

PENNY WISE? Funding School Facilities With a State Sales Tax

Iowa lawmakers are now considering legislation to convert existing School Infrastructure Local Option (SILO) 1-cent sales taxes that must be renewed every 10 years in each of Iowa's 99 counties into a 1-cent statewide, longer-term sales tax. According to an analysis by the Legislative Services Agency, a switch to a statewide sales tax would generate \$400.3 million in FY 2009 for school infrastructure funding, which is \$28 million more than the current SILO system would generate. A 1-cent increase in the motor vehicle use tax, envisioned in some versions of this proposal, would generate an additional \$53 million for roads.

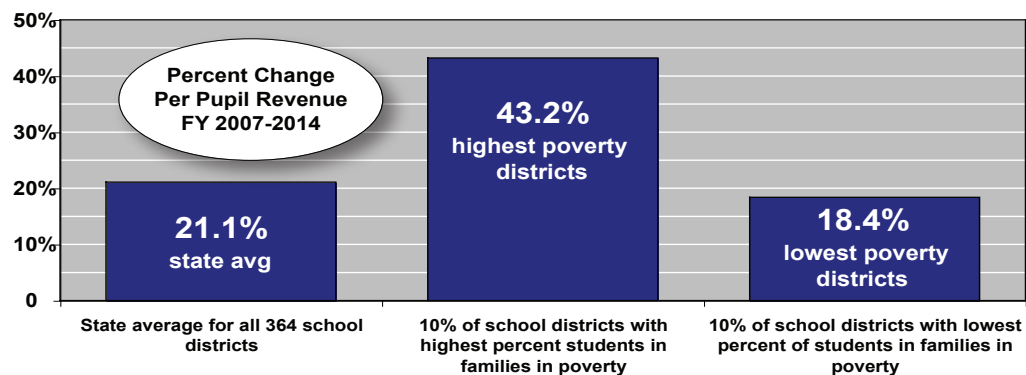
SILO funds can be used for activities for which a school district is authorized to contract indebtedness and issue general obligation bonds under Iowa Code 296.1. This includes purchasing, repairing, improving or remodeling things like a school building, gymnasium or bus garage. It can also mean furnishing a school building by installing new equipment and upgrading technology. In addition to the SILO tax, school infrastructure needs can be met either through approval of the Physical Plant and Equipment Levy (property tax or a combination of property tax and income surtax) or by issuing bonds to be repaid from the debt service property tax levy.

This proposal would increase funding for school district infrastructure needs by removing a per-pupil cap on the distribution of pooled funding, as well as by collecting taxes on out-of-state purchases and the sale of motor vehicles, neither of which are currently subject to the SILO tax. Using a sales tax to fund school district needs raises concerns about fairness since sales taxes have a disproportionately negative impact on low-income Iowa families, which pay a greater percentage of their income in sales tax than families in upper-income brackets. The proposed law would institutionalize the shift from property taxes to sales taxes as a way of funding school infrastructure, rather than changing to a fairer system of financing, such as an expansion of the school income tax.

However, the switch to a state sales tax would also have some positive consequences. It would repeal SILO taxes currently paid on utility bills by those residents who are not already paying a local franchise fee (about half of Iowans). Because low-income Iowans spend a greater percentage of their income on utilities than on motor vehicles, this would improve the fairness of Iowa's tax system. The figure below shows how, by enabling the greatest increases in per-pupil funding for districts with higher proportions of students in poverty, the switch to a statewide sales tax enhances fairness by improving educational opportunities. The bill also facilitates bonding for school buildings and helps ensure an adequate stream of funding.

There are also ways to make sure that school financing proposals currently under consideration are made more fair for all school districts and pupils. Under the current proposal, in districts where a revenue purpose statement outlining their

Poorest Districts Would Benefit Most From Switch to Statewide Sales Tax



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infrastructure funding plans fails to pass, funds from the statewide sales tax must be used to offset property tax. The effect of this is to target property tax reductions not at districts with little valuation per student and high tax rates, but simply at districts with less need or less voter support for new facilities. Some of these districts will in fact be places with the least need for property tax help: They have little need for new facilities because their high valuation per student, and resulting low tax rates, has made it easier to pass bond issues in the past. To address the problem of large disparities in additional levy rates, funding not used by a district that rejects a revenue purpose statement could, instead of offsetting property tax in that district, revert to the state fund and be applied to targeted property tax relief so that districts with the highest additional levy rates benefit.

The statewide penny creates a large annual pool of revenues earmarked for infrastructure needs, and distributes those revenues on an equal per capita basis regardless of the actual needs of the district. This is obviously more equitable than the old SILO system, where district revenue per pupil varied widely depending on the county sales tax base, and more equitable than sole reliance on the local property tax base, when per-pupil valuation varies from \$112,000 to \$752,000. On the other hand, some of the districts with few facilities needs also have low property tax rates, and the sales tax revenue flowing to those districts will then lower those tax rates further or create larger inter-district disparities in the quality of facilities. Earmarking funds for infrastructure prevents a district from using the revenue for what may be higher priority needs. Allowing districts to apply per-pupil revenue to activities currently funded under the Instructional Support Levy would correct this problem, though it could then aggravate disparities in programming.

Sustainable and equitable school infrastructure funding could also be achieved by using the income tax, which, unlike sales or property taxes, recognizes low-income households' limited ability to pay. Districts currently have the option of levying a local income tax surcharge as part of the Instructional Support Levy and the Physical Plant and Equipment Levy. Although the school local option income tax has been limited in amount and use, this does not have to be the case. A local option income tax, of course, would create some new inequities – income-rich districts would have an easier time financing infrastructure than low-income districts – that would require pooling similar to what is done with SILO.

In order to avoid concerns of equity and sustainability that may arise when local option taxes are pooled and distributed as per-pupil revenue, the current SILO tax also could be replaced with an increase in the state income tax. To generate the \$400.3 million that a proposed 1-cent increase in the state sales tax would produce, the state would need to attach an approximate 11.6 percent surcharge to the state income tax. While this figure may seem large, it is actually about half of the proposed 20 percent increase involved in raising the sales tax from 5 percent to 6 percent.

Legislators must weigh the various equity and fairness issues raised by the proposed statewide SILO as they make decisions about school infrastructure financing. The health of Iowa's tax system depends on policymakers' attention to fairness, efficiency and stability as they make decisions about how to generate and distribute state revenue. Legislators should also ask: "If we are going to commit \$400 million in state revenue annually to the PK-12 school system, what is the best use of those funds?" The list of possibilities should include increased funding of preschool programs and raising the state foundation level from the current 87.5 percent, thereby reducing the substantial disparities in property tax rates that still exist.