3rd Draft

Initiative #93
Funding for Public Schools

Amendment ? proposes amending the <u>Colorado Constitution and Colorado statutes</u> to:

- ♦ increase funding for preschool through twelfth grade (P-12) public education;
- ♦ raise the state individual income tax rate for taxpayers with taxable income over $150,000, and increase the state corporate income tax rate to provide additional funding for education; and
- ♦ for property taxes levied by school districts, set the assessment rate at 7.0 percent for residential properties and decrease the assessment rate to 24.0 percent for most nonresidential properties.

Summary and Analysis

Amendment ? increases funding for P-12 public education by raising the individual income tax rate for some individuals, increasing the corporate income tax rate, and setting new assessment rates for property taxes levied by school districts. This analysis describes current funding for public education, how the measure increases school funding, and how the measure changes Colorado's income and property tax systems.

Education Funding

Current P-12 education funding. P-12 public schools in Colorado are funded through a combination of state, local, and federal sources. Based on the latest available data, total education funding is approximately $9.8 billion, of which $6.6 billion is allocated to school districts through a formula in state law. Formula funding begins with the same amount of funding per student, known as the base per pupil funding, which is constitutionally required to increase by at least the rate of inflation annually. In budget year 2017-18, the base per pupil amount was $6,546. The base funding amount is then adjusted by the following factors to determine a final per pupil amount that varies by district:

- **district size factor**, which provides additional funding based on student enrollment, with smaller districts receiving more funding;
- **cost-of-living factor**, which provides additional funding based on the cost of living in a given district relative to other districts;
- **at-risk factor**, which provides additional funding based on the number of low-income and non-English speaking students; and
- **budget stabilization factor**, which was adopted in 2010 as a budget-balancing tool and applies an equal percentage reduction in formula funding across all school districts.

After the factors were applied, final per pupil amounts ranged from $7,236 to $16,247 across all school districts in budget year 2017-18. Once the funding is distributed to districts, each locally elected school board determines how to spend the revenue in its own district.

Formula funding sources. Formula funding is provided by state and local sources. The state pays for the portion of the formula that school districts are unable to fund with their local revenue. Of the $6.6 billion distributed through the formula in budget year 2017-18, the state share was $4.1 billion and the local share was $2.5 billion. The state share is funded by income taxes, sales taxes, and other state revenues, while the local share is funded through local property taxes and vehicle ownership taxes.

Other funding sources. In addition to funding set by the formula, districts receive additional state assistance for specific programs, known as “categoricals.” Categoricals include special education, English language learning, gifted and talented and vocational programs, and transportation and totaled $297.6 million in budget year 2017-18. Additional sources of revenue for education include federal funding, district-assessed fees, competitive state grants for specific purposes, and state capital construction programs, among other sources.

In many school districts, voters have approved property tax revenue above the amount authorized through the school finance formula. These additional property taxes are called “mill levy overrides,” and are used for specific local education needs. As of 2018, voters in 121 out of 178 districts have approved mill levy overrides. For those districts, the additional per pupil funding ranges from $32 to $5,024 per student.

Education funding under the measure. The measure encourages the state legislature to adopt a new public school finance act that distributes funding to public schools. The new distribution formula must be transparent and easy to understand, and meet criteria related to:

- an increase in base per pupil funding;
- equitable allocation of funding among districts, based on certain student and district characteristics;
- additional funding for certain specialized and early childhood programs; and
- the recruitment and retention of teachers.

Until a new act is adopted, the additional revenue generated by the measure must be spent on the funding criteria shown in Table 1. These requirements result in an $866 million spending increase compared with current year spending. New revenue generated by the measure above this amount must also be spent on public education, as determined by the state legislature.

Table 1. Funding Requirements Under Amendment ?
Until New Formula is Adopted

Funding Criteria	Current Law *(Projected Budget Year 2018-19)*	Under Measure For Budget Year 2019-20
Base Per-Student Funding	$6,769 per student	$7,300 per student
Fully Fund Kindergarten	Districts receive approximately half of the per-student funding for each kindergarten student.	Districts receive full per-student funding for each kindergarten student.
Low-income Students	Districts receive funding based on the number of students whose families earn below a certain income level.	Relaxes the income requirements for students to be considered low-income for funding purposes.
Special Education	$176.1 million	$296.1 million (an increase of $120 million)
Gifted and Talented	$12.5 million	$22.5 million (an increase of $10 million)
English Language Proficiency	$21.6 million	$41.6 million (an increase of $20 million)
Preschool	$121.0 million	$131.0 million (an increase of $10 million)

Tax Changes to Fund Education

Income taxes. Amendment ? increases income tax rates to provide additional revenue for public education. Colorado's current individual and corporate income tax rate is a flat 4.63 percent. Beginning in 2019, the measure creates a graduated individual income tax rate for taxable income above $150,000, and increases the corporate tax rate from 4.63 percent to 6.0 percent. The measure is expected to generate $1.6 billion in budget year 2019-20, the first year of implementation, to be spent on public education. This revenue is exempt from constitutional spending limits.

Individual income tax. Table 2 shows the change in individual income tax rates under the measure and the percentage of filers in each tax bracket. The income tax increase will impact 8.2 percent of individual and joint income tax filers. The graduated income tax rate also applies to estates, trusts, and businesses that file individually. The change in income tax rates is expected to increase state revenue by an estimated $1.4 billion in budget year 2019-20.

Table 2. Individual Income Tax Rates Under Amendment?

Taxable income* between...	...is taxed at a rate of...	Percent of filers whose maximum income is in each tax bracket
$0 and $150,000	4.63% (current rate)	91.8%
$150,001 and $200,000	5.0%	3.2%
$200,001 and $300,000	6.0%	2.5%
$300,001 and $500,000	7.0%	1.4%
Over $500,000	8.25%	1.1%

**These taxable income tiers apply to single, head of household, and joint filers.*

Those with taxable income equal to or less than $150,000 will not experience an income tax increase under the measure. The impact of the graduated tax increase on taxpayers with higher earnings will differ based on a taxpayer's taxable income. For example, a taxpayer with taxable income equal to $250,000 would be taxed at 4.63 percent for the first $150,000 in income. The subsequent $50,000 would be taxed at a rate of 5.0 percent, and the final $50,000 would be taxed at a rate of 6.0 percent. Table 3 shows examples of average annual increases in individual income tax liability under the measure.

Table 3. Example Individual Income Tax Increases Under Amendment ?

If your taxable income** is…	The measure will increase your annual income tax liability* by…
less than $150,000	$0
$200,000	$185
$250,000	$870
$400,000	$4,425
$1.0 million	$26,145

** Actual tax liability may vary based on state income tax credits.*
***These examples apply to single, head of household, and joint filers.*

Corporate income tax. The measure increases the corporate income tax rate from 4.63 percent to 6.0 percent. Businesses that pay corporate income tax are typically large businesses that operate across multiple states or countries. In contrast to the measure's individual tax rate changes, the increase in the corporate income tax rate is not a graduated tax rate and applies to all corporate taxpayers. The change is expected to generate $229.4 million in budget year 2019-20. On average, each of the approximately 15,000 corporate income taxpayers with an income tax liability are expected to pay an additional $14,139 per year under the measure.

Property taxes. Property taxes are paid on a portion of a property's value, determined by an assessment rate. Under current law, the assessment rate for most nonresidential property is set at 29 percent, and the rate for residential property is determined by the state legislature based on a formula in the state constitution. Over time, the residential assessment rate has declined from 21 percent in 1983 to the current rate of 7.2 percent. The rate is expected to fall further to 6.1 percent in 2019, based on projections published by Legislative Council Staff in December 2017.

For school district property taxes only, beginning in 2019, Amendment ? reduces the nonresidential assessment rate from 29 percent to 24 percent, thereby reducing taxes for nonresidential property. The measure reduces the residential assessment rate from 7.2 percent to 7.0 percent, and sets it at this lower rate, keeping it from falling further. Relative to the projected 6.1 percent residential assessment rate, the rate under the measure will result in a tax increase for residential property taxpayers. The measure does not impact the assessment rates for mines and lands producing oil and gas, nor does it impact property taxes levied by other local governments.

Taxpayer impacts. As explained above, the measure is expected to decrease school district property taxes for most nonresidential property taxpayers, and increase school district property taxes for residential property taxpayers beginning in 2019. The impact on property owners will vary significantly based on several factors, including the school finance formula mill levy rate for the local school district, the actual value of the property, the 2019 residential assessment rate without the measure, and whether and what type of mill levy overrides have been approved by the voters in the school district. For information about the projected impacts on taxpayers in a particular school district, please visit https://bit.ly/2M8T0ku.

School finance impacts. In 2019, the measure is projected to decrease school district property tax revenue by $62.4 million, reflecting a decrease in nonresidential property tax revenue of $317.8 million, partially off-set by an increase in residential property tax revenue of $255.3 million. If the state legislature chooses to keep school finance formula funding constant, this decrease in school district revenue in 2019 will be replaced by state funding, which could come from the additional income tax revenue generated by the measure. In future years, local property tax revenue for school districts will only be impacted by changes in property values and mill levy rates, not by a changing residential assessment rate.

Reporting Requirements

Amendment ? requires the Colorado Department of Education, within five years of the measure's implementation, to review how the additional revenue is spent and identify best practices for promoting continuous student achievement. In addition, the state legislature, within ten years of the implementation of the new school finance formula, is required to review the formula and ensure that it meets the goals of the measure.

For information on those issue committees that support or oppose the measures on the ballot at the November 6, 2018, election, go to the Colorado Secretary of State's elections center web site hyperlink for ballot and initiative information:

http://www.sos.state.co.us/pubs/elections/Initiatives/InitiativesHome.html

Arguments For

1) The state needs a sustainable source of revenue to adequately and equitably fund public education. Colorado significantly cut P-12 public education funding during the Great Recession, and funding levels have not recovered, even though Colorado has one of the healthiest economies in the nation. Since the 2010-11 budget year, the budget stabilization factor has cut education funding by a total of $7.2 billion. As a result, school districts have had to make difficult choices, such as limiting teacher salaries, increasing class sizes, limiting mental health and counseling services for students, and narrowing course offerings. Further, approximately half of Colorado school districts are currently operating on four-day weeks. The measure alleviates the impact of these historical cuts by providing a dedicated income tax increase to fund public education.

2) The measure provides property tax relief for business property owners, farmers, and ranchers who have paid an increasingly higher proportion of property taxes compared to residential property owners. Since 1983, the nonresidential assessment rate has been set at 29 percent, while the residential assessment rate has fallen from 21 percent to the current 7.2 percent. The measure lessens these inequities between residential and nonresidential property owners by both stabilizing the residential assessment rate and lowering the nonresidential assessment rate for school district property taxes.

3) One of the government's most important functions is to provide children with a high-quality public education. Local school districts will prioritize how to spend the new revenue in ways that best fit their community, such as recruiting and retaining highly qualified teachers, improving access to early childhood education programs, strengthening science and math, vocational, and literacy programs, and providing a safe learning environment for all students. These are key investments in a successful public education system, which could help ensure a strong Colorado economy that is capable of competing in today's global market.

4) Constitutional constraints have suppressed local property tax revenue in many areas and led to greater pressure on the state general operating budget to meet required education funding levels. Stabilizing the local share of required school formula funding and creating a dedicated source of state revenue for education provide additional flexibility for the state to use more of its general operating budget on other core programs, such as transportation, public safety, and health care.

Arguments Against

1) The measure imposes a tax increase without any guarantee of increased academic achievement. A focus on education reform rather than new revenue is more likely to improve student outcomes. Policymakers should be encouraged to find efficiencies within the current system and to reprioritize existing revenue in order to meet current education funding requirements. Since the 2012-13 budget year, total formula funding has increased by between 1.3 percent and 7.4 percent annually, and just this year, the legislature increased school formula funding by over $150 million without a tax increase.

2) Increasing the state income tax rate could negatively impact the state's economy. Businesses will have less money to invest in their workers and individuals will have less money to spend, save, and invest. Colorado may also have a harder time attracting or retaining businesses, as the top income tax rate under the measure would be 8.25 percent, the ninth highest state income tax rate in the country. This puts Colorado at a competitive disadvantage compared to other states.

3) The measure complicates an already complicated property tax system. By creating one assessed value for school districts and another assessed value for all other local taxing entities, the measure will lead to confusion among taxpayers and further complicate tax administration for state and local governments.

Further, this complicated system ultimately represents an additional burden on homeowners, providing a tax cut for businesses at the expense of homeowners.

4) The measure does not allow the state legislature to adjust the income tax thresholds to account for inflation. As a result, over time, more taxpayers will end up in the higher tax brackets as their incomes are adjusted for inflation, resulting in additional revenue that must be spent only on education. To the extent that more revenue is raised than is needed to sufficiently fund education, the state will not be able to use this money to address other critical needs such as transportation and health care. Finally, the additional revenue generated by the measure is exempt from the state's constitutional spending limit, thereby removing an important protection for taxpayers.

Estimate of Fiscal Impact

State revenue. The measure increases state revenue by $750.9 million in budget year 2018-19 (half-year impact) and $1.6 billion in budget year 2019-20. This amount is from individual income taxes and corporate income taxes. This revenue is exempt from constitutional spending limits and must be used for educational purposes identified in the measure.

State expenditures*.* The measure increases state expenditures by $174,933 and 1.6 FTE in budget year 2018-19 and by at least $866.1 million and 1.3 FTE beginning in budget year 2019-20. Expenditure increases in budget year 2018-19 are for administrative costs and increases in budget year 2019-20 include both administrative expenses and the new expenditures for education. Additional administrative expenses may occur in future years to comply with the measure's reporting requirements.

School district impact. The measure increases school district revenue by a minimum of $866 million and up to a net $1.5 billion in budget year 2019-20, the first full fiscal year the measure is implemented. For the potential $1.5 billion, school districts will receive $1.6 billion in state revenue, and see a $62.4 million decrease in revenue from property taxes. The allocation of this revenue to districts is dependent on several factors and has not been estimated; however, a minimum of $866 million must be distributed in budget year 2019-20 for the purposes specified in the measure.

Local government impact. The measure increases costs for county assessors and treasurers offices to update computer and data systems related to the changes in assessment rates. Specific costs will vary among counties.