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May 25, 2005 Joint Committee on Finance Paper #601

School Levy Tax Credit (DPI -- General School Aids and Revenue Limits and Shared Revenue and Tax Relief -- Property Tax Credits)

[LFB 2005-07 Budget Summary: Page 399, #7 and Page 448, #1]

CURRENT LAW

Tax Credit Programs

Wisconsin currently has two tax credit programs where credits are paid to municipalities and shown on property tax bills, the school levy tax credit and the lottery and gaming tax credit. School levy tax credits are distributed to municipalities based on each municipality's share of statewide levies for school purposes during the three preceding years. These amounts are apportioned within municipalities based on each taxable property's assessed value as a percent of the corresponding municipality's total assessed value. School levy tax credits are distributed to municipalities on the fourth Monday in July. The statutory funding level was increased from $319.3 million to $469.3 million effective with the 1996(97) property tax year and funding has remained at that level since then. That $150 million funding increase coincided with the state's commitment to assume responsibility for funding two-thirds of partial school revenues on a statewide basis.

Equalization Aid

The equalization formula is designed to equalize the tax base of school districts. The purpose of this policy is to minimize the differences among school districts' abilities to raise revenue for educational programs. The provision of state aid through the formula allows a district to support a given level of per pupil expenditures with a similar local property tax rate as other school districts with the same level of per pupil expenditures, regardless of property tax wealth. The formula is calculated using school district data (membership, shared costs, and equalized valuations) from the prior school year.

For most school districts, equalization aid is the only type of general school aid received. School districts that have a per pupil equalized value above the primary guaranteed valuation do not receive equalization aid. These districts do, however, receive special adjustment aid. This is a hold harmless payment under which a district receives at least 85% of its prior year general aid payment.

Equalization aid is distributed to school districts according to the following statutory payment schedule: 15% on the third Monday in September; 25% on the first Monday in December; 25% on the fourth Monday in March; and 35% on the third Monday in June. The state pays $75 million of equalization aid on a delayed basis, with school districts receiving these monies on the fourth Monday in July of the following school year.

GOVERNOR

Increase Credit With Distribution Based on Share of General School Aids

Increase the school levy tax credit distribution for the 2006(07) property tax year and for each year thereafter by $150,000,000, from $469,305,000 to $619,305,000. Direct $150,000,000 of the $619,305,000 to be distributed to municipalities in proportion to their share of general school aid paid under the general equalization aids program, as determined by the Department of Revenue. Direct DOR to calculate the $150,000,000 distribution based on the amount of general school aid paid in the same year that DOR notifies municipalities of their credit payments. Current law directs DOR to notify municipalities by December 1 of the amount of credits that will be distributed to them in the succeeding year. The remaining $469,305,000 of the distribution would continue to be allocated to municipalities based on their share of total school levies during the prior three years. Both distributions would be allocated by municipalities to individual taxpayers based on each taxpayer's share of the municipality's assessed value.

Use Any Excess Revenues to Advance July Payment Into June

Direct the Department of Administration to distribute up to $150,000,000 of the school levy tax credit distribution for the 2006(07) property tax year on June 15, 2007, and require an identical amount to be distributed on June 15 of each succeeding year. Direct DOA to distribute the balance of the distribution for the 2006(07) property tax year on the fourth Monday in July, 2007, and require an identical amount to be distributed on the fourth Monday in July of each succeeding year. Define the amount of the June distribution as any excess general fund revenues, as determined by DOA, reduced by any amounts transferred to the health care quality improvement fund (this fund would be created by the bill; since the bill does not specify any minimum or maximum transfer to this fund, the allocation of excess revenues between this fund and the June, 2007, school levy credit payment would be at the sole discretion of the DOA Secretary). Define excess general fund revenues as the difference between the amount of estimated 2005-07 general fund revenues, as determined by DOA no later than September 15, 2006, minus the sum of the 2005-07 general fund revenues, as estimated under the 2005-07 biennial budget, and any amount expended under the supplemental general school aids appropriation (this appropriation would be created by the bill and would be funded with whatever new revenue is estimated to be generated by the streamlined sales tax project). Authorize the Secretary of DOA to transfer any excess general fund taxes to the health care quality improvement fund, prior to determining the June, 2007, school levy tax credit payment amount. Require the DOA Secretary to reduce the amount transferred to the budget stabilization fund in 2007 by any amounts: (a) used to fund the supplemental general school aids appropriation; (b) transferred to the health care quality improvement fund; or (c) paid as school levy tax credits in June, 2007. Currently, 50% of any excess general fund tax revenues are to be transferred to the budget stabilization fund.

Since the school levy tax credits appearing on December, 2006, property tax bills will not be paid until July, 2007, additional funding for the credit would not be needed until 2007-08. Although this provision would not increase appropriations in the 2005-07 biennium (unless excess general fund revenues are made available for the credit, as described above), an increase of $150,000,000 annually over the base funding level would need to be provided in the 2007-09 biennium for this purpose.

DISCUSSION POINTS

Increase the School Levy Tax Credit

1. A major provision in AB 100 is funding two-thirds of partial school revenues on a statewide basis in 2006-07. The state adhered to a statutory two-thirds funding policy for the 1996-97 through 2002-03 school years, but has not met the two-thirds standard during the last two years. Over the next two years, AB 100 would provide an additional $700 million in school equalization aid and $150 million in school levy tax credits, and the bill would provide state funding to support 66.7% of K-12 partial school revenues in the 2006-07 school year.

2. Relative to the 2006-07 school year, school levy tax credits will be paid in July, 2007. As a result, the $150 million funding increase would occur in the state's 2007-08 fiscal year and would represent an advance commitment. This implies that the "first" $150 million in revenue growth in the 2007-09 biennium would be used to fund the school levy tax credit increase. As an example, AB 100 anticipates $485.3 million in general purpose revenue growth in the first year of the 2005-07 biennium. Assuming similar revenue growth in the first year of the 2007-09 biennium, the $150 million increase would use 31% of the additional revenues.

3. School levy tax credits are considered a property tax payment made by the state on behalf of taxpayers. After their payment by the state to municipalities, they are allocated through the property tax settlement process. Under the settlement process, property tax payments to municipalities are allocated to the various taxing jurisdictions in proportion to the amount of taxes that they levied within each municipality. For accounting purposes, the credits are recognized as a payment due to each of the various taxing jurisdictions, even though the credits are characterized as

school property tax relief for state policy purposes.

4. While state expenditures are recognized when they are paid for budgetary purposes, they are recognized when they are incurred under generally accepted accounting principles (GAAP). For the fiscal year ended June 30, 2004, the school levy tax credit program created a $354.7 million liability to the state's general fund under GAAP. This treatment reflects that 51% of the credit payments are eventually received by school and technical college districts, and they have fiscal years that end before the payment is made. Therefore, the credits due these districts are reflected as a liability ($469.3 million x 51.16% = $240.1 million). The remaining $229.2 million in credits are due to districts that operate on a calendar year basis. Under GAAP, half of the payments that they eventually receive is due in the January to June period, and half is due in the July to December period. Therefore, half of the credit payments due these districts is reflected as a GAAP liability ($229.2 million x 50% = $114.6 million).

5. Based on generally accepted accounting principles, Wisconsin's Comprehensive Annual Financial Report (CAFR) for 2003-04 indicates a general fund balance of -$1,931 million. This deficit reflects the differences between GAAP and budgetary accounting procedures. Increasing the school levy tax credit distribution would exacerbate the state's GAAP deficit in 2006-07 by increasing the school levy tax credit liability by an estimated $113.2 million.

6. The GAAP-based CAFR is used to assess the state's fiscal condition. The CAFR is one of the information sources used by credit agencies to rate the state's credit worthiness. Between 2002 and 2004, the major rating agencies have downgraded Wisconsin's general obligation bond issues. In announcing the latest rating changes, these agencies have cited concerns about the state's finances, including the ongoing accounting deficit under GAAP. Typically, lower credit ratings result in higher borrowing costs.

7. The general fund receives revenues and incurs expenditures in uneven patterns throughout the year. Over time, this has led to repeated cash flow problems. The payment schedule for the state's local assistance programs contributes to the imbalance. In 2003-04, the general fund's worst day occurred in July when the cash balance reached -$762.7 million. In July, payments are made under the general school aid, shared revenue, and school levy tax credit programs.

Use Any Excess Revenues to Advance July Payment Into June

8. AB 100 recognizes the preceding cash flow and GAAP deficit concerns by including a provision that would advance up to $150 million of the proposed July tax credit payment to June 15, 2007, and to June 15 of each succeeding year. This would reduce the GAAP liability created under the bill. The proposed advance would occur if estimated general fund revenues for 2005-07, as estimated on September 15, 2006, exceed the 2005-07 general fund revenues, as estimated at the time the budget is enacted. The advance would decrease the amount otherwise transferred to the budget stabilization fund. Although this would reduce the bill's increase in the GAAP deficit, it would reduce the balance in the budget stabilization fund. The lack of a significant reserve or "rainy day" fund was also one of the credit concerns raised by the rating agencies.

9. It could be argued that, if the Committee chooses to increase funding for the school levy tax credit, it is not necessary to include the advance payment provisions. Given that the current levy credit payment is done in July, it may be appropriate to provide any increase in funding on the same payment schedule. Further, if the payment schedule for the levy credit is an issue for the current or future legislatures, the payment schedule can be modified statutorily, without any need to adopt the advance payment provisions.

Distribution of the Additional $150 Million

10. Taxpayers in districts that would tend to benefit from the Governor's proposed distribution for the incremental increase in funding for the school levy tax credit generally have a property value per pupil below the statewide average. Because these districts receive a relatively high level of general school aid, they would not need to fund as much of their costs through the levy under revenue limits. As such, basing a portion of school levy credit funding on general aid, rather than levy, would provide more of the credit to taxpayers in these districts.

11. Distributing a portion of the school levy credit based on total general school aid payments would provide additional state support in the form of a tax credit to reduce the property tax bills of homeowners in relatively property-poor districts. However, this method of distribution would impair the state's effort to equalize the tax effort among school districts. Under the equalization aid formula, school districts with the same shared cost per pupil will have comparable school property tax rates, excluding the effects of using prior year data. Since the levy reduction under the current school levy tax credit, excluding the effects of using a three year levy average, is proportionate for all districts and produces a similar reduction in tax rates, the credit could be characterized as neutral with regard to equalization.

12. To illustrate the potential disequalizing effect of the proposed distribution, the following hypothetical example is presented. School District A has a very low value per pupil ($150,000 in value per pupil), levies $1,500,000 in property tax revenues, and receives $7,500,000 in general school aids. School District B has a higher value per pupil ($600,000 per pupil), levies $6,000,000 in property tax revenues, and receives $3,000,000 in general school aids. Each school district has 1,000 pupils, has $9,000 per pupil in shared costs, and imposes a gross property tax rate of $10.00 per $1,000 of equalized value.

Under the current distribution method (for ease of calculation, using one year of levy data in the calculation rather than a three year average), the low-value school district would receive a levy credit of approximately $62,000, while the higher-value district would receive $249,000. After consideration of the proposed credit, the net school levy would be 9.58 mills for both districts.

Under the proposed distribution method, the low-value school district would receive a levy credit of approximately $260,000, while the higher-value district would receive $105,000. After consideration of the proposed credit, the net school levy would be 8.27 mills for School District A and 9.83 mills for School District B. Taken to an extreme, if $863.5 million (rather than $150 million) would be distributed using the proposed distribution mechanism, the net school levy would be 0.0 mills for School District A and 9.0 mills for School District B.

13. Rather than distribute the additional $150 million through the school levy credit, the Committee could choose to instead appropriate it as general school aids. By distributing this funding through the equalization formula, it would further enhance the ability of the formula to equalize the property tax base of school districts.

14. Compared to the Governor's proposal, districts with property tax values per pupil above the statewide average and with higher shared costs would tend to benefit from distributing the funding through the equalization formula. Districts with property tax values per pupil below the statewide average, districts subject to the primary aid hold harmless, and districts that receive special adjustment aid would tend to benefit from the Governor's proposal rather than from distributing funding through the equalization aid formula.

15. The current law distribution for the school levy tax credit tends to favor taxpayers in those districts that have relatively higher costs and higher property values. Because these districts get relatively less aid under the equalization formula, most of the cost of operating the district under revenue limits is funded from the levy. Because the current law calculation of the school levy credit is based on a district's school levy in proportion to statewide levies, these districts receive relatively more funding than districts that have more of their costs supported from general aid.

16. It could be argued that it is appropriate to provide additional funding for the school levy tax credit through the current law mechanism. The majority of the funding appropriated to meet the two-thirds funding commitment from 1996-97 through 2002-03 was provided as general school aid, with the only increase in levy credit funding occurring in 1996-97. The levy credit is one aspect of the system of state support for K-12 education that helps ensure that property taxpayers in all districts in the state receive some benefit from the current school funding structure.

17. Taxpayers in districts with property values per pupil above the statewide average would tend to benefit from current law as opposed to the Governor's proposal. Taxpayers in districts with property values per pupil below the statewide average would tend to benefit from the Governor's proposal as compared to current law.

18. Districts subject to the primary aid hold harmless or that receive special adjustment aid would tend to benefit from the current law school levy tax credit distribution as opposed to distributing the funding through the equalization formula. Most of the other districts in the state would tend to benefit from distributing the funding through the equalization aid formula as compared to distributing it through the current law school levy tax credit distribution.

19. If the Committee chooses to provide the additional $150 million as general school aids, the funding could either be provided on a current year basis or on a delayed basis. If the funding would be provided on a current year basis, it would be provided through the current statutory payment schedule on the specified dates in September, December, March, and June. This alternative would not worsen the GAAP deficit, but it would represent an additional $150 million in

budgetary expenditures for 2005-07 that are not reflected in AB 100.

20. If the funding were provided as school aids on a delayed basis, the school aids payment in July would increase from $75 million to $225 million. Because the payment would be made to school districts after their fiscal year has ended, the GAAP deficit would increase by $150 million. On a budgetary basis, however, this option would represent no change to AB 100.

ALTERNATIVES

A. Increase the School Levy Tax Credit

1. Approve the Governor's recommendation to increase the school levy tax credit distribution for the 2006(07) property tax year and for each year thereafter by $150,000,000, from $469,305,000 to $619,305,000. Although this provision would not increase appropriations in the 2005-07 biennium (unless excess general fund revenues are made available for the credit under Alternative B1), an increase of $150,000,000 annually over the base funding level would need to be provided in the 2007-09 biennium for this purpose.

2. Delete the provision.

B. Use Any Excess Revenues to Advance July Payment in June

1. Approve the Governor's recommendation to direct the Department of Administration to distribute up to $150,000,000 of the school levy tax credit distribution for the 2006(07) property tax year on June 15, 2007, and require an identical amount to be distributed on June 15 of each succeeding year. Direct DOA to distribute the balance of the distribution for the 2006(07) property tax year on the fourth Monday in July, 2007, and require an identical amount to be distributed on the fourth Monday in July of each succeeding year. Define the amount of the June distribution as any excess general fund revenues, as determined by DOA, reduced by any amounts transferred to the health care quality improvement fund. Define excess general fund revenues as the difference between the amount of estimated 2005-07 general fund revenues, as determined by DOA no later than September 15, 2006, minus the sum of the 2005-07 general fund revenues, as estimated under the 2005-07 biennial budget, and any amount expended under the supplemental general school aids appropriation. Authorize the Secretary of DOA to transfer any excess general fund taxes to the health care quality improvement fund, prior to determining the June, 2007, school levy tax credit payment amount. Require the DOA Secretary to reduce the amount transferred to the budget stabilization fund in 2007 by any amounts: (a) used to fund the supplemental general school aids appropriation; (b) transferred to the health care quality improvement fund; or (c) paid as school levy tax credits in June, 2007.

2. Delete the provision.

C. **Distribution of the Additional $150 Million**

1. Approve the Governor's recommendation to direct that the additional $150 million appropriated for the school levy tax credit be distributed to municipalities in proportion to their share of general school aids paid, as determined by DOR. Direct DOR to calculate the $150 million distribution based on the amount of general school aid paid in the same year that DOR notifies municipalities of their credit payments.

2. Modify the Governor's recommendation to distribute the additional $150 million on the same basis as the current law $469.3 million school levy tax credit appropriation.

3. Delete the Governor's recommendation and, instead, increase general school aids funding by $150 million. In addition:

a. Specify that the funding be provided on a current year basis, so that the funding would be provided in 2006-07.

Alternative C3a	GPR
2005-07 FUNDING (Change to Bill)	$150,000,000

b. Specify that this funding would be paid on a delayed basis on the fourth Monday in July of the following school year, resulting in a total delayed payment of $225 million. The additional aid would first be paid in July, 2007.

4. Delete the provision.

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