# ETPI Facts and Figures

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**Summer Edition 2004**

## SCHOOL FUNDING STUDIES CONDUCTED SIMULTANEOUSLY

The complexities of Ohio's school funding program continue to be examined by two separate initiatives. One is the Governor's Blue Ribbon Task Force on Financing Student Success. The other is a school funding study being conducted by the Ohio School Boards Association and a team of education leaders. Here is background on both:

**Appointed by the Governor.** The Blue Ribbon Task Force was appointed by Governor Bob Taft in August 2003. Its members include representatives from education, business, and the General Assembly. Education Tax Policy Institute (ETPI) officers John Brandt and Barbara Shaner are members of the Task Force.

**ETPI Analysis.** Tax consultants from ETPI are working with education representatives on the Task Force to help shape important ideas that are under consideration. Those issues include phantom revenue, reduction of ballot frequency, and development of a school funding growth mechanism. ETPI helped analyze proposals submitted to the Task Force and prepared a paper exploring constitutional issues that might require amendments to accomplish certain proposed tax changes.

**Committee Composition.** Convened by the OSBA Board of Trustees, the School Funding Study Steering Committee is composed of representatives from the: Alliance for Adequate School Funding, Buckeye Association of School Administrators, League of Women Voters, OAPSE—AFSCME/AFL-CIO, Ohio Association of School Business Officials, Ohio Coalition for Equity and Adequacy of School Funding, Ohio Department of Education, Ohio Education Association, and the Ohio Federation of Teachers. The Committee also includes OSBA officers and staff, school board members, superintendents, treasurers and school attorneys.

**Focus of Attention.** In its inception, the Study Steering Committee was directed to look at the possible development of a ballot issue to let voters decide on school funding changes. In several ways, the OSBA Study has coordinated its efforts with the Governor's Task Force since both groups are discussing many of the same issues.

**Proposal Development.** ETPI's expertise has been widely used by the OSBA Study panel members in development of a proposal to make the state responsible for 100% of the cost of an adequate education for every student, including those in categorical programs. This proposal has been shared with the Task Force. Also, ETPI has been asked to analyze many of the critical issues in funding, such as the cost of doing business, parity aid, gap aid, disadvantaged pupil aid, homestead exemptions, and circuit breakers.

**What's Ahead.** The Task Force is planning to draft its recommendations during August and submit the final report to the Governor this fall. The OSBA Study will continue its work, as well, including a review of the Task Force's report and a recommendation on whether to develop and begin to support a ballot issue for 2005.

## PROPOSED BUSINESS TAX CHANGES WOULD IMPACT SCHOOL FUNDING

The House Ways & Means Committee of the General Assembly has under consideration a comprehensive change in the way Ohio taxes business. Chairman Sally Kilbane introduced House Bill 58 to restructure the existing tax system.

The proposed legislation would have significant effects on the school funding system. Generally, the proposal repeals some existing business taxes and replaces them with a new Business Activity Tax (BAT) with a low rate and a very broad base. Following is an Education Tax Policy Institute examination of the legislation:

### A. Taxes Repealed

HB 58 would repeal the state corporate franchise tax. Revenue from this tax amounts to about $800 million--most of that revenue comes from an 8.5% tax on corporate income. More important to school districts and other local governments, the proposal would repeal the personal property tax, except for personal property taxes paid by public utilities, interexchange telecommunications companies and non-utility generators of electricity. Specifically, as of tax year 2006, personal property taxes would no longer apply to inventory of merchants or manufacturers or to the machinery and equipment or other personal property of any non-utility businesses.

The cost of this repeal probably would equal around $1.8 billion for schools and all other local governments. The proposal would not affect public utility personal property.

The table below summarizes the taxable value and estimated total tax revenue associated with each type of personal property based on tax year 2001 data.

**Types of Taxable Personal Property—Statewide Valuation and Taxes for Tax Year 2001**
**(In millions of dollars)**

| Type of Property | Taxable Value | Estimated Taxes | Proposed Treatment |
|---|---:|---:|---|
| Manufacturing Machinery & Equipment | $7,823 | $586 | Exempt |
| Manufacturing Inventory | $4,785 | $359 | Exempt |
| Merchants' Inventory | $5,347 | $401 | Exempt |
| Furniture, Fixtures, Other | $6,091 | $457 | Exempt |
| **General Personal Property Tax Total** | **$24,046** | **$1,803** | |
| Public Utility Personal Property Tax | $9,843 | $723 | Taxable |
| **Total of All Personal Property** | **$33,889** | **$2,525** | |

The column showing "Estimated Taxes" includes the estimated loss for schools and all other local governments. As a rough approximation, school losses would account for about two-thirds of the total. The last column of the table above shows how the tax law would treat each type of personal property if HB 58 were enacted, as proposed.

### B. New Revenue

The proposal would obtain new revenue from two sources: the repeal of the 10% rollback for commercial and industrial real property, and the enactment of the State Business Activity Tax.

(See next page)

## PROPOSED BUSINESS TAX CHANGES WOULD IMPACT SCHOOL FUNDING (cont.)

By far, the BAT would provide the larger source of new revenue. Although the new tax rate of 0.71% is quite low, it would apply to such a large base that the tax is intended to yield enough replacement revenue to make the proposal "revenue neutral." The BAT base would consist of the sales, payroll, and real property values attributable to Ohio as listed by each corporation and partnership on an annual return. In defining the tax base, the sales factor would receive a triple weight so that the actual formula for the tax looks like this:

$$\frac{(\text{Sales x } 60) + (\text{Real Property x } 20) + (\text{Payroll x } 20)}{100} \text{ x } 0.71\%$$

HB 58 has undergone some major changes since its initial introduction. While the original bill may have achieved revenue neutrality, some subsequent amendments have reduced the personal property tax further than the original bill, and the tax base of BAT has been narrowed. In light of these changes, the revenue neutrality of the proposal now appears suspect.

**C. Replacement Revenue Formula**

The State BAT is intended to provide a source of revenue for the replacement of personal property taxes repealed in the business tax restructuring. The proposal would replace personal property tax losses by means of a formula based on the revenue replacement mechanism in Senate Bill 3 (electric utility property tax restructuring). The replacement revenue amount required by HB 58 would equal about eight times more than the amount of replacement revenue required under SB 3.

For school districts and joint vocational school districts, the revenue loss from HB 58 would equal over a billion dollars compared to about $140 million under SB 3.

Revenue replacement would occur at a 100% level for 2006, 2007, and 2008. Beginning with 2009, replacement revenues would decline by 8 percentage points per year until no replacement revenue is provided in 2021.

**D. Problems with the Replacement Revenue Formula**

The Revenue replacement formula in HB 58 suffers from the same flaw as the replacement system contained in SB 3. It offsets revenue replacement by increases in formula aid. While this adjustment makes sense in concept, the execution is flawed because it fails to account for the phantom effect of other increases in real property valuation.

As a result, under HB 58, adjustments to the special revenue replacement amount would occur based on a paper computation of offsetting aid obtained through the School Foundation Program. In fact, these computations would not account for the phenomenon by which school district valuations can increase without additional revenue through the effects of HB 920. The bill's revenue replacement mechanism also suffers from the use of a rapidly declining percentage of replacement.

**E. The Proposed Changes Would Occur within a Flawed School Funding System**

While the HB 58 proposals address tax policy issues which merit the attention of Ohio policymakers, its changes occur within the context of a flawed school funding system.

Legislative leaders apparently have decided to keep tax restructuring and education funding reform on separate tracks. Without other changes in the school funding structure, separate changes in the tax structure only worsen the situation of many Ohio school districts without improving the situation of any.

## ETPI MEMBER ORGANIZATIONS PROVIDE RESEARCH FUNDING

Funding for the research work conducted by the Education Tax Policy Institute is provided by a number of school districts across Ohio and 10 state-level sponsoring organizations. Those groups are:

Alliance for Adequate School Funding
Ohio Association of Community Colleges
County Commissioners' Association of Ohio
Ohio Coalition for Equity and Adequacy of School Funding
Ohio Federation of Teachers
Buckeye Association of School Administrators
Ohio Association of School Business Officials
Ohio Association of Joint Vocational Schools
Ohio Education Association
Ohio School Boards Association

## 'PHANTOM REVENUE' NOW A PART OF OHIO SCHOOL FUNDING LEXICON

The term *phantom revenue* has become a familiar one to most people who have more than a passing interest in Ohio school funding.

Phantom revenue explanations pop up in school levy campaigns, General Assembly candidate debates, legislative committee presentations, newspaper columns, letters to the editor, and even Ohio Supreme Court citations. It's become part of the Ohio school funding lexicon.

Many observers wonder not only why Ohio is plagued by the many different versions of this malady, but also why the funding systems in other states do not have to suffer from this mystifying and complex problem.

Where and when did the phantom revenue descriptor surface?

A November 1992 report "Equity, Adequacy, and Reliability in Ohio Education Finance" for the Governor's Education Management (GEM) Council includes a section entitled "Attributed (Phantom) Revenue." Written by Howard Fleeter, now an Education Tax Policy Institute consultant, the section explains the original concept of phantom revenue that stems from the application of House Bill 920 tax reduction factors after real property appraisal has occurred. The GEM report points out:

> "…the foundation formula sees the new, reassessed value figure and will reduce state assistance in response to the larger valuation per pupil. This has become known as the 'double whammy'— districts lose once by not having local revenues increase in pace with inflation, and lose a second time by having state assistance actually reduced. This unlikely outcome occurs because the state aid formula attributes revenues to the district which it actually does not receive (these are the 'phantom' revenues)."

While the Governor's Education Management Council report received widespread attention, it was not the first to identify phantom revenue as a school funding problem in Ohio. Carla Edlefson, currently a faculty member at Ashland University, pin pointed the "double whammy" in a 1983 *Journal of Education Finance* article, "Progress Toward Equity in Ohio." In 1991, Jan Resseger of the Coalition for School Funding Reform authored a study called the "White Paper on Phantom Revenue."

In recent years, a number of additional forms of phantom revenue have been identified, all of which represent cases where local districts do not have the resources assumed by the state aid formula.

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