

**RUTGERS-NEWARK
INSTITUTE
ON
EDUCATION
LAW & POLICY**

***SETTING THE STAGE
FOR INFORMED, OBJECTIVE DELIBERATION
ON PROPERTY TAX REFORM***

**What We Know, and What We Need to Know,
About Education Funding and Taxes**

**BACKGROUND PAPER
Invitational Meeting June 3-4, 2005
Rutgers Law School – Newark**

Support for this project has been provided by the Rutgers University Academic Excellence Fund, The Fund for New Jersey, and The Prudential Foundation. The Institute on Education Law and Policy also gratefully acknowledges the assistance of Rutgers University Professor Emeritus Ernest Reock.

**RUTGERS – NEWARK
INSTITUTE ON EDUCATION LAW AND POLICY
Paul Tractenberg, *Founding Director*
Brenda Liss, *Executive Director*
Alan Sadovnik, *Associate Director***

***WHAT WE KNOW, AND WHAT WE NEED TO KNOW,
ABOUT EDUCATION FUNDING AND TAXES***

**Background Paper
Invitational Meeting June 3-4, 2005
Rutgers Law School - Newark**

As New Jersey once again confronts budget pressures that threaten state aid to public schools, and municipalities across the state confront dramatic property tax increases, issues of education finance and tax reform again figure prominently in the state’s public discourse. Debates over property taxes and education funding have simmered in New Jersey – sometimes boiled over – since at least the 1970s, when they arose in the landmark school funding litigation, *Robinson v. Cahill*. They have intensified recently in discussions of a proposed constitutional convention to address property tax reform, although the currently prevailing form of the proposal would limit the convention to revenue-related issues only and prohibit consideration of any amendments relating to spending, including education spending.

Similar tensions between school funding and property taxation have touched virtually every state in the country. Almost every state has endured a challenge to its school finance system over the past 30 years, and the nature of many of those systems remains in flux. *Education Week* reported this year that 31 states are considering major changes in how they pay for education or allocate money among school districts.¹

The issues, in New Jersey and elsewhere, are long-standing and difficult. Whether they are addressed by a constitutional convention, in litigation, by the legislature, the press or the general public, accurate information and objective analysis of the issues are essential. To provide such information and analysis, the Rutgers-Newark Institute on Education Law and Policy has initiated a project entitled “Setting the Stage for Informed, Objective Deliberation on Property Tax Reform.” We plan to examine education funding and tax policy in their legal,

¹ *Education Week*, Vol. 24, No. 17, January 6, 2005, at 7.

fiscal, historical, and programmatic dimensions, and how other states have wrestled with the issues, the policies they have adopted, the impact of those policies, and whether and how those policies balance tax equity and education equity. Our goal is to assist policy makers to find the correct balance between education reform and tax reform, between financing our education system in a manner that meets the needs of all our public school students and imposing a fair and equitable burden on taxpayers.

The project will have three parts: (1) an invitational meeting at which experts in education law, school funding and tax policy will discuss the issues from the standpoint of their respective areas of expertise and identify topics for fruitful inquiry; (2) a study examining education funding and state tax policy and the manner in which states have balanced the needs of schools and taxpayers, and analyzing whether and how the solutions employed elsewhere might apply in New Jersey; and (3) a public information and outreach program to disseminate the results of the study and contribute to informed discussion among policy makers and the public.

This paper, “What We Know, and What We Need to Know, about Education Funding and Taxes,” contains background information that we hope will form the basis of discussion at the invitational meeting. We note the current demands for property tax relief, then describe education finance and taxation in New Jersey in their current and historic dimensions. After each section we set forth questions that we hope will provide starting points for discussion.

The Call for a Constitutional Convention

Demands for property tax relief in New Jersey reached their height in 2004, when the state legislature voted to establish a Property Tax Convention Task Force and directed the task force to “study property tax relief and the need for a constitutional convention to review the property tax system.”²

Constitutional conventions are rare in New Jersey – only three have occurred in the state's history. Thus, they represent an extraordinary means of revising the state constitution. But some think tax reform can best be addressed through this method, as delegates elected for a single term could tangle with hard issues, and even vote contrary to their local constituents' interests but for the greater good of the state, without fear of voter backlash. Such a convention would require legislative authorization and then the support of voters in a referendum.³

² A. 97, enacted July 7, 2004 as L. 2004, c. 85.

³ See Martin, Robert, "Calling in the Heavy Artillery to Assault Politics as Usual: Past and Prospective Deployment of Constitutional Conventions in New Jersey." 29 Rutgers L.J. 963 (1998). Constitutional conventions have been

The 2004 Property Tax Convention Task Force consisted of 15 members, including legislators, mayors, academics and other citizens. Its chair was Professor Carl Van Horn of Rutgers University's Edward J. Bloustein School of Planning and Public Policy. Professors Robert Williams and Alan Tarr of the Rutgers-Camden Center for the Study of State Constitutions served as advisors. The task force held 15 meetings and public hearings at five different locations in fall 2004, and received testimony from 150 individuals and correspondence from hundreds of others.

In December 2004 the task force issued a report recommending that the Legislature authorize a referendum to be held in November 2005, and that if the referendum is approved, a convention be held in spring 2006. Either 90 or 120 delegates would participate in the convention, pursuant to two alternative recommendations. The convention would be authorized to recommend amendments to the taxation provisions of the state constitution and to propose statutory changes in revenue-related areas, but not to address any spending provisions. At the time of this writing, more than a dozen bills have been introduced in the state legislature to go forward with a convention, some in accordance with the task force's recommendations, some with differing provisions. None has come close to being enacted.⁴

The task force itself was not unanimous in its recommendation as to the scope of issues to be addressed by a convention. Although the majority view was that a convention that examined spending as well as taxation would become bogged down in debates over divisive social issues, two members disagreed. One of them, State Senator Leonard Lance, submitted a dissent stating that the convention should examine both revenue and spending provisions, since, in his view, "[a]ny lessening of the overall property tax burden in relation to other forms of taxation will only be temporary unless spending proposals are included in the convention's recommendation to the people." Senator Lance acknowledged the concern that proposed amendments to spending provisions would raise divisive social issues, but said he did not share that concern. In his view, "discussions of government spending can be limited to matters related to property tax reform."

The other dissenting member, State Assemblyman Kevin O'Toole, also expressed the view that reform would be illusory if it did not include reform of spending provisions. He stated:

held in 1844, 1947 and 1966. Another mechanism for considering amendments, the constitutional commission, resulted in substantial amendments adopted in 1875. See Williams, Robert F., "Are State Constitutional Conventions a Thing of the Past? The Increasing Role of the Constitutional Commission in State Constitutional Change," 1 Hofstra L. Pol'y Symp. 1, 7 (1996).

Avoiding difficult choices and controversial ideas is what has brought us to this point, and there cannot be any lasting reduction of the property tax burden unless elected officials, including legislators and future delegates to a constitutional convention, have the fortitude and intellectual honesty to deal with the real factors contributing to the present crisis. Taxpayers deserve nothing less from those they entrust with public office.

Spending issues must be fully addressed in order for the convention, or any other overall property tax reform effort, to have any credibility at all and to have any lasting impact.

Assemblyman O'Toole submitted, accordingly, that the convention should address a range of spending issues, not only overall school spending but special education costs, state borrowing, state government spending caps, local government spending, and "waste and fraud." He also recommended that the convention consider authorizing education tax credits for parents of students in private schools and home schooling, to protect against an influx of those students to the public schools, which he predicted would be caused by the burden of escalating property taxes and result in further school funding pressures.

Even with the task force majority's limitation on the scope of issues, some continue to worry that a constitutional convention could jeopardize spending on education and related items, such as funding for teacher pensions and health benefits. The New Jersey Education Association, for instance, is conducting a campaign opposing any convention at all, saying all issues relating to property tax reform can and should be addressed by the Legislature, and offering its own tax reform proposal.

QUESTIONS: Legally and politically, can meaningful, effective reform be achieved without amending the constitution? If an amendment is needed, what is the best mechanism for pursuing its adoption? Can, and should, reform of revenue-raising provisions be considered separately from state spending reform? Can tax relief be achieved in the absence of spending reform or spending cuts? On the spending side, would inquiry into items such as state borrowing, local government spending, and "waste and fraud" be fruitful?

The Tax Clauses and the Thorough and Efficient Clause of the New Jersey Constitution

The Tax Clause of the New Jersey Constitution, Article 8, Section 1, paragraph 1, states in part:

(a) Property shall be assessed for taxation under general laws and by uniform

⁴ One bill, A. 5269, was passed by the Assembly on May 16, 2005.

rules. All real property assessed and taxed locally or by the State for allotment and payment to taxing districts shall be assessed according to the same standard of value, except as otherwise permitted herein, and such real property shall be taxed at the general tax rate of the taxing district in which the property is situated, for the use of such taxing district.

Notwithstanding the terms of the first sentence, known as the Tax Uniformity Clause, this provision does not require all real property throughout the state to be taxed equally. All property within a taxing district must be taxed uniformly; but since property must be “taxed at the general tax rate of the taxing district in which the property is situated,” tax rates may vary from municipality to municipality.

Moreover, the constitution does not require all real property to be assessed for taxes. Succeeding provisions of Article 8, section 1 authorize a variety of exemptions. Paragraph 2 continues all validly granted property tax exemptions in existence at the time of its adoption in 1947, and authorizes the Legislature to repeal or alter some of those exemptions (but not those for property used exclusively for nonprofit religious, educational, charitable or cemetery purposes, which are mandatory) and to grant additional exemptions; paragraph 3 authorizes a property tax reduction for veterans and their surviving spouses; paragraph 4 authorizes exemptions for senior citizens and persons who are permanently and totally disabled; paragraph 5 authorizes homestead rebates or credits for homeowners and tenants; and paragraph 6 authorizes legislation enabling municipalities to grant exemptions or abatements to properties in areas declared “in need of rehabilitation.” Additionally, Article 8, section 1, paragraph 1(b) authorizes farmland assessment at less than full market value; and Article 8, section 3, paragraph 1 authorizes exemptions for improvements to property made for purposes of clearance, replanning, development or redevelopment of blighted areas.

Another provision of the article on taxation and finance – Article 8, section 4, paragraph 1 – is the Education Clause, also known as the Thorough and Efficient Clause or “T & E Clause.” It provides:

The Legislature shall provide for the maintenance and support of a thorough and efficient system of free public schools for the instruction of all the children in the State between the ages of five and eighteen years.

As interpreted by the state supreme court, the T & E Clause provides both an educational standard and a requirement for substantially equal funding of schools throughout the state.

Regarding education quality, in its 1973 landmark decision, *Robinson v. Cahill*,⁵ the New Jersey Supreme Court interpreted the T & E Clause to “embrace that educational opportunity which is needed in the contemporary setting to equip a child for his role as a citizen and as a competitor in the labor market.”⁶ Regarding funding, the Court in *Robinson* ruled that the T & E Clause and Tax Clause together give the state, rather than local governments, ultimate responsibility for ensuring that all public school pupils receive an education that comports with the “thorough and efficient” mandate; and further ruled that a system that relies on local property taxes, and as a result permits wide disparities in spending from one local district to another and has chronically underfunded schools in districts with high tax rates and low property wealth, is not “thorough and efficient.” The Court has reaffirmed these rulings many times; and in a 2000 decision, *In re Grant of the Charter School Application of Englewood on the Palisades Charter School*, the Court observed that the rights guaranteed by the Thorough and Efficient Clause are “inviolable.”⁷

Both the Thorough and Efficient Clause and the question of whether responsibility for school funding rests with the state or local government in New Jersey date to the Nineteenth Century. The clause was inserted into the constitution by an amendment adopted in 1875.⁸ Twenty years later, in the case of *Landis v. Ashworth*,⁹ the court upheld a system of school finance that relied in large part on local funding by means of property taxation, and rejected a reading of the Thorough and Efficient Clause that would place responsibility on the state alone. In so ruling, the court established that local funding of schools comports with the constitutional mandate. Local school funding developed into the norm, and as it did, disparities between the educational opportunities available in New Jersey’s wealthier suburbs and its poorer cities widened.

Robinson, filed in 1970 on behalf of schoolchildren in the state’s urban school districts,¹⁰ was an attempt to resolve both the question of whether the state or local districts had primary responsibility for funding schools and the question of whether taxpayers in urban districts, who faced higher tax rates than those in other municipalities, had a constitutional right to an equitable

⁵ *Robinson v. Cahill*, 62 N.J.473, 303 A.2d 273, cert. denied sub nom. Dickey v. Robinson, 414 U.S. 976, 94 S.Ct. 292, 38 L.Ed.2d 219 (1973).

⁶ 62 N.J. at 515, 303 A.2d at 295.

⁷ 164 N.J. 316, 753 A.2d 687 (2000).

⁸ The wording of the provision was changed slightly in the 1947 Constitution. See *Robinson v. Cahill* 62 N.J. at 502, 303 A.2d at 288.

⁹ *Landis v. Ashworth*, 57 N.J.L. 509 (Sup. Ct. 1895).

¹⁰ The lead plaintiff, Kenneth Robinson, was a Jersey City public school student.

system of taxation. The trial judge, Theodore Botter, ruled that equal taxation among districts was constitutionally required, and that the state must finance its public school system out of state revenues raised by levies imposed uniformly on all taxpayers of the same class.¹¹ In his view, disparities in tax burdens were as impermissible as disparities in educational opportunity. The Supreme Court reversed this ruling, however, and with an opinion that would have profound implications not only for schools but for taxpayers, the Court rejected the notion that the state constitution required equal treatment of taxpayers in its many local jurisdictions. However, it left open the question of “whether, apart from the equal protection guarantee, there is an implicit premise in the concept of local government that the State may not distribute its fiscal responsibility through that vehicle if substantial inequality will result.” The Court went on, “We need hardly suggest the convulsive implications if home rule is vulnerable upon [this ground]. Nor need we expound the difficulties of management of judicial solutions if the problem must be met by the courts.”¹²

Three years later, in *Bonnet v. State*,¹³ the Law Division of the Superior Court of New Jersey followed the ruling in *Robinson*, and rebuffed the notion that the Tax Clause provided a remedy for taxpayers and municipalities who sought relief for the cost of providing state-mandated services. The plaintiffs were Essex County municipalities, residents and taxpayers as well as the county itself, who complained that the Tax Clause did not enable the state “to utilize local property taxes or to allocate the costs through the counties to the municipalities as a means of supporting state services, functions, facilities, or discharging obligations and responsibilities of the state.”¹⁴ In response, the court stated:

[T]he tax clause was not intended to say that a State function may not be delegated to local government to be met by local taxation . . . The tax clause . . . means that if the State decides to handle a service at the State level and to do so on the basis of a property tax, it must tax all taxable property in the State rather than only property in a part of the State; and that if the responsibility for the State function is assigned to local government, the local tax must fall uniformly upon all taxable property within the county or the municipality as the case may be.¹⁵

¹¹ See 118 N.J. Super. 223, 277, 287 A.2d 187, 215 (Law Div. 1972); see also 62 N.J. at 480, 303 A.2d at 276.

¹² 62 N.J. at 500, 303 A.2d at 287. Some believe that had the Court chosen to address this issue, or had Judge Botter’s opinion been affirmed, New Jersey might have a more equitable tax system today.

¹³ *Bonnet v. State*, 141 N.J. Super. 177, 357 A.2d 772 (Law Div. 1976).

¹⁴ *Id.*, 141 N.J. Super. at 193, 357 A.2d at 780.

¹⁵ *Id.*, 141 N.J. Super. at 194, 357 A.2d at 781.

Bonnet pertained to the costs of state court operations, prosecutors' offices, juries and probation departments, which the plaintiffs claimed were burdensome; but its reasoning and ruling are equally applicable to other programs and services mandated by the state and implemented at the local level, such as public schools. The court refused to intrude, and even intimated that it was constrained from intruding, on taxation matters that it considered purely local issues.

QUESTIONS: Is it time to revisit the question left open in *Robinson*, whether the concept of local government contains an implicit premise that the state should not permit substantial inequity? Is there such an "implicit premise"? Are local governments in New Jersey experiencing "substantial inequity"? If so, is there a remedy? To what extent do other states permit comparable inequality in the burdens placed on local governments? What methods of spreading burdens among local jurisdictions have proven effective and equitable? Do existing constitutional and statutory provisions provide authority for appropriate remedies and reforms?

The Impact of *Robinson v. Cahill* and *Abbott v. Burke* on School Funding and Taxes

The Supreme Court in *Robinson* did hold the state's school funding system unconstitutional, because of its educational impact rather than its tax impact. The Court laid primary financial responsibility for public schools with the state, and directed the state to provide sufficient aid to its poorest school districts to ensure that a "thorough and efficient" education was provided for students in those districts. This decision, issued in 1973, was hailed by education advocates and reviled by others, including some who said the Court had overstepped the bounds of judicial authority. The *Robinson* litigation continued for several years and several Supreme Court decisions, culminating in extraordinary measures by the Court to compel the Legislature to adopt a constitutionally viable funding system.¹⁶ The Legislature finally responded with the Public School Education Act of 1975 and the state's first income tax in 1976.

Five years later, however, in 1981, *Abbott v. Burke* was filed. Like the *Robinson* plaintiffs, the *Abbott* plaintiffs were public school students in the state's urban districts.¹⁷ They claimed that notwithstanding the ruling in *Robinson* and adoption of the Public School Education Act, the school funding system still failed to satisfy the mandate of the Thorough and Efficient

¹⁶ 63 N.J. 196 (1973) (*Robinson II*); 67 N.J. 33 (1975) (*Robinson III*); 69 N.J. 449 (1976) (*Robinson V*); 70 N.J. 464 (1976) (*Robinson VI*). In an infamous standoff in 1976, the Court became so frustrated with the Legislature's recalcitrance that it issued an order enjoining all public school spending until the Legislature acted to fund a system that satisfied the terms of its previous rulings. The Legislature and the Executive (Governor Brendan Byrne) responded by establishing the state's first income tax.

¹⁷ Raymond Arthur Abbott was a student in the Camden public school district.

Clause. In the first of several substantive decisions in *Abbott*, issued in 1990 and known as *Abbott II*,¹⁸ the Supreme Court provided a more definitive answer to the question of state versus local responsibility for financing the public schools. The Court ordered the state to provide sufficient aid to each of the state's poorest urban districts (which it designated "special needs districts") to result in per-pupil regular education spending in those districts equal to the average spending in the state's districts with the highest socioeconomic levels (DFG I and J districts).¹⁹ (It found no constitutional violation with respect to districts other than the state's poorest, and thus left issues of funding and educational quality for all those districts to legislative discretion.) Further, the Court ruled that spending in the special needs districts could not be allowed to depend on the availability of local tax revenues, so that the state was responsible for ensuring that sufficient resources were devoted to schools in those districts.

The two-fold effect of *Abbott II* was significant: by tying funding for special needs districts to the historically high spending rates in I and J districts, the Court required substantial increases in spending for urban schools; but, recognizing that municipal overburden in the special needs districts made such increases in local funding untenable, the Court relieved those districts of the burden of responsibility for those increases, and placed the burden on the state.

The state's compliance with *Abbott* was no quicker or more enthusiastic than it had been with *Robinson*, but it eventually led to a dramatic increase in state aid to the special needs districts (so-called "*Abbott* districts"). Especially after *Abbott IV* in 1997 and *Abbott V* in 1998, in which the Court was very clear and specific as to the extent of the state's obligation,²⁰ primary financial responsibility for the operation of schools in those districts has shifted away from the districts themselves and the municipalities in which they are located and onto the state. Still,

¹⁸ *Abbott v. Burke*, 119 N.J. 287, 575 A.2d 359 (1990) (*Abbott II*).

¹⁹ Since the 1970s, the state Department of Education has classified local school districts in district factor groups (DFGs) according to the socio-economic status of their residents. The districts with lowest socioeconomic status are placed in DFG A, the highest in DFG J. Revisions to the classification have been made after each census. The Court in *Abbott* used the DFG groupings to identify the special needs districts. Specifically, it ruled that districts in DFGs A and B that have urban characteristics required special treatment by the state.

²⁰ 136 N.J. 444 (1994) (*Abbott III*); 149 N.J. 145 (1997) (*Abbott IV*); 153 N.J. 480 (1998) (*Abbott V*). One of the most salient features of the *Abbott* decisions, especially *Abbott IV* and *Abbott V*, is the extent to which the Court specifically prescribed the educational programs that it found necessary to meet the needs of poor urban students. In addition to parity funding, the Court ordered the state to ensure that the special needs districts implemented full day kindergarten, high-quality pre-kindergarten for all three- and four-year olds, whole school reform, and supplemental programs based on need, including summerschool, added security, and school-based health and social service programs. It also ordered substantial funding to improve school facilities. In 2000, New Jersey lawyers and judges overwhelmingly selected *Abbott* as the most important state court decision of the Twentieth Century, and in 2002

there is a wide range in the proportion of operating budgets funded by state aid, among both special needs districts and others. For example, in 2003-04 state aid comprised 83 percent of the regular education budget in Newark, 64 percent in New Brunswick, and 13 percent in Hoboken, although all are *Abbott* districts. It comprised six percent of the operating budget in Highland Park in the same year, and 83 percent in Commercial Township; both are non-*Abbott* districts.

Per-pupil spending has increased in all districts in recent years, but more in *Abbott* districts than elsewhere, so that spending differences among *Abbott* districts and others have narrowed. In 1989-90, the state average regular education budget was \$5,638; in *Abbott* districts it was \$5,003 per pupil; and in DFG I and J districts it was \$6,555. By 2003-04, the state average regular education budget was \$9,849; in *Abbott* districts it was \$10,377; in DFG I and J districts it was \$10,552. Similar narrowing of the differences in spending has occurred among all districts in the state. Expenditures per pupil today are much more similar, from district to district, than they were in the past, and the degree to which they have been equalized cannot be attributed entirely to increased funding for *Abbott* districts. Statewide, the coefficient of variation of regular education budgets per pupil dropped from .208 in 1989-90 to .143 in 2003-04. When *Abbott* districts are eliminated from the calculation, the coefficient of variation for all other districts declined over the same period from .207 to .168.

Spending differences still remain, but the state's poorest districts are no longer those with the lowest spending levels. As shown in Chart 1 attached, *Abbott* districts have gone from having the lowest budgets per pupil to among the highest in recent years. Other poor districts are now the lowest spenders in the state, although their budgets have increased, relative to those in other districts; middle-income districts have barely held their budget level; and until recently, the I and J districts have seen reductions in their budgets, in constant dollars.²¹

The state has imposed a limit or "cap" on annual school budget increases since 1976. For 15 years the impact of the cap was negated by rapidly declining enrollments, but since about 1990, when the enrollment trend reversed, they have had an effect.²² Together with state aid to poorer districts, the budget cap undoubtedly has contributed to reducing disparities in per-pupil

The New York Times described it as "the most significant education case since the [United States] Supreme Court's desegregation ruling nearly 50 years ago."

²¹ In Charts 1 and 2 "other poor districts" are those in DFG A and B that are not *Abbott* districts, and "middle districts" are those that are nor *Abbott*, other poor or I and J districts.

²² Between 1996-97 and 2004-04, enrollment increased by 6.5 percent in *Abbott* districts, 8.1 percent in other poor districts, 12.2 percent in middle-income districts, and 23.8 percent in I and J districts.

expenditures. In 2004 the Legislature enacted a law tightening the cap, limiting school budget increases to 2.5 percent per year or the change in the consumer price increase and limiting budget surpluses to three percent of the total budget, whichever is higher.²³ There has been enormous opposition to this bill from school districts, and several bills have been introduced to amend or repeal the measure, but none has had any success thus far.

Even more striking than the narrowing of differences in spending is the narrowing of differences in tax rates, in recent years. The Court in *Abbott* stated, “We assume the design of any new funding plan will consider the problem of municipal overburden in these poorer urban districts,”²⁴ and this has been interpreted as prohibiting, or at least inhibiting, any increase in the property tax levy in the *Abbott* districts. At the same time, property values have continued to grow, and the result has been a drastic reduction in property tax rates in those districts (see Chart 2 attached). The average equalized school property tax rate for the *Abbott* districts was \$1.168 per hundred dollars of true value in 1993-94, compared with a state average rate of \$1.140. By 2003-04, the rate in *Abbott* districts had dropped to \$.842, and the state rate had risen to \$1.148. *Abbott* districts as a group have gone from being the highest school tax communities to the lowest. The highest school taxes are now in the middle-income suburbs.

School districts and taxpayers have responded to rising costs, the shift in state education funding, and the tax impact in two ways: First, some have sought an increase in state aid, to levels closer to those provided to *Abbott* districts. Almost immediately following *Abbott V* in 1998, a group of 42 "middle income districts," all in the middle DFGs, and taxpayers in those districts filed *Stubaus v. Whitman*,²⁵ claiming they were being subjected to burdensome and unequal rates of taxation and seeking additional funding for their schools on the basis of the Equal Protection Clause of the state constitution. (They did not, however, claim the tax burdens made them unable to provide a “thorough and efficient” educational program; their claims were based solely on taxpayer equity.) The trial court rejected their claims on the ground that unequal rates of property taxation produced no equal protection violation. The Appellate Division affirmed, and the Supreme Court denied the plaintiffs’ petition for certification.

²³ S. 1701, enacted as L. 2004, c.73.

²⁴ 119 N.J. at 388, 575 A.2d at 409.

²⁵ *Stubaus v. Whitman*, 339 N.J. Super. 38, 770 A.2d 1222 (App. Div. 2001); certif. denied, 171 N.J. 442, 794 A.2d 181 (2002).

Second, some districts have sought to be included within the group of special needs districts that receive the largest amounts of state aid. In *Bacon v. Department of Education*,²⁶ 17 non-*Abbott* school districts, all in DFGs A and B, claimed their schools were inadequately funded by the state and their municipal governments lacked the capacity to impose greater burdens on taxpayers. They also claimed, in contrast to the plaintiffs in *Stubaus*, that the combination of insufficient state funding and tax overburden caused them to be unable to provide their students with a thorough and efficient education, and they supported this claim with evidence of educational need and programmatic cuts. The administrative law judge assigned to the case recommended extending special-needs designation to six of the petitioning districts, but the Commissioner of Education rejected that recommendation as to all but one, Salem City. The Commissioner's decision is on appeal to the State Board of Education.

The issue of special needs designation may soon be on the legislative agenda as well, as the Commissioner reportedly soon will present a proposal to the Legislature to change the criteria for such status. A recent report by the Office of Legislative Services analyzed the criteria presented by the Commissioner in a 2003 report, the same as those he applied in his *Bacon* decision, and determined that based on the Commissioner's criteria 13 districts would lose their special needs designation and one would gain it. A "heated and prolonged debate" over the proposal is expected.²⁷

QUESTIONS: Given the present state of the law, is there a valid claim for legal relief on the part of districts that cannot show that they are failing to provide a "thorough and efficient" education to their students? As a matter of policy, should substantial state aid to school districts be limited to those who can show, or admit, such failure? What criteria should qualify a district for special needs status, or for increased state aid? How do other states determine eligibility for aid? If reform of the state aid formula resulted in some districts losing special needs status and others acquiring it, could the result be a more equitable funding system? Could such reform provide tax relief to overburdened communities? Is there a way to provide relief to

²⁶ OAL Dkt No. EDU 2637-00 (2002); Agency Dkt. No. 53-3/98A (2003).

²⁷ Mooney, John, "State Looks to Shrink Needy Schools List," *Star-Ledger*, May 18, 2005, at 1. See Office of Legislative Services, *Analysis of New Jersey Department of Education Budget 2005-2006*, at 67 (*Background Paper: Criteria for Abbott Designation: Existing and Proposed*), <http://www.njleg.state.nj.us/legislativepub/budget/educ06.pdf>; see also Comm'r of Ed., *Designation of Abbott Districts Criteria and Process*, <http://www.nj.gov/njded/abbotts/regs/criteria.htm>

overburdened communities while still satisfying the *Abbott* mandate and meeting the educational needs of students in poor districts?

State Aid to New Jersey School Districts

New Jersey has 574 local school districts, including three state-operated districts. Most serve single municipalities, some with K-12 systems, some with elementary schools only and a few with no schools at all. Of the 574, eight consolidated districts and 70 regional districts serve more than one municipality and apportion costs based on enrollment and wealth in the constituent municipalities. In addition to the 574 local districts, the state has 21 vocational school districts and eight special services school districts that operate on a county-wide basis, for a total of 602.²⁸ Despite perennial calls for district consolidation, few if any districts have shown any interest in a major change in governance structure.

The State of New Jersey is providing \$7.3 billion in direct operating aid to local public school districts in fiscal year 2005. In addition, it is providing \$305 million in state aid for school facilities and about \$100 million to be passed through to non-public schools. It is also contributing approximately \$1.3 billion to pension funds for public school employees. Thus, in total, state education spending is approximately \$9 billion, which represents about one-third of all state spending and roughly 40 percent of all public school spending in the state.²⁹ Revenues raised by local governments – almost exclusively through property taxes – provide another 55 percent, while federal aid provides about five percent. *Abbott* districts serve about one-fifth of the state's public school pupils and receive about one-half of all direct state school aid.

Since 1997, state aid to local districts has been governed by the Comprehensive Educational Improvement and Financing Act (CEIFA),³⁰ which provides a foundation funding formula, along with annual appropriations acts with footnotes providing adjustments to the CEIFA formula. The most significant adjustment is for parity funding, provided pursuant to the ruling in *Abbott* requiring the state to ensure that per-pupil regular education spending in special

²⁸ 2004 New Jersey Legislative District Data Book.

²⁹ Budget in Brief, p. 60.

³⁰ N.J.S.A. 18A:7F-1 *et seq.* Over the past 30 years, state aid to local districts has been governed by three general school finance laws, interspersed with periods of annual *ad hoc* funding. Following *Robinson v. Cahill*, the Public School Education Act of 1975, commonly called Chapter 212, instituted a guaranteed tax base plan of state aid that lasted with minor modifications from 1976-77 through 1990-91. When this law was declared unconstitutional in *Abbott v. Burke*, it was superseded in 1991-92 and 1992-93 by the foundation-type formula of the Quality Education Act (QEA). Changes in state philosophy then resulted in several years of annual *ad hoc* funding, although QEA remained the law. Continuing pressure from the *Abbott* plaintiffs and the Court brought CEIFA into existence for the 1997-98 school year.

needs districts equals the average level of per-pupil spending in the I and J districts. Provisions for meeting this mandate were added to the state appropriations act by a footnote in 1997-98, and they have remained ever since, but they have never been added to CEIFA itself.

CEIFA's foundation aid, called Core Curriculum Standards Aid (CCSA), is provided through a formula that takes into account the cost of providing a "thorough and efficient" education and each district's local share based on its aggregate personal and property wealth. The law requires the Commissioner of Education to issue a report every two years designating the "T & E Amount," the amount per pupil needed in a hypothetical model school to provide the "thorough and efficient" education required by the state's core curriculum content standards. In very simplified terms, each school district's T & E Amount is multiplied by its enrollment, with adjustments for grade level, to establish its "T & E Budget." Each district's local share is then deducted from the T & E Budget. The local share is calculated by applying fixed multipliers to the district's property valuations (equalized valuation) and the personal income of its residents.

CEIFA specifies that the total statewide burden of the local shares should be based in equal proportions on property values and personal income. Each year the Department of Education determines the multipliers which, when applied uniformly to every district's property valuations and personal income, will, together with the total of their T & E Budgets, result in the total CCSA authorized by the Legislature. For the last year in which CEIFA was fully implemented (2001-02), 353 districts had T & E budgets exceeding their calculated local share and accordingly received varying amounts of CCSA. The local shares of the other 242 districts exceeded their T & E Budgets, so they received no CCSA.³¹

From its inception, CEIFA was very complex. This was due largely to the fact that hardly any new money was made available for CEIFA in 1997-98, even though parity aid was provided for the first time that year (and it has been provided ever since). As a result, the CCSA formula provides a smaller amount of foundation aid, overall, than had been provided under the previous funding formulas.³² This appeared to cause hardships for many school districts, so the

³¹ The process is actually much more complicated, involving the use of projected enrollments, the application of a + or - 5% leeway in the T & E Budget, and limitations on the growth of aid or loss of aid in any given school district.

³² Both in 1976, when Chapter 212 was adopted, and in 1991, with QEA, substantial amounts of new state funds were made available through changes in the state's personal income tax, and all of those funds were dedicated to property tax relief. This made it possible to design state aid formulas that would provide aid to most school districts and submerge the wide variations in local property tax resources.

basic CCSA has been supplemented from the beginning with myriad additional provisions to make up in various ways for the perceived losses.

Additionally, since 2002-03, the annual recalculation of CCSA has been abandoned, and the 2001-02 aid figures have been used as the basis for a continuing “freeze” of state aid. Exceptions to the freeze have been specified in footnotes to the annual appropriations acts, and the footnotes become more complicated every year, to the point that the determination of how much a district should receive, and why, becomes an exercise in legislative archaeology. *Abbott* parity aid has generally increased, while the aid “freezes” have been applied to most other forms of aid, sometimes with a minor “sweetener” of across-the-board additional aid. In 2003-04, CCSA comprised about 49 percent of all direct operating aid to school districts. Other forms of aid included special education aid (about 15 percent), *Abbott* parity aid (about 11 percent), early childhood aid (about 5 percent), and pupil transportation aid (about five percent), and numerous others with a variety of qualifiers and formulas: demonstrably effective program aid, consolidated aid, stabilization aid, bilingual education aid, county vocational aid, supplemental stabilization aid, instructional supplement aid, post-secondary vocational aid, and school choice aid.

Parity funding is provided to *Abbott* districts, in addition to basic CCSA and other forms of formula aid, to address the extreme disadvantage that the Court found in those districts. But the Court noted, in *Abbott IV*, that it did not really know how much more aid was needed to address that disadvantage. Lacking any measure of the cost, it ruled that the amount spent in the highest socioeconomic districts was a fair measure, and rejected the state’s position (and the view of one dissenting justice) that average spending in middle-income, rather than high-wealth, districts was a more appropriate measure. The Court ruled, therefore, that parity aid should be linked to I and J district spending “until experience . . . dictates otherwise.”³³ In so ruling, the Court effectively allowed those districts, rather than the state itself, to determine not only the size of their own budgets but the amount of aid to be provided to the state’s poorest districts.

³³ The Court stated: “We are . . . without any constitutional measuring stick against which to gauge the resources needed to provide that educational opportunity other than the inputs in the DFG I & J districts. We reject the State’s invitation to turn a blind-eye to the most successful districts in the State. We are unimpressed by the dissent’s implicit suggestion that the so-called “middle districts” . . . can serve as a more appropriate measure of relief. . . . Without any information or experience regarding achievement levels in those districts—either in terms of the content standards or any other standard—it is difficult to infer that those districts represent the most appropriate barometer of a basic thorough and efficient education. The DFG I & J districts are achieving and undoubtedly will continue to

Moreover, to the extent that parity aid to *Abbott* districts causes a reduction in aid to all other districts (as long as there is an overall limit to the resources for state aid), the Court effectively allowed the I and J districts to determine state aid levels throughout the state.

QUESTIONS: What are the merits of local funding for schools, notwithstanding resultant disparities in available resources? Could district or municipal consolidation, or pooling of resources, substantially reduce costs? Is there a more rational way to allocate aid than that provided by CEIFA and the appropriations footnotes? Is there a better way for the state to measure the cost of providing a thorough and efficient education than the reference to I and J district spending? Does the state's experience since *Abbott IV* dictate that we devise a different method of gauging the resources needed to provide educational opportunity, as the Court suggested it might? How does New Jersey's education aid formula compare with those of other states? Do other states have models that should be considered? Are there ways in which our state's funding system could, and should, be reformed to provide sufficient aid to districts in need while spreading the tax burden equitably?

New Jersey Taxes and Reform Proposals

The New Jersey Property Tax³⁴ is New Jersey's primary means of raising revenue for state and local government programs and services, including public schools. As in many states, property taxes in New Jersey generally have risen in recent decades with inflation and increases in property value. In addition to the overall increase, changes in land use and differences in treatment among classes of property have led to a shift in the state's property tax base. Residential property now generates more tax revenue, statewide, than it did three decades ago, while commercial and industrial property, vacant land and farmland generate less. Among different types of residential property, single-family housing now generates more tax revenue statewide than it did three decades ago, while multi-family housing generates less.

In order to reduce the tax burden on homeowners and renters, the Legislature authorized tax rebates in 1976, and some form of rebate has been in effect ever since.³⁵ Resident homeowners with annual incomes below a specified level have been eligible for rebates on taxes

achieve at high levels, and it is thus eminently reasonable that the Court continue to focus on their recipe for success until experience under the new standards dictates otherwise." 149 N.J. at 176, 693 A.2d at 433-34.

³⁴ In addition to the constitutional provisions discussed above, the property tax is authorized by N.J.S.A. 54:4-1 *et seq.*

³⁵ N.J.S.A. 54:4-8.57 *et seq.* See L. 1990, c. 61, the Homestead Property Tax Rebate Act; L. 1999, c. 63, the NJ SAVER and Homestead Rebate Act; L. 2004, c. 40.

imposed on their principal residences, up to a fixed dollar amount per year (adjusted for cost of living) or the amount by which their property taxes exceed a percentage of gross income. A comparable program is available for renters. The rebate program has risen and fallen in size over the years, having an overall impact on the property tax rate ranging between \$.05 and \$.25 per hundred dollars of true property value, compared with a total tax rate that has ranged between \$1.70 and \$2.70.

The New Jersey Gross Income Tax³⁶ was first adopted in 1976, in response to the ruling in *Robinson v. Cahill*, as noted above. Its enabling legislation provides that all revenues raised from the tax are to be used to offset property taxes and provide for the property tax exemptions for senior citizens and disabled persons. Individuals (except for low-income individuals), estates and trusts are subject to the tax, at graduated rates in recent years from 1.4 percent to 6.37 percent (plus a “millionaire’s tax” added recently), with many fewer deductions, exclusions and exemptions than those in the federal income tax law. Resident homeowners are permitted to deduct from their gross income tax the amount of property tax they pay on their primary residence, and renters are permitted to deduct 18 percent of the value of their residence.

The New Jersey Sales and Use Tax³⁷ was first adopted in 1966. Upon adoption its rate was set at three percent, and since then it has risen to six percent. This tax applies to retail sales of tangible personal property in New Jersey, and use in New Jersey of such property that is not subject to the sales tax (generally because it was not sold in New Jersey). It also applies to services such as printing, advertising, telecommunications, installation and repair of personal property, maintenance and repair of real property, and hotel and motel rooms. Sales of food (except at restaurants or by caterers), clothing, footwear, prescription and over-the-counter drugs, paper goods and flags are exempt, as are sales of motor vehicles, aircraft and boats to nonresidents, sales for resale, casual sales and professional services. Sales to public agencies and nonprofit organizations, as well as sales to qualified businesses for use in urban enterprise zones, are also exempt. Sales within urban enterprise zones are exempt from 50 percent of the tax.

The New Jersey Corporate Business Tax³⁸ is a franchise tax assessed on businesses for the privilege of doing business in New Jersey. Any entity doing business in or deriving receipts

³⁶ N.J.S.A. 54A:1-1 *et seq.*

³⁷ N.J.S.A. 54A:32B-1 *et seq.*

³⁸ N.J.S.A. 54A:10A-1 *et seq.*

from New Jersey, or acquiring taxable status in New Jersey, is subject to the tax. The rate is based on entire net income, graduated from 6.5 to nine percent, or an alternative minimum assessment based on gross profits or gross receipts.

Other state revenue sources include the Inheritance and Estate Tax, the Petroleum Gross Receipts Tax, the Motor Fuels Tax, the Realty Transfer Tax, the Alcoholic Beverage Tax, the Cigarette Tax, and the Insurance Premiums Tax.³⁹

Proposals to reform New Jersey's tax structure and spending practices abound. Short-term reform proposals include those in the Governor's proposed budget for next year, which until recently called for across-the-board budget cuts, elimination of property tax rebates for some homeowners, reduction of those rebates for senior citizens and disabled persons, and elimination of the property tax deduction from the state income tax. (When income tax revenues were found recently to have exceeded projections, the Governor announced that he would restore the rebates.)

Longer-term proposals range from increasing property tax rebates to eliminating those rebates and reducing the sales tax to increasing the income tax. NJEA's reform plan, for example, would eliminate property tax rebates and link property taxes to household income. Taxpayers with annual income up to \$100,000 would pay no more than five percent of their income in property tax; those with incomes between \$100,001 and \$200,000 would pay no more than six percent; those earning over \$200,000 would be ineligible for relief and thus would see no reduction in their taxes. Relief for taxpayers under 65 would be capped at \$2,000. State aid would make up for municipalities' revenue shortfalls, and to increase state revenue, income taxes would increase for individuals with annual incomes between \$70,000 and \$500,000.⁴⁰

Other reform proposals include cuts in state programs and caps on spending increases, some tying permitted increases to the rate of inflation and some to population growth, some using anticipated savings to pay for services currently funded by municipal governments and some for direct relief to taxpayers. Others include exemptions from property tax for homes of limited value or exemptions on the first increment of property value (such as the first \$200,000 in assessed value); limits on increases in public employee collective bargaining agreements or

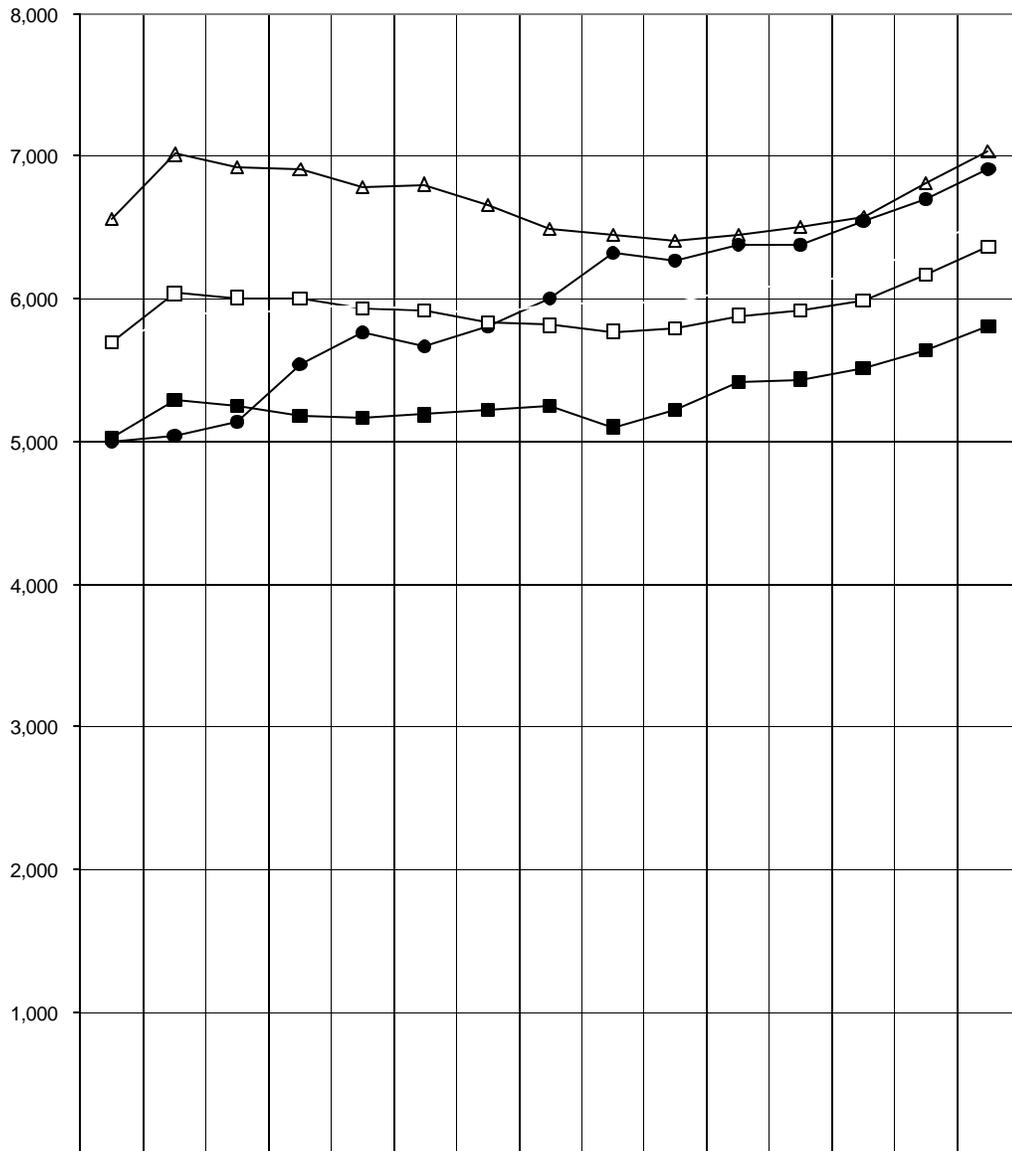
³⁹ Inheritance and Estate Tax, N.J.S.A. 54:34-1 *et seq.*; Petroleum Gross Receipts Tax, N.J.S.A. 54:15B-1 *et seq.*; Motor Fuels Tax, N.J.S.A. 54:39-1 *et seq.*; Realty Transfer Tax, N.J.S.A. 46:15-7; Alcoholic Beverage Tax, N.J.S.A. 54:41-2 *et seq.*; Cigarette Tax, N.J.S.A. 54:40A-1 *et seq.*; Insurance Premiums Tax, 17:33B-1 *et seq.*

⁴⁰ See www.theplan4nj.org.

requirements for voter approval for such increases; and requirements for voter approval for increases in state debt over present limits.

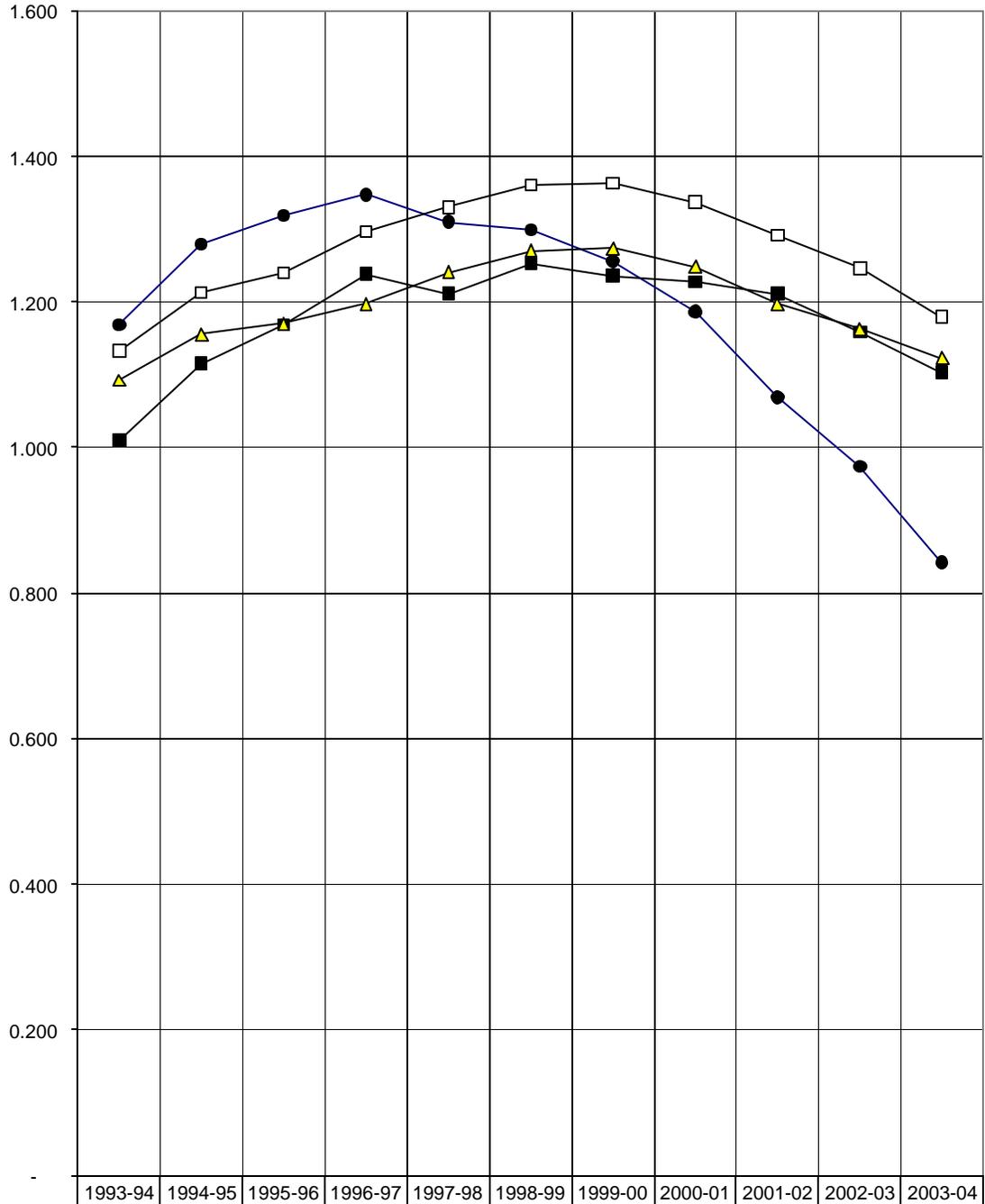
QUESTIONS: Could any form of spending cap be reconciled with the mandates of *Abbott v. Burke*? Even if it could, or those mandates were eliminated, would a cap on state spending be a good idea? Would more limited spending-side proposals, such as limits on collective bargaining increases, provide sufficient savings to serve the purpose of substantial tax relief? On the revenue side, what reform proposals are worthy of serious consideration? Would any form of tax reform in fact offer property tax relief and still ensure that all school districts have adequate funding? Are there lessons that can be learned from other states that have tried to achieve tax relief and also provide quality public schools and other government services? Are there lessons to be learned from states that have focused too much attention on tax relief, to the detriment of the public schools? How have states with ambitious education reform programs funded those programs? If the goal is to provide relief especially to residential property taxpayers, should the focus be on adjusting the mix among property, income and sales taxes? Would adjustments in tax rates for residential, commercial and industrial property taxes, or tax rates on vacant land, be more effective? What predictable side-effects of such adjustments need to be considered? Should increases in other taxes, such as the realty transfer tax, be considered? Would increases in those “other” taxes be sufficient to provide substantial relief?

Chart 1. Regular Education Budget per Pupil in Constant 1989 Dollars



	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
● Abbott Districts	5,003	5,040	5,136	5,536	5,760	5,663	5,809	6,007	6,317	6,269	6,381	6,375	6,546	6,700	6,912
■ Other Poor Districts	5,027	5,285	5,244	5,173	5,159	5,187	5,216	5,250	5,103	5,224	5,416	5,437	5,515	5,636	5,802
□ Middle Districts	5,696	6,036	6,008	5,998	5,935	5,921	5,837	5,813	5,771	5,789	5,883	5,917	5,981	6,166	6,358
△ I & J Districts	6,555	7,012	6,922	6,906	6,786	6,802	6,652	6,488	6,442	6,408	6,449	6,498	6,575	6,807	7,029
State Total	5,638	5,918	5,873	5,942	5,950	5,928	5,896	5,958	5,976	5,975	6,072	6,097	6,183	6,361	6,560

Chart 2. Equalized School General Fund Tax Rates, 1993-94 to 2003-04



● Abbott Districts	1.168	1.279	1.319	1.347	1.310	1.298	1.256	1.186	1.069	0.974	0.842
■ Other Poor Districts	1.009	1.115	1.168	1.238	1.211	1.253	1.236	1.227	1.211	1.158	1.103
□ Middle Districts	1.132	1.213	1.240	1.296	1.330	1.360	1.363	1.337	1.292	1.246	1.179
▲ I & J Districts	1.092	1.155	1.170	1.197	1.241	1.270	1.273	1.248	1.197	1.163	1.122
All Districts	1.140	1.222	1.248	1.292	1.317	1.344	1.341	1.312	1.260	1.213	1.148