

Penny Wise?

Funding School Facilities with a State Sales Tax

Peter S. Fisher and Beth Pearson

April 2008

Iowa Fiscal Partnership

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Iowa Fiscal Partnership

The Iowa Fiscal Partnership is a joint initiative of the Iowa Policy Project and the Child & Family Policy Center, two nonprofit, nonpartisan Iowa-based organizations that cooperate in analysis of tax policy and budget issues facing Iowans. IFP reports are available at <http://www.iowafiscal.org>.

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Introduction

Proposed legislation that would convert existing School Infrastructure Local Option (SILO) 1-cent sales taxes in each of Iowa's 99 counties into a 1-cent state sales tax raises questions of how this change would affect low-income Iowans and the overall health of the Iowa tax system. The proposal increases funding for school district infrastructure needs by removing a current 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. 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 — proposed by some for this legislation — would generate an additional \$53 million for road uses.

The sales tax has a disproportionate impact on low-income Iowans, who pay a greater percentage of their income in sales tax than do those 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 also would have 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 change would improve the fairness of Iowa's tax system. And by enabling the greatest increases in per-pupil funding for districts with higher proportions of students in poverty, switching to a statewide sales tax improves educational opportunities and enhances fairness.

The bill also facilitates bonding for school buildings and helps ensure an adequate stream of funding. The funding flowing to a district, however, is the same amount per student regardless of the district's actual needs for facilities and equipment. While some districts may be in desperate need for new buildings, computers or energy-efficiency upgrades, others may have little in the way of basic or high-priority needs, in which case the revenue could be used for facilities tangential to the district's educational mission, or simply for property tax relief.

Building a SILO

In 1998, the Legislature granted counties the authority to impose a voter-approved local sales tax of up to 1 cent per dollar for school infrastructure. Local option taxes are collected

countywide and distributed to all school districts in the county in proportion to the number of pupils in each district. Localities in Iowa also have the authority to impose a limited number of other local option taxes, including a Local Option Sales Tax (LOST), approved in 1985, that gave cities and the unincorporated portion of counties the ability to levy a 1-cent sales tax. The Local Hotel and Motel Tax, authorized in 1978, allows cities and counties to impose a tax of up to 7 percent on the renting of hotel and motel rooms.

Woodbury County was the first county in Iowa to approve a SILO tax, in October 1998. Growth in the number of counties with a SILO tax was modest from 1998 until 2003, in part because many rural counties had a limited sales tax base. Districts on the fringes of metropolitan counties were particularly disadvantaged by the SILO tax system, since their residents in many cases found themselves paying an additional penny sales tax when shopping in the adjoining county, with the revenue going to support that county's school systems. Disparities in SILO revenue between sales-tax rich and sales-tax poor counties were large.

In response to this problem, the Legislature amended the 1998 legislation in 2003 to, among other things, create the Secure an Advanced Vision for Education (SAVE) fund, which collects and distributes SILO revenues so that every district adopting the tax would receive a per pupil amount, currently capped at \$575. To equalize sales tax revenue across districts, the legislation also provided that the state will annually contribute \$10 million to the SAVE fund through 2014. The legislation further required that any district renewing a SILO tax in the future would have to contribute any excess SILO revenue above \$575 per pupil to the SAVE fund. Districts generating less than \$575 per pupil would receive supplemental revenue from the SAVE fund.¹ Districts that already had a SILO tax approved and were receiving over \$575 per pupil would continue to receive all of the revenue generated in that county until the 10-year authorization expired.²

The number of counties adopting SILO increased rapidly after 2003, and when Johnson and Linn counties approved SILO in February 2007 they became the last of Iowa's 99 counties to have adopted the measure.³ Original SILO legislation included a 10-year sunset provision for the local option sales tax, and further amendments in 2004 provided for an extension of this sunset. Some counties have approved a 10-year extension of SILO, but almost three-quarters of counties will have it expire by the end of FY 2014. The 2003 legislation also included a provision to repeal the SILO sales taxes everywhere as of December 31, 2022.

Proposals for a Statewide School Infrastructure Sales Tax

A proposal now under consideration by the Legislature would convert the local option SILO sales tax into a longer-term, statewide 1-cent sales tax.⁴ This "sixth penny" of the state sales tax would go directly into the SAVE fund to be distributed to school districts on the basis of a

¹ Some school districts currently receive less than \$575 per pupil cap since local option sales tax revenue has not yet generated enough revenue to fund each school district at the cap level. However, the Legislative Services Agency expects this cap to be reached for all school districts by FY 2009.

² A special provision for Johnson and Linn Counties, the only counties without the SILO who would generate more than \$575 per pupil if they adopted the tax, allowed districts in those counties to retain all SILO revenue generated for the first five years, as an inducement to adopt the tax. Both counties subsequently did so.

³ For an illustration of SILO growth, FY 1998 to FY 2008, see Iowa Legislative Services Agency (2007) *School Infrastructure Local Option Sales Tax*. December 19, 2007. Available from: <http://www.legis.state.ia.us/lsadocs/lssReview/2008/IRSL002.PDF>.

⁴ House File 2663.

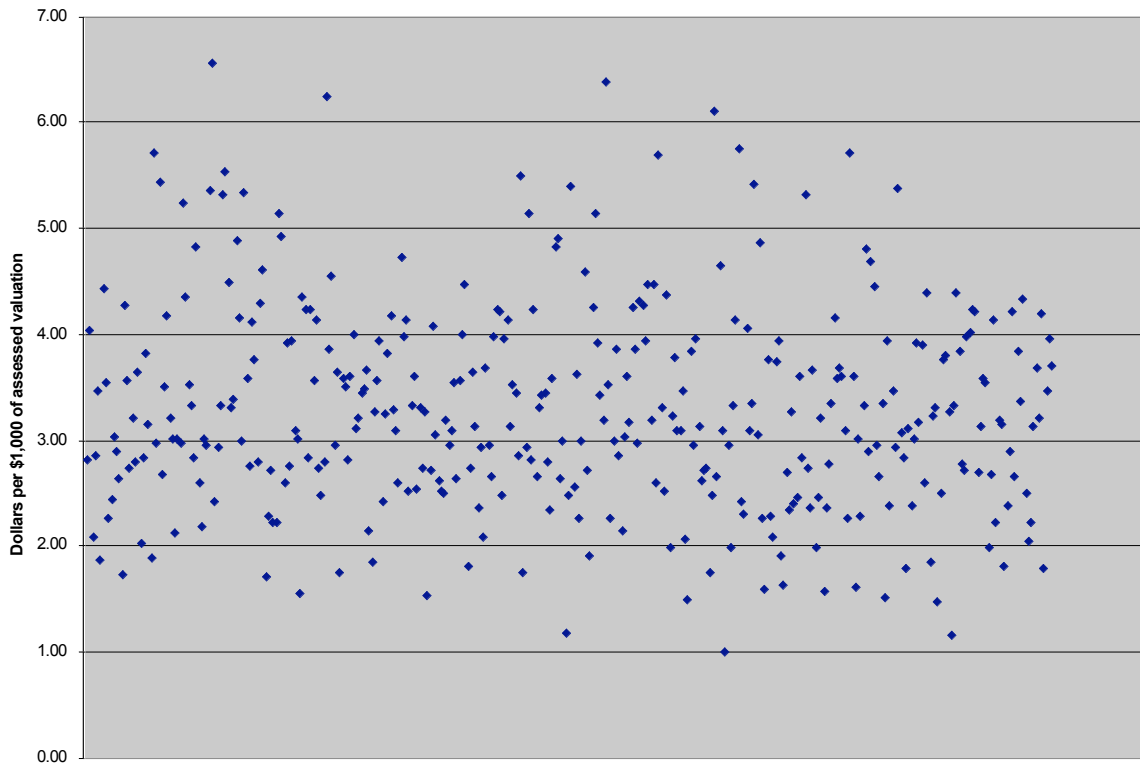
revised per pupil distribution formula. Districts currently receiving more than the statewide per pupil amount because they had approved SILO prior to the creation of the SAVE fund in 2003 in would continue to receive all of the revenue from the state penny generated in their county until the expiration date of the original SILO authorization, or until the end of the five-year grace period in Linn and Johnson counties.

At the state level, the sales tax on goods purchased in Iowa and the use tax on motor vehicles, as well as on goods purchased elsewhere but used in Iowa (primarily goods purchased by businesses), go hand in hand. An increase of 1 cent in the sales tax would be accompanied by a 1-cent increase in the use tax. For local option sales taxes, however, there is no accompanying use tax. The shift to a statewide school infrastructure tax would therefore apply the “school penny” for the first time to car sales and out-of-state purchases. Revenue collected from taxing out-of-state purchases would be directed to lowering property taxes in districts with the highest additional levies, while the revenue from car sales would go to the road-use tax fund. In addition, some residential gas and electric utility bills are taxed by the existing SILO taxes but were exempted from state sales taxes by legislation passed in 2001. The shift to a statewide school tax would eliminate the 1-cent tax on utilities that exists for some customers. The Legislative Services Agency estimates that this change would eliminate approximately \$12 million in sales taxes currently being paid by some residential utility customers.⁵

There is little question that increasing the adequacy and sustainability of funding for school infrastructure in Iowa is an important goal of state tax policy. The first 87.5 percent of a district’s per pupil cost (the “foundation level”) is funded through a combination of state aid and local property taxes. Every district must adopt the “uniform levy,” which is a local property tax of \$5.40 per \$1,000 of assessed valuation; state aid then makes up the gap between the revenue from the uniform levy and the 87.5 percent foundation level. In order to meet the remaining 12.5 percent of total cost, local districts must levy an additional property tax. The tax rate required to generate sufficient funds to meet this level varies from district to district, depending on the amount and value of available taxable property. According to the Iowa Association of School Boards (IASB), the additional levy rate for fiscal year (FY) 2009 ranges from a low of \$1.00 per \$1,000 in the Okoboji school district to a high of \$6.57 per \$1,000 in the Carlisle school district. The statewide average additional levy rate is \$3.30 per \$1,000 of assessed valuation. Figure 1 below illustrates the range of additional levy rates across school districts in Iowa.

⁵ Iowa Legislative Services Agency (2007) *School Infrastructure Local Option Sales Tax*, p. 7.

Figure 1. FY 2009 Additional Levy Rates in Iowa School Districts Vary Widely



Converting the current system of local option sales taxes into a permanent, statewide penny dedicated to school infrastructure would help make this funding more sustainable and would increase the amount of funding available for districts' infrastructure needs. 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 a broad range of infrastructure-related costs such as purchasing, repairing, improving or remodeling a school building, gymnasium or bus garage. It can also mean furnishing a school building by installing new equipment.

In addition to the SILO tax, school infrastructure needs can be met either through the adoption of another property tax (the Physical Plant and Equipment Levy) or by issuing bonds to be repaid from the debt service property tax levy. Because bonds require the approval of a supermajority (60 percent) of voters, they have not always proven to be a reliable source of revenue for districts with infrastructure needs. Since 1998, 56 percent of the 31 school bond issues presented to local voters across Iowa have been approved; if only a simple majority had been required for passage, that approval rate would have increased to 77 percent.⁶ In other words, a minority of the voters in a school district was able to defeat the wishes of the majority in over one out of five school bond referenda during the past 10 years.

Before issuing bonds to be repaid from the school sales tax, a district revenue purpose statement, or infrastructure plans, must be approved by the voters. However, these statements

⁶ Legislative Services Agency (2007) *Legislative Guide to Basic Education Finance*, Available from: <http://www.legis.state.ia.us/Central/Guides/edfin.pdf>, p. 26-7.

require voter approval by a simple majority rather than a supermajority, which makes it easier for districts to fund infrastructure than if they were required to issue a bond backed by property taxes. Furthermore, a statewide penny increases school districts' ability to leverage bond funds by allowing them to rely on a permanent funding stream. Under the current system, school districts receiving supplemental funding from the SAVE fund because their SILO tax generates less than the \$575 per pupil level are only allowed to bond against the portion of their per pupil funding that they generate from the local option tax itself. This is a consequence of the potentially unsustainable nature of SAVE funding, which relies on the participation of individual counties that must locally approve extensions of the sales tax, as well as on a temporary annual state appropriation of \$10 million per year through FY 2014.

For example, although Warren County receives \$536 per pupil in SILO revenue through the SAVE fund, it is only allowed to bond against the \$356 per pupil that it generates locally. Humboldt County, on the other hand, can bond against \$575 per pupil since it generates \$621 per pupil in SILO revenue (but, because it implemented SILO in 2005, must pay its excess revenue into the SAVE fund). Districts in counties that approved SILO before the creation of the SAVE fund and can keep their excess revenue can currently bond against even higher amounts; Cerro Gordo County, for instance, approved SILO in 2003 and can bond against the \$1,097 that it generates locally and retains.

Converting SILO to a permanent statewide tax would affect school district bonding capacity in two ways. First, it would increase equity in that all school districts would rely on the same level of per pupil sales tax revenue — estimated at \$774 for FY 2009 — or issuing bonds. Second, when school districts bond against locally generated sales tax revenue in the current system, they cannot actually bond against the entire amount of this revenue since local sales tax revenue fluctuates from year to year. As a result, bond issuers only allow districts to bond against a lower level of their projected sales tax revenue and may charge higher interest rates. Moving to a statewide sales tax would likely allow school districts to bond closer to their total per student amount and take advantage of lower interest rates because the revenue is more sustainable, stable, and predictable.

The amount of funding available to meet districts' infrastructure needs would increase with the transition to a 1-cent statewide sales tax because this transition would also involve a switch to the use of a five-year rolling average to calculate the per pupil infrastructure funding level. Under existing SILO legislation, per pupil funding amounts are statutorily capped at \$575, even though revenue is soon predicted to be flowing into the SAVE fund in excess of this level. The Legislative Services Agency estimates that, were a rolling average methodology used, per pupil funding for FY 2009 would be \$774.

Sustainability of infrastructure funding is a key concern because of the sunset provisions in the current SILO law. These provisions also have consequences for the equity of funding across the state. The SAVE fund that was created in 2003 to collect and distribute SILO revenue on a per-pupil formula increases equity by using sales tax revenue from districts with a large sales tax base to subsidize infrastructure costs in districts with small sales tax bases. However, equity can be assured only if all Iowa counties continue to participate in the system by maintaining a local option sales tax. Consider a school district that approved a SILO tax before 2003 and is generating sales tax revenue well above \$575. Because the county approved SILO before the creation of the SAVE fund, it is allowed to keep its excess revenue without contributing to SAVE until the 10-year expiration date of its original SILO. Suppose when the

original SILO expires, voters do not approve an extension because it no longer seems like such a good deal — with the extension, their ability to export part of school taxes to shoppers from surrounding counties will have been eliminated. When this county drops out of the system, it will no longer pay into the SAVE fund.

For instance, Johnson and Linn counties, both with large regional shopping centers, will contribute substantial amounts to SAVE for the second five years of their SILO taxes, but their contributions to SAVE would cease if voters failed to approve an extension, meaning that the SAVE fund would shrink. Each school district would subsequently receive a lower per pupil SAVE disbursement, which would especially disadvantage poorer school districts. Converting SILO into a statewide sales tax effectively makes the SAVE fund permanent and makes school infrastructure funding more predictable and equitable. The sales-tax-rich counties cannot drop out. Instead, all pupils will continue to receive an equal share of all sales tax revenue generated statewide.

Under the current proposal, in districts where a revenue purpose statement outlining their infrastructure funding plans fails to pass, funds from the statewide sales tax must be applied to property tax relief. The effect of this is to target property tax relief 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 relief: 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 fails to pass a revenue purpose statement could, instead of being applied to tax relief 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. Proposals to use the additional funds generated by moving to a statewide sales tax (which is estimated to generate approximately \$28 million more than the current SILO system) for targeted property tax relief already recognize the importance of making sure that property tax relief goes to the districts that need it most. The same principle could apply to unused statewide sales tax revenue.

The current SILO system and the proposed statewide penny reserve sales tax revenue solely for infrastructure purposes. Another drawback to such an approach is that it creates a “use it or lose it” situation for local districts, which could result in spending on any kind of facility, needed or not, just to keep from losing the funds. This can mean that some property-tax rich districts that have few existing infrastructure needs may spend the funds for less essential purposes than would a property-tax poor district that has struggled in the past to build a school building. These inequities were present in the pre-SILO era as well. Spending for facilities has never been equalized in the way that general operating costs are equalized through the foundation formula. Property rich districts can finance buildings with much lower property tax rates. What the infrastructure sales tax does (both the SILO and statewide versions) is create a pool of money earmarked for buildings, encouraging a higher degree of disparity in the quality of facilities. The state would benefit from conducting a comprehensive review of district infrastructure needs to assess how exactly these inequities are manifested.

An argument can also be made that districts should have more flexibility in how per-pupil revenue from the sales tax increase is spent, especially if they have few infrastructure needs or already have low property tax levies. Instead of being limited to activities specified under

Iowa Code 296.1, statewide sales tax revenue could also be spent for the kinds of activities funded through the Instructional Support Levy. This would allow districts to apply funds for programmatic purposes — a music program, more foreign language courses — but not for things already covered by the foundation aid formula. The virtue of this approach is that it gives districts the flexibility to direct the funds toward enhanced educational programming, if that is of higher priority than facilities or property tax relief.

In addition to some of the benefits related to sustainable and adequate funding of a transition from the current SILO tax arrangement to a permanent, statewide 1-cent sales tax dedicated to school infrastructure funding, there are ways in which this move would reduce the equity of Iowa's tax system. A primary criterion for tax fairness is whether a tax system is based on ability to pay, in which those at higher incomes pay at a higher rate than those with lower incomes. Some aspects of a tax system will be fairer than others because each tax system is made up of several different kinds of taxes. The state sales tax is the least fair part of Iowa's tax system because it most disproportionately impacts low-income individuals. Analysis by the Institute on Taxation and Economic Policy shows that Iowans in the lowest income quintile pay almost 7 percent of their income in sales taxes, which is more than any other income group.⁷ The wealthiest Iowans, for instance, pay only 1.2 percent of their income in state sales taxes.

Some proponents of the switch to a statewide penny sales tax for school infrastructure argue that it does not amount to a sales tax increase since all counties in Iowa currently have the SILO tax. While all counties do currently have the tax as a local option, the switch would institutionalize the shift in school funding from property to sales taxes that began in 1998 with passage of the SILO law, and proposes implementation for a longer period than 10 years. As a result of this law, property taxes are lower and sales taxes are higher, meaning that the tax system as a whole is somewhat less fair because it places more emphasis on the tax that most disproportionately affects lower-income people.

However, although the elimination of \$12 million in residential gas and electric utility bill taxes is less significant than the \$81 million that could be generated by moving to a statewide sixth penny that includes use taxes on motor vehicle purchases, the statewide penny ends up being more progressive than the status quo for about half of Iowa residents. This is because, as Table 1 shows, low-income Iowans spend a higher percentage of their income on utilities than they do on motor vehicles. (They are also less likely to be affected by the statewide sales tax being applied to out-of-state-purchases than are businesses, for instance.) A 1 percent sales tax levied on expenditures on gas and electricity (through utility bills) would end up being more expensive for the lowest-income Iowans than a 1 percent use tax on vehicles. The low-income Iowans who would benefit from this switch are those currently paying a 1-cent SILO tax on their utility bills, which is only the case for those residents served by utilities not paying a local franchise fee. This is the case for about 49 percent of Iowans.

For the half of Iowans not subject to the SILO tax on utilities, a 1-cent tax on motor vehicles that — under some proposals — would be imposed by the statewide penny is a tax increase without any offset. Furthermore, a tax on motor vehicle purchases has a slight disproportionate effect on lower-income families. However, this the motor-vehicle provision is not part of all proposals for a statewide school infrastructure sales tax.

⁷ Institute on Taxation and Economic Policy (2003) "Iowa Taxes Hit Poor and Middle Class Harder than the Wealthy," *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. Available from: <http://www.itepnet.org/wp2000/ia%20pr.pdf>.

Table 1. Low-income lowans gain from replacing utility tax with motor vehicle use tax

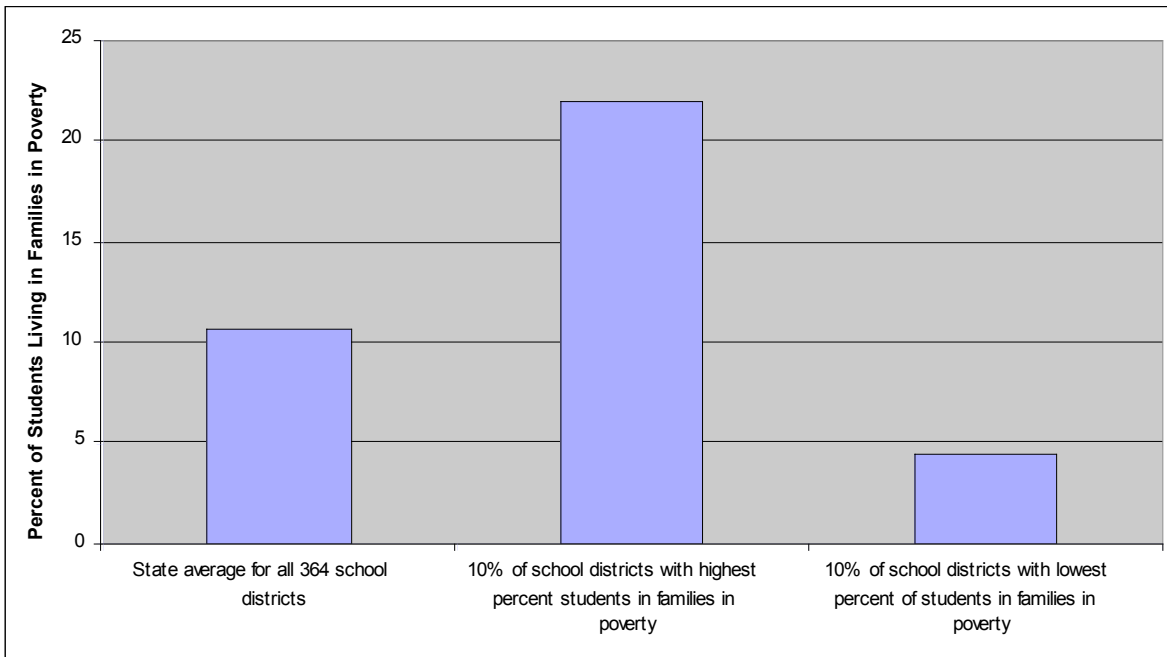
	\$5,000 to \$19,999	\$20,000 to \$49,999	\$50,000 and more
Number of consumer units	5,155	8,918	11,887
Total income	65,634,678	303,573,692	1,182,656,219
Total expenditures			
Natural gas, electricity and fuels	6,556,170	15,572,044	27,957,905
Motor vehicle purchases	3,738,188	15,762,619	57,997,248
Average income before taxes	12,732	34,041	99,492
Average expenditures			
Natural gas, electricity and fuels	1,272	1,746	2,352
Motor vehicle purchases	725	1,768	4,879
Expenditures as a percent of income			
Natural gas, electricity and fuels	10.0%	5.1%	2.4%
Motor vehicle purchases	5.7%	5.2%	4.9%
Sales tax			
1% sales tax on utilities	12.72	17.46	23.52
1% use tax on vehicles	7.25	17.68	48.79
Net impact	(5.47)	0.21	25.27

Source: Table 32. Midwestern region by income before taxes: Average annual expenditures and characteristics, Consumer Expenditure Survey, 2005-2006

It is of course important to recognize that public education is based on the idea that disadvantaged students should have a quality education equal to that of their peers. Infrastructure is a key aspect of a quality education, just as are textbooks and good teachers. Increasing funding for school infrastructure promotes fairness if it improves funding for students in poor districts, but the actual mechanism by which infrastructure funding is generated must be a fair one in order for poor districts to benefit.

Poverty levels vary widely across Iowa school districts. Figure 2 illustrates the wide gap between the most- and least-poor school districts in Iowa. While the statewide average for proportion of a district's students living in families in poverty is 10.7 percent, the 10 percent of school districts with the highest poverty levels have an average of 22 percent of students in poverty. This compares to the 10 percent of school districts with the lowest level of poverty, where an average of only 4.5 percent of students live in poverty.

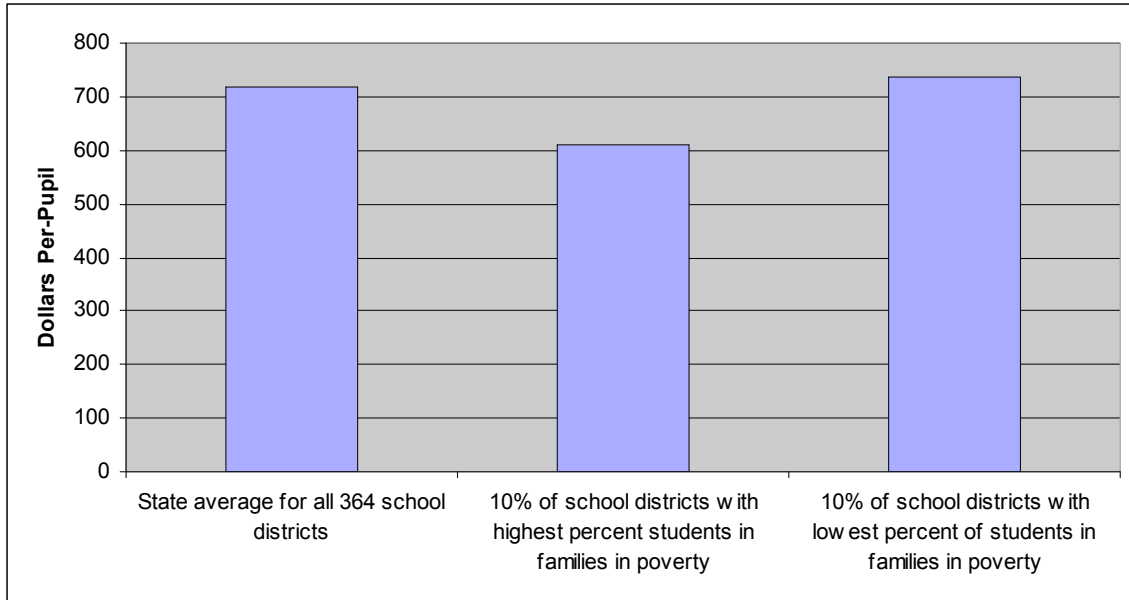
Figure 2. Proportion of Students in Poverty Varies Greatly Across Iowa School Districts



Source: U.S. Census Bureau, Small Area Income and Poverty Estimates (SAIPE), 2006.

Transitioning to a statewide, 1-cent sales tax for school infrastructure would increase the amount of per-pupil funding that each school district receives from the SAVE fund. Per pupil funding is currently capped at \$575, and although some districts are currently generating a higher amount because they approved SILO before the 2003 creation of the SAVE fund, even this funding is subject to the statutory expiration of SILO in 2022. Figure 3 below shows the distribution of FY 2007 average per-pupil SAVE funding for three different groups: the state as a whole, the 10 percent of school districts with the lowest proportion of students living in poverty, and the 10 percent of school districts with the highest proportion of students living in poverty.

Figure 3. Poorest School Districts Receive Lower Per-Pupil SILO Revenue in Current System (FY 2007)



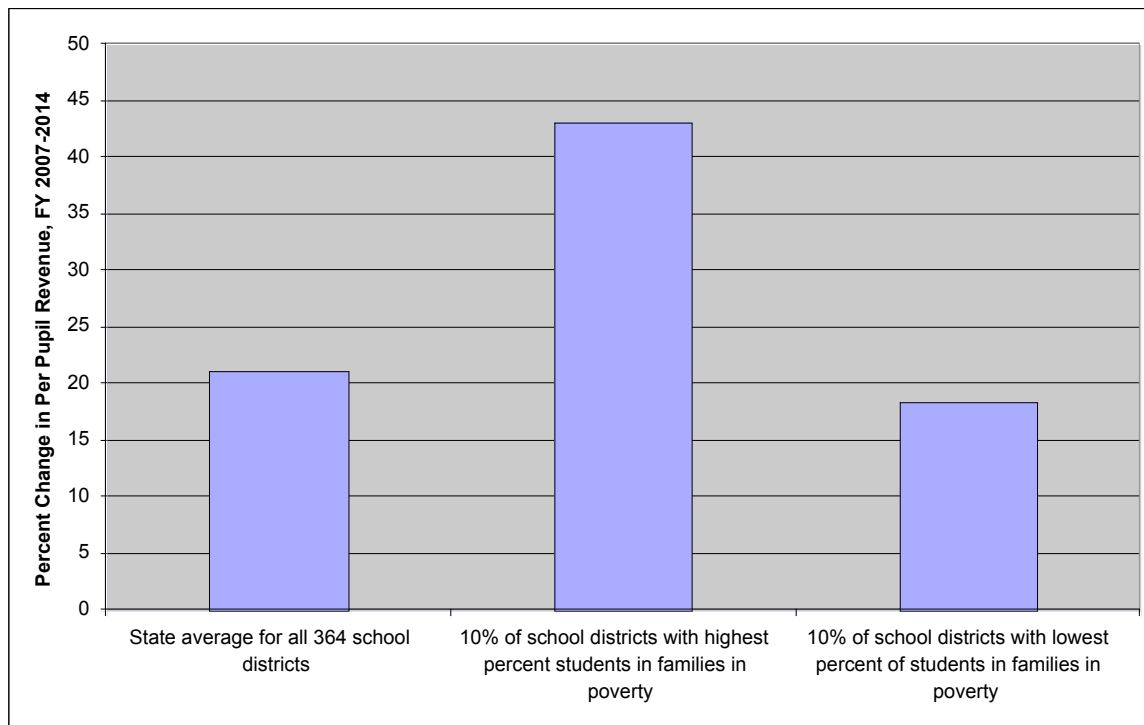
Source: Legislative Services Agency (2007) *School Infrastructure Local Option Sales Tax* and U.S. Census Bureau, *Small Area Income and Poverty Estimates (SAIPE)*, 2006.

In FY 2007, per-pupil SAVE funding ranged from a high of \$1,213 in the Spirit Lake school district to a low of \$478 in Fort Dodge.⁸ The state average for per-pupil funding is \$720, but the school districts with the highest proportion of students living in poverty have a per-pupil funding average of \$609. School districts with the lowest proportion of students living in poverty had a FY 2007 per-pupil funding level of \$736.

Figure 4 illustrates how a switch to a statewide tax would increase the average per-pupil funding of school districts with the highest proportion of students living in poverty more than it does the average per-pupil funding for the state as a whole or for the districts with the lowest proportion of students living in poverty.

⁸ This range excludes school districts where the FY 2007 per pupil amount is deflated by virtue of having a portion of the district within Linn or Johnson County, neither of which approved SILO until 2007.

Figure 4. Poorest Districts Benefit Most from a Switch to the Statewide Sales Tax



Source: Legislative Services Agency (2007) *School Infrastructure Local Option Sales Tax* and U.S. Census Bureau, *Small Area Income and Poverty Estimates (SAIPE)*, 2006.

Statewide, a 1-cent sales tax dedicated to school infrastructure would increase per-pupil revenue by an average of 21 percent, from \$720 to \$872, by FY 2014. The increase for school districts with the highest proportion of students living in poverty is substantially higher, at 43 percent, and the increase for school districts with the lowest proportion of students in poverty is only 18 percent.⁹

In addition, many of the school districts with the state’s lowest proportion of students living in poverty are partially or entirely located within Johnson County or Linn County and have lower per-pupil funding levels because Johnson and Linn counties had not approved SILO by FY 2007. When these school districts are excluded from calculations, the average per-pupil funding for school districts with the lowest proportion of students living in poverty actually rises to \$793 and the increase as a result of the statewide sales tax drops to 10 percent.

Conclusion

Proposals to replace local option sales taxes funding school infrastructure with a 1-cent statewide sales tax increase have both fair and unfair effects. On the one hand, moving from a set of local option taxes that will expire by 2022 to a longer-term state sales tax further institutionalizes the shift from property taxes to sales taxes as a source of school funding. Sales taxes are levied without regard to a taxpayer’s income and affect low-income lowans most acutely. Property taxes also have a disproportionate impact on low-income households, but less so than the sales tax. The possibility that this statewide sales tax increase involves an

⁹ This figure includes school districts located partially within Johnson and Linn Counties, except for Mount Vernon, which had a per pupil SAVE distribution of only \$6 in FY 2007.

expansion of the SILO tax to motor-vehicle purchases (in some versions of the proposal) and out-of-state purchases means that many lowans could end up paying more sales taxes than they do under the current system.

On the other hand, eliminating the local option sales taxes in favor of a longer-term or permanent statewide penny would make funding for school infrastructure more sustainable and more adequate. The current system is at risk of losing funding as sales-tax-rich counties drop out of the SAVE pool by failing to extend their local option tax. Moving to a statewide sales tax removes this risk and improves school districts' ability to bond against their sales tax revenue, while also making this bonding capacity more equitable across districts. Replacing the SILO tax on utilities in localities without franchise fees with a motor vehicle use tax has a progressive impact on about half of the state's population since low-income lowans spend a greater percentage of their incomes on utilities than on motor vehicles. Finally, the fact that increases in per-pupil funding generated from a statewide sales tax would be greatest for districts with the highest proportion of students living in poverty indicates an additional fairness aspect to the proposed plan, especially if all property tax relief that occurs under the proposal is targeted to districts with the highest additional levies. Public education itself strives to give all students equal opportunity, regardless of means, and funding arrangements that seek to improve equity in school financing help support this project.

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 \$752,000.¹⁰ 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 the funds for infrastructure also 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 the limited ability to pay of low-income households. Unlike the sales tax, where low-income lowans pay a greater proportion of their income in taxes than do upper-income lowans, the income tax is based on an individual's ability to pay, with low rates for those with little ability to pay. This makes it a much fairer form of tax. The Institute on Taxation and Economic Policy reports that lowans in the lowest income quintile (earning less than \$14,000 a year) pay only 0.7 percent of their income in income taxes, while lowans in the top quintile of income (earning over \$65,000 a year) pay over 4 percent of their income in income taxes.¹¹ This relationship between income and taxes paid is the exact opposite of the sales tax, which makes up a smaller percentage of income the more an individual earns.

¹⁰ FY 2008 per pupil valuation determined by January 2006 net taxable valuation divided by October 2007 certified enrollment.

¹¹ Institute for Taxation and Economic Policy (2003).

There is a strong precedent in Iowa for using income taxes to fund schools. Districts currently have the option of levying a local income tax surcharge as part of the Instructional Support Levy and as part of the Physical Plant and Equipment Levy. The surcharge is simply a percent of the state income tax the district resident must pay, making it inexpensive to administer and collect. Although the school local option income tax has, until now, unfortunately 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 was 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 could also be replaced with an increase in the state income tax. In order 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.¹² 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 concerns of 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 pre-school 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.

¹² Excluded from these calculations is the motor vehicle use tax, which current proposals would dedicate to road use funds and not to per pupil district revenue.