LEGISLATIVE BUDGET BOARD

TAX CUTS AND APPROPRIATIONS:

SELECTED ISSUES

PRESENTED TO HOUSE COMMITTEE ON WAYS AND MEANS

LEGISLATIVE BUDGET BOARD STAFF **February 2015**

TOPICS ADDRESSED

We were asked to provide information on the following:

1. The relationship of tax changes to the appropriations process
2. The relationship of tax changes to the Article VIII Constitutional Spending Limit
3. Review of the property tax actions taken by the Legislature in 2006
4. Present hypothetical scenarios on implications of a homestead exemption in relationship to appraisal growth

Tax Changes and Appropriations

Changes in state or local revenue do not in themselves also adjust state appropriations:

- Revenue may only leave the treasury by virtue of an appropriation
  - Texas Constitution
- If revenue that supports entitlement programs is reduced, other revenues may be appropriated to replace the forgone revenue
  - If not replaced, the program would simply be under-funded and face a shortfall
  - Alternatively, statute could be amended to reduce the entitlement
- In most cases, a change to a tax simply reduces or increases available revenue

Local Property Tax Revenue and Appropriations

The Foundation School Program is funded with a mix of state and local revenue.

- The FSP is an entitlement program, which means local school districts are entitled to a certain amount of revenue as prescribed by state statutes. The total 2016-17 entitlement (including the additional $2.2 billion) assumed in HB 1 is $90.6 billion.
- Local property tax revenue, generated by school district levies, supports as much of the program as possible
  - Local revenue for the 2016-17 biennium is estimated to be $52.6 billion
- State revenue makes up the balance of funding for the FSP. Total state aid in HB 1 is estimated to be $38.0 billion.
  - State aid is funded with the Foundation School Fund, Available School Fund, Lottery Fund, Property Tax Relief Fund, and Appropriated receipts (Attendance Credits)
- Under current law, to the extent that local revenue either increases or decreases, state aid changes to offset that adjustment.
- Absent a change in statute, a state-mandated reduction to local property taxes will result in either:
  - An increase in state appropriations to offset the reduction; or
  - Under-funding of the entitlement

Property Tax Relief Fund and Appropriations

The Property Tax Relief Fund is one of the revenue streams supporting state aid in the FSP.

- The following is the order of operations in determining state aid to the FSP:
  - Determine the amount of the entitlement
  - Determine the amount of available local revenue
  - The balance represents state aid:
    - Total revenue in Lottery, Property Tax Relief Fund, Available School Fund, and Attendance Credits is determined.
    - The balance is the Foundation School Fund (General Revenue)
- To the extent the Property Tax Relief Fund goes up or down, and net of the change to the other funds, Foundation School Fund makes up the difference.

Spending Limit Implications

Both the Foundation School Fund (General Revenue) and the Property Tax Relief Fund (Other Funds) are subject to the constitutional spending limit. Swapping one for the other (for example, reducing the margins tax and replacing that revenue with GR) will not materially change how much GR may be appropriated under the spending limit.

Any change in state revenues will affect the overall "mix" of revenue supporting state appropriations, however, and thereby shift GR capacity under the limit.

- The Foundation School Fund will, under current law, be appropriated to replace any lost local revenue as a result of a local property tax cut (creates a shift from local funds to General Revenue appropriations).
- The Foundation School Fund will also make up any loss to the PTRF as a result of a reduction to the franchise tax (shifts appropriations from the PTRF (Other Funds) to the Foundation School Fund (General Revenue)).

2007 School Property Tax Relief and State Revenue Initiatives

In 2006, the Legislature reduced school district property taxes by compressing the maintenance and operations (M&O) tax rate by one-third over a two year period.

- State tax revenue was increased to help pay for the reduced school property tax collections
- The franchise tax was restructured and its base expanded, the price consideration for certain taxable motor vehicle sales was redefined, the cigarette tax rate was increased, and the tobacco products tax, other than cigars, was increased
- The newly created Property Tax Relief Fund (PTRF) was established to provide a separate accounting for these increases
- The amount of revenue deposited to the PTRF from these tax changes was originally projected to total $8.3 billion in the 2008-09 biennium, and was forecasted to grow slightly in subsequent biennia. Actual deposits have been lower, initially totaling $5.0 billion in the 2008-09 biennium and growing to $5.7 billion in the 2012-13 biennium
- Forecasted PTRF collections for the 2016-17 biennium total $5.5 billion

State Cost of 2007 Property Tax Actions

$14.2 billion was the total lost local revenue due to the property tax reduction in the first biennium of full implementation, the 2008-09 biennium. This revenue was replaced dollar-for-dollar with state aid.

- From that time forward, the school finance system was "reset," with M&O local revenue generated on a lower $1.00 maximum Tier 1 rate (previously $1.50 maximum), and state aid filling in the remainder up to districts' entitlement.
- That entitlement, and the amount of state aid required by it, is driven by student counts, student and district characteristics, and any legislative changes to the funding formulas.
- Therefore, there is no component of Foundation School Program state aid that represents the "state cost" of the 2006 tax relief. One could calculate what that 50 cents of lost local revenue is worth in the 2016-17 biennium, but that figure would have no relationship to the amount of state aid required by the school finance system; it would rather be a measure of how much a <u>new</u> reduction would cost.

Homestead Exemption Examples

We were asked to provide hypothetical examples illustrating the relationship of a homestead exemption increase and appraisal growth.

- For most homeowners the value of an increase in the state mandated school district residence homestead exemption is the amount of increase multiplied by their combined school district M&O and I&S tax rate.
  - ☐ If the exemption was increased by $15k, a homeowner taxed at the statewide weighted average total ISD tax rate (1.32%) would pay $198 less in school district taxes than they would under current law.
  - ☐ Taxpayers owning homes valued at less than the total amount of provided exemptions would not receive the full tax benefit of the exemption;
- The intended initial tax savings from an increase to the school property homestead exemption may be reduced in the following circumstances:
  - ☐ Appraisals increase;
  - ☐ School property tax rates increase; or
  - ☐ Rates of other taxing jurisdictions increase

$15K Homestead Exemption Increase

Taxing Jurisdiction	Last Tax Year with 15k School Homestead Exp.				First Year with 30k School Homestead Exp. *increase in appraised value = 4.402%*			
	Tax Rate	Appraised Value	Taxable Value	**Tax**	Tax Rate	Appraised Value	Taxable Value	**Tax**
Austin ISD	1.222	184,000	169,000	**$2,065**	1.222	192,099	162,099	**$1,981**
City of Austin	0.4809	184,000	184,000	**$885**	0.4809	192,099	192,099	**$924**
Travis County	0.4563	184,000	147,200	**$672**	0.4563	192,099	153,679	**$701**
Travis Healthcare	0.1264	184,000	147,200	**$186**	0.1264	192,099	153,679	**$194**
ACC	0.0942	184,000	179,000	**$169**	0.0942	192,099	187,099	**$176**
TOTAL TAX				**$3,976**				**$3,976**

**Assumes no change in district tax rates. Results will differ if rates are adjusted up or down by districts.*

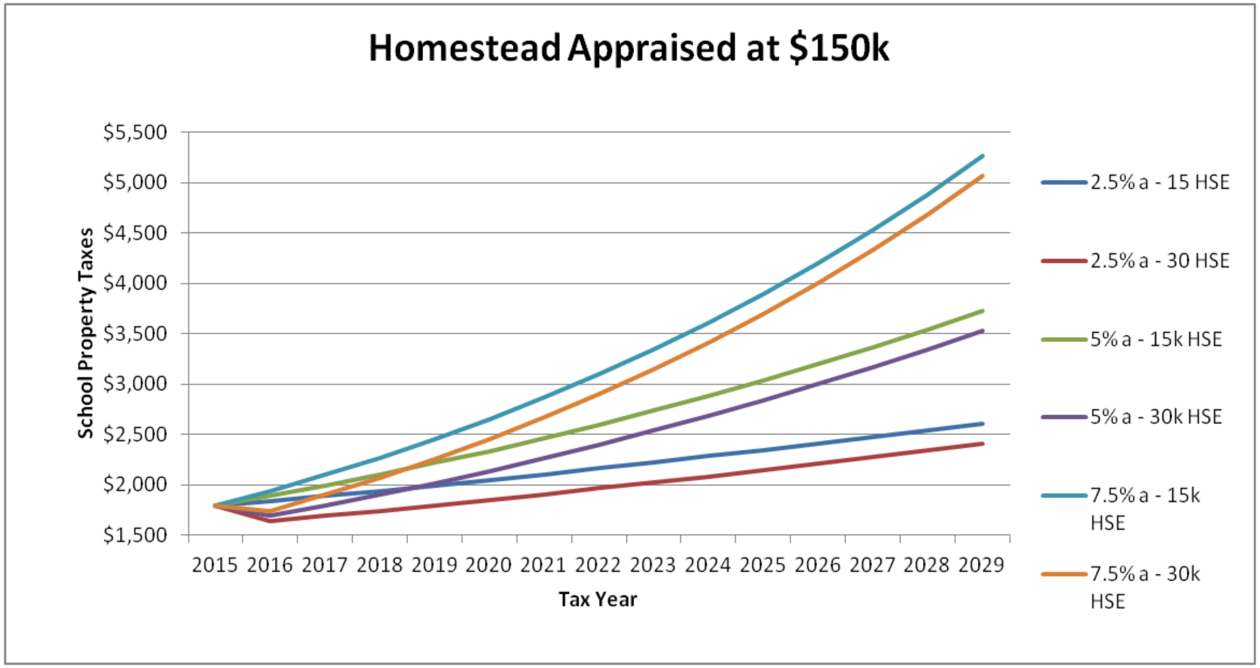
The above example of a homestead appraised at $184,000 in Travis County demonstrates that a 4.4 percent increased in appraised value would exactly offset the impact of a $15,000 homestead increase. Taxpayers with homesteads appraised below $184,000 would need to experience a higher level of appraisal growth before the nominal value of a homestead exemption increase is offset, while taxpayers with homesteads above $184,000 would need to experience a relatively lower level of appraisal growth before the nominal value of the increased exemption is offset.

SOURCE: Legislative Budget Board.

Hypothetical Examples of Appraisal Growth

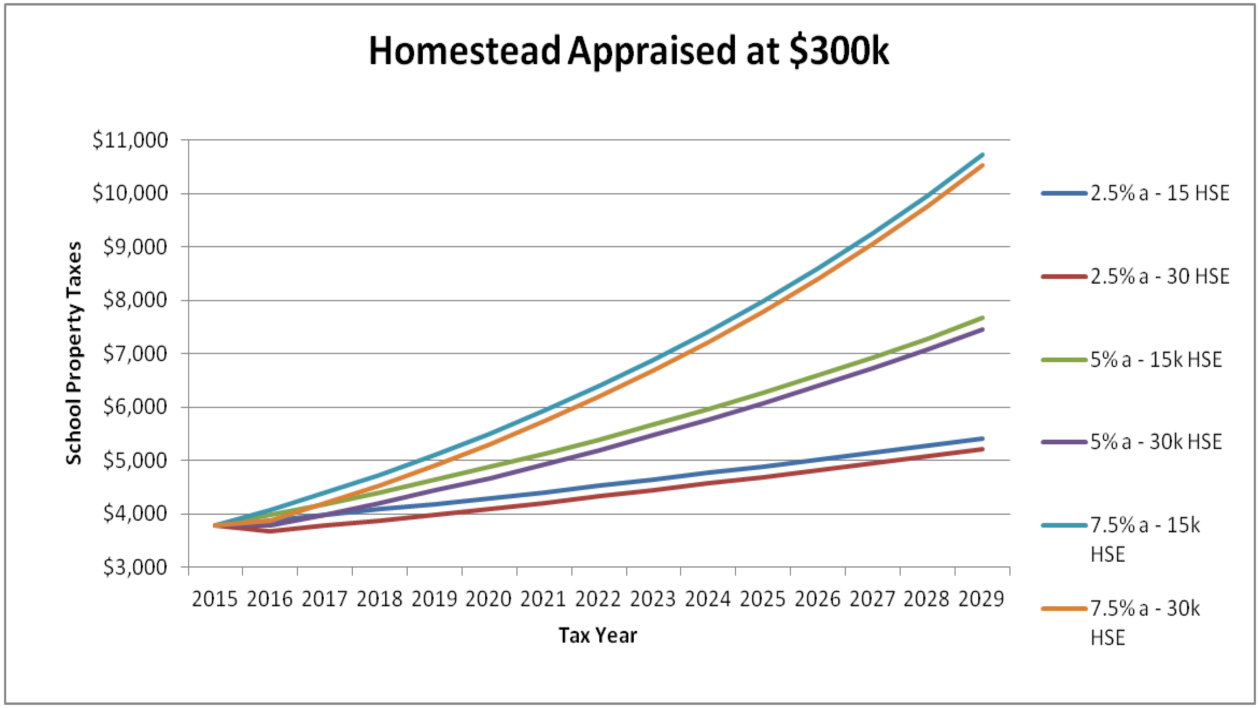
The following charts display estimated school taxes paid over the next 15 years for 3 properties, valued at $150,000, $350,000, and $450,000. Each is shown with and without a $15,000 increase in homestead exemption. For each assessed home value school taxes are estimated assuming an illustrative and hypothetical 2.5%, 5.0%, and 7.5% annual average appraisal increase.

Example: $150K Homestead



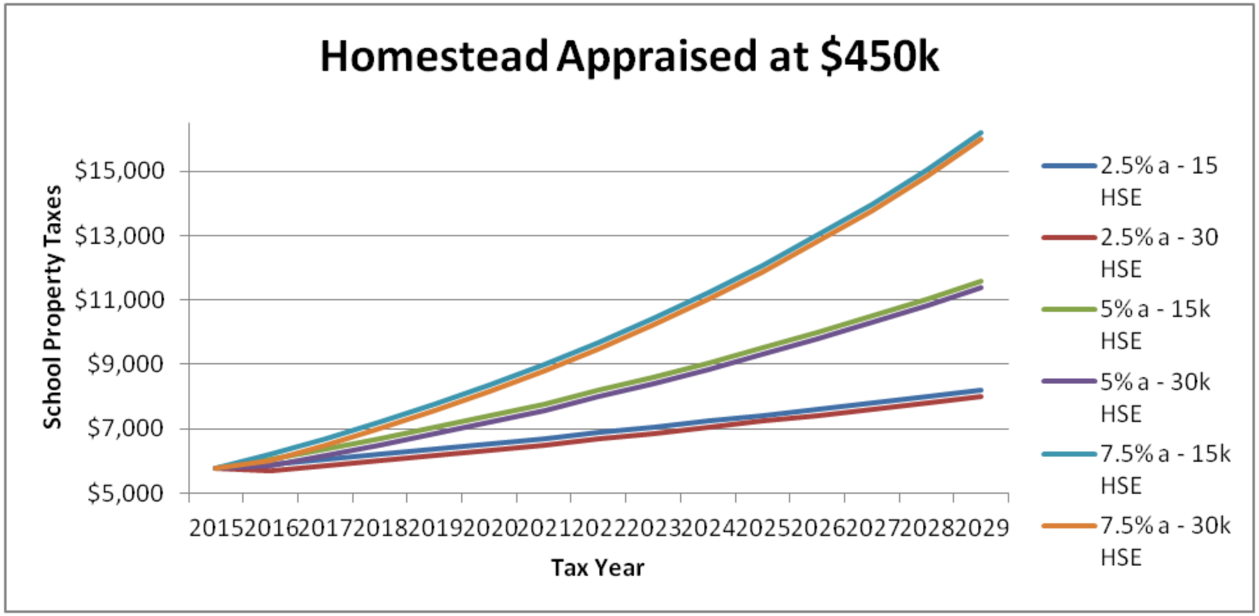
Note: Each line represents estimated school property taxes assuming different average annual appraisal increases (a) for two different levels of homestead exemptions (HSE). Assumes constant tax rates.

Example: $300K Homestead



Note: Each line represents estimated school property taxes assuming different average annual appraisal increases (a) for two different levels of homestead exemptions (HSE). Assumes constant tax rates.

Example: $450k Homestead



Note: Each line represents estimated school property taxes assuming different average annual appraisal increases (a) for two different levels of homestead exemptions (HSE). Assumes constant tax rates.

SOURCE: Legislative Budget Board.

Contact the LBB

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