7. Local Revenue Options for K–12 Education

by Susanna Loeb

Summary

In 33 out of 50 states, the property tax generates at least 95 percent of local tax revenues for schools. Even so, the property tax has many alternatives. Local sales and income taxes, user fees, and a host of other taxes provide additional funds to school districts in many states, and their experiences shed light on potential sources of local funding for California schools. This essay describes these alternatives, how they are structured and administered, and how they might be used in California.

The Local Income Tax

Four states—Iowa, Kentucky, Ohio, and Pennsylvania—currently allow school districts to levy a local income tax for school funding. A surcharge on the state income tax is relatively easy to administer and can be progressive. One drawback is that income tax proceeds are less stable than property tax revenues. State governments can shift revenues across school districts to avoid shortfalls, but some of these governments also depend on income tax revenues and are therefore vulnerable to the same fluctuations. California's experience in the 1990s provides an example of this problem.

The Local Sales Tax

Local sales tax revenues are also used for schools in a number of states. However, only Louisiana and, to a limited extent, Georgia permit independent school districts to levy a sales tax. The local sales tax contributes most of the locally raised revenue in Louisiana; in Tennessee, it provides 28 percent of that revenue, almost as much as the property

tax. Sales taxes are easy to collect, and some voters seem to prefer them to other kinds of taxes. However, revenues from the sales tax are even less stable than those from the income tax. The sales tax tends to be regressive as well, although that regressivity can be mitigated by exempting food and drugs from the sales tax or by levying it only on luxury goods. Another problem with the sales tax is that it may affect consumer or retailer behavior. If two neighboring jurisdictions have different sales tax rates, for example, residents of both districts may choose to shop in the district with the lower rate. Retail businesses will then have incentives to locate in that district, even if all other aspects of the two jurisdictions are similar. A similar rate across local jurisdictions, as in Tennessee, alleviates but does not eliminate this problem, as consumers can make purchases online or in nearby states.

User Fees and Other Taxes

Many school districts collect user fees, of which food service and student activity fees are the most prevalent. Because public education benefits the community at large, however, user fees are not an ideal means for fully funding schools. At the same time, the nation's school districts may be able to collect more user fees than they currently do. One study maintains that up to 13 percent of all public school expenditures could be funded through user fees for meals, transportation, child care, extracurricular activities and clubs, driver education, adult education, and access to various capital goods. In 1984, the California courts ruled that schools may not charge user fees for activities that are closely linked to classes. For example, schools cannot charge a student to participate in a dramatic production that is associated with a drama course. Other user fees are unlikely to provide substantial supplementary revenues for California schools.

California allows school districts to levy a parcel tax, but only 48 out of 987 districts have chosen to do so. Parcel tax revenue contributes less than 0.2 percent of school revenue in the state.

The Options for California

Local revenue options could benefit many districts by addressing local needs and preferences and by linking finance and governance in those communities. To implement many of these options in California, however, local jurisdictions would need additional taxing authority. In 1996, the California Constitution Revision Commission recommended two ways for localities to raise additional school revenues: a local property tax, which would require two-thirds voter approval, and a county sales tax of up to 0.5 percent, which would require a simple majority.

By law, district revenue disparities created by local revenue options may not reflect differences in district wealth. However, California may be able to balance district flexibility and equity by capping revenue supplementation and guaranteeing an effective tax base for these additional dollars. The ultimate effects of school finance reform in California will depend on the details of the specific measures: which taxes are authorized, how the revenues are equalized across districts, and what limits are placed on local supplementation.

Introduction

As in many states, the property tax in California is the major source of local tax revenue for schools. In 1978, however, the state's voters approved Proposition 13, which put a 1 percent ceiling on the property tax rate, limited the assessed value of property, and forbade state and local governments from imposing "special taxes" without a two-thirds local vote.[1] In approving that initiative, voters began a process that effectively shifted control over the property tax (and school revenues) from the local to the state level. Today, California's 987 local school districts have limited options for supplementing school revenues. Their primary options are the parcel tax and voluntary contributions, neither of which generates substantial funds for schools.[2]

There are reasons to favor state control of school finance decisions. Districts differ greatly in the costs of educating children and in their ability to fund schools. Low-income and low-wealth communities have fewer resources to draw on, and communities with expensive property,

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[1]See Sonstelie, Brunner, and Ardon (2000) for a recent history of California school finance reform.

[2]Parcel taxes assess each property owner the same amount regardless of the property's value.

alternative opportunities for teachers, high crime rates, and high poverty rates need to spend more than other communities to achieve the same quality of education. States can equalize funding across districts in ways that locally funded systems cannot.

Local flexibility in school finance also has its benefits. Residents of one district may put a relatively high value on public education, whereas others may prefer to spend more on parks, community centers, or private consumption. Residents of both kinds of districts are better off with local flexibility than with a fixed level of school spending. Moreover, school districts may have short-term situations that require extra funds, such as a high concentration of students with special needs. These districts would also benefit from local flexibility. Finally, local taxation creates a link between finance and governance that may increase accountability and facilitate community involvement in schools.

There are two potential problems with authorizing local revenue options for schools. First, they could erode support for state funding in high-wealth districts and thereby undermine state equalization goals. A cap on district supplementation would alleviate this problem.[3] A related concern is that local supplementation efforts would reflect differences in district wealth rather than differences in preferences or needs; if so, these efforts would contravene the equity requirements established in California by *Serrano v. Priest.* The state could address this concern by guaranteeing an effective tax base for supplementary revenue. With these restrictions, local revenue options may benefit California's school finance system.

The experiences of other states can shed light on California's local revenue options and their prospects. This essay describes these options, which vary widely. It begins with a general overview of local funding and then examines local income and sales taxes, user fees, and other taxes. It draws information from a variety of sources, including academic papers, books, and compilations from The Nelson A. Rockefeller Institute of Government, the National Institute of Education Statistics, and the Advisory Commission on Intergovernmental Relations. It also

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[3]See Loeb (forthcoming) for a more detailed discussion of capped supplementation.

relies on state web pages and conversations with officials in state departments of education.

Overview

School finance is largely a state and local responsibility.[4] In 1997, state governments provided an average of $3,210 per pupil, whereas local sources provided $3,037 per pupil. About 86 percent of this local revenue came from taxes, of which almost 90 percent was raised through the property tax. In at least five states (Arizona, Connecticut, Delaware, New Hampshire, and Wisconsin), property taxes were the sole source of local district tax revenues.[5] As Table 7.1 shows, only nine states received less than 85 percent of local tax revenues from sources other than the property tax. These states were Alabama (58 percent), Alaska (none), Kentucky (75 percent), Louisiana (40.5 percent), Maryland (52 percent), Nevada (43 percent), Pennsylvania (78 percent), Tennessee (54 percent) and Virginia (none). Only eight other states received less than 95 percent of local tax revenues from the property tax.

Not all school districts have taxing authority. Independent districts raise their own tax revenues, whereas dependent districts rely on county or city governments to generate school revenue. Table 7.1 divides tax revenues into those that are raised by the school district and those that are raised by other local jurisdictions and then used for schools. In Arizona, school districts levy all school taxes, and local governments in Connecticut levy all local taxes. In a number of states, such as New York, local funds for schools come from school districts as well as other local jurisdictions. Although California districts can levy parcel taxes, the state controls most operating expenditures through the allocation of property tax and other revenues.

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[4] 1997 National Public Education Financial Survey.

[5] American Education Finance Association and Center for the Study of the States (1995) reports that Arkansas, Idaho, Illinois, Michigan, Mississippi, New Jersey, Texas, Vermont, and Washington obtained 100 percent of local tax revenues from the property tax and Kansas and Massachusetts obtained slightly less than 100 percent from the property tax. These states derive almost all local tax revenues from the property tax. Hawaii has a single statewide school district.

Table 7.1

Taxes from National Public Education Financial Survey

State	% of Tax from Property Tax	% of Tax Raised by Independent School Districts	State	% of Tax from Property Tax	% of Tax Raised by Independent School Districts
Alaska	0.0	0.0	Nebraska	98.6	100.0
Virginia	0.0	0.0	Mississippi	98.9	99.4
Louisiana	40.5	100.0	California	99.0	100.0
Nevada	42.7	100.0	North Dakota	99.1	99.8
Maryland	52.0	0.0	Michigan	99.2	100.0
Tennessee	53.9	0.0	Idaho	99.4	100.0
Alabama	57.7	0.0	Vermont	99.6	100.0
Kentucky	74.9	99.0	Oklahoma	99.6	99.6
Pennsylvania	78.3	100.0	Oregon	99.6	99.7
Missouri	85.7	100.0	West Virginia	99.7	99.7
Indiana	88.1	100.0	Washington	99.8	98.8
South Carolina	88.5	64.8	New Jersey	100.0	100.0
Utah	88.9	100.0	Arizona	100.0	100.0
Colorado	89.5	100.0	Connecticut	100.0	0.0
Montana	89.7	100.0	Delaware	100.0	100.0
Illinois	94.0	94.0	Florida	100.0	100.0
North Carolina	94.5	0.0	Hawaii	100.0	0.0
South Dakota	96.0	96.0	Kansas	100.0	100.0
Arkansas	96.3	100.0	Maine	100.0	100.0
Iowa	97.3	100.0	Massachusetts	100.0	0.0
Georgia	97.8	97.9	Minnesota	100.0	100.0
Ohio	97.8	100.0	New Hampshire	100.0	80.1
Wyoming	97.9	100.0	New Mexico	100.0	100.0
New York	98.5	68.7	Rhode Island	100.0	0.0
Texas	98.5	99.9	Wisconsin	100.0	99.4

States with Local Income Taxes

Many states allow local jurisdictions to levy local income taxes. These states are listed in Table 7.5 at the end of this essay. However, only four—Iowa, Kentucky, Ohio, and Pennsylvania—currently allow school districts to levy a local income tax. School districts in Maryland draw a substantial share of local revenues from income taxes at the county and (in the case of Baltimore) city level.[6] The details of these taxes are presented below.[7]

Iowa

The property tax is Iowa's primary source of local revenue for school districts. In 1993–1994, a uniform levy of $0.54 per $100 of assessed valuation was required of all districts. The amount raised from the uniform levy is subtracted from the state-supported foundation level. Districts then use additional property tax revenue to supplement this state foundation level up to the "district cost per pupil," which is determined by historical per pupil spending in the district plus a per pupil growth amount.

A district may increase its spending authority by up to 10 percent of its regular program guaranteed budget. In 1993–1994, 203 out of 397 districts used this optional funding. Districts participate in the program through either a board action or referendum. The board may approve the implementation without voter approval for up to five years. Revenues for this second tier of funding come from increased property taxes or from a local income tax. In 1993–1994, school districts raised $979 million through the property tax, $17 million through the income tax, and $32 million through nontax revenue sources.

The local income tax is a surtax on the state income tax and thus applies to all personal income.[8] Surtaxes may be used with other sources for funding five areas:

- Instructional support programs,
- Physical plant and equipment levies,

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[6]In Indiana, a county-adjusted gross income tax or a county option income tax is available to replace property tax receipts or reimburse for receipts lost as a result of homestead exemptions to the property tax. Neither provides significant additional money to schools.

[7]Unless otherwise noted, information on state finance systems comes from the American Education Finance Association and Center for the Study of the States (1995).

[8]A surtax on the state income tax is computed as a percentage of an individual's state tax liability.

- Asbestos removal,
- Educational improvement levy, and
- Enrichment levies.

In the first four areas, the local board determines the mix of income surtaxes and property taxes. The total income surtax rate for all levies cannot exceed 20 percent.[9] Income surtaxes are collected by the Iowa Department of Revenue and Finance and are held in a special account.

Kentucky

Kentucky's finance system derives from the Kentucky Education Reform Act of 1990. Each district is required to contribute a minimum local tax effort based on assessed property valuation in the district ($0.30 for every $100 of assessed property valuation). This is an equivalent tax rate, and school districts can raise the required revenue through any combination of the property tax (real estate and tangible), motor vehicle tax, occupational tax, utility tax, and the excise tax on individual income. There is a two-tiered supplementation system above this base. First, districts are allowed to generate additional revenue up to 15 percent of the adjusted base guarantee. This tax is levied by the local school board, is not subject to a recall by voters, and is equalized in those school districts with per pupil property assessments of less than 150 percent of the statewide average. School districts may choose to generate the entire 15 percent or any portion thereof. As of 1993–1994, all but one of the state's 176 school districts participated. School districts can generate additional revenues up to 30 percent of the adjusted base plus the tier 1 funds. These funds are not equalized by the state and are subject to recall by the voters.

Two of Kentucky's local taxes are income-based. The occupational license tax applies to the salaries or wages of those who work in the county and on the net profits of all businesses, professions, or occupations in the county. Exemptions are provided for public service

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[9]The enrichment levy has been sunset, and only three districts were using the levy as of 1993–1994. The income surtax rate for the enrichment levy was determined in relation to the taxable valuation of the district. The proportionate mix was a property tax of $0.27 per $1,000 taxable valuation for each 5 percent of income surtax.

companies that pay an ad valorem tax, insurance companies, banks, trust companies, savings and loan associations, and income received by members of the Kentucky National Guard for training. The occupational tax rate cannot exceed 0.5 percent and must be a single uniform rate. Any county with 300,000 or more residents can levy a rate up to 0.75 percent. Only eight out of the 176 school districts levy an occupational tax (six at 0.5 percent and two at 0.75 percent). Although it has been available since 1966, no district chose this tax before 1994.[10]

The second type of local income tax in Kentucky is the excise tax on residents. As in Iowa, school districts in Kentucky may levy this tax up to 20 percent of state income tax liability. Districts may hire someone to collect the excise tax or can request that the Revenue Cabinet act as a tax collector. If the Revenue Cabinet is requested to be the tax collector, the school district must reimburse the cabinet for the actual cost of collection. No school district in Kentucky has ever levied an excise tax.

Ohio

Ohio has 611 school districts that are essentially fiscally independent, although county budget commissions review proposed school district budgets, establish estimated revenues and expenditures, and set property tax millage. The state mandates the equivalent of a 20-mill property tax levy, which, as in Kentucky, can be raised either through property or income taxes. In 1993–1994, property taxes generated $4.57 billion, income taxes generated $75 million, and local nontax sources generated almost $1.56 billion.

In 1981, the Ohio General Assembly granted school districts the authority to levy an income tax. Certain provisions of the law were repealed in 1983 to prevent additional districts from exercising that authority; however, districts that enacted the tax before August 3, 1983, could continue to levy it. Before the repeal went into effect, voters had approved the tax in six school districts. In 1986, one of these districts chose to remove the tax because of concern from business and municipal governments. Businesses argued that withholding the school district

[10]This information is drawn from the Kentucky Department of Education web page and discussions with department employees.

income tax was burdensome because it required keeping track of the school district in which each employee resided. From the municipality's standpoint, the tax competed with its major funding source.[11]

Although businesses and municipalities did not like the school district income tax, farmers liked it because they often bear a large share of the property tax burden in rural districts. Also, income taxes (unlike property taxes) fall with farm profits. In 1989, the legislature reauthorized the use of the local income tax for school districts, and as of December 1999, 123 school districts had levied it. Rates range from 0.5 to 2 percent, with most being at or below 1 percent. The levies occur primarily in districts in the west-central part of the state, a pattern that reinforces the notion that farming communities prefer the income tax.

The school district income tax in Ohio, unlike that levied by municipalities, is levied on residents only. The tax is based on adjusted gross income as reported for state income tax purposes, less a $650 personal exemption. It is collected in the same way as the state income tax: through employer withholding, individual quarterly estimated payments, and annual returns. The state retains 1.5 percent of collections to cover administrative expenses.

Pennsylvania

Revenues from local sources provided 57 percent of the funding for Pennsylvania's public schools in the 1997–1998 fiscal year. The real estate tax (including the public utility realty tax) was the primary local source of funding for public schools, with almost $6 billion collected in that year. This amount represented 80 percent of the total local taxes collected and 43 percent of the total general fund revenue.

The Local Tax Enabling Act of 1965, known as Act 511, allowed public school districts (except those in Pittsburgh and Philadelphia) to levy certain local taxes.[12] Currently, only one district does not levy any

[11] For details, see www.state.oh.us/tax/stats/SDITQA.PDF.

[12] The Philadelphia City School District levies similar taxes as a result of Public Law 45 of 1932, known as the Sterling Act, and Pittsburgh School District has had similar special taxing power since 1947. Special taxes for Philadelphia and Pittsburgh accounted for 2.4 percent of local tax revenues, and Act 511 taxes accounted for 12 percent of tax revenues in 1997–1998.

of these. Act 511 taxes include an earned income tax, a per capita tax, a real estate transfer tax, an occupation tax, an amusement tax, business privilege flat and millage taxes, mechanical devices flat and percentage taxes, mercantile taxes, and other flat rate and proportional taxes. The earned income tax raised $574 million in 1997–1998, accounting for 63.5 percent of Act 511 taxes. This percentage has remained fairly constant for at least a decade.

Pennsylvania has 501 school districts, of which 451 chose to levy an earned income tax in 1993–1994. This tax is levied on the wages, salaries, commissions, net profits, or other compensation of persons subject to the jurisdiction of the taxing body. The tax is limited to 1 percent. Where both school district and municipality levy the tax, the 1 percent limit must be shared 50-50 unless otherwise agreed to by the taxing bodies. There is no limit on the earned income tax rate for the Philadelphia School District. The limit for the Pittsburgh School District is 2 percent. The Pennsylvania Department of Community Affairs prepares a "Register of Earned Income Taxes" that lists the school districts and municipalities levying the tax, the stated rate for the tax, taxes levied by coterminous jurisdictions, the effective tax rate, and the name and address of the tax officer responsible for collecting the earned income tax. Employers within the taxing jurisdiction are required to register with that officer. They must also deduct the earned income tax from their employees whenever an ordinance or resolution of a taxing jurisdiction is listed in the register.

Maryland

Maryland's 24 school districts are fiscally dependent. Twenty-three are dependent on county governments, and Baltimore's school district is fiscally dependent on its city government. Counties need not designate whether local income tax revenues are used for school or other purposes. Statewide, schools receive slightly less than 50 percent of all local appropriations, with most counties using more than 40 percent of local funds for schools. Baltimore schools received less than 25 percent of locally raised revenues in 1993–1994.

Local tax revenues for schools come primarily from property and income taxes. The local income tax is a surtax on the state income tax first permitted in 1958. In 1993–1994, property taxes contributed 47 percent of locally raised revenues; the income tax, 26 percent; other taxes, 10 percent; and service charges, 17 percent. Jurisdictions can levy an income tax surtax of 20 to 60 percent on the amount of the Maryland state income tax liability. The money is collected by the state on the state income tax returns. In 1993–1994, four counties levied the maximum of 60 percent, one levied 55 percent, and one levied 30 percent. The remaining counties chose a rate of 50 percent.

Table 7.2 summarizes the use of the local income tax to fund public schools in other states.

Table 7.2

Summary of Local Income Taxes

State	Level	% of Revenues (approx.)	Additional Comments
Iowa	District	<1	Surtax on state income tax
Kentucky	District	<1	Surtax and occupational license tax
Maryland	County or city	17.8	Surtax. Cannot distinguish school district revenues from general local revenues
Ohio	District	<1	Surtax on state income tax
Pennsylvania	District	4	Earned income tax on individuals who work in the district

The Local Income Tax Considered

The local income tax is not widely used to fund schools in the United States. Even in the five states that use this tax, the property tax is the primary source of locally raised revenues. In 1993–1994, Ohio raised $75 million and Iowa raised $17 million through local income taxes; in both cases, this revenue represented less than 1 percent of total school revenues. In 1997–1998, the local earned income tax in Pennsylvania raised $574 million, or approximately 4 percent of general fund revenues. Maryland counties and cities raise more than 17 percent of local revenues with the income tax. (Maryland does not distinguish school revenue from other local revenues.)

In Iowa, Ohio, and Maryland, the tax is a surcharge on state income tax. The taxes therefore cover all income, not just earned income. In contrast, the occupation license tax in Kentucky and the income tax in Pennsylvania are levied only on wages and salaries. Surcharge taxes are likely to be more progressive than earnings taxes for two reasons. First, they are based on state income tax schedules that are usually graduated. Second, higher-income taxpayers on average have a greater proportion of unearned income, which is not taxed under the Pennsylvania tax or the Kentucky occupation license tax.

Local income taxes are levied on different tax bases. Surcharge taxes apply to residents, whereas earned income taxes apply to businesses and workers in the district. These taxes also differ in their means of collection. Income taxes are difficult to collect because of evasion and the sheer number of taxpayers (Monk and Brent, 1997). However, the administrative cost is minimized if local income tax collection can "piggyback" on state tax collection. This piggybacking is easier with income surtaxes than with earned income taxes, which require compliance from local employers.

Because the revenue stream from the income tax rises and falls with the business cycle, it is not as stable a source of revenue as the property tax. This instability is a drawback for schools. State governments can provide insurance against this fluctuation to the extent that they can shift revenues across districts to avoid shortfalls. However, many state governments also depend on income tax revenues and are therefore vulnerable to economic downturns as well. California's experience in the 1990s provides an example of this. At the same time, the revenue stream from the income tax may be more stable than that from sales taxes, especially those that exempt staples such as food.

Finally, it is worth noting public opinion of the local income tax. In Ohio, farmers favor the income tax. The lack of income taxes in Kentucky, even though school districts are authorized to use them, suggests that they may not be as popular as the property tax in many districts. At the state level, too, there is evidence that voters prefer the sales tax to the income tax. For example, Michigan voters approved Proposal A in 1994, thereby increasing the sales tax instead of the income tax for school funding.

A Local Income Tax in California

A local income tax could take a variety of forms in California. Kirst (1994), for example, proposed an optional local surcharge on state income taxes. This surcharge would be equalized so that the same tax effort would raise the same supplemental funds per pupil in each district. The proposal would require support from a majority of school district voters.

In the aftermath of Proposition 13, only a constitutional amendment can allow local districts to levy property taxes that would exceed the limit of 1 percent. However, a local income or sales tax requires no such constitutional change. Because California already has a state income tax, a local surcharge would be relatively easy to administer. State equalization of local revenue-raising capacity would enhance equity. A potential disadvantage of such an equalization program is that the state would need to predict and supply the funds needed for this equalization.

Local Sales Taxes

More than 30 states allow local jurisdictions to levy local sales taxes. (The states are listed in Table 7.6 at the end of this essay.) In a number of these states, including Alabama, Alaska, Nevada, New York, North Carolina, Tennessee, and Virginia, local sales tax revenues are used for schools.[13] In Tennessee, this tax raises almost 15 percent of local revenues. However, independent school districts have this taxing authority only in Louisiana and, to a limited extent, Georgia. The tax structures in each of these states are summarized below.

Louisiana

Louisiana has 64 parish school systems and two city school systems (Monroe and Bogalusa). All are independent and have the authority to tax and incur debt. School boards are constitutionally given the

[13]In Florida, the 67 fiscally independent school districts levy only property taxes. However, a few school districts also receive local county sales tax revenue, which accounts for a very small proportion of locally raised revenues. In Montana, schools obtain revenue from a local sales tax on public power districts.

authority to levy a 5-mill tax, except for Orleans, which is given a 13-mill authority. This tax does not require a vote of local taxpayers.

Any school district authorized by a majority of voters can levy a proportional property tax for a specific purpose. The legislature has set a maximum millage of 70 mills, not applying to millages for debt service. All residential property is assessed at 10 percent of fair market value. For the 1998–1999 year, the constitutional millage ranged from 2.91 to 6.44, except for Caddo at 9.41 and Orleans at 27.65. The equivalent millage ranged from zero to 56.73 mills. In total, ad valorem nondebt taxes raised almost $478 million and ad valorem debt taxes raised almost $141 million (Louisiana Department of Education, 2000).

Louisiana alone uses the sales tax as its primary source of local tax revenue. The state sales tax rate is 4 percent, and other jurisdictions add their sales and use taxes to this figure. These other sales taxes are administered and collected locally and separately from the taxes collected by the department of revenue. All local government entities have a combined limit of 3 percent local sales tax unless the legislature approves an exemption. Sixty-five of the 66 school districts levy a local sales tax. In 1998–1999, 31 of the 66 school districts imposed a 2 percent sales tax, 12 imposed a 1.5 percent tax, 13 imposed a 1 percent tax and only two imposed the maximum of 3 percent. The average sales tax was 1.71 percent, yielding a total of $913 million in revenue.

Georgia

Georgia has 159 fiscally independent county districts and 21 fiscally dependent city districts. Districts are required to generate revenues equivalent to a 5-mill property tax on assessed property equalized at 40 percent of true market value. Although this revenue need not be raised through the property tax, the vast majority of local revenue is derived from that source. Each district levies more than the required 5 mills and raises more revenues than is required by the state.

Before 1997, the property tax was also the primary source of local revenue available to renovate, modify, and construct educational facilities. Local boards of education could either use maintenance and operation tax revenues to fund capital improvements or, with voter approval, issue general obligation bonds to be repaid from property tax revenues. In 1996, voters approved a constitutional amendment to allow school boards to call for a referendum on a local option sales tax of 1 percent on all purchases, to be administered at the county level. The revenues are limited to five years and can be used for specific capital improvements, to retire bond debt for previous capital projects, or to issue new bonds for specific capital projects. As of March 1999, 125 counties had sales tax votes, with 20 of the 21 independent city school systems included in those votes. The referenda failed in only 12 counties. Of these, six had second sales tax votes and five of those were successful.

Alabama

Because Alabama's 127 local education agencies have no taxing authority, they are dependent on cities and counties for local revenue. The state funding formula requires the equivalent of 10 mills raised locally. The ad valorem property tax traditionally has provided the most local funds, about $293 million in fiscal year 1993–1994. The sales tax was second with $181 million. In this same year, city and county commission appropriations accounted for $39 million, alcohol and tobacco taxes for $14 million, other sources for $99 million, and payments on behalf of local schools, $35 million.

The state sales and use tax rates are 1.5 percent for manufacturing machinery and farm machinery, 2 percent for automotive vehicles, 3 percent for food and food products sold through vending machines, and 4 percent for all other tangible personal property. The general local sales tax rate ranges up to 4 percent. Some local lodging taxes reach 8 percent. Certain organizations and drugs as well as food stamp purchases are exempt from the sales tax. The state administers approximately 300 local sales and use taxes, but some additional local sales and use taxes are administered locally.

Nevada

Nevada has 17 fiscally independent schools districts that are coterminous with its counties. In 1979, the legislature approved a property tax relief package that reduced the total levy for school districts from $1.50 ($0.70 mandatory and $0.80 optional) to $0.50 per $100 of assessed valuation. Two years later, the legislature increased the local school support tax from 1 percent to 1.5 percent of taxable sales. To make up for the revenue shortfall caused by lower-than-predicted sales tax revenues, the 1983 legislature increased the mandatory property tax rate to $0.75 per $100 of assessed valuation. In 1991, the legislature raised the mandatory local school support tax from 1.5 percent to 2.25 percent. Thus, the 2.25 percent sales tax and the $0.75 property tax are mandatory local taxes. Districts can raise additional revenue by levying an optional $0.50 per $100 assessed value tax on real property, a motor vehicle privilege tax, or both. Nevada school districts cannot use the sales tax to raise additional funds.

New York

New York has almost 700 school districts. Except for those in the state's five largest cities, all are fiscally independent. The property tax accounts for 98.5 percent of local school tax revenues. The state's sales tax laws reserve 4 percent for the state and permit counties to levy an additional 3 percent (or, by specific authorization in about 20 counties, 4 percent). Some areas collect an additional 0.25 percent for dedicated purposes. Although eight counties allocate local sales tax revenues to school districts, these allocations account for a minor portion of district revenues.

North Carolina

North Carolina has 117 school districts, one per county plus 17 city districts. Of these, 115 are dependent. Two city districts may levy a local property tax without approval from the county or city government. The primary source of local revenue is the property tax, whose rates vary substantially across localities. The average tax rate in 1998–1999 was 71.1 cents per $100 of assessed value in rural areas and $1.17 per $100 assessed value in other areas.

Currently, all counties may levy a sales and use tax of up to 2 percent on food purchased for home consumption (which is exempt from the state sales tax) and on transactions subject to the state's general rate of 4 percent. Most services are exempt, but the sales tax is added to the rental of hotel and motel rooms, dry cleaning and laundry services, and telecommunications services. The state administers the sales tax and distributes its proceeds to the counties.

Local sales tax revenues can be used for school or other expenditures. All counties now levy the maximum 2 percent rate. Mecklenburg County levies an additional sales and use tax of 0.5 percent specifically for public transportation. In 1998–1999, local governments raised $46 million for capital expenditures and $5 million for current expenditures with the sales tax and an additional $8 million for capital expenditures with restricted sales taxes. Compared to the property tax, however, this contribution is small. Local property tax revenues from the county contributed $1.3 billion toward current expenditures and $146 million toward capital expenditures.

Tennessee

Tennessee has 139 fiscally dependent school districts. Statewide in 1993–1994, $515 million (28 percent) of local revenue for education came from local option sales taxes and $647 (36.5 percent) came from property taxes. The maximum local option sales tax rate is 2.75 percent, which is added to the state rate of 6 percent. At least half of this additional revenue must go to education. Revenue collected at the county level for educational purposes must be distributed on the basis of weighted full-time equivalent average daily attendance to each school district within the county. City and special school districts may elect to raise taxes in their districts without sharing the proceeds with other districts in the county.

Table 7.3 summarizes the use of the sales tax to fund public schools in other states.

The Local Sales Taxes Considered

Like the local income tax, local sales taxes can provide substantial funds to schools. In Louisiana, they contribute most of the locally raised revenue, and in Tennessee, they provide 28 percent of it, almost as much as the property tax. In addition, sales tax revenues are not difficult to collect (Rosen, 1999), especially when they piggyback on a state sales tax. However, when considering the use of a local sales tax, three questions are paramount. First, who bears the burden of the tax? Second, how

Table 7.3

Summary of Local Sales Taxes

State	Level	% of Revenues (approx.)	Additional comments
Alabama	County and city	6.9	
Alaska	General municipal entity	4	
Georgia	County	<1	
Louisiana	District	18.9	Districts are coterminous with counties
Nevada	District/counties	<1	Tax is mandatory, districts have no discretion
New York	County	<1	Only 8 counties distribute a portion of sales tax revenues to schools
North Carolina	County	7.3	Cannot distinguish school district revenues from general local revenues
Tennessee	County	14.6	
Virginia	County	3	Cannot distinguish school district revenues from general local revenues

does the tax affect consumer behavior? And third, how stable is the revenue stream?

General sales taxes can be regressive; compared to their high-income counterparts, low-income taxpayers often pay a higher proportion of their income in sales tax. This is because wealthier taxpayers save a greater proportion of their incomes and spend proportionately more on housing, on services, and in other areas not covered by the sales tax (Monk, 1995). However, many states mitigate the regressive nature of the sales tax by exempting food and drugs.[14] Sales taxes on luxury goods can be quite progressive.

Most taxes distort consumer or taxpayer behavior to some extent. In the case of the local sales tax, this distortion may be significant. If two neighboring jurisdictions have different sales tax rates, residents of both districts may choose to shop in the district with the lower rate. Retail

[14]Of the 45 states with retail sales taxes, 28 exempt groceries and ten exempt prescription drugs (Bruce, 1998).

businesses will then have incentives to locate in the low-tax district, even if all other aspects of the two jurisdictions are similar. Evidence of this type of sorting is clear across states with differing tax rates. Residents of the New York City area shop in New Jersey. Those living near the border of Tennessee shop in neighboring states with a lower sales tax rate. Large differences in sales tax rate across local jurisdictions are likely to have a similar and perhaps more pronounced effect. A similar rate across local jurisdictions, as in Tennessee, alleviates this problem.

Finally, sales tax revenues are sensitive to economic fluctuations and are therefore more difficult to predict than property tax revenues. In East Baton Rouge Parish, for example, sales tax collections fell by a third in 2000 after several years of 6 to 7 percent increases. Even if sales tax collections gained 1 percent a year, the school system would be $6 million short of projections at the end of the fifth year. As noted above, in Nevada revenue shortfalls from the sales tax resulted in increases in local property taxes in the early 1980s.

Another source of instability is the increasing use of the Internet for shopping. According to the Department of Commerce, the nation lost an estimated $742 million in sales tax revenue in 1998 as a result of Internet sales.[15]

A Local Sales Tax in California

In 1996, the California Constitution Revision Commission recommended two ways for localities to raise additional school revenues: a local property tax, which would require two-thirds voter approval, and a county sales tax of up to 0.5 percent, which would require a simple majority. The commission did not recommend a district-level sales tax. With 987 school districts in California, such a local sales tax would be impractical. Differing tax rates within such small areas would be confusing and might lead to substantial market distortions. A county-level sales tax is more practical but does not create as direct a link between finance and governance as a more localized school tax. In addition, there is generally a tradeoff between equity and stability with a

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[15]See Newman (1995) for discussion.

sales tax. Exemptions for food and drugs make the sales tax more progressive but less stable.

Other Local Taxes and User Fees

Other Taxes

A multitude of additional local taxes provides revenues to school districts. These include parcel taxes, utility gross receipt license taxes, severance taxes, death and gift taxes, amusement taxes, business privilege taxes, mechanical device taxes, and mercantile taxes. Of these, California's school districts may levy only the parcel tax (see Chapter 9). In 1998–1999, 48 of California's 987 districts levied a parcel tax, yielding less than 10 percent of school revenues in those districts and 0.2 percent of all school revenue in the state.

User Fees and Other Nontax Revenue

Most locally raised revenues come from taxes, although the reliance on user or service fees and other nontax revenues has increased over time. In 1950, 11.4 percent of the revenue of all local jurisdictions came from nontax sources. By 1990, this proportion had climbed to approximately 23 percent. School districts are less dependent on user fees than other local jurisdictions. In 1991–1992, school districts collected through fees only approximately 4 percent, or $5.8 billion, of the $137 billion collected locally (Wassmer and Fisher, forthcoming).

Using 1997 National Public Education Financial Survey data, Figure 7.1 illustrates the relative proportion of nontax revenue streams from tuition, transportation fees, earnings on investments, food service fees, student activity fees, textbook revenues, and summer school fees. Food service fees (37.6 percent), student activity fees (19.8 percent), and earnings on investments (36.4 percent) are the largest contributors. Table 7.4 reports these proportions by state. The percentage of locally raised school revenues coming from nontax sources ranges from 2.6 percent in Maine to 34.7 percent in Alabama (excluding Hawaii at 99.23 percent). North Carolina obtains more than 10 percent of locally raised revenues from food service fees; Oklahoma receives more than 11 percent

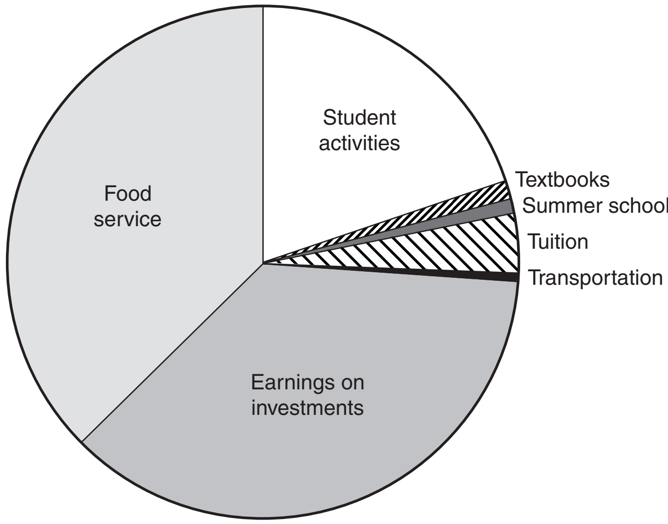

Figure 7.1—Local Nontax Revenues

from student activity fees; and New Mexico receives more than 11 percent from earnings on investments.

Four states (Illinois, Indiana, Iowa, and Kansas) raise substantially more than other states through textbook revenues. North Carolina receives no revenue from student activities, but 17 other states obtain more than $100 per pupil. In some cases, nontax revenues are relatively substantial supplements to other revenue streams. Nebraska collects over $200 per student in student activity fees, and Indiana collects $150 per student in lunch service fees and $52 per student in textbook charges. Earnings on investments provided $223 per pupil in Illinois and $186 per pupil in Nevada.

In 1989–1990, only half of the variation in fee uses could be attributed to differences across states; the other half was due to differences among districts in the same state. In Michigan, for example, the percentage of own-source funding from fees averaged 3.3 percent but ranged from zero to 19.3 percent across districts (Wassmer and Fisher, forthcoming).

Table 7.4

Local Revenue per Pupil from Various Sources, Selected States, 1997

State	Taxes	Tuition	Transportation Fees	Earnings on Investments	Food Service	Student Activities	Textbook Revenues	Summer Schools	Other Revenues
Arizona	1893.48	0.56	0.06	83.43	87.88	38.70	0.00	0.15	198.71
California	**1573.34**	**0.00**	**1.29**	**104.94**	**64.80**	**0.00**	**0.00**	**0.00**	**186.64**
Florida	2267.90	0.30	0.78	111.15	96.72	138.23	0.60	0.00	92.02
Illinois	3935.11	5.80	3.88	223.24	89.14	22.13	26.75	9.24	131.92
Michigan	1745.30	23.78	2.10	165.63	98.08	32.30	0.00	3.63	144.37
New Jersey	5475.83	28.84	0.58	72.72	144.40	39.60	0.77	0.40	59.56
New York	4736.72	8.84	0.00	85.66	74.43	2.60	0.06	1.24	206.93
North Carolina	1187.60	2.36	0.00	22.50	149.38	0.00	0.00	2.27	112.04
Ohio	3130.92	25.09	2.10	107.12	130.27	102.08	7.60	7.27	108.29
Oregon	2002.11	3.81	0.25	159.45	87.01	149.64	0.17	0.88	165.52
Pennsylvania	4027.12	15.82	0.14	117.85	127.63	3.48	0.00	1.75	124.77
Texas	2616.37	14.68	0.00	138.99	102.63	30.23	0.00	0.00	111.47
Washington	1423.76	27.17	2.49	104.10	80.83	91.72	5.53	2.81	105.89

SOURCE: National Public Education Financial Survey Data.

User Fees Considered

Insofar as public education benefits the public at large as well as individual students, user fees are not an adequate means for fully funding schools. At the same time, school districts may be able to collect more user fees than they currently do. Wassmer and Fisher (forthcoming) argue that up to 13 percent of all public school expenditures could be funded through user fees for meals, transportation, child care, extracurricular activities and clubs, drivers education, adult education, and access to various capital goods.

User Fees in California

Although California's school districts may lease or sell property and receive voluntary contributions, user fees were ruled unconstitutional in *Hartzell v. Connell* in 1984. Specifically, the ruling does not permit user fees that are closely linked to classes. For example, schools cannot charge a student to participate in a dramatic production that is associated with a drama course.[16] Other user fees may be constitutional, but these nontax sources are unlikely to provide substantial supplementary revenues for California schools.

Conclusion

Although the state government in California plays an important role in equalizing resources across districts, local revenue options could benefit many districts by addressing local needs and preferences. By capping this sort of revenue supplementation and guaranteeing an effective tax base for these additional dollars, California may be able to strike a balance between state and local control over revenue decisions.

The property tax is the primary source of local revenues for public schools in the United States. However, California's local jurisdictions do not have the constitutional authority to levy property taxes to supplement school revenues. Are there alternatives? Clearly there are. Many school districts in Ohio and Maryland rely heavily on the income tax. Districts in Louisiana and Tennessee rely heavily on the sales tax.

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[16]See Henke (1986) for more details.

Finally, many states use other taxes and user fees to supplement school revenues.

When assessing local revenue options, several factors must be considered, including constitutionality, ease of collection and administration, equity, stability, public opinion, and the extent to which they cause behavioral changes. Income taxes, sales taxes, and user fees all have advantages and disadvantages. The sales tax can provide substantial revenue, and it tends to be more popular with voters than either the income tax or the property tax. However, it has other disadvantages. First, it is likely to cause unwanted consumer responses; for example, residents of high-tax districts are likely to shop in other districts or on the Internet, and retail businesses may move to low-tax areas. These responses are particularly problematic with a district-level sales tax. A county-level sales tax may mitigate this difficulty, but it often breaks the link between school finance and governance. Second, sales tax revenues are not as stable as income or property tax revenues. Finally, the sales tax is usually regressive, although exemptions for food and certain drugs reduce the regressivity of this tax. These exemptions also reduce the stability of its revenue stream, however, as purchases of nonexempt goods tend to fluctuate with the economy more than purchases of exempt goods. A sales tax that includes services would also be less regressive.

The income tax is a feasible alternative to the property tax. A surcharge on the state income tax is relatively easy to administer and can incorporate graduated state tax rates. It is also more stable than the sales tax and less likely to distort behavior. However, the income tax is not necessarily preferable to the property tax, which is even less vulnerable to economic downturns. The property tax is especially appealing in urban areas insofar as it permits cities with rich commercial and industrial tax bases but low-income residents to fund local schools. Although limitations on the property tax in many states seem to signal its relative unpopularity, they also may reflect feelings of powerlessness regarding the other taxes (Rosen, 1999). The reliance on the property tax in Kentucky, where districts have the authority to levy income taxes, is consistent with this hypothesis.

Local revenue options may benefit California's schools by linking governance to finance and allowing districts to meet local needs and preferences. At the same time, such local control is likely to affect equity. This effect may be beneficial. High-cost districts may increase their revenues more than low-cost districts, creating a more equitable distribution of resources across districts. However, the alternative is possible as well. Revenue increases may simply reflect the ability of residents to pay for schooling, thereby increasing the current disparities in school resources across districts. If so, the school finance system is unlikely to comply with the *Serrano* requirements. The ultimate effect of school finance reform in California will depend on the details of the reforms themselves: which taxes are authorized, how the revenues are equalized across districts, and what caps are placed on local supplementation.

Table 7.5

Local Income Taxes: Number and Type of Jurisdiction, Selected Years, 1976–1994

State	Jurisdiction	1976	1979	1981	1984	1985	1986	1987	1988	1989	1990	1991	1992	1994
Alabama	Cities	6	5	5	8	10	10	10	10	11	11	11	11	18
Arkansas	No cities chose to levy income taxes													
Delaware—Wilmington	Cities	1	1	1	1	1	1	1	1	1	1	1	1	1
Georgia	No cities chose to levy income taxes													
Indiana	Counties	38	37	38	43	44	45	51	68	79	79	76	80	80
Iowa	School districts	3	21	26	57	57	61	57	60	52	59	144	179	379
Kentucky	Cities	59	59	59	61	67	78	85	81	84	83	87	86	94
	Counties	n/a	8	8	9	11	14	25	27	26	27	27	29	39
	School districts													7
Maryland	Counties	24	24	24	24	24	24	24	24	24	24	24	24	24
Michigan	Cities	16	16	16	16	16	17	17	18	19	19	20	20	20
Missouri—Kansas City and St. Louis	Cities	2	2	2	2	2	2	2	2	2	2	2	2	2
New York—New York City and Yonkers	Cities	1	1	1	2	2	2	2	2	2	2	2	2	2
Ohio	Cities	385	417	n.a.	460	467	480	482	481	492	506	512	512	523
	School districts	0	0	n.a.	6	6	6	6	5	5	22	52	76	92
Pennsylvania	Cities, boroughs	2553	2585	n.a.	2644	2758	2777	2782	2788	2795	2809	2824	2830	2830
	Towns, townships, school districts[a]													
Virginia	No cities or counties chose to levy income taxes													

SOURCE: Advisory Commisson on Intergovernmental Relations staff compilations, Table 20.

NOTES: Employer payroll taxes are levied in California, New Jersey, and Oregon. n/a, not authorized; n.a., not available.

[a]Estimates.

Table 7.6

Local Sales Taxes: Number and Type of Jurisdiction, Selected Years, 1976–1994

State		1979	1981	1984	1986	1987	1988	1989	1990	1991	1993	1994
Alabama	Municipalities	270	281	310	323	326	334	343	344	345	355	359
	Counties	31	40	43	51	56	55	55	59	60	60	62
Alaska	Municipalities	86	85	92	91	87	95	95	95	95	95	93
	Boroughs	7	7	7	6	6	6	6	6	6	6	5
Arizona	Municipalities	39	59	70	74	75	79	81	82	81	83	86
	Counties	n/a	n/a	n/a	1	2	2	2	3	11	12	14
Arkansas	Municipalities	1	2	44	59	76	100	120	131	136	181	192
	Counties	n/a	n/a	16	19	35	42	55	54	56	63	69
California	Municipalities	380	380	380	380	380	380	380	380	380	380	380
	Counties	58	58	58	58	58	58	58	58	58	58	58
	Special districts	3	3	5	6	7	8	12	22	22	23	27
Colorado	Municipalities	144	159	175	191	193	200	200	198	198	200	201
	Counties	20	23	39	30	31	34	34	37	39	41	42
	Transit districts	1	1	1	1	1	1	1	1	1	1	1
	Special districts	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	6
Florida	Counties	n/a	n/a	n/a	0	0	10	10	21	25	38	44
	Transit districts							1	2	1	1	1
Georgia	Municipalities	3	0	0	0	0	0	0	0	0	0	0
	Counties	80	103	132	142	143	154	153	164	157	159	159
	Transit districts	1	1	1	1	1	1	1	1	1	1	1
Illinois	Municipalities	1,256	1,256	1,249	1,272	1,271	1,279	1,278	31	42	70	70
	Counties	102	102	102	102	102	102	68	0	8	1	8
	Transit districts	1	1	2	2	2	2	2	2	2	2	2
	Water district	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1	1	1	1
Iowa	Counties						5	9	12	15	19	27

Table 7.6 (continued)

State		1979	1981	1984	1986	1987	1988	1989	1990	1991	1993	1994
Kansas	Municipalities	15	35	87	108	108	112	116	119	124	135	142
	Counties	5	5	52	60	60	62	62	61	61	63	69
Louisiana	Municipalities	136	152	158	177	192	193	189	193	195	203	203
	parishes	21	30	30	63	63	63	64	63	63	63	63
	school districts	60	66	65	47	47	46	47	48	48	48	50
	Special districts	7	12	18	23	23	23	25	21	21	25	24
Minnesota	Municipalities	1	1	2	1	3	3	3	3	3	5	5
Missouri	Municipalities	214	662	406	458	474	479	490	508	563	573	580
	Counties	1		81	98	114	120	126	126	126	109	107
Nebraska	Municipalities	1	1	2	1	3	3	3	3	3	5	5
Nevada	Municipalities	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	Counties	12	1	1	5	7	7	7	7	7	17	9
New Mexico	Municipalities	93	76	98	101	100	101	101	102	101	103	106
	Counties	6	8	22	33	28	31	33	33	33	33	33
New York	Municipalities	25	29	29	27	26	28	30	25	27	27	22
	Counties	45	45	57	53	58	54	54	61	61	56	56
	Transit district	n/a	n/a	1	1	1	1	1	1	1	1	1
North Carolina	Counties	99	99	100	100	100	100	100	100	100	100	100
North Dakota	Municipalities	n/a	n/a	n/a	3	3	4	5	5	10	24	35
Ohio	Counties	50	52	62	74	79	83	85	83	86	86	88
	Transit districts	1	3	3	2	2	3	3	4	7	9	4
Oklahoma	Municipalities	398	398	441	452	457	458	468	470	470	476	481
	Counties	n/a	n/a	6	14	16	21	24	24	25	45	49
South Carolina	Counties	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	6	15	16
South Dakota	Municipalities	46	61	82	107	111	117	132	136	141	158	166
	Indian reserves	n/a	n/a	n/a	n/a	n/a	3	3	3	3	3	3

Table 7.6 (continued)

State		1979	1981	1984	1986	1987	1988	1989	1990	1991	1993	1994
Tennessee	Municipalities	12	11	8	10	10	11	11	9	8	8	9
	Counties	92	94	94	95	95	95	95	95	95	95	95
Texas	Municipalities	921	921	1117	1026	1023	1023	2521	1164	1176	1157	1193
	Counties	n/a	n/a	n/a	n/a	n/a	78	82	105	105	105	110
	Transit districts	25	28	3	6	6	6	7	7	7	7	8
	Special districts									3	7	7
Utah	Municipalities	201	n.a.	219	219	219	222	225	222	226	228	227
	Counties	29	29	29	29	29	29	29	29	29	29	29
	Transit districts						7	6	n.a.	n.a.	3	3
Virginia	Municipalities	41	41	41	41	41	41	41	41	41	41	41
	Counties	95	95	95	95	95	95	95	95	95	95	95
Washington	Municipalities	264	264	267	266	268	267	266	268	268	268	269
	Counties	38	38	39	39	39	40	39	39	39	39	39
Wisconsin	Counties	n/a	n/a	n/a	2	12	18	24	28	40	45	47
Wyoming	Counties	13	15	15	14	15	16	19	19	23	20	23

SOURCE: Advisory Commission on Intergovernmental Relations staff compilations, Table 27.

NOTES: California: Los Angeles and San Francisco impose a special gross receipts tax. Florida: Counties may impose a tourist development or effect tax on rentals or leases of living quarters for a term of six months or less. Georgia: Local school tax—specified counties are authorized to impose a local sales and use tax for education. n/a, not authorized; n.a., not available.