districts with low property wealth.⁴

The state has decided it is administratively more convenient to direct the counties to pay the revenues from the general education levy to the school districts, rather than direct payment to the state for deposit into state general fund for appropriation and payment to the school districts. The direct payment from the counties to the school districts, bypassing the state, justifies the following statement, which state law requires to appear in upper case letters and boldface print on all property tax collection statements: “THE STATE OF MINNESOTA DOES NOT RECEIVE ANY PROPERTY TAX REVENUES.”⁵

But the administrative convenience of bypassing the state does not change the “state” nature of the general education levy for the reasons set forth above. The direct payment from counties to school districts does allow the revenues from the general education levy to reach the school districts without being included in the budget process for allocating the state general fund. That same result, however, could be achieved by having the revenues paid into a dedicated state fund rather than the general fund.⁶

³ In practice, the general education tax capacity rate varies slightly from district to district. The rate in each district is adjusted to compensate for the difference between the district’s total net tax capacity in the current taxes payable year and its total adjusted net tax capacity in the prior taxes payable year. The difference between net tax capacity and adjusted net tax capacity results from variations in the accuracy of property valuations. If estimated market value always equaled “true” market value, and the one-year lag in the system were eliminated, net tax capacity and adjusted net tax capacity would be the same in all districts, and consequently the general education tax capacity rate would be the same in all districts.

⁴ Similarly, jurisdictions with high concentrations of high-income residents pay a higher share of state individual income taxes than jurisdictions with high concentrations of low-income residents.

⁵ Minn. Stat. § 276.04, subd. 2.

⁶ Advocates of an explicit state property tax might argue that dedicating the revenues from the state property tax would diminish the visibility of that tax in the state budget process, since general fund revenues and appropriations tend to be the primary focus of the budget process. Each budget session, however, legislators and the governor would have to discuss whether sufficient resources are available in the state general fund both to provide—along with the dedicated revenues—adequate K-12 education funding, and to provide adequate funding for other general

The only possible argument against characterizing the general education levy as a state property tax would be that most school districts are not required to levy at the rate established by state law. Most school districts can choose to levy at a lower rate, but if they do so they will receive less funding under the general education formula.⁷ In addition to receiving less property tax revenue, a school district that levies at a lower rate also will lose state aid (unless the district is “off formula”). Regardless of whether the school district levies at the full, state-set rate or a lower rate, the relative proportions of property tax revenue and state aid will be unchanged. It is as if each dollar a school district receives under the general education formula is a hybrid of property tax revenues and state general fund revenues (unless the district is “off formula”). If a school district chooses to levy at a lower rate, it suffers the penalty of receiving fewer of these hybrid dollars.

The hybrid nature of the dollars reinforces that they are dollars from the state. It would be irrational for a school district to decline some of the state hybrid dollars that it is eligible to receive. Consequently, school districts that are eligible to receive the hybrid state dollars always levy at the full rate determined by state law to maximize the amount of state hybrid dollars they receive.

The argument that the general education levy is a state property tax is even stronger for “off formula” school districts. All but one of those districts are required by law to levy at the full rate. The state then reduces other aids to those school districts by the amount by which their respective levies exceeded their weighted-per-pupil-unit allowances. One district, Becker, would receive so much excess property tax revenues and receives so little other state aid that the offset mechanism used for other “off formula” districts would not work. The Becker district is permitted to adjust its rate downward so that its levy raises only the weighted-per-pupil-unit allowance.

Misconceptions About A State Property Tax

Some local government officials are concerned that once an explicit state property tax has been enacted, in difficult financial periods the state might choose to increase property taxes to fund non-education appropriations. Currently, the state funds only approximately 40 percent of K-12 education from property taxes, and it is unlikely that the state would increase property taxes enough to fund 100 percent of K-12 education from property taxes plus generate additional revenues to fund non-education appropriations. The state could free up resource to fund non-education appropriations by increasing the share of K-12 education funded by property taxes, but the state already has that ability under the existing general education formula. The fact that the state has used increases in the general education levy (or the levy recognition shift) to free up resources to fund non-education appropriations is yet another reason to identify the existing general education levy as a state property tax.

People from relatively property-rich school districts have expressed concern that a state property tax would take their property wealth and redistribute it throughout the state. Unfortunately for people who have that concern, the current-law general education formula already does that.

To demonstrate that fact, let us look at two hypothetical school districts called Industry Prairie and Bedroomdale. Industry Prairie has a large concentration of commercial, industrial or public utility properties. Bedroomdale consists primarily of residential properties. Industry Prairie and Bedroomdale each receive \$3,505 per pupil unit under the general education formula for the 1996-97 school year. The 40.8 percent general education tax capacity rate set by the

fund spending priorities. The amount of school funding provided from the state property tax still would be more visible than it is now under the general education formula.

⁷ All “off formula” school districts except the Becker district are required to levy at the state-mandated rate.

state is applied in both school districts. In Industry Prairie, that rate generates \$2,000 per pupil unit, or 57.1 percent of the general education formula; the remaining \$1,505, or 42.9 percent, is provided from the state general fund. In Bedroomdale, that rate generates only \$1,000, or 28.5 percent of the formula; the remaining \$2,505, or 71.5 percent, is provided from the state general fund.

Statewide, property tax revenues are 40.7 percent and state aids are 59.3 percent of the general education formula for the 1996-97 school year. The state requires school districts like Industry Prairie to pay more than 40.7 percent of the formula allowance in property taxes so that the state can pay those districts aid of less than 59.3 percent. By paying less aid to districts like Industry Prairie, the state in turn can afford to pay aid of more than 59.3 percent to districts like Bedroomdale. The table below summarizes those results.

	Industry Prairie		Bedroomdale	
Average Property Tax	\$1,427	40.7%	\$1,427	40.7%
Property Tax Adjustment	\$573	16.3%	(\$427)	-12.2%
Total Property Tax	\$2,000	57.1%	\$1,000	28.5%
Average State Aid	\$2,078	59.3%	\$2,078	59.3%
State Aid Adjustment	(\$573)	-16.3%	\$427	12.2%
Total State Aid	\$1,505	42.9%	\$2,505	71.5%
Total Revenue	\$3,505	100.0%	\$3,505	100.0%

In essence, the state takes additional property tax revenues per pupil unit from Industry Prairie and other property-rich school districts and gives those revenues to Bedroomdale and other property-poor school districts. For the 1996-97 school year, the general education formula “moved” \$263 million in property tax revenues from property-rich school districts to property-poor districts.⁸

Exactly the same result would occur if the general education levy were made an explicit state property tax. Owners of properties in Industry Prairie would pay the same \$2,000 per pupil unit into the state general fund, and the school district would receive the same \$3,505 per pupil unit in revenue; the school district would receive \$1,505 per pupil unit more than its property owners paid in, which is the same as the amount of state aid it receives under the current system. Owners of properties in Bedroomdale would pay the same \$1,000 per pupil unit into the state general fund, and the school district would receive the same \$3,505 per pupil unit in revenue; the school district would receive \$2,505 per pupil unit more than its property owners paid in, which is the same as the amount of state aid it receives under the current system.⁹

⁸ The \$263 million dollar figure was computed as follows. First, the statewide average per-weighted- pupil-unit levy amount was subtracted from each school district’s per-weighted-pupil-unit levy amount to determine each district’s “additional levy” per weighted pupil unit (school districts below the statewide average were assigned an “additional levy” of zero). Each district’s “additional levy” amount was multiplied by each district’s number of weighted pupil units, and the sum of those products was \$263 million. The data used for the computations, which includes some estimates, was provided the House Research Department.

⁹ If the explicit state property tax were not distributed across property types in the same proportions as the existing general education levy, then the same result, obviously, would not occur. For example, if commercial, industrial

Other Equalized School Levies Are Not State Property Taxes

In addition to the general education levy, most other school levies are “equalized,” meaning that if a given rate fails to produce a set amount of dollars per pupil unit, the state will fill in the difference with aid. Bonded debt service and operating referenda levies are equalized to some extent. Those referenda levies, however, clearly are not state property taxes, because each such levy is proposed by a school district and collected only if local voters approve it.

Many other equalized school levies should not be considered state property taxes because of the limitations on the uses of the revenues they produce. Unlike revenues from the general education levy, revenues from those other equalized levies may be used only for specific categorical purposes, *e.g.*, special education, early childhood family education, and community education. Because not every school district has the same amount of need in each of those categories, the rates for those other equalized levies vary from district to district. Some school districts do not use some of those categorical equalized levies at all. In contrast, every school district needs the full amount of the non-categorical revenue it receives under the general education formula. Therefore, the general education levy properly is characterized as a state property tax, whereas the other equalized school levies are not.

School districts have considerable discretion in setting the large number of K-12 education levies that are authorized in addition to the general education, bonded debt service referenda and operating referenda levies.¹⁰ Those discretionary, non-referenda levies are small compared to the general education and the referenda levies. Nonetheless, school districts can significantly impact their total levies by adjusting those discretionary, non-referenda levies. Consequently, school districts are required to participate in the “Truth in Taxation” notice and public hearing process.

and public utilities properties paid a larger percentage of the explicit state property tax than the existing general education levy, then school districts with high concentrations of those properties would pay a larger share of state property tax revenues. Conversely, if seasonal recreational properties paid a smaller percentage of the explicit state property tax than the existing general education levy, then school districts with high concentrations of those valuable lake shore properties would pay a smaller share of state property tax revenues.

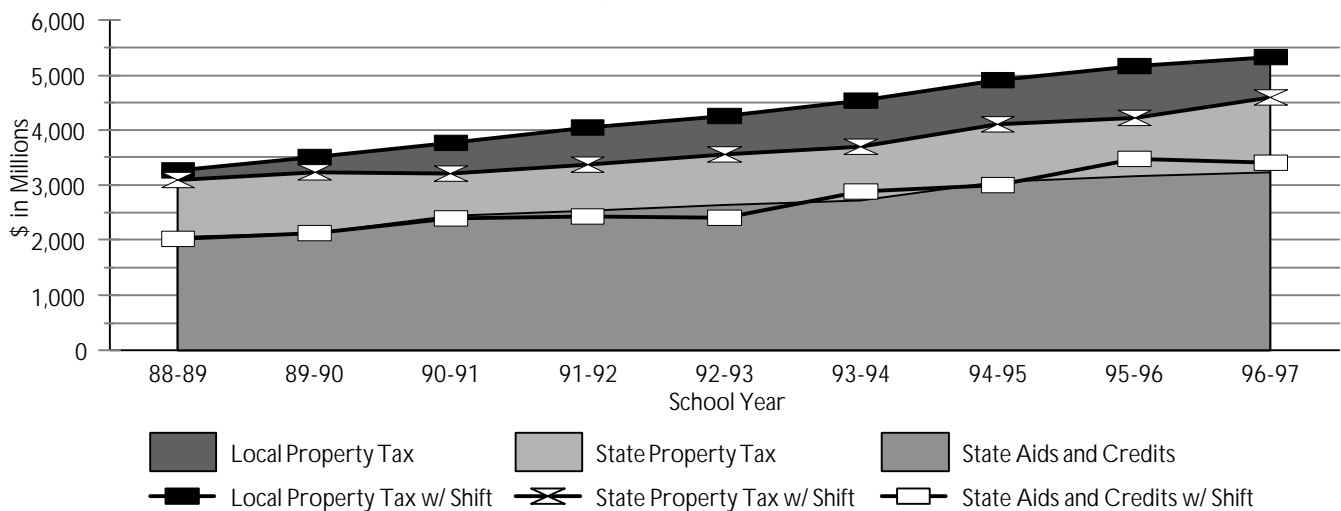
¹⁰ There are roughly 50 distinct K-12 education levies, depending on how one counts them, in addition to the general education, bonded debt service and operating referenda levies.

A Different Look At The State Share Of K-12 Education Funding

An earlier *Money Matters* provided information on K-12 education funding broken down into the percentage provided from the state general fund and the percentage provided from “property taxes collected locally.” That latter category, “property taxes collected locally,” included revenues from the current state property tax—the general education levy—as well as local property tax revenues. The chart below breaks K-12 education funding into three categories: appropriations from the state general fund for aids and credits, state property tax revenues, and local property tax revenues. The chart provides the information in two forms, one including the effect of changes in the school levy recognition shift (marked by lines) and one excluding that effect (marked by shaded areas).

State and Local K-12 Funding

Cumulative; Federal Funds Excluded



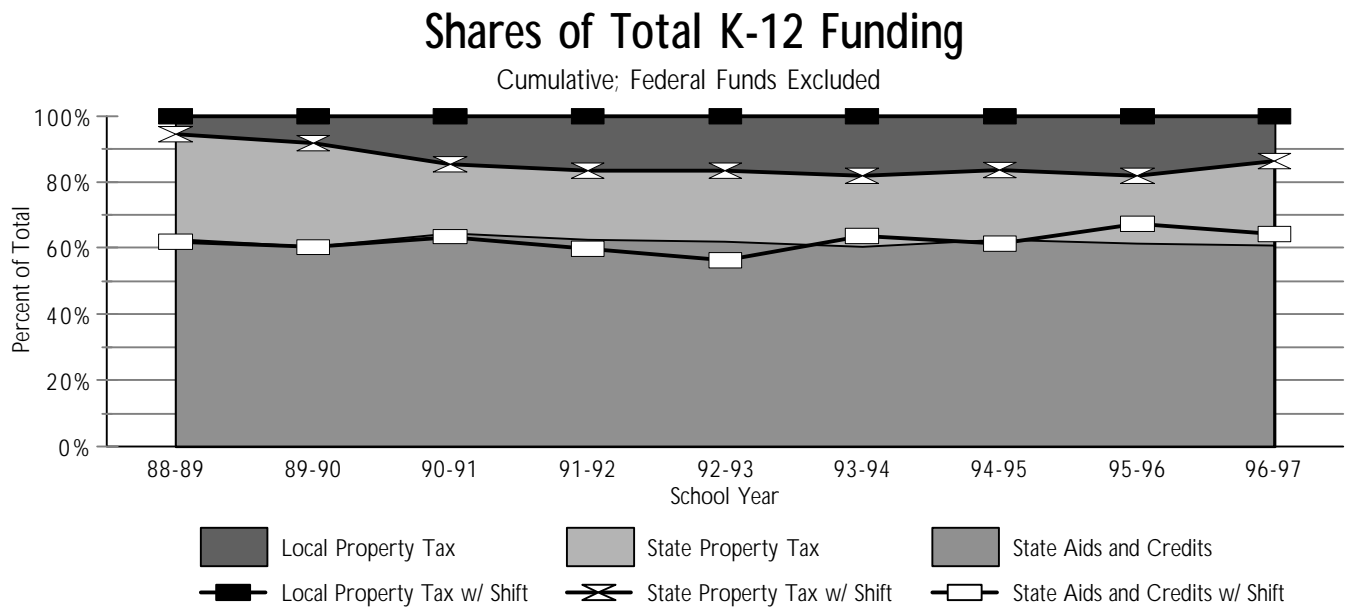
The school levy recognition shift requires school districts to take a percentage of the property tax revenues they receive during a calendar year and allocate those revenues to the previous school year. For example, the levy recognition shift for property taxes payable in 1996 (FY 97) has been certified at 7.0 percent. Therefore, school districts are required to allocate 7.0 percent of the property tax revenues they receive during 1996 to the 1995-96 school year. For taxes payable in 1992 (FY 93), the shift was 50.0 percent, and consequently school districts were required to allocate essentially all revenues from the first-half property tax payments in May, 1992, to the 1991-92 school year that was just ending. For taxes payable in 1993 and 1994, the shift was 37.4 percent, and for 1995, the shift was 18.1 percent.

The total amount of K-12 education resources is the same each year regardless of whether the effect of the levy recognition shift is included or excluded. Including or excluding the effect of the shift only alters the division of that total between appropriations for aids and credits on one hand and property tax revenues (state and local) on the other.

The chart above is based on the assumption that the levy recognition shift affects the recognition of revenues only from the state property tax, not from local property taxes. That assumption is an oversimplification, because some local levies also are shifted. But the amount of local levies shifted is quite small compared to the amount of state property tax shifted. To ease computations, it was assumed that only the state property tax was shifted.

Because of that assumption, including or excluding the effect of the levy recognition shift has no impact on the percentage of K-12 education funding provided by local property tax revenues. As the chart below shows, including

or excluding the effect of the levy recognition shift alters only the percentages provided by appropriations for aids and credits on one hand and state property tax revenues on the other.



The chart above shows that the “state” share of K-12 education funding was 94.5 percent for the 1988-89 school year. The state share declined to 81.8 percent for the 1993-94 and 1995-96 school years. For the 1996-97 school year, the state share is 86.2 percent.

Including the property tax portion of the general education formula in the “state” share of K-12 of education funding may have a profound impact on proposals that attempt relate changes in school funding to property tax relief. Legislators frequently focus on increasing the state share of school funding to provide property tax relief. However, the issues of increasing the state’s share of school funding and providing property tax relief need not be linked. Increasing the state general fund portion and decreasing the property tax portion of the general education formula would provide property tax relief, but it would not increase the state share of school funding. Furthermore, the property tax relief could disappear easily in future years; it would be a simple matter to increase the property tax portion and decrease the state general fund portion of the general education formula to free up state general fund resources for other spending priorities. On the other hand, if the state “took over” some or all of the discretionary, non-referenda school levies, that would both increase the state share of school funding and provide relatively lasting property tax relief.

Conclusion

A strong argument can be made that the general education levy is a state property tax. Replacing the general education levy with an explicit state property tax would make our tax system easier for taxpayers to understand, which would enhance accountability. Taxpayers for the first time would clearly understand that the state is responsible for setting the rate for that tax, and proposed changes to that rate for the first time would be visible as part of the state budget process.

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