

**Office of Legislative Services  
Background Report:**

**Dedication of Tax Revenue in New Jersey**

OLS Background Report No. 81

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**Date Prepared:**  
**January 31, 2003**

**New Jersey State Legislature  
Office of Legislative Services**  
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Trenton, NJ 08625-0068  
<http://www.njleg.state.nj.us>

# OLS Background Report On Dedication of Tax Revenue in New Jersey

## INTRODUCTION

Many of the states of the United States have adopted, in varying degrees, the practice of dedicating or "earmarking" certain revenues for the support of a specific category of expenditure or a specific program.<sup>1</sup> Such a dedication of revenue can be accomplished through a constitutional mandate upon the Legislature to appropriate given amounts from general revenue, or the full amount or a portion of the revenue from a specified source, for a specified public purpose. It can also be accomplished by statute, as where the revenues from certain fees are directed to be deposited into a fund to cover the cost of services having some relation to the fees imposed. In effect, it can be achieved indirectly by "organizational devolution," through delegation to an autonomous entity of both the responsibility for public functions and the power to raise revenue, as when the state establishes an independent authority to manage public roads and authorizes the authority to collect tolls from road users.

Why might a state earmark specific revenues for the support of specific spending? It is not done from the broad constitutional necessity of balancing its budget (virtually every state operates under a constitution prohibiting the Legislature from authorizing expenditures for a fiscal period in amounts exceeding the resources anticipated to be available during that period), for that requirement applies to the budget as a whole, not to specific programs or spending categories within the spending plan. Rather, the states have adopted revenue dedication policies in service of narrower political or public policy ends. A few of those that have been identified in the literature on public finance are:

- "[T]o make a particular tax more palatable to the public by allocating its revenues to a purpose for which there is strong popular support . . . ."<sup>2</sup>
- In appropriate situations, to ensure that the parties deriving benefits under a particular program, or whose private actions burden the state with the need to take remedial steps through the program (as in the case of environmental clean-up), pay their just share of the cost of the program.<sup>3</sup>

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<sup>1</sup>Due and Friedlaender, Government Finance (6th ed., 1977), note that the federal government "has never allocated particular taxes to specific functions . . . by constitutional provision" but that Congress has allocated certain taxes to trust funds for specific purposes (p.137). Holcombe, Public Sector Economics (1988), notes that "[e]armarked taxes are most often used at the local level of government. For example, schools are often funded by a specific portion of the local property tax . . . ." (p.177)

<sup>2</sup>Due and Friedlaender, *idem*.

<sup>3</sup>See discussion in Musgrave & Musgrave, Public Finance in Theory and Practice (3rd ed., 1980), pp.239-242, of the "benefit principle" of taxation.

- To "make it easier for citizens to compare the benefits of specific government-provided services with the taxes that they pay for those services. If the tax scheme is designed well, it can link tax payments with benefits received by taxpayers."<sup>4</sup>

This report summarizes the development of statutory -- and more recently, Constitutional -- provisions for the dedication of tax revenue in New Jersey.

### **STATUTORY DEDICATIONS: A LIMITED TRADITION**

Prior to the mid-1970s, few of the principal State taxes imposed in New Jersey were dedicated for particular uses or for apportionment to local governments. The alcoholic beverage tax (first imposed in 1933 with the end of Prohibition), cigarette tax (1948), corporation business tax (CBT) (1945), insurance premiums taxes (various), motor fuels tax (1935), transfer inheritance tax (1909) and estate tax (1934), the public utility excise tax (1940), and the sales and use tax (1966) were all basically unrestricted as to use, and fully available to fund general State purposes.

There were limited exceptions to this overall rule. The inheritance tax statute has long provided for payment to a county of 5% of amounts of the tax collected on the property of the resident decedents of the county.<sup>5</sup> Small percentages of the tax collected on premiums for fire insurance coverage issued by out-of-state carriers are allocated for distribution to the Firemen's Home and Fire Association. From State Fiscal Year 1970 until enactment of the income tax in 1976, \$25 million per year of sales tax revenue was required to be distributed to municipalities under a population formula. And finally, in conjunction with the enactment in 1966 of restrictions on the ability of local governments to tax business personal property, portions of CBT collections were statutorily dedicated for payment to municipalities as replacement revenue. Still, as recently as 1975, revenue from the itemized taxes -- \$1,749.3 million -- constituted almost 83% of all taxes collected by the State, and of this revenue, the dedicated portion (aside from the CBT dedication, which was eliminated shortly after) totaled only \$31 million.

It is important to note that there was one "traditional" State-collected tax that was wholly unavailable for general State purposes. The public utility gross receipts and franchise tax (1940) was from its inception subject to apportionment in full (after deduction of administrative costs) to municipalities in replacement of local taxes on the property of water, sewer, gas, electric, and other

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<sup>4</sup>Hyman, Public Finance: A Contemporary Application of Theory to Policy (3rd ed., 1990), p.376.

<sup>5</sup>N.J.S.A.54:33-10.

utility companies. In 1975, the amount of tax collected and apportioned was \$260.7 million.

## CONSTITUTIONAL DEDICATIONS: A RECENT DEVELOPMENT

The relatively limited scope of revenue dedication in New Jersey ended with the enactment of the Gross Income Tax Act in 1976. Legislative willingness to enact the tax, and popular consent to the constitutional amendment authorizing its implementation, would almost certainly have been unobtainable but for the inclusion in that constitutional amendment of a provision requiring that

the entire net receipts [from the tax] shall be received into the treasury, placed in a perpetual fund and be annually appropriated . . . to the several counties, municipalities and school districts of this State exclusively for the purpose of reducing or offsetting property taxes.<sup>6</sup>

With the enactment of the tax, a very important new source of revenue became available to the State. (Collections in FY1977, the first year of the income tax, exceeded \$656 million). But with the adoption at the same time of the cited provision, that revenue was made unavailable for general State use. It was, of course, available as a substitute for previously enacted apportionments to local governments. For example, the above-mentioned business personal property tax replacement program, enacted in 1966 to replace municipal revenue, was terminated, with the income tax providing a substitute source of municipal aid. Termination of the program included repeal of two minor taxes (the unincorporated business tax and the retail gross receipts tax, which in FY1976 yielded \$30 million and \$8.1 million, respectively) and more importantly, repeal of a dedication to municipalities of revenue under the business personal property tax (FY1976: \$78 million), making that revenue available for general State purposes.

(The constitutional amendments authorizing various forms of gambling present additional examples, somewhat similar to the case of the income tax, of revenue dedications incorporated as a commitment to the voters to whom the amendments were presented for approval that the proceeds to the State derived from such gambling would be used solely to support worthy purposes. These amendments include

- ▶ State lottery (1969), "the entire net proceeds of [which] shall be for State institutions, and State aid for education . . . ."<sup>7</sup>
- ▶ Casino gambling in the city of Atlantic City (1976), provided that any State revenues therefrom be used solely to fund "reductions in property taxes, rental, telephone, gas, electric,

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<sup>6</sup>N.J.Const., Art.VIII, Sec.I, par.7

<sup>7</sup>N.J.Const., Art.IV, Sec.VII, par.2, subpar. C

and municipal utilities charges of . . . , and for additional or expanded health services or benefits or transportation services or benefits to[,] eligible senior citizens and disabled residents . . . ."<sup>8</sup>

The analogy with the income tax is not perfect, however, since the dedications under the gambling amendments authorized, not simply the collection of the revenue being dedicated, but the legal establishment of the very activities from which that revenue would be derived.)

Eight years after the adoption of the income tax, the voters approved a constitutional amendment providing that, for a period of 17 years, there be credited annually to a special account in the General Fund an amount equal to \$.025 per gallon of the tax on motor fuels.<sup>9</sup> The amendment provided that the amount so credited would be dedicated to financing the costs of the planning, engineering, construction and repair of the State's transportation system. In the first fiscal period (FY1986) in which the amendment was applicable, the indicated amount dedicated was roughly \$100 million. In 1995, the voters approved a phased increase in the portion of the motor fuels subject to the dedication: to \$.07 per gallon in FY1997 and 1998, \$.08 per gallon in FY1999, and \$.09 per gallon in FY2000 and thereafter; the same amendment eliminated the 17-year "sunset" of the dedication. The effect of the amendment was to increase the indicated amount dedicated to roughly \$300 million in FY1997, rising to an indicated \$400 million or more in FY2000.

In the general election of 2000, the voters approved an augmentation of the transportation dedication by approving a further constitutional amendment dedicating to the support of the State transportation system (1) revenue from the petroleum products gross receipts tax, in the amounts of \$100 million in FY2001 and \$200 million thereafter, and (2) revenue from the State sales and use tax, in amounts increasing from \$80 million in FY2002 to \$140 million in FY2003 and \$200 million thereafter.

Since the 1970s, the growing public concern in New Jersey with environmental protection has been reflected, not only in the establishment of programs for the regulation of air and water quality, waste disposal, and related matters, but also in the dedication of revenue to the remediation of environmental problems and the preservation of environmental assets. Most recently, such dedications have been incorporated into the Constitution. In 1996, the voters adopted and amendment requiring that there be credited annually to a special General Fund account an amount equal to 4% of the revenue derived from the corporation business tax, and dedicating those moneys to the payment of costs incurred by the State for the remediation of discharges of hazardous substances; for the upgrade, replacement or closure of underground storage tanks; and to finance

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<sup>8</sup>N.J.Const., Art.IV, Sec.VII, par.2, subpar. D

<sup>9</sup>N.J.Const., Art.VIII, Sec.II, par.4

water quality monitoring and water resource planning and management and pollution prevention.<sup>10</sup> Recent statutory changes, together with economic uncertainties, are expected to introduce some intermediate-term fluctuation into the amount of revenue that may be expected to be generated by the CBT, but application of the 4% factor to the estimated to have been received in FY2002 yields an indicated dedication of \$44 million for that period. In 1998, another constitutional amendment was adopted providing for the dedication, during each of the 10 fiscal years from FY2000 to FY2009, of \$98 million from collections of sales and use tax for (i) land acquisition and development for recreation and conservation purposes, (ii) farmland preservation, and (iii) historic preservation.<sup>11</sup>

## **MODERN STATUTORY REVENUE DEDICATIONS**

The 1996 and 1998 constitutional amendments were not the first measures in the modern era dedicating tax revenue for environmental programs. Beginning in 1977, a sequence of taxes were imposed on activities that endangered or tended to degrade the environment, with the proceeds of those taxes being dedicated to covering the cost of the abatement or remediation of environmental damage. These taxes included the landfill closure and contingency tax, the litter control tax, the public community water systems tax, the solid waste importation tax, the solid waste recycling tax, the solid waste services tax, and the spill compensation and control tax. During their period of greatest revenue production, these taxes jointly yielded as much as \$40 million. The resource recovery and solid waste importation and recycling taxes have expired; the litter tax also expired but has been revived in similar form under recent legislation.

In recent years, a stringent form of statutory dedication has been developed, the so-called "poison pill" dedication. Exemplifying this form of dedication is the 1992 law (1) requiring that each annual appropriations act make provision for the crediting of State revenue (specifically, the State's share of the realty transfer tax collected by the counties) to accounts established to finance shore protection and neighborhood preservation, and (2) prescribing that, upon failure of an appropriations act to include such a provision, the tax from which the revenue subject to dedication is derived shall be suspended.

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<sup>10</sup>N.J.Const., Art.VIII, Sec.II, par.6

<sup>11</sup>N.J.Const., Art.VIII, Sec.II, par.7