Colorado Legislative Council Staff

ISSUE BRIEF

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School Finance as a Tax Policy Tool

by Deb Godshall

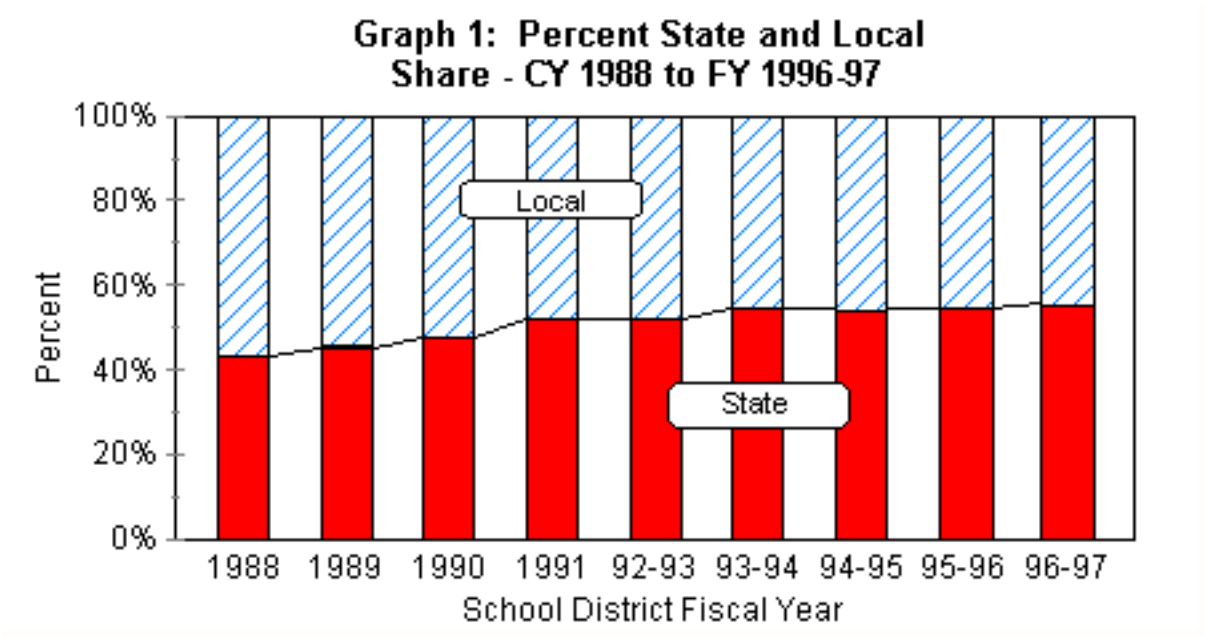
School finance has historically been a useful tool to implement state tax policy for a variety of reasons. The first reason is the sheer volume of tax dollars that support public K-12 education. Colorado's school finance act distributes over $3 billion annually to Colorado school districts. The second reason is the partnership of state and local tax dollars that fund the program. State tax revenues account for 56 percent of school finance funding, while local taxes provide the remaining 44 percent. Third, school finance consumes a significant portion of taxes paid by Coloradans. On average, 35 cents of every state tax dollar collected to operate Colorado government and 43 cents of every property tax dollar is funneled into the school finance act. Finally, the components of the school finance act -- total program, property taxes, and state aid -- are interrelated and, to a large degree, controlled by the General Assembly. Thus, the General Assembly can quantify the impact of a tax policy change on one component of the act and make adjustments to other components. These changes can be made without impacting revenues for other units of local government. This *Issue Brief* looks at two components of the school finance act: state aid and local property taxes.

State Aid Is Increasing as a Source of Revenue for Schools

Funding for schools is a significant expenditure of state tax dollars. In the current budget year, the Department of Education accounts for about 41 percent of state General Fund appropriations. The vast majority of the department's budget, $1.69 billion out of $1.82 billion, funds the school finance act. The amount of state funding is driven by the number of pupils enrolled in school, the level of per pupil funding (which is set by the General Assembly), and available property taxes.

Over the last ten years, state aid has become an increasingly important source of revenue for school districts. As Graph 1 shows, the state's share of school finance funding has increased from about 43

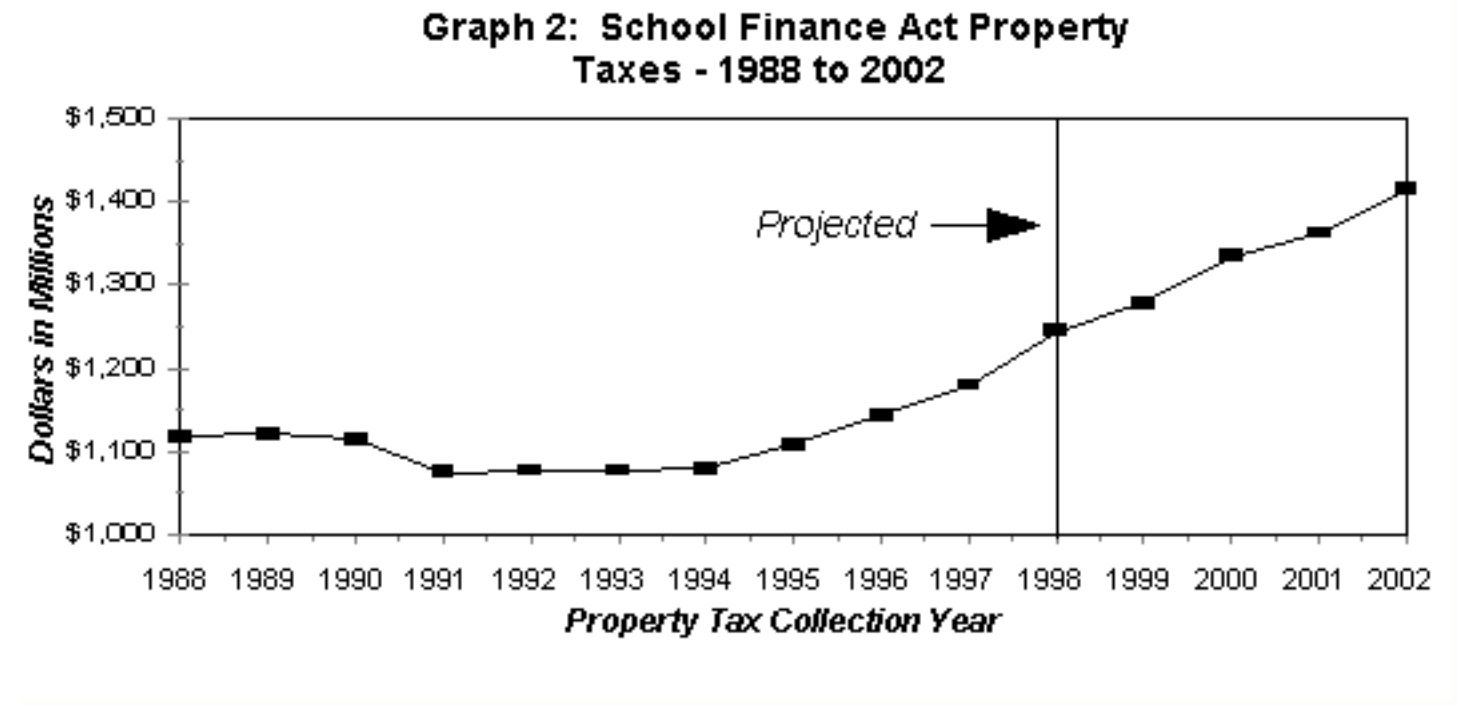
percent in 1988 to 56 percent in 1997.



Today, a one percentage point increase in the state share costs $30 million. Thus, this 13-point increase in the state share means a shift in education's funding source from local taxes to state taxes of about $390 million annually.

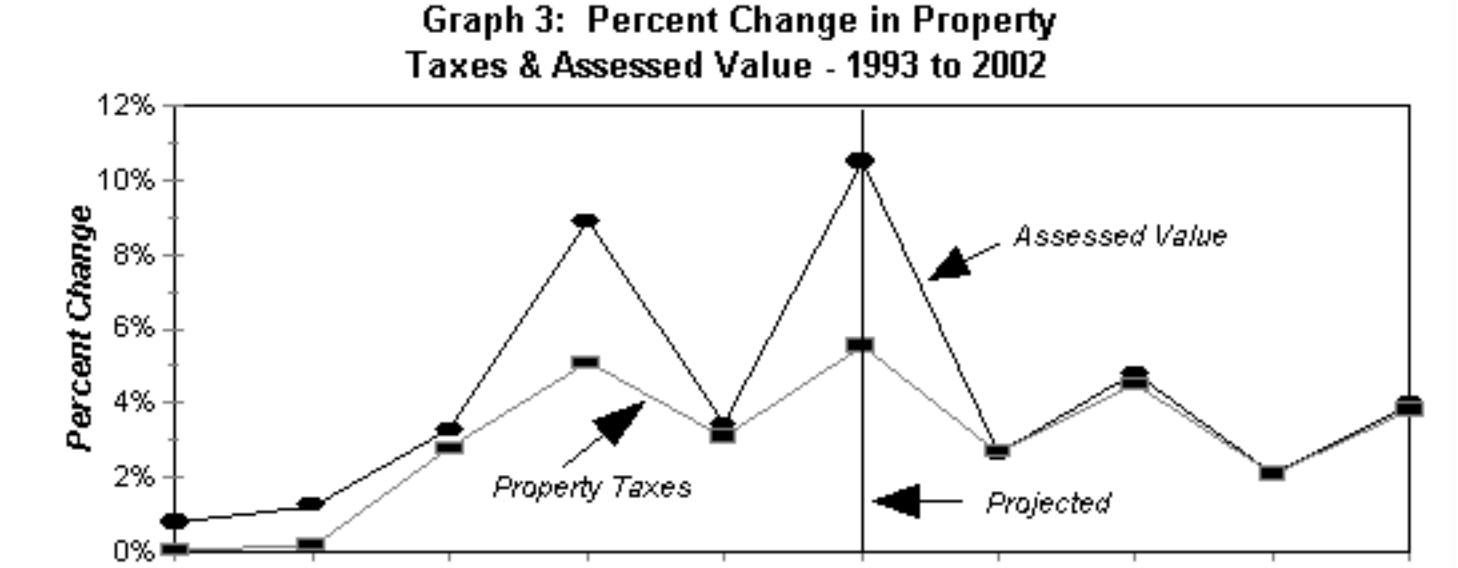
Property Taxes Are Increasing While Levies Decline

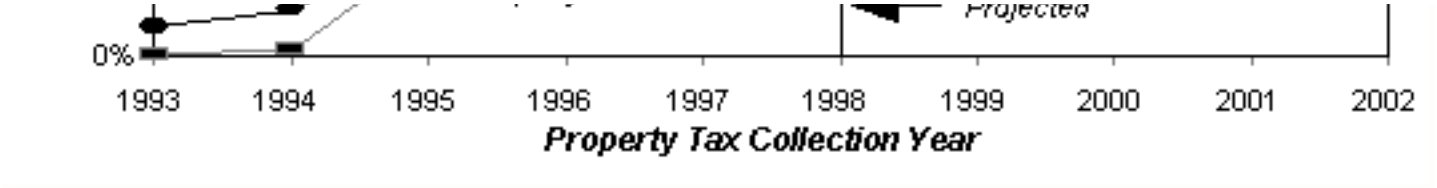
In the late 1980s and early 1990s, the General Assembly set property taxes for school finance, and these taxes were based on the idea that most districts should impose the same levy. Although most districts imposed the same levy, referred to as the "uniform" levy, the General Assembly used a variety of methods to determine that levy. In various years, the Department of Education was directed to set the levy to raise a dollar amount of property taxes set by law or to target a specified percentage state share. In one year, the General Assembly put the mill levy in statute. Since the adoption of TABOR in 1992, the General Assembly has been less directly involved in determining school finance property taxes. The law for school finance taxes is essentially the same as the TABOR limit on property tax revenues and mill levies. School districts levy the same number of mills from year to year, unless the mill levy would raise more property taxes than TABOR permits (inflation plus the percentage change in enrollment). In these circumstances, the levy is reduced to avoid exceeding the property tax revenue limit. Graph 2 provides historical and projected property tax revenues for school finance.



The historical data in Graph 2 complements the data in Graph 1. In the late 1980s and early 1990s, when property taxes were relatively constant or declining, the increase in the state share was pronounced. In more recent years, as property taxes have increased, the percentage state share has been more stable.

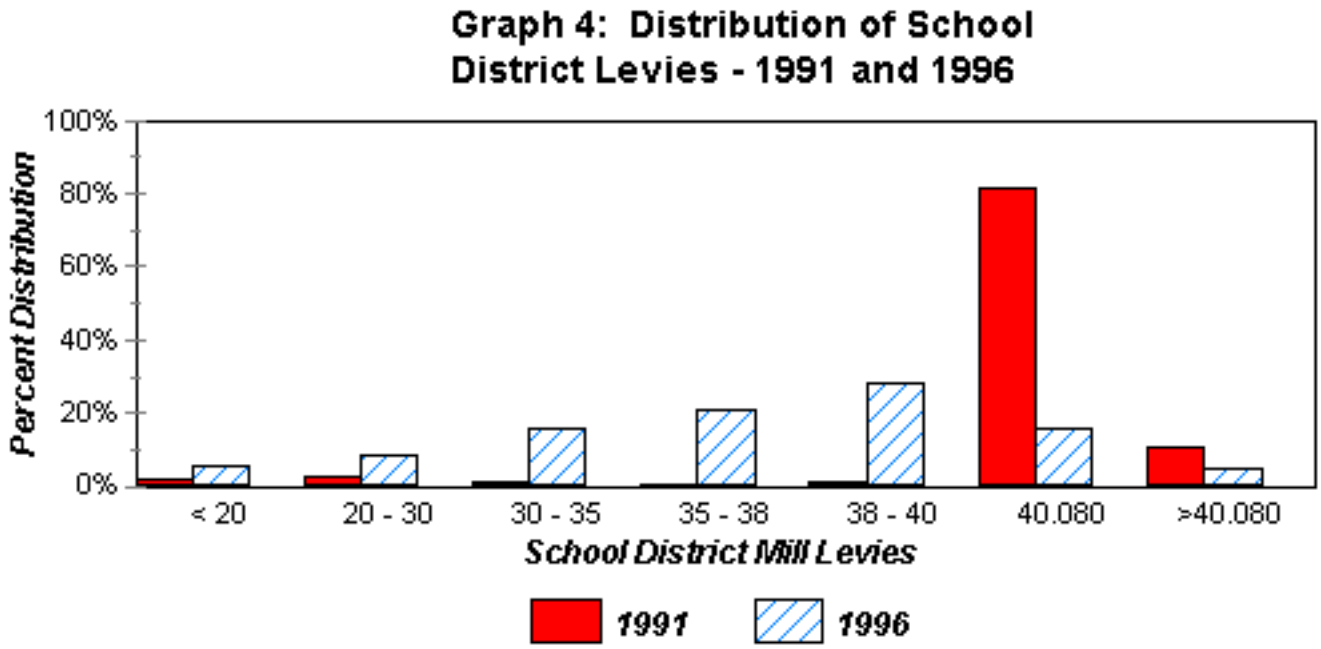
School finance property taxes follow changes in assessed value.Because the TABOR limits are now the driving factors in school finance property taxes, changes in assessed value influence changes in property taxes. When assessed values are relatively stable statewide, property taxes can be expected to remain relatively constant. As assessed values increase, so too will property taxes. Because changes in property taxes are essentially limited to inflation plus the percentage change in enrollment, property taxes will be capped when assessed values grow at a greater rate. These phenomena are illustrated in Graph 3.





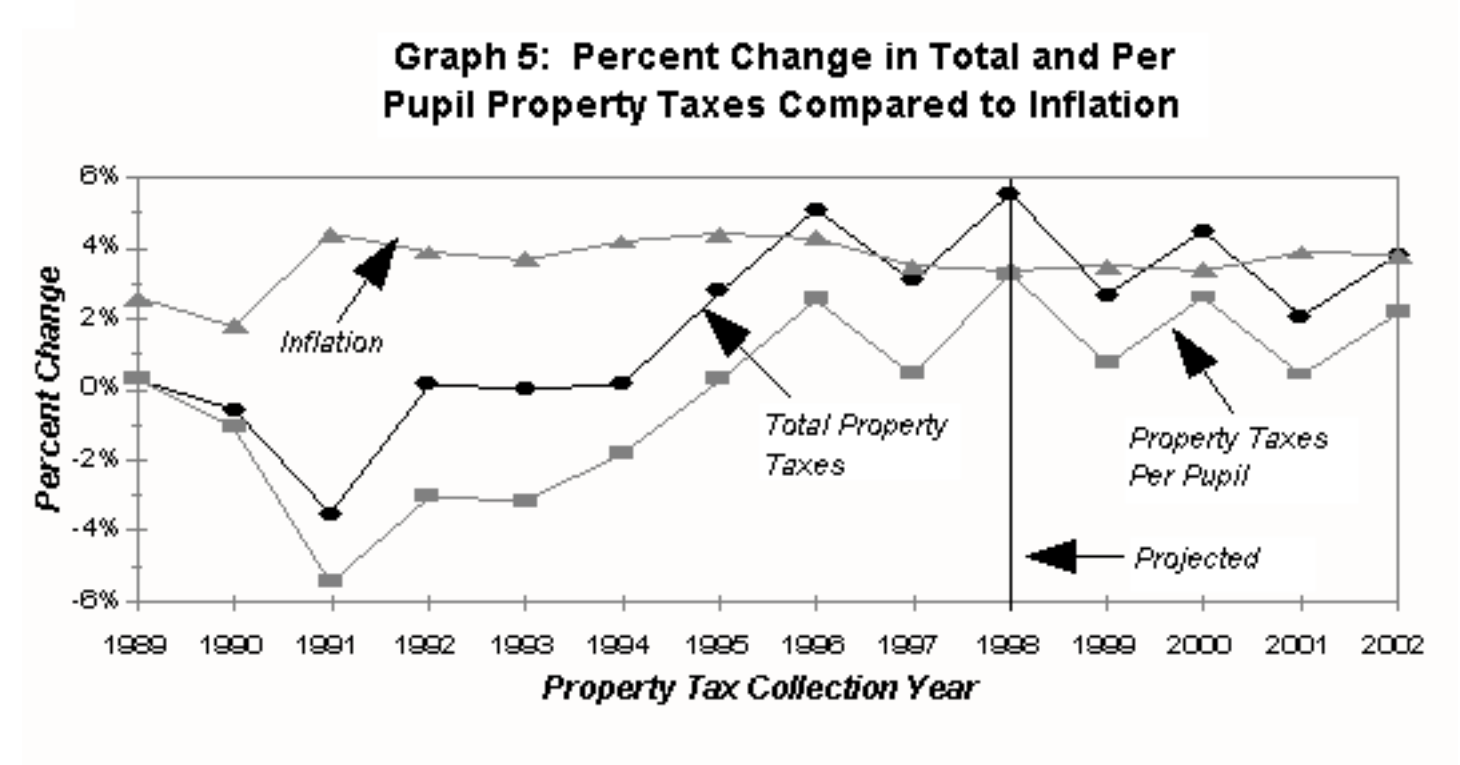
Graph 3 also points out a second impact of the current method for collecting school finance property taxes. The change in property taxes tends to follow the reassessment cycle, which occurs every two years. When property values increase after a reassessment, property taxes increase in the following, even-numbered year. In the year between reassessments, when property values are relatively stable, growth in property taxes moderates. This situation produces a "sawtooth" effect, which has implications for state aid. The pressure on state aid will be greater in "valley" years than in "spike" years.

District mill levies are decreasing. While property taxes have been increasing and are projected to continue to increase, school district mill levies are declining and have become more disparate. Graph 4 compares the distribution of mills levied by school districts in 1991, the last year a uniform levy was in effect, with 1996 mill levies.



The decline in mill levies has been caused by individual district circumstances relative to the district's property tax limit. As a general rule, mill levies decline in districts where the assessed value increases at a greater rate than the property tax limit. They tend to stay the same in districts with stable or declining assessed values, unless there are significant declines in enrollment.

Property taxes are increasing at rates closer to inflation. Graph 5 shows the actual and projected change in school finance property taxes (total and per pupil) relative to inflation.



The change in property taxes in recent years and in the future more closely follows the inflation rate than it did earlier in the decade. The reason for this closer relationship is threefold. First, school finance property taxes are now determined by the TABOR formula, unlike earlier in the decade when they were capped by the General Assembly. Second, TABOR permits inflationary growth in property taxes if it can be accomplished without increasing the mill levy. Third, assessed values are increasing at rates that permit growth in property taxes, even with declining levies. Increases above the rate of inflation are caused by the inclusion of the second factor in the property tax formula -- the percent change in enrollment.

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