TESTIMONY

2015-16 Executive Budget

Education-Related Tax Policies

Senate Finance Committee
Assembly Ways and Means Committee
February 9, 2015

Chairman DeFrancisco, Chairman Farrell, and members of the Senate and Assembly:

I am Terrance Pratt, Assistant Director for Government Relations of the New York State Council of School Superintendents (THE COUNCIL).

Thank you for your support of public education and for taking the time to review this testimony.

Several tax policy proposals within the Revenue and Education, Labor, and Family Assistance Article VII bills proposed as part of the 2015-16 Executive Budget would have a significant impact on school districts in the state.

Changes affecting school property taxes and personal income tax credits related to school property taxes and private schools are proposed within the Governor's budget. THE COUNCIL views these changes with a mixed outlook – some would be beneficial to taxpayers and school districts while THE COUNCIL views others as potentially harmful to our public schools.

Property Tax Changes

The first several sections of the Governor's Article VII Revenue bill read in sequence as a transition away from the existing School Tax Relief (STAR) program to an income-based tax credit program. By taking steps to cap STAR payments, transitioning STAR to an income tax credit program, and providing a graduated income-based tax credit for additional property tax relief (which would apply to all taxing jurisdictions, not just schools as STAR does now), the Governor appears to be setting up the pieces for the end of the STAR program altogether, and beginning what has been previously referred to as a "circuit-breaker:" a graduated property tax liability based at least in part on a homeowner's ability to pay.

THE COUNCIL would support moving away from the STAR program in favor of a graduated income-based property tax reimbursement program as a strategy to target help to the most burdened taxpayers. However a complete strategy for property tax relief would also include increasing state aid to education and providing mandate relief to school districts. These actions would relieve the dependence on local taxpayers and decrease the need for property tax "relief."

STAR Conversion to Tax Credit

One of the most significant – yet least talked about – proposals within the Executive budget, this section proposes to eliminate the STAR *property tax exemption* program in favor of a STAR *personal income tax credit* program, called the "School Tax Relief (STAR) Credit."

The legislation would prospectively do away with STAR exemptions homeowners currently receive directly off of their property tax liability (both regular and enhanced STAR), in favor of a comparable tax credit reimbursement to be paid to them by the state upon filing of an income tax return.

The legislation retains the qualifying parameters of the current STAR program, including those for enhanced STAR. It would allow those currently receiving a STAR property tax exemption on their home to retain that exemption, with no changes. The legislation would close STAR filing to any new homeowners, and require those individuals to instead apply for the income tax credit. Any current STAR beneficiaries would be allowed to switch to the income tax credit program if they wish, but they are not obligated to switch. Once a homeowner switches to the income tax credit, they may not return to receiving the property tax exemption. Similarly, if a homeowner transfers ownership of their home or purchases a new home they will lose eligibility for the property tax exemption.

For those transferring into the new income tax credit program, eligibility appears to be identical to the current property tax exemption program and the bill memo purports that the tax credit benefit will be "virtually the same" as the existing exemption benefit.

One of the concerns THE COUNCIL has with this proposed program is the out of pocket tax payment required by homeowners. Where currently homeowners see an exemption benefit on their property tax bill and are not required to pay that additional amount in property taxes, an income tax credit would require homeowners to pay the amount out of their pocket up front in September and then seek reimbursement through the new tax credit in April of the following calendar year. There are many homeowners who simply would not be able to afford this. This scenario appears only problematic in the first year, as the previous year's repayment would then be available to make that upfront payment in each subsequent year.

This is especially concerning for senior citizens – some would now be required to make a very large upfront payment. Seniors are not only likely to have a larger amount of initial tax payment because of the enhanced STAR program, but are also more likely to be on a fixed income that would make such a payment more difficult.

Additionally, state retention of this money for eight or more months could produce a large benefit to the state in the form of interest. That benefit currently inures to homeowners and would be lost under this program. It would constitute a cost shift from the state onto local taxpayers.

While the implementation of this program appears to be part of a larger tax savings strategy to phase-out the STAR program, it seems somewhat convoluted, although arguably no more so than the existing STAR exemption program.

Freezing STAR Benefits

The Executive budget proposes to freeze taxpayer benefits through the state's School Tax Relief (STAR) program at 2014-15 dollar amounts. The original property tax cap, passed in 2011, capped annual increases in STAR exemption benefits to homeowners at 2 percent. The proposed action in this year's budget would permanently end any increase in exemptions to homeowners, including both basic STAR recipients and enhanced STAR recipients. Individual homeowners would receive no more in STAR benefits than they did in 2014-15. This amount would be capped in perpetuity.

One of the reasons behind capping the STAR exemption benefit may be to persuade homeowners to transfer into the STAR tax credit program; it appears that the tax credit benefit would grow where the exemption benefit would remain capped.

THE COUNCIL opposes freezing STAR benefits to homeowners. Homeowners' school property taxes will presumably rise each year roughly consistent with their school district's tax levy limit, however their STAR exemption would no longer rise, remaining capped at the 2014-15 dollar amount. This would require homeowners to pay a larger portion of their school property tax each year, with less reimbursement from the state.

This proposed action is concerning as an increased tax liability to local taxpayers. The Governor's bill memo states a need to cap payments in order to save money at the state level and balance the state budget. It is estimated to save the state $54 million in the next fiscal year; money that would otherwise have gone to property tax relief.

While other provisions of the governor's budget appear likely to change the current property tax exemption system and bring about the end of STAR in favor of a new income tax relief program, taxpayers continuing to rely on the STAR program would be shortchanged.

THE COUNCIL opposes this action as it stands alone. It is very simply a shift of responsibility for education funding from the state onto local taxpayers.

Real Property Tax Relief Credit

The program proposed in this section would create a credit against personal income for the share of a homeowner's or renter's property tax liability that exceeds a percentage of their income. This has been called a "circuit-breaker" in the past, where crossing a percentage threshold of a person's income "trips" a lowered tax liability. A much more limited income-reliant property tax credit was passed as part of last year's state budget. This proposal would replace and expand that program.

The amount of the credit would be graduated based upon the income of the resident. The measure to determine an individual's income would be "adjusted gross income" as reported to the IRS. The proposed bill language does not speak to calculating income or credit for joint owner-occupants of a residence or those married filing an income tax return jointly. It speaks only of "resident individuals."

The tax credit will only be available to those individuals residing within a jurisdiction that remains under the state's levy limit cap for the taxable year. Taxpayers will not receive a tax credit if their school district exceeds the cap, even if the cap is legally exceeded by the voters of the jurisdiction. THE COUNCIL opposes this linkage.

Senior citizens (over age 65) would be eligible for a duplicative benefit, as they would be allowed to take an enhanced STAR exemption at the outset, and also be able to apply the exempt amount back into the calculation of their tax liability for the purpose of this credit.

The implementation of the program would be gradual, with the maximum benefit in 2015 being 14 percent of the taxpayer's liability exceeding 3.75 percent of their income or $500, whichever is lower. This threshold rises to 6 percent in the following year and thereafter.

The program is expected to cost the state $350 million in 2015 and $1.7 billion in 2018. The program relies upon projected revenues in 2018 that do not exist in the current year. It is estimated that cuts to existing areas of the state budget would need to occur in 2018 to pay for this program.

For renters, the credit would be based upon the value of rent attributable to the property tax. The state would set that amount at 13.75 percent of rent payments, excluding utilities and other ancillary rent inclusions. However, there is a difference in the maximum rental benefit by region. Renters in the City of New York and Nassau, Suffolk, Rockland, Westchester, Putnam, Orange, and Dutchess counties would receive a higher maximum credit amount than those living elsewhere. While cost of living in these counties can generally be described as higher than some other areas of the state, this regional distinction seems to be arbitrarily established, especially given the fact that cost of living and housing costs are not part of the credit equation. Only property tax and income are used to determine the credit, which would negate the need for any cost of living differentiation between regions of the state.

Income eligibility for the program would be capped at $250,000 for homeowners and $150,000 for renters. Again, establishment of this income threshold appears entirely random.

The idea of an income-based graduated property tax is not new to state policy debates. THE COUNCIL has supported such concepts in the past. Many "good government" policy groups have called for an income-based property tax exemption in place of the state's STAR exemption as well. It appears from this proposal and others that is what the Governor is attempting to accomplish.

While the state and its taxpayers would likely be better served to include this proposal instead as a formula for returning money to school districts in the form of increased state aid that would actually *lower* property taxes, moving to a system of income-based graduated property tax relief is a notable step toward greater targeting of tax relief to the taxpayers who need it most.

The attached requirement that taxing jurisdictions remain under the property tax levy cap is designed to further pressure local governments into staying under the cap, but fails to take into account local dynamics and needs. The tax cap itself is operationally flawed; placing more significance on its parameters for the purpose of other programs only further erodes local decision making. Many school districts were in fact holding down local property tax growth years prior to implementation of the tax cap.

THE COUNCIL opposes the Governor's proposal to limit eligibility for this tax credit to taxpayers in districts that remain under the tax cap. Over the four years the tax cap has been in place, an average of only about 5 percent of districts have attempted over-rides each year. The judgment by their elected school boards that circumstances warrant an over-ride attempt should be respected and allowed to be considered by their voters without injecting a monetary incentive to reward rejection.

Overall, from THE COUNCIL'S perspective, this program is a step toward property tax relief, although flawed. At its core, the program would return money to local taxpayers, lessening the impact of property taxes locally, especially for taxpayers least able to afford them. However, the lack of any corresponding mandate relief is concerning, as is tying the credit for individual taxpayers to their local government's compliance with the tax cap. The proposal fails to recognize the factors that drive property taxes higher and seeks to place all blame on the locality.

The proposal will likely be beneficial to many taxpayers and will lessen the impact of property taxes in real dollars for many. When combined with STAR, it could result in considerable tax savings, especially for senior citizens. A test for the program will be its conversion over time into what appears to be the end of STAR. Will the state use this to replace STAR, essentially lessening the benefit from that program for some taxpayers over time? Will this be a shift away from current property tax relief into an income-based local tax system? We do not yet have solid answers or assurances to those questions.

Commentary on Combination of New Property Tax Policies

By capping STAR exemption benefits, converting the STAR exemption to an income tax credit, and implementing an income tax credit based upon a property tax-to-income calculation, the stage would be set for the elimination of STAR and reliance upon the new income-based tax credit.

THE COUNCIL would support a more targeted approach to property tax relief as part of a strategy that includes reliable school aid and significant mandate relief, measures that would *lower* property taxes for millions of New Yorkers.

Education Tax Credit

This proposal creates an "Education Tax Credit" that would be available to benefactors of public school educational programs and educational scholarship funds. The mechanism would be a pre-application process, prior to making a donation. Once donations are approved and the benefit secured, a taxpayer would subsequently make the donation during a taxable year and seek a reimbursement credit on their tax return for that year.

The Governor proposes to allocate $100 million to the program annually, with no program sunset. Fifty percent of the funds would be available for donors to public education entities, (public) school improvement organizations, and local (public) education funds. The other 50 percent would be available for those making donations to educational scholarship funds. Those educational scholarship funds would provide scholarships to students attending private schools or public schools of their choice.

Donors would be entitled to a maximum credit of 75 percent of their donation or $1 million, whichever is less. The values of any charitable deduction, federal or state, taken by the taxpayer for the subject donation would be deducted from the amount of any credit to be returned to that taxpayer.

The benefit is not solely a personal income tax credit, but would be open to individuals, partnerships, LLCs, and corporations.

Passage of this program is contingent upon passage of the DREAM Act and would not become effective without simultaneous passage of both proposals.

This proposal was the subject of significant debate in the last legislative session. The scheme of providing tax credits to private school donors is opposed by THE COUNCIL.

The Governor's proposal is markedly different from the Legislature's proposals in a number of ways. A bill that passed the Senate on the same day the Governor proposed his budget would allow for a 90 percent credit and a $300 million cap, as well as having no provision for reducing the credit based upon state charitable tax deductions. The Senate version would also allocate a greater percentage of the available funds to private schools.

While the Governor's proposal would limit the yearly amount to $100 million, it is likely there would be an annual battle over expansion of the credits once they were in place. THE COUNCIL does not oppose all efforts to provide financial support for private schools, however with the state continuing the Gap Elimination Adjustment which reduces School Aid by over $1 billion and still over $4 billion behind in phasing-in Foundation Aid, it should not be drawing funds away from public education for the benefit of private schools. It is also questionable to what extent the tax credit scheme would spur new donations to these schools, as opposed to simply providing a windfall to their current donors.

The scheme is also questionable from a constitutional standpoint. The New York State Constitution prohibits the use of state funds, either directly or indirectly, to the benefit of an institution under control or direction of a religious denomination. The Governor may have been trying to avoid this legal fight by linking the tax credits to scholarship funds, which would function more like a voucher. The United States Supreme Court has ruled that some voucher programs are constitutionally acceptable in overcoming such a constitutional provision, however this proposal is missing many key components of those programs deemed acceptable by the Court.

The proposal as it relates to scholarship organizations functions very much like a voucher. A voucher would be government support for a student to attend a school of their choice other than the public school to which they are geographically assigned. The Governor's bill even includes express directions for use of a scholarship to attend another public school (tuitioning-in). The bill memo makes mention of an intent to provide public school choice as well. THE COUNCIL has serious concerns with vouchers or "portability" measures that would allow private schools to draw students away from their designated public school.

In addition to this, the legislation establishes express rules for the creation and administration of an eligible scholarship fund. Such scholarship fund would have little in the way of "rules" governing it in order to be eligible, and would allow scholarships to students with annual household incomes up to $300,000. While it would require scholarship funds to provide more than 50 percent of their scholarships to students from households with incomes below 150 percent of the eligibility threshold for free and reduced price lunch, this measure could be aggregated by jointly reporting with another scholarship fund. There is also a question as to the enforceability of this provision, as the tax benefit inures to the donor (not the scholarship fund) and the benefit must be applied for and approved in advance of the taxable year.

This proposal also directs 50 percent of the funds for reimbursement of donations to public schools and their affiliated education support organizations (this does not include charter schools). This appears on its face to be an attempt by the Governor to provide a benefit to public schools, however these funds would be better directed into state school aid for school districts.

Allowing for reimbursement of voluntary donations to public schools is likely to inure to the benefit of wealthy communities who can afford such donations. In addition, the established pre-application process is very complex and has a short timeline (15 days). It appears likely that the bulk of the capped benefit would be consumed by those with considerable legal savvy and resources.

As indicated in Part D above, the effectiveness of this proposal is contingent upon passage of the DREAM Act. While there may be a viable strategy in linking two unrelated pieces of legislation, it would seem extremely risky given the controversy of the two proposals. In last year's legislative session, the Senate defeated a version of the DREAM Act and the Assembly did not bring the Education Tax Credit to the floor for a vote. This leaves a question as to the political viability of either of the two linked pieces of legislation.

Conclusion

Thank you for your consideration and for all your past efforts to help our public schools.

Superintendents are greatly concerned with the state of education funding in New York. They must in essence do what lawmakers do - ensure that their schools can continue to provide the highest quality education to students while balancing the fiscal interests of their communities. These tax policies will all have an impact on our schools and our communities.

We promise to work with you to produce a budget and sound state and local financial policies that can give our schoolchildren the opportunities they need and deserve.