

## INTRODUCTION

It is human nature for some people to view the same issue from different perspectives. All of us have grown in our understanding of various concepts through a process of elimination. We read, have experiences, discuss, debate, and reflect as we look at an issue and begin dissecting the information through our own personal lens. You have probably also heard the phrase “looking through rose colored glasses.” The lens probably has bias; however, a knowledge base gives us the foundation to conceptualize our dispositions/beliefs and viewpoints/philosophy. Leading schools financially is no different. People must begin the process of forming a lens to view school finance with their own core values of honesty, trustworthiness, work ethic, and integrity, and then form a knowledge-based viewpoint that leads to a financial concept that then leads to a style and approach to problem solving and decision making. Why is the lens used as an analogy for each person to form a concept of equitable allocation and distribution of revenue? An optometrist has a patient look through several lenses before prescribing the one best for an individual patient. In this chapter, we look through several lenses as you form a “prescription” for the lens you use to view fiscal resources. As you continue expanding your knowledge base, performance (skills), and dispositions (beliefs) during your lifetime, lenses can change just as a person’s eyesight changes.

Although school finance is complicated, this short chapter is designed to introduce the nuts and bolts of how to allocate revenue and distribute the revenue (expenditures) in public education. We explore and examine the concepts behind the sources of revenue and the concepts for allocating and distributing (expending) public school revenue. However, first let’s look at the structure through which revenue is collected and expended. Education does not appear in the U.S. Constitution. In the 1972 landmark case *Rodriquez v. San Antonio*, the U.S. Supreme Court established that the federal government does not have a responsibility for public school funding. Under the Tenth Amendment of the U.S. Constitution, all powers not delegated to the federal government automatically become a state responsibility. Therefore, individual states have the responsibility for their public education system. Each state, by the nature of demographics and political philosophies, approach state and local policy differently. Since the 1950s, Federal Courts have made rulings that affected state policymakers, for example, in the area of civil rights. Since the 1960s, Congress has intervened in state responsibility with statutes that attempt to standardize state controlled public education, for example, special education, the Secondary and Elementary Education Act, and most recently the No Child Left Behind Act.

With federal intervention, including court decisions and state legislation policies concerning allocating and distributing public school revenue, school finance has become very complex and varies from state to state. School finance, therefore, is not a spectator sport. Why? As a spectator in any sport, you are on the sidelines. You might cheer or complain about the game but you are not actively participating. You need to get off the sidelines and into the “game” of public school finance. However, a process is required to be a participant. The process involves reading, discussing, debating, and reflecting

to build a knowledge base. Let's begin that process as we explore the concepts for allocating and distributing revenue for public schools.

## SOURCES OF REVENUE

School finance is limited by revenue. Revenue sources or at least the **allocation of revenue** varies from state to state. It is also true that the concepts for allocating revenue vary from state to state and school districts within a state. Some basic concepts that cause these differences, however, are common to the knowledge base of how schools receive revenue.

### Concepts for Allocating Revenue

You can't spend it if you don't have it. The debate over equal, equitable, and **adequate revenue** for a child's education began in earnest in the 1960s. If you believe the premise that money matters, then you agree with research, for example, that says "an increase of \$500 per student above the national average would boost achievement significantly—the equivalent of taking students at the fiftieth percentile and moving them up to the seventy-sixth percentile" (Hedges, L., Laine, R. and Greenwald, R., April 1993, 5-15). Research also exists that supports the premise that increased revenue provides a smaller teacher-pupil ratio and this ratio increases achievement. Additional research also exists that refutes both of these premises; therefore, for now we will concentrate on where revenue originates and how equitable, fair, and equal revenue is allocated to school districts. School finance and politics go hand and hand, therefore, the system for allocating revenue to local school districts originates in state government and that means political philosophies and agendas.

### State and Local Partnership

Local school governance, including finances, is connected at the hip with state constitution, statutes, rules, regulations, agencies, and policy. As state government forms policy that impacts schools, the legislature and governor receive plenty of advice and, it is probably safe to say, arm twisting from various special interest groups. Schools are not the only stakeholders looking for a piece of the revenue pie. In effect, schools become partners with the state, except in Hawaii where schools are in fact agencies of the state. Therefore, several issues come into play. Because most school revenue originates through taxes and most politicians don't like to raise taxes, how will the revenue pie be constructed? States tend to construct formulas and tax rate caps or revenue ceilings to control the outflow of revenue to match the inflow of revenue from taxes. Schools might comprise 50% or more of the state budget, which means the remaining tax revenue is allocated to other government entities such as counties, towns, welfare, police, and fire. As the revenue pie is constructed, questions that might come to mind include the following:

- How equitable will the revenue be divided among all governmental entities and is the revenue adequate?
- Is the money taken from one school and given to another school based on philosophy or special interest group (Robin Hood Syndrome)?
- Will a school district(s) file a lawsuit against the state for inequitable, unequal, unfair, and inadequate funding?
- What taxes will be assessed on citizens, and how will the tax revenue be divided among government entities?

Before discussing these issues we need to discuss taxation.

## Taxation

A tax has been defined as “a compulsory contribution from one person to the government to defray the expenses incurred in the common interests of all without reference to the special benefits conferred” (Seligman 1995, 423). The truth is no one really likes to pay taxes. The philosophical belief of individuals drives their approach to what tax, how it is collected, and where it is spent. The three major tax sources in state government are income, sales, and property. The state income taxes that are deducted from a pay check are viewed as gross (before taxes) and net (after taxes). Therefore, if you didn’t see it in the first place, you might not miss it as much as sales tax. Sales tax is a consumption tax. Certain items, such as cars and televisions, have a percentage of the sales price added to the cost of the purchase just as food and beverage tax is added at the restaurant. Therefore, you see the tax at the point of purchase. Income tax and sales tax go directly to the state government, and they are difficult for people to track and understand. Even a local food and beverage tax that goes to the state and town government doesn’t have the visceral feeling property tax creates. Property tax is a local tax, and people feel they can see the results of expenditures in the schools. Many taxpayers see property tax as a tax on unrealized capital gains. Because property taxes predominantly go to the city or town and schools, local taxpayers have opinions, which are sometimes strong, about where “their” money goes and how it is spent. When property taxes are increased, everyone in state and local government feels the emotions and impact. Therefore, raising local taxes requires public hearings and strong leadership to develop a consensus that supports the need to increase taxes.

State and local governments tend to assess taxes in many ways (tax and method of taxation varies among states). It should be noted that federal income and payroll (federal taxes don’t play a major role because only a very small percent of revenue for k-12 public schools comes from the federal government) taxes do not play a major role in school; however, both taxes are a cumulative burden for taxpayers when coupled with state and local taxes. The ways taxes are assessed include the following:

- Income: Individual and corporate (state and local)
- Sales: Taxed items vary state to state
- Property: Residential, agriculture, and corporate (state and local)
- Inventory on businesses
- User fees (state and local)
- Food and beverage (state and local)
- Gaming
- Inheritance and estate
- Gasoline
- Vehicles, boats, and planes (state and local)
- Alcohol
- Cigarettes

Note: This is not a complete list; however, the majority of taxes that impact school revenue are listed.

## THEORIES OF TAXATION

Taxes are generally placed into two categories: benefit theory and ability to pay theory. The definition of benefit is in the word. Taxes are assessed in proportion to the benefit received by the taxpayer. As the benefit increases, the tax increases. A system of measurement must be developed to determine a fair tax and benefit relationship. A good example is the gasoline tax. The more gallons of gas you purchase, the more you use the roads, and, therefore, the greater amount of taxes you pay. If people walk or ride a bicycle as a means of transportation, they would not buy gasoline for a vehicle and not pay a tax for roads even though they obviously use the roads on a limited basis.

The definition of **ability to pay** is also found in the words. It is more difficult to determine a creditable measure of ability. The value of a home, the amount of income, and the cost of products or materials purchased determines the tax. Let's take one of these at a time. Income tax increases as the person's, business', or corporation's income increases. You make more—you pay more. Sales tax, however, is a direct percentage of cost; if you can purchase more expensive items, you pay more tax. If food and other necessities are subject to sales tax, it could be argued that it is unfair to those with lower incomes. The property tax, however, is the elephant in the room. Every state has a method for determining the value of real and personal property value. In general, the greater the value (assessed valuation) that has been assigned to the property, the greater the tax. How fair is the assessment method? This is a big question. However, also of importance is the idea that when taxes increase, lower income citizens can have difficulty paying the increased tax.

Nearly all states use a property tax based on property value as a means of measuring school district fiscal capacity (Salomon 1988). Because the state has the responsibility for school funding, the state controls this interrelationship by a formula connecting the state to a given tax rate or levy. As the following explains, property taxes have both weaknesses and strengths.

## Strengths and Weaknesses of Property Taxes

The strengths of property taxes are as follows:

- The tax is stable: If property taxes are not paid, the property is sold and the first lien is for property taxes. It is, therefore, hard to avoid paying property taxes.
- The tax is predictable: Unless the tax base (property wealth) decreases considerably from one year to the next, the tax base remains the same or increases even without a tax increase. Property tax base decrease is usually due to one or more large businesses closing. This is, however, generally predictable.
- Anticipate future revenue: Many school districts have increasing property wealth and, thus, more revenue.
- Enhances local decision making: As mentioned earlier, taxpayers see the result of property taxes in teachers, buildings, and so on, and they, therefore, take more ownership in what their dollar is buying.

The weaknesses of property taxes are as follows:

- Fairness: The value placed on property is subject to judgment and human error. In addition, the lower the property wealth of a school district, the fewer dollars can be raised with a tax rate that is sustainable in the community.
- Although state aid flows to the school district monthly, property taxes are normally sent to the school district twice a year in lump sum payments.
- One of the biggest complaints from taxpayers is that the tax is on unrealized capital gain. Although income tax is on realized income and sales tax is on realized goods, property tax is on a property value that would not be realized until the property was sold, and then the capital gain might not equal the tax paid over a period of years. This is where it is particularly important for any property tax increase to be justified to the community so they see the need to pay the tax.
- The tax is regressive: Lower income taxpayers have a greater struggle with property taxes proportionate to their income, especially if taxes are increasing.
- Costly to administer: Assessing property value, collecting the tax, accounting, investing, and allocating the revenue all involve people, and people cost money.

When state revenues are less than the previous year, a formula for revenue might place more burdens on the local property taxpayer. This is called shifting the tax burden because more responsibility for revenue is “shifted” to the local tax base. Obviously school districts with greater property wealth can create more revenue with a lower tax rate. Therefore, school districts with poorer property wealth have less, and perhaps inequitable and inadequate, revenue to meet the educational needs of the school and community. Adequacy and equity are concepts that drive both the state funding process and lawsuits against the state by school districts. “School districts and education advocates seeking better funding from their states have had success in courts, but often

have to endure a lengthy process before seeing additional funding” (Kennedy 2005, 19). Let’s look at adequacy.

### Equal and Adequate Revenue

Because state legislatures are responsible for funding schools, how they arrive at the funding mechanism is critical to each school district’s educational program. If the funding mechanism leaves the school district with inadequate revenue, what remedies are at its disposal? The school district could focus on lobbying the legislature for changes or file a lawsuit against the state. Both approaches take time and place the school district in a position to “hold the line” or reduce staff and programs.

A lawsuit for adequate funding was successful in Idaho’s Supreme Court in 1993. The ruling is still in appeals. When the legislature makes changes pursuant to a court ruling, then the courts determine if the changes meet the spirit of the court ruling. This is the case in a 1999 Kansas Supreme Court ruling. Adequate funding for facilities is another approach. The Ohio Supreme Court in 1997, the Arizona Supreme Court in 1999, and the New Jersey Supreme Court in 2002 have ruled in favor of school districts and inadequate funding for facilities. “According to the Campaign for Fiscal Equity, only five states—Delaware, Hawaii, Mississippi, Nevada, and Utah—have not had litigation challenging the constitutionality of K-12 school funding” (Kennedy 2005, 20). A total of twenty-seven cases for adequate funding have been filed by school districts against states, and twenty-three have been successful. In 2005, twenty-three states were still embroiled in school funding lawsuits. Indiana school districts are the latest to file a lawsuit for inadequate funding. How does an adequacy lawsuit become successful?

The first lawsuits to be filed against states after the 1973 U.S. Supreme Court ruling were equity driven and based on the wealth of a school district and “fair” funding for students. These were difficult for school districts to prove because fair can be subjective. As lawsuits moved to adequate funding, it became important for school districts to develop a way to define and measure inadequate revenue. The health and safety of students has risen in recent years to a priority status. School districts, therefore, emphasize the need for adequate facilities that are safe and healthy environments with fire safety, security, indoor air quality, communication systems, lighting, student capacity, and so on. These needs are not only driven by health and safety that can be quantified but also academic achievement with NCLB and state mandates for reform, including high-stakes testing. Even though lawsuits against state funding have moved to quantifying adequacy, equity is still an important concept. Whether state legislatures consciously apply equity concepts to a funding mechanism, the concepts are at the foundation of fairly allocating revenue to school districts. Let’s take a look at the three main equity concepts for funding school districts.