PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

Revenue and Transportation Interim Committee

60th Montana Legislature

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TO: Revenue and Transportation Committee

FROM: Jeff Martin, Legislative Research Analyst

SUBJECT: Senate Joint Resolution No. 31 and Senate Bill No. 554

House Joint Resolution No. 31, introduced by Senator Jeff Essmann, requests a study of taxation and school funding. The Legislative Council assigned the study to the Revenue and Transportation Committee. The study requests an examination of the future viability of the use of property taxes to fund education, an examination of equalization through a statewide school equalization district that would levy taxes against specific classes of property, and an inquiry into the use of a statewide sales tax and use tax to provide education funding that would include property tax relief in a permanent manner. Specifically the study is to:

(1)(a) examine future demographics of property taxpayers, school age children, retirees, and other factors relating to the viability of property taxes to fund education; and

(b) examine the distribution or maldistribution of classes of taxable property in counties and school districts;

(2) study the feasibility of a statewide school equalization district with property tax levies against particular classes of property and other sources of statewide revenue; and

(3) study the use of a sales tax and use tax for funding to replace property taxes and provide tax relief for homes, commercial properties, and agricultural and forest lands.

The direction of the study is similar to many of the provisions contained in Senate Bill No. 554 (SB 554), introduced by Senator Essmann during the 2007 regular session. The purpose of this memorandum is to summarize SB 554 to give the committee a better understanding of what may be included in the study based on the provisions of SB 554.

SB 554 would have revised the funding of public schools and the revenue sources used to support schools. The bill included the following provisions:

- increase direct state aid for schools to 80%;
- eliminate the guaranteed tax base aid for school general fund, retirement, and school facilities reimbursement;
- revise state support for school facilities reimbursement;
- revise state support for school retirement;
- revise state support for school transportation;
- eliminate all current statewide property tax levies;

- create a statewide school adequacy and equalization account (SAEA);
- create a new statewide school equalization district and impose a levy on most classes of business property for deposit in the statewide school adequacy and equalization fund;
- impose a sales and use tax on tangible personal property and certain recreational services for deposit in the SAEA;
- redirect distribution of certain natural resource production taxes to SAEA;
- exempt most classes of business property from local school levies;
- increase the property tax exemption on class eight business equipment;
- provide a individual income tax credit for sales taxes paid;
- provide an earned income tax credit based on the federal credit;
- refer the proposal to the electorate in November 2008.

School funding

SB 554 would have made substantial changes to the way public schools are funded. The bill would have eliminated elementary and high school county equalization levies and the state equalization levy. However, direct state aid to schools would have increased from 44.7% to 80% of the basic entitlement and the total per-ANB for the general fund of the budget. Guaranteed tax base aid for eligible school districts, including aid for the basic entitlement, the total per-ANB entitlement, special education, and county retirement would be eliminated. The county levy for retirement would have been eliminated and a local school district would impose a levy for its share of teacher retirement.

In addition, SB 554 would have revised the calculation of the school facility entitlement. The reimbursement would be determined by the ratio of a district's mill value per ANB to the statewide mill value per ANB per dollar of debt service obligation rather than on a guaranteed mill value per ANB.

The state would be responsible for the state share and the county share of transportation costs.

Revenue

In order to increase direct state aid to schools, the bill would have imposed a general sales tax on tangible personal property (food products, utility services, medicine, drugs, motor fuels, and certain other items were exempt) and on selected recreational services. Most of the sales tax revenue (87.5%) would have been deposited into a newly created statewide school adequacy and equalization account and the remainder (12.5%) would have been distributed to local governments.

The local share of sales tax revenue would be used first to offset the revenue loss to local taxing jurisdictions and tax increment financing districts that is associated with increasing the class eight business equipment property tax exemption to the first $150,000 of market value. Twenty-five percent of the sales tax revenue received by local governments, exclusive of the reimbursement amounts, would have to be used for property tax relief. The remainder, if greater than $50,000, would have to be used for debt reduction or investment in infrastructure and capital equipment unless used for another purpose approved by the voters. If the amount received was less than $50,000, the distribution would be used according to a plan adopted by the local government governing body.

The bill also would have created a new statewide school equalization district that would have included all classes of business property except agricultural land, residential and commercial land and improvements, and forest land. The property included in the statewide school equalization district would have been subject to a tax of 233 mills (presumably revenue-neutral in comparison to current local school general fund levies and the statewide 101 mills).

In addition to sales tax revenue, the following would have been deposited into the school adequacy and equalization account:

- revenue from the statewide school district levy;
- an allocation from the state general fund equal to the school block grant allocations established in House Bill No. 124 (Ch. 554, L. 2001) and repealed in SB 554;
- the school share of coal gross proceeds;
- the school share of oil and natural gas production tax proceeds;
- the school share of bentonite production taxes;
- school interest and income from the state as provided in 20-9-342, MCA; and
- the school share of forest reserve funds and other federal funds.

The entire amount of natural resource production taxes attributable to school funding, whether for local school district purposes or school equalization purposes, if applicable, would be deposited into the new account. The rationale for this allocation is that if the natural resource property were subject to property taxation, it would be included in the statewide school equalization district and not subject to local school district levies.

Money in the account would have been appropriated for the following purposes:

- funding the state share of BASE aid;
- funding the state share of teacher retirement;
- funding the state share of school transportation costs;
- not less than 7% for state payments for school facility entitlement under 20-9-371, MCA;
- not less than 3% for property tax transition for local school districts;[1] and
- funding for the Montana University System in an amount equal to a statewide property tax levy of 6 mills.

Other provisions

The bill would also have increased the class eight business equipment property tax exemption to the first $150,000 of market value. Local governments and tax increment financing districts

[1]This item would reimburse certain local school districts for a loss in revenue that may result from removing business property from the local school district property tax base. The amount of reimbursement would be phased out over a 10-year period.

would be reimbursed for the property tax revenue loss from sales taxes.

In addition to the statewide school equalization levies, the university levy and the vocational-technical levy would have been eliminated.[2]

The bill would have provided two individual income tax credits. The first would have provided a refundable tax credit for a portion of sales taxes paid equal to the substantiated amount of sales and use taxes paid, not to exceed 1.3% of the median adjusted gross income for Montana individual income tax returns for full-time resident taxpayers, plus $50 or an amount that does not have to be substantiated, equal to 1.3% of the median adjusted gross income for Montana individual income tax returns for full-time resident taxpayers.

The second would have provided a refundable earned income tax credit equal to 15% of the federal earned income tax credit.

Senator Essmann also introduced a companion constitutional referendum (Senate Bill No. 529). The measure would have amended Article VIII, section 16, of the Montana Constitution, (Limitation on sales tax or use tax rates) by inserting the following language:

> If a general statewide sales tax or use tax is enacted and if it contains a provision for property tax relief, no statewide tax or fee on property may be levied on class three, class four, class ten, or the first $150,000 in market value of class eight property as those classes were defined on December 31, 2006.

If either Senate Bill No. 554 or Senate Bill No. 529 failed, the other bill would be void.

Future meetings

At subsequent meetings, Legislative and Executive Branch staff will present more information on the sales tax, school funding, and constitutional issues related to the proposal.

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[2]The vocational-technical levies are only imposed in counties in which a vocational-technical institution is located: Cascade, Lewis and Clark, Missoula, Silver Bow, and Yellowstone Counties.