

- SUBJECT:** Appropriating state funds to school districts for property tax reductions
- COMMITTEE:** Appropriations — favorable, without amendment
- VOTE:** 18 ayes — Chisum, Branch, B. Brown, F. Brown, Crownover, Darby, J. Davis, Gattis, Harper-Brown, Hopson, Isett, Jackson, Kolkhorst, Otto, Riddle, Taylor, Van Arsdale, Zerwas
- 0 nays
- 1 absent — England
- 10 present, not voting — Guillen, Allen, Chavez, Dukes, Lucio, McClendon, McReynolds, Menendez, Noriega, Turner
- WITNESSES:** For — None
- Against — Dick Lavine, Center for Public Policy Priorities
- BACKGROUND:** In its third called session in 2006, the 79th Legislature enacted HB 1 by Chisum, which mandated a one-third reduction in school district maintenance and operations (M&O) taxes by tax year 2007. Districts were required to calculate their reduced M&O tax rates according to a "state compression percentage" of 88.67 percent of their 2005 tax rate in fiscal 2007 and 66.67 percent of the 2005 tax rate in fiscal 2008. Beginning in fiscal 2009, the Texas Education Agency (TEA) will determine the state compression percentage. For districts taxing at the maximum of \$1.50 per \$100 of valuation, the base tax rate dropped by 11.3 percent, to \$1.33 in the 2006 tax year, and by one-third, to \$1.00 in the 2007 tax year.
- The Legislature also enacted a revised business franchise tax (HB 3 by J. Keffer), a motor vehicle standard presumptive value for sales tax purposes (HB 4 by Swinford), and an increase in the tax rate for cigarettes and other tobacco products (HB 5 by Hamric). All of the additional revenue generated by these new or revised taxes was dedicated to reducing school property tax rates (HB 2 by Pitts) and placed in a property tax relief fund.
- The Legislative Budget Board (LBB) estimated that these new taxes alone would not generate enough revenue to cover the full cost of reducing

school property taxes mandated by HB 1 and that an additional spending commitment would be needed to make up the difference.

Texas Constitution, Art. 8, sec. 22 caps spending of state tax revenue not dedicated by the Constitution to a particular purpose. The growth of spending from undedicated tax revenue may not exceed LBB's official estimate of the growth rate of the state's economy. A majority vote of the members of each house may override this spending limit by adopting a resolution finding that an emergency exists and identifying the nature of the emergency. On January 11, 2007, the LBB approved an estimated growth rate of 13.1 percent, which added to total non-dedicated spending of \$55.5 billion projected for the current fiscal biennium would mean a spending cap of \$62.8 billion for fiscal 2008-09.

DIGEST:

HB 2 would appropriate a total of \$14.1 billion for fiscal 2008-09 to the Texas Education Agency under the foundation school program to fund school district property tax rate reductions required by Education Code, sec. 42.2516. For fiscal 2008, the bill would appropriate an estimated \$4.2 billion from the property tax relief fund and an estimated \$2.7 billion from general revenue, for a total \$6.9 billion. For fiscal 2009, the bill would appropriate an estimated \$3.84 billion from the property tax relief fund and \$3.38 billion in general revenue, for a total of \$7.2 billion.

The bill would allow the TEA commissioner, with the prior approval of the governor and the LBB, to transfer funds as needed between the two fiscal years to fund the entire appropriation for fiscal 2008.

HB 2 would take effect September 1, 2007.

**SUPPORTERS
SAY:**

HB 2 would fulfill the Legislature's commitment to property tax relief by appropriating state funds needed to make up for local tax reductions required under school finance legislation enacted in May 2006. These reforms, included in HB 1 by Chisum, enacted by the 79th Legislature in 2006 during its third called session, enabled the state to meet the Supreme Court's requirement that school districts have "meaningful discretion" in setting local tax rates. School districts already have reduced local taxes as required under HB 1, and they are depending on the state to meet its commitment to make up for these reductions with the funding appropriated in HB 2.

The bill would increase significantly the state's share of education funding, reversing a trend in which the state has depended more and more on increases in local property values to fund public education while reducing the state's share of financial support. The state's share would increase from about 40 percent to about 50 percent of total funding, reducing the burden on local taxpayers and creating a more equitable system for funding public education.

This shift in public education funding has created an unusual situation in which state spending will exceed the growth in personal income, the basis on which the constitutional spending cap is determined. This special situation justifies exceeding the spending cap. Spending for other state needs, such as health care or prisons, while important, should not be considered a factor in this unusual situation in which state spending is being used for school property tax reduction.

Approving HB 2 and adopting a resolution (SCR 20 by Ogden, on today's House calendar) to exceed the spending cap now would allow the Legislature to meet its commitment to property tax reduction and to fund other state services as part of the appropriations process. The Legislature should not wait to determine whether or not funds will be available to meet both objectives.

OPPONENTS
SAY:

HB 2 would commit the state to spending more general revenue for property tax relief than is necessary. The \$14.1 billion appropriated in HB 2 only would be necessary to make up for lost local tax revenue if 2007 property tax revenue is reduced by one-third of 2005 tax revenues. If the tax changes enacted during the 2006 special session do not generate sufficient revenue to "buy down" property taxes to \$1.00 per \$100 of valuation, the Legislature should enact a more limited school tax cut.

Reducing property taxes by a smaller amount, such as to \$1.13 per \$100 of valuation, would provide significant tax relief and still meet the constitutional requirement that school districts have "meaningful discretion" in setting local tax rates. While property tax reduction is a worthy goal, the state should have to live within its means in providing this tax relief.

A more modest property tax cut would allow the state to stay below the spending cap and contain state spending now and in the future. If the cap is exceeded for this fiscal biennium, the Legislature will be allowed to

spend more in the future because subsequent spending caps would be determined based on this year's higher budget amount. The more the state spends in one biennium, the higher the allowable spending cap will be in a subsequent biennium.

With so many other pressing state needs, it would be premature to devote more than \$6 billion in general revenue, as HB 2 would, to property tax relief before the Legislature has a better idea of how much money will be generated by the revised franchise tax and other taxes adopted in 2006. In early April, the comptroller will release a report estimating the amount that selected businesses would have paid if the revised franchise tax had been in effect on January 1, 2006. This will allow for a more accurate estimate of how much general revenue will be needed to make up the difference between what the new taxes will bring in and the total amount needed for property tax relief. Instead of taking \$6 billion in undedicated general revenue off the table now, the Legislature should wait until later in the legislative session to get a better idea of how much general revenue actually will be needed to meet the state's commitment to provide property tax relief.

The appropriation in HB 2 and the resolution (SCR 20) to exceed the spending cap should be considered later in the legislative session as part of the overall appropriations process and should take into account spending on other priorities, such as criminal justice and health care. HB 2, in tandem with SCR 20, practically would invite the Legislature to exceed the spending cap by \$14 billion by granting leeway to spend that amount over the cap. Current LBB projections indicate that \$5.2 billion will be available for property tax relief without exceeding the spending cap. HB 2 and SCR 20 at least should allow the Legislature to exceed the cap by no more than the \$9 billion needed to make up the difference.

NOTES:

On February 5, Gov. Perry declared legislation making appropriations to the Texas Education Agency for the purpose of school district property tax rate reductions to be an emergency matter for immediate consideration by the Legislature.

SCR 20 by Ogden, on today's House calendar, would make a legislative finding that the need for lower school district property taxes established in HB 1, third called session, 79th Legislature, constitutes an emergency and would authorize the 80th Legislature to appropriate undedicated state tax

revenues of up to \$14.191 billion above the constitutionally required spending cap.

The Senate adopted SCR 20 on February 14 by 17-12. On February 15, the House Appropriations Committee approved SCR 20 in a formal meeting by 18 ayes, 2 nays, 9 present, not voting.

The companion bill, SB 2 by Ogden, has been referred to the Senate Finance Committee.

During second reading consideration of HB 2 on February 19, the House tabled amendments that would have made the appropriation for school property tax relief contingent on approval of a constitutional amendment increasing the amount of the residential homestead exemption to \$45,000 (by Rep. Leibowitz), on enactment of an appropriations bill raising the average minimum teacher salary to the national average (by Rep. Herrero), on enactment of an appropriations bill funding instructional materials at the fiscal 2002 level, adjusted for inflation (by Rep. Castro), and on appropriating amounts for fiscal 2008-09 for pre-kindergarten grants and the student success initiative equaling or exceeding the amounts appropriated for those programs for fiscal 2006-07 (by Rep. Coleman). The House passed HB 2 on second reading by 138-6.