Committee Meeting

of

JOINT LEGISLATIVE COMMITTEE ON CONSTITUTIONAL REFORM AND CITIZENS PROPERTY TAX CONSTITUTIONAL CONVENTION

"Testimony from invited speakers regarding alternative revenue sources to the property tax, including local option taxes and the NJ SMART Homestead Rebate program, and constitutional amendments to the Debt Limitation Clause"

LOCATION: Committee Room 11
State House Annex
Trenton, New Jersey

DATE: October 12, 2006
1:00 p.m.

MEMBERS OF JOINT COMMITTEE PRESENT:

Senator Bernard F. Kenny Jr., Co-Chair
Assemblyman John J. Burzichelli, Co-Chair
Senator Fred H. Madden Jr.
Senator Leonard Lance
Assemblyman Louis M. Manzo
Assemblyman Richard A. Merkt

ALSO PRESENT:

Catherine Z. Brennan
Philip N. Liloia
Office of Legislative Services
Committee Aides

Linda Schwimmer
Senate Majority
Kay Walcott-Henderson
Assembly Majority
Committee Aides

Victoria Brogan
Senate Republican
Mary C. Beaumont
Joseph Glover
Assembly Republican
Committee Aides

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SENATOR BERNARD F. KENNY JR., Co-Chair: Good afternoon, everyone, and welcome to the Joint Committee on Constitutional Reform. This is, I think, our sixth actual hearing in this room, on a range of issues over the past few months. And we also had two public hearings.

So it's my honor at this time to pass the gavel over to the Co-Chairman, John Burzichelli.

So thank you for joining us.

ASSEMBLYMAN JOHN J. BURZICHELLI, Co-Chair: Thank you, Senator.

For those in the room, welcome. For those watching, via either the Internet or television, a welcome to all of you as well.

This Committee, as Senator Kenny said, is a Joint Committee between the Assembly and the Senate. The Senate and I share as Chairs, and we rotate the meetings. This happens to be my day, and next week will be Senator Kenny's day.

This body is made up of Senator Leonard Lance, who is expected to join us; Senator Fred Madden; Assemblyman Richard Merkt; and Assemblyman Lou Manzo, who is sitting, about to address us.

The order of business today: We will hear from Assemblyman Manzo on what is called the SMART Bill, which is the result of a think tank of effort that addresses property tax.

So Assemblyman Manzo -- Lou, we welcome you. Remember, people's attention spans are short. (laughter) So whatever you can do to be too the point, and we know you'll be brilliant. But welcome to you -- and then you'll rejoin us on this side after you make your presentation.

Lou.

ASSEMBLYMAN MANZO: Thank you very much.

I want to thank the Committee for their indulgence in allowing me to be up here and talking about a bill I worked very hard on in trying to get before the Legislature for the last three years.

Before I begin, a little on the history of this bill: Its genesis is actually out in the public. The New Jersey Coalition for Property Tax Reform initially came up with the concept of this bill about five to six years ago; which President, Mr. John Meyerle, developed a bill by going out and meeting citizens groups all throughout New Jersey to try to come up with a solution to the property tax problem that virtually shot an arrow through a forest and didn't hit a tree -- without hitting or hurting anyone.

This bill has evolved from its initial stages when it was first introduced in 2003. The changes up to -- the history of the bill, you have in your draft. That's the latest draft copy. So I would ask you, for referring to anything on the bill, to refer to those that you have in your packet and not any other bills with the SMART Bill title that might have been previously posted.

ASSEMBLYMAN BURZICHELLI: And Assemblyman, am I correct that you would ask us to hold questions until the end of the presentation?

ASSEMBLYMAN MANZO: Yes, I would. And there's a reason for that. Having done this all over the state to many citizen groups, what I find is -- and you'll find -- is that the question you have generally in the beginning is answered somewhere within the presentation. If not, there are pages on the bottom of each of your presentations. I won't be speaking on every slide. Some of them are just information that you'll want to have, that I'll refer to, as information on how you could see how it would affect different incomes, different property taxes. But your answers -- if you have a question, just jot it down on the page, and I'll be glad to answer, in depth, all questions at the end.

Most of the information that I'm going to be giving you is updated and actually from some of the packets that have been presented to our Committee. We know we have the highest taxes in the nation. We know our property tax is the most regressive. We are among the top 10 states with the highest taxes on the poor. And we also know that the latest numbers -- that school taxes comprise about 59 percent of the average property tax bill in New Jersey. It's no secret that addressing the school tax portion of the property tax component is the most practical way to provide New Jerseyans with the most meaningful property tax relief and reform if we're going to tackle the property tax monster. And in fact, our Governor, in kicking off this session, said, in our case, middle-class families, seniors, bear the brunt of the failure to meaningfully address the root cause of the problem. And our citizens pay through the roof for a tax that is imposed without regard to income or to the ability to pay.

The school funding component, which is the culprit: the national average, property taxes revenue, 42.7 percent to fund schools; state revenue, 48.6 percent; and Federal revenue, about 8.8 percent. When it comes to New Jersey, you can see the stark contrast -- the 59 percent, approximately, we fund from the local tax dollar. And in State revenue, 38.3 percent, well below the national average.

The conclusion is that New Jersey relies entirely too much on property taxes for funding its schools.

Over the years, two New Jersey property tax commissions have concluded that property taxes in New Jersey had a disproportionate impact on lower- and middle-income residents, for that very purpose of funding it through property taxes and not other revenue sources. That impact today, and born out by recent articles in *The Star-Ledger*, is now even creeping on the lower tier of upper-income earners in our state, who are now fleeing. The impact is created by a regressive taxing, because the home represents the largest share of the total wealth to the average family than it does of a wealthier family.

And here you can see, in contrast to the taxes that we have in New Jersey, you can see the regressivity mainly of our sales taxes, our property taxes, our total tax load; and you can see the progressivity, if you will, of our income tax. And that's why this bill argues for funding taxes, and in particular funding school taxes, in a more fairer way.

This is what brings it home, I think, and what we really need to focus on. This is the burden of taxes compared -- property taxes compared to income taxes in New Jersey. And if I could point out, if you note, a household earning $50,000 living in a $200,000-value home will pay 5.5 times more property tax than income tax, assuming the State median. While there is relationship in the value of the home to the income of the owner at the time of purchase, over time, inflation of the value of the home and changes in the income of the owner can result in the residence valued far higher in proportion to the income of the owner. For the vast majority of New Jersey families, the amount of State income tax paid is far less than the amount of property taxes paid.

If you graph that out, you can see it on the chart; the red indicating school property taxes in New Jersey. And you can see from the lower tier of income earners, working up to the highest income earners in our state, how regressive we are. If you would-- To put this in terms of dollar amounts, the lower two tiers, the 11,000, 26, and even creeping into the $44,000-income tier, spend about 1 cents to 2 cents out of every -- spend about, actually, 5 to 6 cents out of every dollar they earn to fund education. When you get into the middle tiers, from 70,000 to 200,000, it's maybe 3 to 4 cents out of every dollar earned to fund education. And finally, when you get to the highest, the top tier, the top 1 percent, it's about a penny out of every dollar earned to fund education in New Jersey.

Since the SMART Bill premise was to move to a little bit of the sales tax revenue -- that we will be receiving from the sales tax passed in the last budget session -- and some income tax, we want to look at how New Jersey compares in income taxes as a burden compared to other states. Now, granted that our income tax does accelerate from the $100,000 level on, it's more graduated, and our top 1 percent do pay more. When you average it out above $100,000, you'll see we're in pretty good shape with our income tax compared to our neighbors.

And looking at the terms -- of the percentage of income of school taxes paid as a percentage of income, some sample towns in New Jersey -- and you can see that, relatively, the middle-income towns, primarily some towns without Abbott aid, are severely strapped and are paying the lion's share of the their income to fund education, while some of even the wealthier towns don't contribute as significantly. And I believe this is a key reason, as pointed out by *The Star-Ledger* piece, why many of our middle-income and now our lower -- upper tier of upper-income people are fleeing our state.

This has created a vicious cycle which I think everyone has faced with some of the towns in their district. Municipalities are so dependent upon property taxes to fund schools they often chase and compete for new development rateables, even where it doesn't fit the character and vision of their community. This adds to the elimination of open space. Developers and businesses that could help communities in need of development avoid the neediest areas because of the high property taxes. Outlying suburbs and sprawling low-density development become a mismatch as the character of those communities change and the development of schools begins to drive the demand for more property taxes. The property tax system drives communities then to favor commercial, industry, and senior housing over traditional housing in order to avoid the need for additional schools and higher property taxes, creating some of the housing crisis that we have in the state. And then the cycle begins again.

So what to do? The concept of the SMART Bill -- we look at the current revenue -- and this is from a budget a year ago in New Jersey -- $10.2 billion of revenue from school property tax base. Under the SMART Bill concept, we would raise only 7.8. We would limit how much of the school taxes levied can be charged to the property tax bill, basically. And we're going from a smaller base here, and New Jersey's most regressive tax, to shift 2.4 billion over to the income side. And as you can see, our income tax, which is our most progressive tax and the larger base of taxpayers, now we would take a total of 10.4 billion, rather than our 8 billion. And at the end of the day, we're revenue neutral. We haven't increased the overall tax burden in the state. We've collected the same revenue, but we've used it in a more prudent and smarter way. The additional offset to the income tax is about $1.3 billion, which we utilize from the new sales tax revenue and the existing FAIR plan revenue that's out there, which brings the total package of the SMART Bill to a $3.7 revenue shift.

And what does that produce? Fifty percent reduction -- all Class 2 primary homeowners, school property tax bills. On average, that's a net tax reduction of 30 percent -- the combination of school tax and income tax -- for New Jersey residents. All tenants get a refund of 50 percent of school taxes paid as part of their rent; 9 percent of their rent is the calculation, which seems to be a fair calculation which we worked out with DCA. Approximately 2 million homeowners and 1 million tenants will pay less taxes, and more than 94 percent of homeowners and tenants in every legislative district will pay less taxes. If this bill is tie-barred to cutting the millionaire's tax in half, we can say that nearly every New Jerseyan will pay less taxes in the future tax year than the previous tax year, with the exception of the top 1 percenters, who aren't currently paying the state average of school taxes, which is about $1.68 per $100 of assessed value.

To summarize this funding source again, $2.7 billion shifted out of residential property taxes. Funding from the following sources: 2.4 billion from a dedicated income tax surcharge; 1.3 billion from the sales tax and Homestead Rebate plan; the senior tax freeze remains untouched; the $250 property tax deduction remains untouched; the $250 veterans' deduction remains untouched; and we use the existing state infrastructure that administers the FAIR plan to administer this plan.

These are just for you to have. You have these in your packet. This chart will show you basically what -- how much of an income tax disproportion there will be to institute the SMART Bill. And you can see, from an income of $55,000, it's about three-tenths of 1 percent more in income tax someone will pay; down to a millionaire, who will pay about 1.2 percent more in taxes. If you tie-barred that to the millionaire's tax, you can see that we're then moving from, again, about a fourth-tenths of 1 percent income increase to a person at about $55,000 of income, to only eight-tenths of 1 percent income tax increase to a millionaire.

Also in your program, you will have charts of the SMART Bill savings. To easily calculate, you would just run across the top, see what the property tax bill is, run down the side, see the taxable income, and you can easily calculate the savings to joint filers at the regular SMART Bill, the regular SMART Bill for tenants; the SMART Bill with -- tie-barred to the millionaire's tax cut, and for tenants also tie-barred to the millionaire's tax cut.

How does that figure out on the scope of income tax earners in New Jersey? Basically, you have about 1.4 million filers at the $50,000 threshold of income. And the SMART Bill provision is that no one under $50,000 would pay any income tax increase. The income tax increase would kick in at the income levels above $50,000.

At the $55,000 to $200,000 level, there's another 1.1 million filers in New Jersey. The increase of income tax to them would be about three-tenths of 1 percent, to about nine-tenths of 1 percent.

Income tax filers between 200,000 to 500,000, there's 100,000 filers here. The income tax increase, on average, would be nine-tenths of 1 percent, to 1.2 percent.

And then the top 1 percent of our income filers between $500,000 and a million dollars, there's 18,000 filers in this category. And the bill would hit them at 1.1 percent to 1.5 percent. Again, tie-barred to the millionaire's tax, all these numbers, especially for the top 1 percenters, would come down.

The SMART Bill basically credits -- not goes back on a rebate check -- credits 50 percent of the prior year's school taxes paid to the primary resident's block and lot number. So it comes back and shows up on the tax bill as a deduction. To provide immediate tax relief, mortgage companies would adjust escrow withholdings to reduce monthly mortgage payments. Tenants would receive credits or refunds for 50 percent of school taxes paid as part of their rent. Again, that formula -- since 18 percent of rent is considered to go to property taxes, half of that being 9 percent, that is what we calculate for the SMART Bill purposes. We have amendable provisions in the bill that they give you, to take that when they calculate their income taxes the following year; or they could do it, if the Legislature so wishes, through our existing rebate program, where tenants would be the only ones eligible for a rebate refund.

It's funded by a dedicated, dynamic, progressive, and revenue-neutral income tax surcharge. And the taxpayers, again, with incomes below 50,000 paying no surcharge. Commercial property taxes are unaffected. And I will note this, at this point, is that there was a concern that people who were on the FAIR program -- that there could be a discrepancy, because our current rebate program doesn't tie tax relief to property taxes paid, believe it or not, just basically to income. And the SMART Bill makes a great correlation in that. But for our purposes, we don't penalize anyone. So seniors primarily who might have gotten a bigger FAIR rebate last rebate, if they're SMART Bill calculation doesn't match up to that, they will get the greater of either until they change residence. Once they move to another community, the provisions of the bill provide, then they go into the SMART Bill formula.

Again, the current system for administering our rebate program goes into the State income tax, over to the Treasury, and it's issued out in Homestead Rebate checks. The SMART Bill, basically same thing -- collect the income tax, add the sales tax mix, over to the State Treasurer's office, and then electronically crediting 50 percent to the municipality and the individual's block and lot number.

We do have a cost-control amendment, which was part of the concern by the legislators. Since there might be an inclination for districts to go on a spending spree, since the State is now picking up 50 percent of the cost of funding schools in some of the districts, what we provided is that as long as the districts remain within cap, they could continue to get their 50 percent reduction. However, if someone went over cap, even if the town council decided to vote the budget over cap, that town would not receive their 50 percent rebate. It would be whatever percentage that they went over cap -- would calculate out to a dollar amount. And that dollar amount would be subtracted from the overall money coming back into that town, which puts the onus back onto the taxpayers of that town to ensure that their local officials are keeping within the confines of the cap and budget restraints.

And you can see here, we show you an existing town which stayed within cap, one that went over cap 2 percent, one that went over cap 50 percent, and the difference that had to be made up by the local taxpayer.

I've also -- since one of our bill is tie-barred to cutting the millionaire's tax in half -- I've given you a chart to show you what that cut relates to in dollars. And you can see, on the top 1 percenters starting at $750,000 of income, it's about a $3,250 savings; down to someone who is at the top -- actually the highest levels, which would be about $5 million -- it winds up being at $58,500 savings. And we feel that this was a fair contrast. If you're asking them to share most of the burden in straightening out the tax mess, that this is only a fair tradeoff -- to make that cut.

I've also provided you with the table where you can look at average incomes in the state tied into assessed property tax values. Follow out the SMART Bill formula: At the top you see at the average school tax rate, and on the bottom you can see at a below-average school tax rate. And you can see, at the end of the column, the percentage of tax decrease that the bill delivers at each of these income levels. What it does is it provides fairness, in that if someone is living to their means in a house assessed at a value that they can afford, they're going to finally contribute what they should be towards funding education.

You'll also see one tie-barred to the millionaire's tax. And the statement I made before about nearly everyone in the state winding up with a tax decrease by tie-barring SMART to the millionaire's tax, you can see where, virtually, if they're paying their fair share of taxes, the average in

Jersey tax, you can see individuals at a million dollars and $3 million netting out under the SMART Bill, because they, too, would be getting relief from paying the highest school taxes in the state. If they're paying below average, like some folks in my town might have a -- living in a tax-abated home on the waterfront or a condo, $500,000 to a million dollars of value -- they're not contributing anything to county or school taxes. Well, then you can see on the bottom chart, they're going to be paying more to fund the overall income tax for relief in the state.

We're not alone in this opinion. The February 2004 report of the Citizen's Tax Assembly said there was a strong consensus that the State's gross income ought to be the primary vehicle used to raise revenue needed to reduce the amount of property taxes collected. To a more moderate extent, there was an agreement that the sales tax ought to also be employed. And there was strong agreement that the property tax relief should no longer be delivered to the public in the form of rebate checks.

Of course, that was handed over to the Property Tax Convention Task Force, which was delivered to us and the Governor. And the scope of what they recommended was basically: reform the current system of property taxation; eliminate inequities in the current system of property taxation, especially as they affect low- and moderate-income residents; ensure greater uniformity in the application of property taxes; reduce property taxes as a share of overall public revenue; and provide alternatives that reduce the dependence of local governments on property taxes, including possible increases -- be they revenue-neutral -- in other taxes for the funding of local government services.

The Regional Planning Association also reviewed the SMART Bill -- this document is also in our binders that we got at the start of the session. RPA's comments is that the SMART Bill -- found that it would be a good candidate for property tax reform, with the major caveats being its impact on fiscal stability and on fiscal responsibility. Income taxes should be considered as a source that could be increased to allow for future property tax reduction. Income taxes appear to be the most promising alternative to property taxes. New Jersey's portfolio of taxes is heavily weighted towards property taxes. While other State and local taxes are also high on a per capita basis as a proportionate income of the overall tax burden in New Jersey, it is only slightly higher than the national average; much lower than New York's; and in line with those of Connecticut, Pennsylvania, and Delaware. By itself, a shift from local property taxes to statewide taxes should have the following beneficial impacts on our state: land use, housing construction, tax fairness; and it could also be constructed in a way that minimizes negative impacts on local autonomy, fiscal stability, and fiscal discipline.

And also -- we also make reference to the fact that in our Constitution we have the T&E clause, but we also sometimes forget the clause that comes right behind that, that speaks about "for the equal benefit of all the people of the state." And it is our failure to follow that provision that I feel has lead to the argument between Abbott and non-Abbott districts, in that if we were funding it for the equal benefit for all the people of the state, we would even treat those non-Abbott districts -- funding them for T&E as well. And the SMART Bill actually mitigates that issue. How does it mitigate it? Because you'll find that most of the funding already comes from the State to the Abbott districts. When you look at the relief that is being given out in the state through the property tax credit, it's mostly going to those non-Abbott districts, which primarily are funding education on their own and have no reliance on the State. So within the structure of this bill is a financial reform for education -- of how to finance education.

The Governor made several comments during his address to us. And in them you will find comments that promote the solutions that are advocated by the SMART Bill. They're included in your packet.

And getting down to the wind up, remember this example, remember these, folks. This was the OLS example given us by Dr. Rosen at the beginning of our session. And here you can see three people on the same block -- $7,000 in property taxes. If they were paying the State average in school taxes, it would be a liability of $4,130. If we applied the SMART Bill to them, their school taxes would be reduced $2,065 across the board. You can see we calculated in their surcharge. And you can see the most important thing that I want to point out here, is look at the tax burden for each of these families going from the $90,000 income family, 9.3 percent; 12.4 percent to the senior couple; and 7.5 percent to the $400,000-income person.

When you apply the SMART Bill, look now at the tax burdens: 7.4 percent for the $90,000-family income, 7.2 percent for the married couple, and 8 percent for the $400,000 income. You can see the uniformity, and all we did was apply fairness. And this happens across the state. Everyone winds up paying their fair share.

I also think that we have to tie-bar this bill possibly to doing something, as the Governor said, on refining and cutting spending. However, the Governor was also right when he said that cutting spending alone just wouldn't be enough. And here you can see the same example, same percentage of school taxes: and again, if we were to cut spending and, say, get our -- prevent property taxes from increasing, just to 3 percent next year, you could see that we have done nothing to correct the overall burden of income. In fact, it increased for the family and for the senior couple, while it stayed relatively the same for the higher-income individual. So a component of cutting spending and a component of tax fairness, I believe, should be what we strive for in pushing forward.

And finally, you can see what the SMART Bill does to the regressivity of the funding of school taxes through our property tax bills, when applied to the chart that we showed you in the beginning.

And finally, SMART Bill and schools in the community: Schools are funding as per whatever directives that we come out of this session with. The local school districts still develop their budgets. Local taxpayers vote on school budgets and school board elections. They're enforced by the provisions of the SMART Bill. Home rule is maintained.

And the SMART Bill and the senior community: Seniors actually benefit the most, because they have less-than-average income and pay little or no surcharge. They live in homes that have appreciated in value and generally pay higher taxes than the average school taxes. And the combination results in a higher-than-average school tax cut and a lower-than-average surcharge.

Enacting the SMART Bill, as I said, will produce the largest net tax decrease in our State's history. Two million homeowners benefiting; one million tenants benefiting. Ninety-five percent of all New Jerseyans -- enacting the SMART Bill and cutting the millionaire's tax 50 percent will provide a net tax decrease to nearly every New Jerseyan, compared to the current year, with the exception of those top 1 percenters who are not paying at least their average of school taxes.

And that's the bill, and I'll be happy to answer any question.

ASSEMBLYMAN BURZICHELLI: Assemblyman -- Lou -- let me say to you, let me commend you for the effort. I know the passion that you developed working with the coalition, especially as this has evolved. And you almost think, when you look at the overlaying of the income tax, the words *public education* -- you sort of sense that when the income tax was initiated in this state for purposes of relief for the cost of public education, you wonder how we weren't on this track earlier on, since the beginning. And of course you know, because you're pragmatic, that one of the issues of resistance is additional taxes, although there wants to be a balance in this program. So this is an important public discussion, especially for this Committee, as we weigh all -- that we may want to consider as we work to a close.

Let me see if anyone from the Committee would care to raise a question? (no response)

If not, everyone okay?

So, Lou, you were persuasive -- that there were no questions. But everyone has this brochure and the details of it.

And I thank you very much, Lou.

ASSEMBLYMAN MANZO: Thank you, Mr. Chair.

ASSEMBLYMAN BURZICHELLI: And you'll rejoin us at the dais here.

Now, let me ask Assemblyman Merkt, who is going to open our discussion on debt. Are you okay, time wise, Rick, do you think? Or do you want me to see if we can have our people from Colorado join us? It may be a little too early for them. Let me ask.

ASSEMBLYMAN MERKT: Rather than have downtime, why don't I get into it. I think I may be able to do it.

ASSEMBLYMAN BURZICHELLI: Would you like to roll? Okay. Okay.

Lou, please rejoin us.

The next-- For those with us, the next discussion is going to be initiated by Assemblyman Rick Merkt, who is going to talk to us and open the discussion on how our Constitution is structured when it comes to this State and the people of this state acquiring and being responsible for debt, whether it be long-term or short-term. As many of you are aware who are following these proceedings, a considerable portion of our budget is required to pay the debt service as it has been accumulated over a long period of time. And there's issues, all of us felt, that since it is a significant part of the budget, since the Governor spoke about how to reduce it, that we should talk about the mechanism of how it works.

And Assemblyman Merkt has taken a lot of time to study this structure. So, Assemblyman, the microphone is yours.

ASSEMBLYMAN MERKT: Thank you, Mr. Chairman, and thank you, members.

I appreciate this opportunity to present an issue that is not my issue alone, but has been an important issue, I think, for a number of my colleagues; most notably Senator Lance, who has been at the forefront of this issue for some years.

Mr. Chairman, last week we discussed spending caps, and it was a specific proposal and I think an important proposal, because our Committee has to get to specifics. We've had some great general discussions, but I think it is time, as Chairman Kenny has said, for us to get down to particulars. And this week we've had Assemblyman Manzo's proposal, and now we're going to have a brief presentation, if I may, on the debt limitation clause. So I'd like to thank you -- both the Chairs -- for this opportunity. I'd also like to thank the folks at OLS who helped put together this presentation, and also the Committee staff.

Let's go right to the first slide, if I may. The first slide shows the growth in New Jersey's total State debt over the past 15 years. It reflects a seven-fold increase in State debt. And I think the obvious question most of us have is, "Gee, that's a pretty big increase in the overall State debt. Why has this occurred?"

And I think as a preface to the next slide, we have to say there are two different kinds of debt involved here. The first form of debt is voter approved, normally general obligation debt of the State of New Jersey; which as Senator Kenny pointed out last week, has been a great tool for the people of New Jersey over the years. It certainly is an important thing for a state or any government to be able to have access to capital funds, so that when you have important and necessary projects such as the Garden State

Parkway, or such as the New Jersey Turnpike, we can raise the capital and use it for a good and valid long-term public use.

So let's take a look at what has happened over the past 16 years with voter-approved debt. And when I say voter-approved debt, by the way, I'm referring to the debt limitation clause in Article VIII of the State Constitution, which provides that voters will approve any debt that exceeds 1 percent of the State budget per year.

It looks like a set of teeth, doesn't it? What you're looking at there is the percentage or existing State debt over the past 15 years that has been State voter-approved debt. I think what the slide shows is, it shows there's not a real problem here. It's running at approximately, I believe, yes -- constant. It's about $3 billion. That's only about 10 percent of the State budget. If this were the State budget, State debt, we wouldn't have a problem.

Next slide, now we're talking about State non-voter-approved debt. This is the stuff that, frankly, has been issued over the last decade more or less; and it has been issued during Republican administrations, it's been issued during Democratic administrations; it's been issued during Republican-controlled Legislatures, and Democratic-controlled Legislatures.

And this is, I think, the nub of our problem. Non-voter-approved State debt has risen from approximately $1 billion to the point where it's now $29 billion, and that's as we speak today.

This is where it's headed, unfortunately. We've already, as everyone knows, approved the Transportation Trust Fund renewal, which was a good and worthy project. There is also school construction debt that is going to come on, in addition. The whole point of this slide is to simply make it clear that we're not only at $29 billion of non-voter-approved debt right now, but that number is going to naturally increase over the next few years. And by the time all the Transportation Trust Fund money is out, I think we're going to be looking -- instead of at a total debt of about 33 billion -- we're going to be looking at a total State debt that's more on the order of $40 million. I think that has to be a matter of concern for us.

You can see there that the projected debt is going to grow for the TTF, the Transportation Trust Fund; and also discussion of the school construction fund.

This is a slide that displays the growth of debt service associated with non-voter-approved debt. And as you can imagine, based on a few slides ago, if non-voter-approved debt has grown significantly, obviously non-voter-approved State debt service is also going to increase. What's the impact? What's the concern? Well, obviously it impacts on our State budget. And I believe Mr. Rosen, weeks ago, presented to us something that basically showed that the amount of the State budget that is attributable to capital spending -- debt service and such things -- has grown fairly dramatically.

My concern is, as this figure increases -- along with all the other things that we have to pay out of the State, such as pensions and health benefits -- we are taking a larger and larger share away from discretionary spending that could be used for property tax reform. So this to me is a very troubling number. That number is only going to get worse. And, oh, by the way, that number that's reflected in this graph does not include some fairly serious -- and I mean hundreds-of-millions-of-dollar -- issues concerning debt service that is back-end loaded. So we're not even really seeing the full impact of the bonds that have been issued.

You can see, over the years, the increase. It was only $100 million 15 years ago. Today, it's over 1.5 billion.

The last slide I have tries to put this in context. There are four major issues that the Joint Legislative Committees, the four of them, have to deal with. One is not ours -- that is public employee pension costs. There is a Committee out there to review that -- that's their baby. But it's a big issue. The State Treasurer has told us it's around $18 billion. Actually, it's a much bigger problem if you consider that there are local governments and county governments out there that also have problems.

The second issue -- public employee health benefit costs. Again, we know that that's at least a $20 billion problem at the State level; but there's a Committee that has addressed that particular issue.

Public education funding costs -- about $20 billion. Obviously, one of those big issues. These are all tens of billions of dollar issues. That has its own special Committee.

And lastly, what I call the *orphan issue*, State debt. And I hope it won't be an orphan, because I hope we will adopt this as our own and recognize that long-term solutions to the property tax problem in New Jersey are going to require certain new disciplines. And in that respect, I would have the following to say, Mr. Chairman: It was intended, in the 1947 Convention and the 1947 Constitution -- it was intended that the people would retain the right to approve State debt. That's obviously why Article VIII appears in the Constitution. It was not a new provision. I've been advised by Senator Lance that that goes back, I believe, to 1844, when it was originally--

SENATOR LANCE: When I was young. (laughter)

ASSEMBLYMAN MERKT: He remembers it well.

But the fact of the matter is, the State government today is not the State government that existed at that time. Many of the independent agencies and authorities that the State has created over the years have come about in the 60-year period since this Constitution was projected.

Now we have a situation where, frankly, governors have found it convenient not to go through the traditional route of putting bond issues on the ballot for the people's consideration, but rather have used other methods -- namely of non-voter-approved debt. And as you can see from the first slide, the debt has grown dramatically.

I think it's time for us -- and when I say us, I mean this Committee -- to help put the genie back in the bottle. I think it's time for us to update our Constitution to restore the people's right. The people's right is to approve debt. They trust us with the budget every year. They also trust us, under Article VIII, with two exceptions to the voter requirement. One is if we keep State-issued debt, in any given year, under 1 percent of the State budget; and this year it would be about $300 million that would not have to go to the people. Also, there is a very important exception. And the exception is, in the case of an emergency the Legislature can act without putting the issue on the ballot for the people to approve or to reject. And I think those are good and sound principles. They provide some flexibility that the Legislature can use.

However, I think we've had too much flexibility with contract borrowing, with some of the other things that have gone on; and the result has been we've had a growth in State debt that is very troubling, has put pressure on our debt service. Our debt service -- if you have $40 billion in debt, which we will in a few years, the debt service on that is going to be somewhere in the area of $65, $75 billion. That's huge. And it's going to have a major impact on our ability to provide property tax relief to the people of New Jersey.

This issue has gone -- and I'm actually going to invite my colleague, Senator Lance, to discuss this briefly. This issue has gone to the Supreme Court. The Supreme Court took a very narrow view, unfortunately, in this issue, and they said, "Yes, there is a constitutional debt provision, limitation clause, but it doesn't apply if you put the little mouse print at the bottom that says it's not really an obligation of the State of New Jersey." But I think everybody in this room understands that when the Legislature votes for something, it really is an obligation of the State of New Jersey, whether we put that on the bottom of the bonds or not.

Long term, we have to do something about this. If we accomplish this, if this comes out of this Committee and out of this Legislature, we will have done more for the people of New Jersey than anyone can possibly imagine. It is an important reform and it's one that needs to be done. And I really hope that this Committee will seize this issue by the horns, and that we will take it and bring it to the entire Legislature as part of our recommendation.

Mr. Chairman, thank you so much.

And I'm happy to entertain any questions that you or the members may have.

ASSEMBLYMAN BURZICHELLI: Assemblyman, thank you.

The presentation, I think, was right to the point. The only good news was, on the last slide, three out of the four -- the big four issues -- are being handled by other Committees (laughter), which I think we should be grateful for. But this is a challenging issue.

As you mentioned, Senator Lance was in Court for clarification, I guess a cycle or so ago -- a budget cycle or so ago -- and the Supreme Court spoke at that time, which I guess gives us some indication -- in that sense, the language in the Constitution was functioning as it was thought to be intended to function. But the points you make about how things have changed, and how this government has changed, and we're doing work in other areas -- whether it's economic development or things of that nature -- there are areas that maybe weren't contemplated in 1947, and it is time to reach them.

I was happy, not happy but -- happy isn't the correct word. You mentioned, at the top, how important it is for a state to be able to use borrowing to its benefit, for its people -- is certainly worthy. And the question is how we manage that.

Let me see if anyone else would like to join with a question for clarification -- I think there may be. Anyone?

Fred.

SENATOR MADDEN: Yes.

ASSEMBLYMAN BURZICHELLI: Senator Madden, would you like to start?

I'm going to ask Senator Kenny to take the Chair for a moment while I step aside.

SENATOR MADDEN: Thank you, Assemblyman.

Just one question -- I'll ask you the same question I actually did to Senator Allen, regarding the overall control in government's ability to borrow. If we were to put on a referendum a statewide issue on spending and borrowing to spend, what's the potential that the lighter populated areas of our state could be hurt, primarily southern New Jersey? And I say it for this reason: We had a large-scale bond initiative that we knew that we needed in the south -- we have to take that out now to a statewide vote. Arguably, the central and northern part of the state are much heavier populated than southern New Jersey. Do we really have a real chance at getting our needs met in southern New Jersey if we were to require everything go to the people, without maybe really looking at giving, maybe, a little stronger balance between -- the government's ability to borrow? So really, I guess I have one question about -- do you see that potentially happening to southern New Jersey on that imbalance? And as a follow-up question, how could we alleviate that if you think it could happen?

ASSEMBLYMAN MERKT: What I would suggest to you first, if I may, through the Chair, Senator, that there's nothing that would prevent that kind of result from happening now within the Legislature, if the Legislature itself is doing the voting, because obviously the majority of legislators do not come from southern New Jersey at this point. So if the Legislature is capable of being fair to a particular section, I believe that the voters of New Jersey are capable of being fair to that section as well. Practical politics, reality -- I'm sure when we frame these kinds of things, that more likely they would be framed as multipurpose efforts to garner the necessary support. Obviously, it would be a lot more difficult to frame stuff when you know it has to go before the voters and the voters are going to be asking themselves, "Do I want to make this kind of long-term commitment for the State of New Jersey?"

But in one sense -- and I mean no disrespect for your question, because it's a good question -- but it's beside the point. The point was, when the people gave us the power as a Legislature, they basically said to us, "We trust you, Legislature, to handle the budget for the State a year at a time. We entrust you to handle following, up to now, $300 million, one year at a time, without coming to us. We trust you in the event of an emergency to handle borrowing to meet that emergency. But we do not empower you to go out and commit the State to 30 or 40 years on large amounts of money -- one Legislature." That I think is the key issue here.

And in one way, in my proposal, the most conservative possible issue-- I'm not arguing to change the law, I'm arguing to restore the law to what it was and what the intent was when this Constitution was adopted; as Chairman Burzichelli says, noting the fact that the State government has changed and its functions have increased since that time. But it seems to me that as the State government has grown and as those functions have increased, we need to make sure that the same protections that the people enjoyed originally are not compromised, either by the Legislature or by the Governor, or frankly by the Supreme Court. I do believe there are ways of dealing with the concern that you have, and the obvious one would be, let the Legislature work out how these bond issues that are to be proposed to the people should be structured to ensure good, broad-based support from the people of New Jersey.

SENATOR MADDEN: If I may, Chairman?

ASSEMBLYMAN BURZICHELLI: Please, please.

SENATOR MADDEN: On the beside-the-point issue, you have upwards of 15 years, I believe, on voter-approved or not-approved debt. Is it possible that we could have a geographic breakdown between northern and southern Jersey on that voter-approved debt? Do you think that we could have that screen presented to us? Maybe it would further comfort me in realizing that southern New Jersey could get its fair share, so to speak, or a fair shake in the statewide referendum.

ASSEMBLYMAN MERKT: That would merely require a request to OLS, and I certainly think that's worthwhile. It's something that I would like to see myself. I hope you understand we are somewhat limited in terms of the amount of information we're able to present in a short period of time.

SENATOR MADDEN: I understand.

ASSEMBLYMAN MERKT: Good idea.

SENATOR MADDEN: And the whole -- this-- I probably beg to differ a little bit about: we can already have that occur in the Legislature right now. Though I'm only in my third year in the Senate, from what I've seen, basically, a lot of the spending issues tend to be along party lines. I've yet to see a real unified gathering within the whole legislative body, as far as projects go. But that all being said, I might part company with you on that particular position, as to how I've seen the borrowing and spending go on in the three years that I've sat there.

But, Assemblyman, thank you for your presentation.

Just if I -- will go on the record, as I did back in Collingswood, that I do believe that all the voter debt should go before the people, in principle. That's a great concept. And I kind of walked along that same path with you. My major concern is, though, I represent southern New Jersey, and I have to make sure that the best interest of that region is in intact also. And if I think the people could get short-changed then, yes, we need to work on that. I'm not quite sure that 1 percent on the Constitution is where it goes, or we raise that, or-- I believe we have to work on that a little bit just to ensure the safety net for the less-populated regions of our state.

Thank you for your time.

Thank you, Chairman.

ASSEMBLYMAN BURZICHELLI: Thank you.

Senator Lance, if I may, we have people joining us from Colorado at five after, so I'd like to work this to a conclusion. But, Senator, if you need more time, we'll come back -- and then if, Lou, you wanted to jump in. But, Senator, you're up.

SENATOR LANCE: Thank you, Mr. Chairman. I'll certainly conclude my remarks before 2:05.

I appreciate the opportunity to address this issue, and I want to congratulate Assemblyman Merkt for his excellent presentation, and for the underlying view of public policy as expressed by Assemblyman Merkt.

It is clear without dispute, Mr. Chairman, that in 1947 the framers of the modern Constitution thought that they had placed in our most fundamental document an ironclad provision that State debt beyond

1 percent, in any budget year, should go to the people for a vote. And that provision was honored until the middle 1990s. And our history is replete with examples, over the last 50 years, where we have asked the people for their approval on various issuance of debt. And that was a regular occurrence. And, indeed, year in and year out there would be a voter question on State debt, and sometimes the people would approve and sometimes the people would disapprove. And the modern Governors -- Governor Driscoll, Governor Meyner, Governor Hughes, Governor Cahill, Governor Byrne, and Governor Kean, and Governor Florio -- all thought that they were living within the prescriptions of Article VII, Section II, paragraph 3 of the Constitution.

And all we have to do is look at the legislative manual referendum since 1947 -- I'll pick a year at random: 1961, $40 million for prisons; 1964, $50 million for public institutions; 1968, $337 million for other public institutions, including transportation facilities; and on and on and on. But over the course of the last 10 to 15 years we have subverted the intent of the constitutional provision, and instead of going to the people for their approval, which we no longer do, we issue the debt not through the Department of the Treasury, but rather through State agencies that are independent of the Department of the Treasury, such as the Economic Development Authority. And therefore, we avoid going to the people for their approval.

This was first an issue of concern as a matter of public policy in 1997, Mr. Chairman, when the Whitman administration authorized the issuance of almost $3 billion in bonds for pension obligations. And quite appropriately, in my judgment, that matter went to the Supreme Court of

New Jersey, and it was brought by our former colleague, Assemblyman Spadoro, who was then Mayor of Edison. Certainly Senator Kenny will remember serving with Assemblyman Spadoro in the Assembly, as I did. Assemblyman Spadoro's attorney in that suit was our beloved, late colleague Assembly Speaker Karcher, the father of Senator Karcher.

The Supreme Court erroneously, in my judgment, said that the case was moot because the bonds had already been authorized. The bonds had not been issued, Mr. Chairman, they had simply been authorized. And the difference between authorization and issuance is, of course, dramatic. And every taxpayer in this state will understand the difference. So the Supreme Court took a pass, irresponsibly. But that decision was not unanimous. The most distinguished justices on the Supreme Court at that time, Justice Handler and Justice Stein -- and of course Justice Handler was an appointee of the Democratic governor, Governor Byrne; and Justice Stein an appointee of a Republican governor, Governor Kean -- they warned that by not deciding the case, the Supreme Court would -- invariably lead to a situation where the Legislature would continue the issuance of debt without voter approval, unabated.

And Justice Handler said that our precedents do not and should not permit the debt limitation clause to be so easily sidestepped. And this is a case, let me repeat, where the majority did not rule in the other direction; they simply didn't rule. As is well known, I was an opponent of the 1997 borrowing, even though it was a legislative action by my own political party. It began the train wreck that now exists in this state, clearly demonstrated by Assemblyman Merkt's charts.

The next step was the issuance of debt for school construction without voter approval. Not several hundred millions dollars, but rather $8.5 million -- the largest issuance of debt for school construction anywhere in the United States with the exception of California -- but the difference being that the Legislature in California asked the people of California for their approval. And that again went to the Supreme Court.

And in a follow-up case the year after, the Court ruled on the issuance of debt without voter approval when that debt has been issued by such authorities as the Economic Development Authority and not by the State Treasury. And in the extremely unfortunate decision of *Lonegan v. the State of New Jersey*, in 2003, the Supreme Court, in a 4-to-3 decision, ruled that the debt limitation clause does not apply in a two-contract debt. The configuration of the Court at that time was, of course, different from what it is today. But in that 4-to-3 decision, Justice Long, Justice Verniero, and Justice Zazzali dissented, and dissented vigorously. And this is one of the reasons why I intend to support the nomination of Justice Zazzali as Chief Justice when that comes before us in the next several weeks. And the three dissenters warned again that we were erasing, in effect, the debt limitation clause. And that was in 2003.

The next step on this disastrous train wreck was the following year, in 2004, when a new low was reached, and we issued debt not for bricks and mortar, but rather for general operating expenses, for the paying of the ongoing costs of State government, the costs to run this building, the costs of paper and pencils, the costs to pay the State workforce. And all of us recognized that we need to have a healthy State government, and we should be proud of our State workforce, and we should be proud of the buildings that exist here in Trenton. But the question was whether we should borrow the general operating costs of State government. I likened it to mortgaging your house to pay your grocery bills.

The Legislature passed the budget with $2 billion with this type of borrowing, and I was so incensed over it that I litigated that issue to the Supreme Court. And in the case of *Lance v. McGreevey*, the Court agreed with me and said we could no longer borrow for general operating expenses. Unfortunately, from my perspective, the decision was not made retroactive, but was in -- the full force in effect the following year, in 2005. I again went to court in 2005, because I thought that budget contained inappropriate borrowing. The Supreme Court agreed with me in the case of *Lance v. Codey*, and the administration recently has decided not to appeal that case, and I want to thank Governor Corzine for not appealing my successful decision at the trial level in that case.

We reach a point now in New Jersey where we are third in the nation in level of debt, with more than $30 billion in outstanding debt. I think it's $31 or $32 billion. Although we are 11th in population, there is more debt in New Jersey than in any other state in the nation with the exception of California and New York -- and of course, California has 35 million people, a much larger state.

And so the issue with which we are confronted, in my judgment, is whether we as a society are going to place on the backs of our children and our grandchildren unconscionable amounts of State debt, given the fact that we have a debt limitation clause that is not being fully honored. I agree completely with Assemblyman Merkt, and I believe the debt limitation clause will have to be strengthened -- not that the framers in

1947, based upon the precedent of 1844, didn't know what they wrote -- but rather based upon this unfortunate decision of several years ago. We have to make it even tighter. And I believe that we would do an enormous service to the people of New Jersey if in our deliberations this Autumn we were to recommend a strengthening of the debt limitation clause, so that all of this debt would have to be brought to the people for their review, and then the people themselves would decide whether or not to move forward with the issuance of debt.

I have great faith in the people to decide good debt from bad debt. That is the tradition of New Jersey over the last 150 years. We should return to that tradition.

Thank you, Mr. Chairman.

ASSEMBLYMAN BURZICHELLI: Senator, that was well-spoken and very clear in giving us an idea of how we got to where we are, and I think helping refocus of what work there is to do.

Assemblyman, I think we're going to move to Colorado, if you'd please join us back on the dais.

And let me say to those who are watching, we are going to be joined, now, from -- two individuals that are coming to us, joining this meeting electronically.

First, I want to introduce Judy Zelio -- I may be pronouncing it a little bit off. She's Program Director in the Denver-based National Conference of State Legislatures' Fiscal Affairs Program, where she has worked since 1988. She specializes in tax and budget issues, as well as local and state tribal matters; and has written a number of articles, reports, and books on these topics.

With her is Bert Waisanen. I know -- Bert's pronouncing that. Bert, you'll clarify your name when you join us. He is a Senior Policy Specialist for Fiscal Affairs at the National Conference of State Legislators, also; and he is the organization's tax policy analyst within the Fiscal Affairs Program, at NCSL. He is the author of NCSL's *State Tax Actions 2005*.

They are going to join us, I believe, to talk to us about local tax options. Is that correct? So I welcome both of you, traveling to us via satellite to join us at this meeting in Trenton. Do we have them? There we are. Welcome to both of you.

JUDY A. ZELIO: Thank you, Mr. Chairman.

ASSEMBLYMAN BURZICHELLI: Yes.

And if you can hear me -- I know you've been following some of this meeting -- I say to both of you, the microphone is yours and we look forward to your presentation.

MS. ZELIO: Thank you, Mr. Chairman. We very much appreciate this opportunity to speak with you today about information NCSL has collected on local option taxes around the United States. I was asked to provide an overview of other states' local option tax authority, the pros and cons of allowing local option taxes, and the factors that should be considered in evaluating local option taxes.

For definitional purposes, local option refers to taxes that are levied with state approval by city, county, and special district governments, including school districts. Examples of such local taxes may include sales, income, lodging, and other types of tourism taxes, real estate transfer taxes, tobacco and alcohol excise taxes, and even severance taxes. The variations, as you can imagine, are numerous and wide-ranging.

Of the 50 states, 43 permit some type of local option sales or income tax. In some cases, the authority granted may be limited to just cities or counties of a certain size, or resort cities, or home rule cities, as example. Three-quarters of the states, or 38, permit local sales taxes which, according to the most recent census bureau statistics, generated 12 percent of local revenue. Fewer states, one-third, or 18, allow local governments to levy income taxes or payroll taxes, which are responsible for an additional 5 percent of local tax revenue in the aggregate. Some states allow both types of local taxes.

You have available, I believe in your pack -- of both a map and table that will give you additional detail.

The expansion of local taxing authority can have important implications for individual taxpayers, businesses, and the economy, with key policy issues that legislators may wish to consider when determining whether to grant additional taxing authority to local governments.

On the plus side are arguments that local governments gain flexibility with revenues when they have some control over them. The fact that additional revenues may become available with the addition of a local tax can help with more programs and services without additional state money. There is the potential for local revenue-based diversification; that is, levying taxes on portions of the tax base that may reflect a locality's economic strengths, such as tourism. This also can allow shifting of some of the tax burden off residents and onto visitors or other nonresidents.

Local taxes also place some of the taxing and spending decisions closer to residents, which may be of particular interest in geographically large states with more regional diversity and varying political views, such as

California. Greater accountability for taxing and spending decisions may result.

Local autonomy is also supported with taxing and spending authority linked to local option taxes. Local option taxes allow voters either directly or through their representatives to choose whether to increase taxes to pay for services that state taxpayers may be unwilling to fund. Proponents of local option taxes also argue that public opinion polls show that taxpayers prefer sales taxes over property and other taxes, in the event a local option sales tax is chosen.

On the other hand, there are some significant disadvantages to the use of local option taxes. Local option taxes will increase combined state/local taxes. Local taxes can reduce state control over these tax sources and affect the extent to which state governments can tap these sources for their own purposes.

And diversification alters the tax burden on residents and may lead to interlocal competition for revenues. If the local option tax is a sales tax, which opponents believe is a regressive form of taxation, the poor are likely to carry a disproportionate share of the sales tax burden.

Local option taxes also may create disparities among localities, particularly in rural states where the retail base is not necessarily evenly distributed. This can possibly limit a state's flexibility to raise tax rates in the future.

It's possible that local option tax structures will increase administrative and compliance costs for both taxpayers and governments, especially local governments, and create confusion if separate tax bases, exemptions, and collection activities are authorized. A situation may affect a state's economic competitiveness and business climate.

Finally, there's no guarantee that the total tax burden will not increase. Once local option tax provisions are in place, removing or modifying them, because of the revenue, is difficult -- because of the revenue impact on local governments. Shifting the revenue burden from property to sales or income taxes also may worsen revenue fluctuations caused by economic cycles and worsen governmental fiscal problems.

Policymakers considering the pros and cons of local option taxes may wish to keep in mind a variety of issues. Some of these items go deep into the realm of sophisticated tax policy and administration, in which I am certainly no expert, but I will offer them anyway with your permission. Such issues could include the importance of local accountability and flexibility. States differ on whether all local governments or only those that meet certain criteria may levy local option taxes. In some states, only some cities or counties may levy taxes, while other states grant statewide authority.

States also vary considerably on voter-approval requirements for local taxes. It is not uncommon for a state to require voter approval for some local taxes, but not for others. Voter-approval requirements may make it more difficult for local governments to levy or increase a tax, and may delay imposition of a tax until the next election. Also, if voter approval is required for some local levies but not others, the local governing body may choose the path of least resistance and impose taxes that do not require voter approval. On the other hand, voter-approval requirements force local governing bodies to carefully justify tax increases. Such requirements tend to minimize the number of times that local governments seek rate increases, creating a more stable tax climate.

It's possible that state decisions about the type of local option taxes authorized could alter the progressivity or regressivity of the entire state-local tax system. State and local governments rely primarily upon property and consumption-based levies that are viewed by many as regressive. Policymakers may want to consider whether a proposed local option tax alternative will increase or decrease the progressivity of their state-local system.

Administrative and compliance costs also should be considered. Businesses that must file multiple tax returns will incur increased compliance costs, as will governments. Assuming local option taxes are permitted by the Legislature, uniformity among these taxes also may be a consideration. Uniformity or lack of it can effect the potential for competition among localities that want to attract new or expanding businesses; and a single set of tax rules can possibly reduce the costs for all parties.

One principle of a high-quality revenue system is balance. Balancing (*sic*) means that states have a roughly equal mix of income, consumption, and property taxes. Balance allows states to keep rates as low as possible in any one tax, minimizing the potential that the tax system will distort economic behavior. Balance also improves the stability of state-local revenue systems by distributing the tax burden to various types of economic activity. States will likely want to consider how granting local option taxation could affect the balance of the state-local tax system.

There will be disparities or differences in the revenue-raising capacity in the tax base available to finance services any time local, rather than state, taxes are used. When evaluating the use of local option taxes, state policymakers will want to consider whether a local option tax alternative will improve or exacerbate the fiscal disparities among local governments in the state.

Economists use the term *elasticity* to describe the responsiveness of the tax or a tax system to personal income growth. Elastic sources increase more quickly than personal income, while inelastic sources increase more slowly than personal income. Income taxes are typically the most elastic state-local revenue source, while excise taxes typically are the most inelastic. Policymakers will want to consider whether the local option tax source will produce the long-term revenue necessary to finance the programs being financed by local governments.

As I mentioned earlier, states differ on whether all local governments or only those that meet certain criteria may levy local option taxes. One consideration is that states that grant authority broadly may help minimize the tendency for tax rates to be higher in larger cities. Just as states compete with one another on the basis of tax policy, local option taxes may lead to competition among local governments. This competition may create an adversarial relationship among localities as they try to use a competitive tax policy to lure businesses and residents. This has sometimes been the case, for example in Colorado. Such competition does not improve the state's overall economic performance and possibly diverts resources from more productive uses.

Finally, state and local income and property taxes are deductible from Federal adjusted gross income. Shifting from deductible to nondeductible local taxes may increase the amount of Federal taxes paid by state residents.

Perhaps most important, as I previously mentioned, state policymakers may wish to consider at length how granting local taxing authority could affect future state system modifications.

And this concludes my presentation.

Thank you.

B E R T L. W A I S A N E N: Thank you, Mr. Chairman and members of the Committee. I'm Bert Waisanen, a Fiscal Analyst with NCSL, in Denver.

I'm here to provide just a few remarks on state property tax circuit-breaker programs in the states. Circuit breakers are named after the electrical devises that shut off electric power and prevent circuits from overloading. The programs prevent property taxes from overloading a taxpayer. Because when property taxes exceed a certain level of income, the state provides a rebate or credit to the taxpayer. There are 30 states that have circuit-breaker programs. The specifics of the programs vary around the states, but in general the benefits are inversely proportional to income, meaning that as income increases the benefits decline.

The circuit-breaker programs for homeowners are designed in one of two ways, either in a sliding scale or a threshold manner. Under the sliding scale approach, the state sets rebate amounts for qualified homeowners or renters. The amount of the rebate can either be a fixed amount or a percentage of the tax paid.

For example, in the state of Nevada, taxpayers with household incomes of about $25,000 or less are entitled to a refund based on a graduated schedule that is adopted by the Department of Aging Services. The refund must not exceed the amount of accrued property taxes or $500, whichever is less. So the allowable percentage of the tax benefit decreases as income increases and until the benefits are fully phased out.

Other sliding scale programs rebate fixed amounts: Instead of a percentage of the tax paid, Arizona provides a fixed credit of $502 for households with incomes under $2,500, and that rebate falls by $22 per $150 in additional household income, until it is phased out completely, as well, at approximately $5,500.

Threshold circuit-breaker programs are designed to ensure that property taxes do not exceed a certain level of the household income, a certain percentage. Homeowners in Vermont, for example, with household incomes under $47,000, receive property tax rebates equal to the amount by which the taxes exceed a percentage of their income, from 3.5 to 4 percent of income, and is subject to a maximum benefit of $1,500.

Circuit-breaker programs for tenants, or renters, are in most cases similar to the homeowner programs with one additional step involved. Tenants pay property taxes indirectly in the form of rental payments rather than directly to local governments. Therefore, the state is required to make an assumption about how much of the rent payment represents property taxes. This property tax rent equivalent varies from state to state, depending on the supply and demand for rental units.

Who benefits from circuit-breaker programs? Because many seniors own property and are more likely to have fixed incomes, most states target more of the property tax relief in these programs towards seniors. Of the 30 states' circuit-breaker programs for homeowners, only seven of them and the District of Columbia allow all households to participate without regard to their age. Some additional states, including Maine and New York, allow all households to participate but provide more generous benefits to their senior citizens.

In Iowa, for example, taxpayers must be age 23 or older, and there must be enough revenue in to fund the program, otherwise senior citizens have a priority in distribution of the benefit.

In Kansas, taxpayers under age 55 must have dependent children in order to qualify for circuit breakers. So there are a variety of programs around the states.

Most renter programs are also targeted to seniors. In the 29 states that have renter programs that allow elderly to participate, only 5 states provide the same benefits to renters of all ages.

Among the policy considerations of circuit-breaker programs are several: One is, if the mechanism's rule is as a targeted benefit, the circuit breaker is focused on income characteristics, which adds flexibility to its ability to be calibrated. It can include renters, since property ownership is not required under these programs. Other tax relief programs are more focused on property ownership or property value.

Another aspect is cost. States often limit benefits to senior citizens and the disabled as a means of controlling the aggregate program costs. Low-income homeowners and renters who are younger than retirement age may certainly be equally deserving of relief, but extending programs broadly to all taxpayers increases the program costs, when the program's budget may have limited funds.

Finally, circuit breakers are not automatic benefits. The taxpayer must be informed of the availability of the programs. And if the taxpayer is eligible, must file an application each year to receive a circuit-breaker rebate or credit.

In summary, states continue to make use of circuit-breaker programs, in recent years having been -- expanding certain eligibility for such tax relief. NCSL has included in your packet a handout that also compares the various circuit-breaker provisions around the states.

I appreciate this opportunity to make some brief remarks, and I thank the Chair and members of the Committee.

SENATOR KENNY: Thank you both for your presentations.

I'm going to ask any of the members if they have any questions for either of the panelists. (no response) No.

We appreciate your testimony and for taking the time out of your day. It's been very helpful to us, and we will reach out to you if we need further information. So I want to thank you very much.

MS. ZELIO: Thank you.

MR. WAISANEN: Thank you.

SENATOR KENNY: You can disconnect the video conference at this time.

Yes. Oh, the Chairman is here. Just in time to adjourn. (laughter)

ASSEMBLYMAN BURZICHELLI: Thank you. Perfect.

I've been informed by the Co-Chair, in his high-level of wisdom, that we have concluded our work for today. So this meeting shall be adjourned.

Next week, I understand, Chairman, you'll be taking up the issue of the constitutional convention--

SENATOR KENNY: Right.

ASSEMBLYMAN BURZICHELLI: --and the parameters of it.

And then we'll announce the agenda at that time for the following week.

I thank everyone who participated.

SENATOR KENNY: May I say something?

ASSEMBLYMAN BURZICHELLI: Please.

SENATOR KENNY: I just thought the presentations today were outstanding by Assemblyman Manzo, Assemblyman Merkt; and Senator Lance's informed discussion. I thought -- it was a pleasure to be associated with such talent.

Thank you.

ASSEMBLYMAN MANZO: Thank you.

ASSEMBLYMAN MERKT: Thank you, Mr. Chairman.

(MEETING CONLUDED)