

# Facts & Figures

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## Schools Score Supreme Court Win in Gas Pipeline Case

On February 14, 2008, the Ohio Supreme Court decided the Columbia Gas Pipeline case (*Columbia Gas Transm. Corp. v. Levin*, Slip Opinion No. 2008-Ohio-511). The Court ruled 7-0 to uphold the existing 88% statutory assessment rate for taxable pipeline property.

In rejecting the Board of Tax Appeals determination that Columbia Gas Transmission (CGT) qualified for the lower 25% assessment rate

applicable to retail distributors of natural gas, the Court also rejected claims by the taxpayer that the higher assessment rate required by the statutes violated Due Process, Equal Protection, and Commerce Clause provisions of the U.S. Constitution.

By rejecting the Board of Tax Appeals ruling in favor of CGT, the Court reinstated a determination by the Ohio Department of Taxation in

which the Department applied the 88% assessment rate to CG property.

ETPI undertook two initiatives to help school districts understand the potential effects of the CGT case while it was pending at the Board of Tax Appeals and the Supreme Court. First, ETPI commissioned the law firm of Taft, Stettinius & Hollister to assess CGT's chances for prevailing in the

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## State Board of Education Funding Subcommittee: The Role of Gap Aid Districts in Defining Education Costs

The State Board of Education has appointed a subcommittee to examine school funding issues. Specifically, the subcommittee has focused on the preparation of recommendations for the Governor and General Assembly in connection with the biennial budget process for fiscal years 2010 and 2011. Among the ideas under serious consideration by the

subcommittee is a method for computing basic per pupil costs by relying upon the experience of successful "Gap Aid" school districts.

The rationale for using Gap Aid districts for this purpose rests on the argument that the ability to meet performance standards as a Gap Aid district implies efficiency. By definition, local spending in such districts

equaled less than the amount of the charge-off. Therefore, achievement in these districts occurred without additional local expenditures beyond the official minimum amount. As a result, Gap Aid school districts represent a "best buy" for education performance.

ETPI conducted an investigation of Gap Aid districts and (continued on page 8)

## ETPI Report Rebutts Tax Foundation

In the Fall of 2007, the Tax Foundation, a national anti-tax group, published its 2008 “tax climate index.” The Tax Foundation has developed a procedure for evaluating state tax climates.

The application of this procedure found that Ohio ranked 46<sup>th</sup> for 2008 among the 50 states. In the Tax Foundation’s ranking system, the number one state has the

intended its work as humor. The ETPI analysis praised the index for its value as comedy.

In the process, it combined ridicule and solid tax policy analysis to attack the Tax Foundation’s research methods and conclusions in a serious way.

The Ohio Business Roundtable, an organization of some of the state’s largest business enterprises, found the ETPI

analysis of the Tax Foundation’s work so persuasive that it now features a verbatim copy of the Executive Summary from the ETPI analysis on its own website and supplies a link to the ETPI website where a visitors can obtain a complete version of the ETPI analysis.

ETPI research concluded that the Tax Foundation business tax climate

index provided a poor indication of Ohio’s true tax situation.

A brief summary of the problems with the index included the following points:

**1). The index focuses on tax structure rather than actual tax burdens.**

The Tax Foundation’s notion of tax climate involves creation of a list of features within a state’s tax structure mostly without regard to how much those structural features contribute to the actual tax burden.

As a consequence, the Tax Foundation’s approach rewards states that do not impose certain taxes at all, and penalizes states, such as Ohio, that have more balanced tax structures.

This approach is in direct contrast to accepted methods for ranking state taxes which examine relative tax *burdens* (see discussion of Federation of Tax Administrators rankings to the right).

In addition, the Tax Foundation’s approach implies that Ohio’s tax climate would improve if the state lowered the cigarette tax, taxed sales of gasoline under the sales tax, and included sales of food (groceries) under the sales tax.

**2). The actual construction of the tax climate index is based wholly on subjective judgments made by the Tax Foundation regarding the relative role of different factors.**

The tax climate index assigns scores to over 100 different



best tax climate for business, and the number fifty state has the worst. Thus, the report ranked Ohio very close to the worst tax climate for business.

ETPI prepared a 16 page analysis of the Tax Foundation’s tax climate index in which ETPI consultants mocked the index by pretending that the Foundation

## ETPI Report Rebuts Tax Foundation *(continued)*

aspects of state tax systems without any basis for the scoring system other than the Tax Foundation's own biases. For example, the scoring rewards states with flat rate income taxes and penalizes states with graduated income tax rate structures, regardless of the actual impact of the rate structure on taxpayers as measured in dollars.

**3). The methodology is inconsistent, and arguably irresponsible, in the extent to which it takes future tax changes which have already been enacted into account in its rankings.**

The Tax Foundation intentionally used the year 2008 in the title of this report, but the data used in the ranking actually come from earlier tax years. The result was that Ohio received at best partial credit for many reductions in Ohio's tax burden enacted in recent years but not in place in 2006 or 2007. In spite of its title, the index did not account for reductions scheduled for 2008.

A recent report by the Federation of Tax Administrators (FTA) supports ETPI's conclusion that the Tax Foundation's tax climate index grossly distorts the tax situation for Ohio's businesses. FTA is a national

organization of state tax collection agencies. It reports state-by-state tax information on a continuous basis.

FTA's analysis of 2007 tax burdens shows that Ohio ranks 38<sup>th</sup> in state tax burden per capita and 35<sup>th</sup> in state tax burden per thousand dollars of income. This comparison involves state taxes only and does not include local property taxes.

According to the Ohio Department of Taxation, Ohio's per capita state tax burden ranked 27<sup>th</sup> in 2005 and 34<sup>th</sup> in 2006, so that by ranking 38<sup>th</sup> in 2007, the state has dropped eleven places in two years.

Note that the FTA ranking system measures tax burdens so that the state with the highest rank levies the most taxes. Therefore, in contrast to the Tax Foundation's tax climate index, a high rank on the FTA scale means lower taxes. ■

## ETPI Looks to National Expert on School Funding

The 2010-2011 biennial budget; the governor's plan to reform education and funding; numerous legislative plans for funding schools - how can the education community be sure they are part of all these important discussions?

The ETPI officers and trustees have asked themselves that very question. With the prospects for changing the way Ohio funds schools better than they've been in recent years, we need to be prepared to contribute. ETPI has embarked on a research project meant to inform the governor's education and funding process and to make sure the education community is engaged.

We have excellent local resources through our long-time consultants for ETPI, Bill Driscoll and Howard Fleeter (from the firm Driscoll & Fleeter). They will certainly help contribute to these important talks, but we believe the times call for a fresh approach that will allow for new ideas and perspectives.

Ohio must also take advantage of innovative research that is available from other states.

To that end, we have contracted with a nationally known expert, James Guthrie, a professor at Vanderbilt University. Guthrie has just begun to work with the ETPI officers and trustees, but he is expected to guide the group through a process that  
*(continued on page 9)*

## School Levy Update

Tracking trends in school levies is an ongoing ETPI project. This article provides analysis of school operating and capital issues on the ballot in 2007 along with a brief summary of March 2008 levy results. It also provides analysis of the relative success of school levies by millage amount, as well as a comparison traditional and earned income tax levies.

### 2007 Levy Summary

The table below continues ETPI's levy analysis, comparing the number of issues from 2003-2007. 2007 marked the third consecutive year that the total number of school levies on the ballot decreased. It was also the third consecutive year that the total number of operating issues on the

three years has been fairly consistent, ranging from 150-159. However, the passage rate has decreased noticeably the past three years, with the 49.7% passage rate in 2007 nearly five percentage points lower than the historical average of 54.4%.

Passage rates for operating levies in 2003, 2006, and 2007 has been slightly higher than the historical average. These are also the same three years when the number of levies on the ballot has been lower than average.

### Levy Passage by Millage Rate (2003-2007)

The table on the right shows the results of ETPI analysis of passage rates of levies in three different millage rate categories. These figures are based upon all levies (capital and operating) on the ballot from 2003 through 2007.

Year	Total # of Issues*	% Passing	# Operating Issues	% Passing	# Capital Issues	% Passing
2003	439	52.2%	270	53.7%	169	49.7%
2004	617	45.1%	433	43.0%	184	50.0%
2005	515	51.7%	361	49.3%	154	57.1%
2006	430	52.6%	280	51.4%	150	54.7%
2007	412	50.7%	253	51.4%	159	49.7%
<b>1984-2007 Averages</b>	<b>470</b>	<b>51.5%</b>	<b>293</b>	<b>49.7%</b>	<b>177</b>	<b>54.4%</b>

\*Total # of Issues excludes millage reduction issues.

ballot had decreased. To put this trend in some perspective, however, it is important to note that the 617 total issues and the 433 operating issues on the ballot in 2004 were the highest totals since 1984 (there were also 617 total issues in 1991).

The number of issues on the ballot in 2005 was also higher than historical averages from 1984 through 2007. In this context, the table also shows that the number of issues on the ballot in three of the past five years (2003, 2006, and 2007) has been lower for all categories than the historical average.

The number of capital levies on the ballot the past

Consistent with what many suspect, the table shows that the passage rate falls as the millage amount increases. Levies of less than four mills passed roughly two-thirds of the time, levies between four and seven mills passed half the time, and levies of more than seven mills passed only 38% of the time.

### Comparison of "Earned Income" and "Traditional" Options for School District Income Tax Operating Levies

In 2005 the Ohio General Assembly authorized a new option for districts interested in adopting the school district income tax. In contrast to the

## School Levy Update (*continued*)

traditional school district income tax which utilizes the state definition of Adjusted Gross Income as the tax base, the new school levy option taxes only earned income, similar to how Ohio's municipal income tax functions.

Millage Rate	# of Levies	# Passing	% Passing
0.1 – 3.99 Mills	686	451	66%
4.0 – 6.99 Mills	795	396	50%
7.0 Mills and >	545	206	38%

\* Figures include all levies, operating and capital

While the definition of taxable income is different, the school district Earned Income Tax levy applies only to residents of the particular school district, in contrast to the municipal income tax which taxes the earnings of both residents and non-resident workers. The table above provides data showing the passage rates for both traditional and earned income tax operating levies from 2005-2007.

Initial examination of the data in the table below reveals that 40.4% of traditional income tax levies from Nov 2005-2007 passed while only 23.1% of

earned income tax levies on the ballot over the same period were approved by voters. However, when new levies and renewals are considered separately it becomes clear that the two types of income tax levies are approved at comparable rates. New traditional income taxes pass 24.4% of the time while the rate for earned income taxes is 21.6%. All renewal income tax levies were approved over this time frame.

### March 2008 Levy Results

There were 165 issues on the ballot in the March primary election, of which 77 (46.7%) passed. Fifty-one of 103 operating issues were approved by voters (49.5%). This percentage is roughly equal to the historical average. However, only 25 of 61 capital issues passed (41.0%). This figure is significantly lower than the 54.4% historical average. In March 2008 there were 15 income tax operating levies on the ballot. Three of the eight earned income tax levies passed while two of the seven traditional income tax levies passed. ■

Year	Traditional Income Tax Levies			Earned Income Tax Levies		
	# of Levies	# Passing	% Passing	# of Levies	# Passing	% Passing
11/ 2005	26	6	23.1%	7	1	14.3%
2006	45	21	46.7%	26	8	30.8%
2007	33	15	45.5%	19	3	15.8%
<b>2005-07 Total</b>	104	42	<b>40.4%</b>	52	12	<b>23.1%</b>
<b>New Levies</b>	82	20	<b>24.4%</b>	51	11	<b>21.6%</b>
<b>Renewals</b>	22	22	<b>100.0%</b>	1	1	100.0%

## State Budget Outlook, FY08 - FY11

Ohio's state budget outlook through the current (FY08-09) and upcoming (FY10-11) bienniums is influenced primarily by two factors. The first factor is the affect of the continued phase-in of the tax reforms accomplished in the FY06-07 budget (HB 66).

Because these tax reforms are being phased-in over a 5-year period which began in FY06 their effects will continue to be felt through FY10.

Among the major changes enacted in HB 66 were the phase-out of the corporate franchise tax, the phase-out of the tangible personal property tax, the creation of the Commercial Activity Tax (CAT), a 21% reduction over five years of the state income tax, and the lowering of the sales tax rate from its temporary FY04 and FY05 rate of 6% to a permanent rate of 5.5% in FY06 and beyond (the prior permanent rate had been 5% from 1981 through FY03).

The second factor, of course, is the state of Ohio's economy now and in the near future.

### State GRF Tax Revenue Projections Assuming a Moderate Economic Growth

The table below shows actual GRF tax revenues for FY05-FY07 and estimated revenues for FY08-11. The estimates for FY08 and FY09 are the OBM revenue estimates at the time the budget was enacted in June 2007. The estimates for FY10 and FY11 were done by Driscoll and Fleeter in November 2007. These estimates are all based upon assumptions of moderate" economic growth. The table above shows that in three of the five years of the HB 66 Tax Reform Phase-out period (FY07, FY09 and FY10) GRF tax revenues will actually decrease. Even assuming a moderately growing economy, FY10 OBM originally estimated would see a 1% decrease in GRF revenue from FY09 (which itself is .5% lower than FY08).

### Revised FY08-09 State Budget Projections

During the budget process in the first half of calendar 2007, the State assumed that the economy would improve in the first half of calendar year 2008 with even better performance in 2009.

**Actual and Estimated GRF Tax Revenues, FY05-FY11 Assuming Moderate Economic Growth  
(In Millions of Dollars)**

	Actual	Actual	Actual	OBM Estimated	OBM Estimated	D&F Estimated	D&F Estimated
GRF Taxes	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Sales	7,827	7,368	7,425	7,680	7,948	8,186	8,432
Income	8,599	8,786	8,885	9,147	9,201	9,255	9,718
Corporate	1,052	1,055	1,077	833	522	0	0
CAT	0	185	0	0	0	0	0
KWH/PU	444	501	487	401	306	306	306
Other	1,167	1,667	1,594	1,598	1,587	1,600	1,600
<b>Total</b>	<b>19,089</b>	<b>19,562</b>	<b>19,468</b>	<b>19,659</b>	<b>19,564</b>	<b>19,348</b>	<b>20,056</b>
<b>Percent Change</b>		<b>2.48%</b>	<b>-0.48%</b>	<b>0.98%</b>	<b>-0.48%</b>	<b>-1.11%</b>	<b>3.66%</b>

## Budget Outlook, FY08 - FY11 *(continued)*

However, on January 23, OBM released an updated economic forecast. Based on the signs of economic difficulty for the state of Ohio in labor, stock, and credit markets, declines in housing value, and the apparent threat that the economy could enter a recession, the update presents three alternative scenarios to the projected revenues and expenditures envisioned when the current budget was enacted about seven months prior.

OBM is considering three alternative economic scenarios:

- **Low growth** in which Ohio Gross Domestic Product (GDP) grows by 1.5% to 2.3% over the remainder of the biennium. This scenario will create a **\$733 million budget shortfall** over the FY08-09 biennium;
- **Zero growth** in which GDP growth ranges from 0% to 1.5%. This scenario will create a **\$1.3 billion budget shortfall** over the FY08-09 biennium;
- **Recession** in which GDP does not grow at all for the rest of the biennium. This scenario will create a **\$1.8 billion budget shortfall** over the FY08-09 biennium.

Even under the most pessimistic “recession” scenario, the State appears likely to finish the current fiscal year (FY08) in the black. The prospect of budgeted expenditures exceeding revenues does not occur until FY09.

In February, the Governor authorized \$733 million in budget reductions for the FY08-09 biennium, consistent with the “Low Growth” economic scenario.

The state’s “rainy day fund” balance currently stands at approximately \$1 billion. Utilization of this fund in the event that a worsening of economic circumstances causes the FY09 budget to go out of balance would cushion the need for further cuts in

spending (or increases in taxes) to bring expenditures in line with revenues.

### Implications for FY10-11

Even without a worsening of the economy, it appeared likely that the final phase-outs relating to the HB 66 tax reforms would place a great deal of pressure on the FY10 budget. Driscoll & Fleeter estimated that, with a stable economy, GRF tax revenues in FY10 would be lower than in FY09 and, in fact, lower than FY06 as well. Only when scheduled tax reductions cease in FY11 would growth in revenue occur.

If the economy worsens in FY08 and FY09 then the prospects for FY10 and beyond look worse as well. According to OBM estimates, the low growth, zero growth, and recessionary scenarios result in 2.2%, 4.2% and 6.8% GRF tax revenue decreases, respectively, in FY09 relative to the estimated FY08

Estimated GRF Revenue Under Different Budget Scenarios: FY08 through FY11				
	FY08	FY09	FY10	FY11
As Enacted	19,659	19,564	19,348	20,056
Low Growth	19,527	19,226	18,922	19,615
Zero Growth	19,391	18,837	18,131	18,795
Recession	19,346	18,327	16,904	17,522

Source: FY08 and FY09 are official OBM estimates. FY10 and FY11 are Driscoll & Fleeter estimates based on the assumption that percentage changes from FY08, as enacted to different FY09 scenarios are duplicated from FY09 to FY10 and from FY10 to FY11.

revenue level as originally enacted in the budget. The table below shows the effect of extending these percentage reductions into FY10 and FY11. The implications are that even the low growth scenario barely results in as much revenue in FY11 as the State received in FY06. Under the zero growth and recession scenarios, the State would have substantially less revenue than it had in FY05. ■

## State Board of Education Funding Subcommittee *(continued from pg. 1)*

compared them to other school districts. Before presenting the results of that investigation, a review of the Gap Aid concept is appropriate. “Gap Aid” (a.k.a. “charge-off supplement aid”) equals:

- 1). The sum of a school district’s required local contribution for base cost amounts plus the local share of special education, career tech education, and transportation; *minus*
- 2). The amount that the district actually raises with its existing property and school district income taxes; *minus*
- 3). The amount of any “Excess Cost Aid” provided to the district.

As a practical matter, Gap Aid districts include those school districts whose average effective

those districts for the preceding school year.

While only 9% of Gap Aid school districts achieved an “Excellent” rating, 27% of the non-Gap Aid districts received that report card designation.

Further analysis of report card data about Gap Aid and non-Gap Aid school districts shows that Gap Aid districts scored lower in terms of average number of report card indicators met, percent of indicators met of 30 possible, percentage of districts rated as satisfactory in average yearly progress (AYP), and average Performance Index score.

A closer look at one specific report card indicator shows that among “Effective” or “Excellent” school districts, the Gap Aid districts tend to have lower graduation rates.

districts among the Gap Aid districts versus the non-Gap Aid districts, the results show the following:

- Gap Aid districts tend to have a lower percentage of Honors Graduates;
- Gap Aid districts tend to have lower participation in the ACT college test;
- Gap Aid districts’ pupils tend to achieve lower average ACT test scores; and
- Gap Aid districts tend to have lower percentages of pupils who take AP examinations.

Thus, various measures of academic success show that the report card ratings of “Effective” or “Excellent” only tell part of the story. The report cards provide a kind of minimal standard of performance.

The addition of other measures, such as one might expect to find in a “world class” education program, the higher spending non-Gap Aid school districts consistently exceed the Gap Aid districts’ bargain basement education by significant measures.

Finally, Gap Aid districts are neither typical of Ohio school districts either in terms of geographical location in the state or in terms of the Department of Education’s district typology.

For example, in terms of geography, the South, Southeast, and Salt Fork regions of the state account for 17% of all school districts. These same three regions account for 45% of the “Effective” or “Excellent” Gap Aid districts.

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**Table 1: Number and Percent of Effect and Excellent Districts – Gap Aid and Non-Gap Aid Districts in FY08**

	Total # of Districts	# of Effective Districts	% of Effective Districts	# of Excellent Districts	% of Excellent Districts
Gap Aid Districts	150	103	69%	14	9%
Non-Gap Aid Districts	459	243	53%	125	27%
All Districts	609	346	57%	139	23%

tax rate equals less than 26.3 mills. (Some minor exceptions could occur but they are not important for understanding the general concepts at issue here). Table 1 shows a comparison of FY08 Gap Aid districts with the report card rating assigned to

While 29% of these Gap Aid districts achieved graduation rates over 96%. The comparable percentage for non-Gap Aid school districts equaled 51%.

When ETPI looked beyond report card data to compare “Effective” and “Excellent” school

## State Board of Education Funding Subcommittee *(continued from pg. 8)*

Similarly, rural/high poverty school districts account for 16% of all school districts and 14% of all “Effective” or “Excellent” school districts. However, among Gap Aid school districts, rural/high poverty districts account for 41%. Of the “Effective” or “Excellent” Gap Aid school districts, 33% are placed in the rural/high poverty type.

Therefore, poor rural school districts and school districts located in the Appalachian region of the state have significant over-representation in the Gap Aid districts.

These data clearly show that the “best buy” approach to identifying base costs for an adequate education rests upon an inappropriate collection of school

districts for two reasons:

- districts which receive Gap Aid do not perform as well as non-Gap Aid districts even when they achieve the minimal report card standards of “Effective” or “Excellent.”
- districts which receive Gap Aid come from a grossly unrepresentative group of school districts. ■

## Schools Score Gas Pipeline Case Win *(continued from pg. 8)*

case. The firm’s opinion correctly predicted that the State’s assessment would be upheld by the Supreme Court.

Second, ETPI consultants used data provided by the Department of Taxation to simulate the effect of refunds to gas pipeline companies if the taxpayer prevailed in the case.

ETPI estimated that schools would lose about \$18 million per year of which the State’s SF3 aid formula would replace about \$12 million.

Since the case included eight years of tax liability by the time of the Court’s decision last month, schools would have owed substantial refund amounts if the

taxpayer had prevailed. These two research projects led school officials to reject offers from CGT for a compromise settlement of the case.

Gas pipeline property is not uniformly distributed throughout the state. ETPI’s analysis showed that about 120 school districts would have lost \$1 million in valuation for each tax year if the State were required to assess personal property of CGT and other pipeline companies at 25% instead of the statutory rate of 88%.

CGT could ask the US Supreme Court to review the constitutional issues, but the Court would not have to accept the appeal. The Ohio Supreme

Court’s decision on the statutory issue cannot be appealed further because it involves an issue of state law only.

Unless CGT obtains further judicial review at the U.S. Supreme Court, the decision of the Ohio court would protect local governments and school districts from the necessity to pay refunds to CGT.

Prospectively, CGT could pursue legislative changes to the 88% assessment rate. The fact that it lost its case before the Ohio Supreme Court decisively by a vote of 7-0 would undermine the leverage that the company’s arguments about unfair treatment might otherwise provide. ■

## ETPI Looks to National Expert on School Funding *(continued from pg. 3)*

will lead to information and proposals the education community can use to contribute to this important school funding/education reform debate.

ETPI has developed a statement of work that will drive Guthrie’s work and the process we expect to go through over the next several months. For a copy of the statement, go to ETPI’s website at [www.etpi-ohio.org](http://www.etpi-ohio.org). If you have comments or questions, please feel free to contact us. ■

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