



The
UNIVERSITY
of VERMONT

Vermont Legislative Research Shop

Education Funding Sources

Education funding has been a hot topic around the country for quite some time. Within the past decade there has been renewed interest in shifting education funding to a system based on state income taxes; such a shift has been proposed in at least five state legislatures around the country.

Property taxes, at least in Vermont, have been rising for years and some Vermonters say adding a base tax on income would be fairer than the property tax funding system.¹ An income tax would be easier for those who have valuable property but a small income, a situation which exists due to the reassessment process when houses usually increase in value and make the property taxes higher without the owner's income increasing to match. The income tax is more evenly distributed across the population, affecting all citizens as opposed to just those owning property. In Vermont, this is being examined strictly on a statewide basis; however, there are states that allow for a local income tax to fund schools. Local income tax is already being used to fund education in at least four states: Indiana, Iowa, Maryland, and Ohio.² A list of education funding sources in all fifty states is shown in Table 1 at the end of this report.

Types of Taxes

While property and income taxes are the main focus of the debate so far, there are states (such as Alaska, Louisiana, South Carolina and Tennessee) that are also looking at sales taxes. By looking at the costs and benefits of all three forms of tax, it is easier to evaluate which would be most useful in education funding, so each tax is evaluated below.

Property Tax

The most common source of education funding from the states comes through revenue raised via property taxes. Vermont is one of four states whose property taxes comprise more than ten percent of the state revenue.³ Along with the rest of New England, there is a heavy reliance on property taxes because there are few local alternatives.⁴

¹ Beth Parent, "Income Tax vs. Property Tax," *WCAX-TV News* August 21, 2007
<http://www.wcax.com/Global/story.asp?S=6963515> visited March 24, 2008.

² Michael Griffith, "Taxation and Spending Policies," Education Commission of the States (ECS), June 2004
<http://ecs.org/clearinghouse/52/94/5294.pdf> visited March 26, 2008.

³ National Conference of State Legislatures, "A Guide to Property Taxes: An Overview," May 2002,
<http://204.131.235.67/programs/fiscal/fpproptax.htm>, visited 4/2/08.

⁴ National Conference of State Legislatures, "A Guide to Property Taxes: An Overview."

Property taxes tend to be unpopular. “They are based on assessments that are often viewed as unfair, are regressive [those with lower incomes pay a higher tax rate], and are highly visible because they are paid in lump sums.”⁵

Income Tax

Income tax has many benefits that make it viable as a source for education funding. It has the potential to raise a great deal of revenue and is easy to administer.⁶ The framework for the income tax would be the same as the federal framework so therefore states would need only to adjust the income brackets and other rates.⁷ Income tax is also argued to be the most progressive tax available.⁸ Progressive tax systems are those in which the wealthier people in a society bear a disproportionately higher share of the taxes.⁹

This being said, there are arguments against income taxes. Income tends to vary with business cycles, so the revenues from income taxes are often low while spending on public programs is high. Income taxes decrease private returns on economic activity, therefore largely progressive income tax rates tend to hamper further economic growth. Income taxes are hard to sell politically due to the fact that the people that are hardest hit by income taxes are the wealthy, and the wealthy are more likely to be politically active and make campaign contributions.¹⁰

Sales (or Excise) Tax

A sales (or excise) tax is a federal or state tax imposed on the manufacture and distribution of certain non-essential consumer goods or activities. Sales taxes “have the potential to generate a great deal of revenue and may be more stable than income taxes because people have to buy food, clothing, and so on even in a recession. However, they are usually regressive because the amount people spend on consumer purchases does not rise as fast as income.”¹¹ This is often addressed by exempting “necessities,” such as food, medicine, and clothing, from the sales tax.

Some selective sales taxes may be politically popular, however, if they apply only to products that the majority of people consider undesirable or that create social costs, such as alcohol and cigarettes (sometimes referred to as “sin taxes”). The problem with this sort of selective sales tax is that the two objectives of raising revenue and discouraging behavior are incompatible.¹²

⁵ Robert C. Lowry, “Fiscal Policy in the American States,” in Virginia Gray and Russell L. Hanson (editors), *Politics in the American States: A Comparative Analysis*, 9th Edition (Washington, DC: Congressional Quarterly Press, 2008), pp.287-315, p. 301.

⁶ Robert C. Lowry, “Fiscal Policy in the American States.”

⁷ Robert C. Lowry, “Fiscal Policy in the American States,” p. 300.

⁸ New Jersey School Boards Association, “How a New School Funding System Should Work,” June 2007 http://www.njsba.org/press_releases/funding-white-paper.pdf visited March 24, 2008

⁹ Robert C. Lowry, “Fiscal Policy in the American States,” p. 299.

¹⁰ Robert C. Lowry, “Fiscal Policy in the American States,” p. 299.

¹¹ Robert C. Lowry, “Fiscal Policy in the American States,” p. 300.

¹² Robert C. Lowry, “Fiscal Policy in the American States,” pp. 300-302.

Typically, these taxes fall on products like cigarettes and gasoline, which may help to prevent smoking and promote more eco-friendly modes of transportation. In addition to the problems above, the sales tax can also be negatively affected by the state of the economy. This is evident in Boston, as the *Boston Globe* reported, that revenue from excise taxes on motor vehicles is expected to drop for the second straight year in Boston. Last year's fiscal year excise tax revenue across the state was down 4.89 percent less than the previous year. They attribute the slump from people keeping their cars longer and a slump in new car sales. This has been the trend throughout many cities in Massachusetts; some have suffered loss in excise tax revenue resulting in \$60,000 less in 2007 than in 2006.¹³

States are increasingly turning to casinos as a source of revenue in the model of states like Nevada, which generates nearly twenty-five percent of its revenue from gambling. Many states also gain revenue from a state lottery—which is usually earmarked for functions such as education. However, these taxes are controversial because many people believe that the state should not be encouraging gambling and they are perceived to be a regressive source of revenue that is used to provide benefits for middle and upper class residents.¹⁴

Other State Initiatives on Education Funding

A few states have considered the option of funding education with a state income tax.

Pennsylvania

In Pennsylvania in 2008 the State House of Representatives passed an education funding plan that included some of the educational programs that Governor Edward Rendell promoted during his campaign for governor. The major provisions of the legislation include a personal income tax increase that will give local schools block grants for pre-school and full day kindergarten for school districts that choose to participate, more money to improve standardized test scores, and funds to make tutoring programs more widely available.¹⁵

The funding plan was modified by the state senate and ultimately passed albeit with a lower income tax increase and consequently lower education funding.

A poll of residents revealed that they were not supportive of an income tax hike, except when it was tied to education. This tie to education increased the support for the tax hike from near zero to over fifty percent of the residents polled.¹⁶

¹³ Steven Rosenberg, "Stuck in Reverse," *Boston Globe*, March 13, 2008, http://www.boston.com/news/local/articles/2008/03/13/stuck_in_reverse/, visited 5/7/08.

¹⁴ Robert C. Lowry, "Fiscal Policy in the American States," p. 302.

¹⁵ Berwood Yost and G. Terry Madonna, "Public Education, Education Funding and Public Opinion: What do Pennsylvanians have to say?," November 2003 <http://edisk.fandm.edu/FLI/politics/pdf/PublicOpinionandEducationalFunding.pdf> visited March 24, 2008.

¹⁶ Berwood Yost and G. Terry Madonna, "Public Education, Education Funding and Public Opinion: What do Pennsylvanians have to say?"

Illinois

The switch to income tax was also proposed in Illinois, where school funding reform advocates were pushing to increase income taxes to fund education in 2005. Despite the push, Governor Rod Blagojevich vetoed the bill because of his pledge not to raise taxes.¹⁷

Maine

In Maine, the legislature created an Education Funding Reform Commission, which produced a report that recommended balancing the primary methods of raising taxes between property, sales and personal income tax. They also proposed putting a cap on the amount of property taxes that can be raised to fund education and suggested substituting a reduced rate excise tax to make up the difference.¹⁸

New Jersey

New Jersey is attempting to shift a portion of school funding away from the local property tax and over to state revenue sources, resulting in the state funding at least 50 percent of the cost of public education. The state attributes property tax funding as the root of the continued failure to provide adequate and equitable education funding for all students in all communities. New Jersey ranks fourth highest among the 50 states in the percentage of school costs funded by local property taxes.¹⁹

This report prepared by Jamie Parot, Ryan McCormick, and Kevin Channell under the supervision of Professor Anthony Gierzynski on April 28, 2008.

Disclaimer: This report has been compiled by undergraduate students at the University of Vermont under the supervision of Professor Anthony Gierzynski. The material contained in the report does not reflect the official policy of the University of Vermont.

¹⁷ Guinane, Pat, "The governor has ruled out a tax hike so budgeters will need to be creative," May 2005 <http://illinoisissues.uis.edu/state/creative.html> visited March 24, 2008

¹⁸ State of Maine Legislature, "Final Report of the Education Funding Reform Committee," February 2002, <http://maine.gov/legis/ofpr/efrcreport.htm>, visited March 24, 2008.

¹⁹ New Jersey School Boards Association. "How a New School Funding System Should Work". http://www.njsba.org/press_releases/funding-white-paper.pdf - Visited 5/7/08

Table 1: Taxation and Spending Policies

State	Taxes Used To Fund Education
Alabama	Property, sales, amusement, tobacco, alcohol, gasoline and mineral lease taxes
Alaska	Property and Sales taxes
Arizona	Property taxes
Arkansas	Property, personal property and severance taxes
California	Property tax and sales tax (used by the San Francisco district only)
Colorado	Property and specific ownership (vehicle) taxes
Connecticut	Property taxes
Delaware	Property taxes
Florida	Property taxes
Georgia	Property and sales taxes
Hawaii	None
Idaho	Property taxes
Illinois	Property taxes
Indiana	Property, motor vehicle, financial institutions and income taxes
Iowa	Property and income taxes.
Kansas	Property taxes and motor vehicle/ recreational vehicle taxes
Kentucky	Property, motor vehicle, utility, income tax surcharges and occupational license taxes
Louisiana	Sales and property taxes
Maine	Property taxes
Maryland	Property and income taxes
Massachusetts	Property, motor vehicle excise and hotel/accommodations taxes
Michigan	Property taxes
Minnesota	Property and mineral taxes
Mississippi	Property taxes
Missouri	Property taxes
Montana	Property and "flat taxes" (which include revenue from motor vehicle/ recreational vehicle fees and oil, gas and coal production taxes)
Nebraska	Property taxes, city/county fines and license fees and proceeds from sales tax on public power districts
Nevada	Property, tangible personal property, motor vehicle privilege and franchise taxes
New Hampshire	Property taxes
New Jersey	Property taxes
New Mexico	Property taxes
New York	Property taxes, a share of the county sales tax and a utility tax (for small districts only)
North Carolina	Property taxes and sales taxes (for school construction only)
North Dakota	Property and mineral taxes
Ohio	Property and income/payroll taxes
State	Local Taxes Used To Fund Education
Oklahoma	Property taxes
Oregon	Property Taxes and private timber taxes
Pennsylvania	Property taxes and "Act 511" taxes (see note)
Rhode Island	Property taxes
South Carolina	Property and sales taxes
South Dakota	Property taxes
Tennessee	Property and sales taxes
Texas	Property taxes
Utah	Property taxes
Vermont	Property taxes & sales taxes (in use in only one district)
Virginia	Property, tangible personal property and sales taxes
Washington	Property Taxes and private timber taxes
West Virginia	Property taxes
Wisconsin	Property taxes
Wyoming	Property taxes

Source: Michael Griffith, "Taxation and Spending Policies," Education Commission of the States (ECS), June 2004
<http://ecs.org/clearinghouse/52/94/5294.pdf> visited March 26, 2008.