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NEW JERSEY STATE AND LOCAL EXPENDITURE
REVENUE POLICY COMMISSION

FINAL REPORT

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I. INTRODUCTION

STRATEGY FOR THE FUTURE

Our Mandate. The New Jersey State and Local Expenditure and Revenue Policy Commission was established by the State Legislature in December of 1984 to conduct a systematic and comprehensive review of the state and local tax structure, the structure of state expenditures, and mandated spending formulas. We were directed to pay particular attention to the relationship of the tax system to the economy of the state and its localities; the relationship of state expenditures to the vitality of the economy of the state; the ability of taxpayers to pay taxes and to bear the burden of increases in government spending; the adequacy of the tax system to support needed services; and the reasonableness, efficiency, and fairness of the state and local tax system and spending formulas.

In reviewing all aspects of state and local fiscal policy, we divided our work into four task forces: Local Government Expenditures and Financing, Economic Development, State Tax Structure, and State Government Expenditure Activities. We also established an Education Subcommittee, composed of a group of members from the Local Government and State Government Task Forces.

A Systemic Approach. In adhering to the systemic approach urged by our legislative mandate, we have developed a strategy to correct what we see as the imbalances in New Jersey's state and local fiscal structure by building on the strengths of the state's economy and people. New Jersey's fiscal structure has evolved piecemeal over two centuries. If we are to have a structure that works well into the future, we must institute today a cohesive system of reforms to accommodate the complexities of an advanced and growing economy.

The Problem of Imbalance. The major problem that we see and address is the imbalance between the state and local fiscal system. While the State of New Jersey as sovereign has delegated various responsibilities to county and local governments, it has not given those jurisdictions the resources they need to pay for what they are required or expected to do.

The State's fiscal system relies on local governments to provide services that are, in effect, State services. Traditional local services are crowded out or provided at significantly lower levels. This results in an undue reliance on local governments in terms of the types of services being provided, an inequitable distribution of burdens between State and local taxes, and a serious imbalance between local government responsibilities and the resources available to these jurisdictions to finance those responsibilities.

The changes we propose have two main purposes: First, to relieve the pressures on local taxes for many local governments; and, second, to sort out responsibilities and functions between the states and localities on a more rational and logical basis.

Home Rule. We propose to restructure the state and local fiscal system by increasing the reliance on the state's broader tax capacity, allocating to every unit of government the resources to do what must be done. The new system presented in this report will move in the right direction of helping local governments to provide essential services within New Jersey's tradition of home rule. New Jersey is a state with many relatively small local governments that historically have had strong local fiscal and legislative powers compared to the powers granted to local government in many other states. Local determination--the ability of citizens to make their own decisions, shape the character and future of their communities, and identify with their home governments--is a strong and cherished tradition in New Jersey. Our goal is not to abolish home rule but to make it work more effectively, promoting a state-wide system that is balanced, fair, efficient, while permitting orderly growth.

The Right Time for Reform. We are confident that this is the right moment for serious reform. Reforms are most easily instituted in times of strength--and New Jersey is a strong and vibrant state. Studies show that the state's diversified economy will continue to expand, that its job base is likely to increase through the year 2000, and that its unemployment rate, now at 3.6 percent, is likely to remain well below that of the nation.

Our own analysis shows that the state's finances are sound, and that this sound condition can continue into the future providing that adjustments as proposed in this report are made. We propose six major taxing and expenditure strategies for reform:

First, the structure and operation of the system for providing state aid to local school districts should tie these aid flows more closely to community needs. Our proposals are designed not only to change the system of financing, but to increase the efficacy of education as a public service in the districts in which its weaknesses are most glaring and costly for society.

Second, certain essential services, such as public assistance and the courts, which are now partly financed through local taxes, should be entirely financed through the state's broad-based revenue system. The local burden for these services is particularly heavy for the jurisdictions in which welfare dependency and crime are concentrated--which also are those jurisdictions with the fewest local resources to pay for services.

Third, other state aid should be reallocated to produce greater targeting based on community need while limiting local property tax burdens. (When all our proposals are taken into account, no locality is hurt.)

Fourth, we propose modifications in the state's tax system to facilitate these reforms in the State's fiscal system.

Fifth, because some households may still bear too heavy a property tax burden even after our revenue reforms, we propose a tax relief program designed to protect family income from property and consumption tax overload.

Sixth, we believe that the state and local governments of New Jersey should subject every dollar of public spending to close, hard scrutiny. Even as we propose additional dollars for some programs, we accompany those proposals with

a concern for the capacity of government agencies to carry out their public purposes. We urge additional spending in education, but coupled with adherence to school performance standards, particularly in those districts with low performance now. We urge that traditional public assistance be converted to a comprehensive system focused on job preparation and employment, emphasizing training, service, and productivity.

Throughout our deliberations, we have consulted with state officials and carefully reviewed the state's budget. A number of our proposals entail greater efficiencies and potential long-run economies. While we have not put ourselves in the role of writing a budget for the state, we believe that all public programs should be regularly reviewed and eliminated if they don't pass muster.

We urge attention to this agenda for change in light of the resurgent spirit of federalism as reflected in the energized role and initiatives of state governments across the country. State governments are increasingly taking on responsibilities in meeting the needs of their citizens and in allocating functions between state capitals and local units.

Our proposed system would permit an adequate level of essential public services to be provided by all local governments. It will increase reliance on the State's broad-based tax structure, while allowing cities to compete for investment, thereby encouraging a more rational pattern of land use and development in New Jersey.

We advance proposals to reform New Jersey's overall state and local financial system, with particular emphasis on the property tax. We have done this in a manner that will promote more balance, fairness, efficiency, and orderly growth.

ORGANIZATION OF THE REPORT

The remaining part of this report is divided into six sections. Chapter Two reviews the current conditions and trends regarding the New Jersey economy and public sector. This chapter first examines changes in economic conditions in New Jersey relative to the nation. Next, it describes the structure of the State's public sector and the allocation of major expenditures in state and local government budgets. Overall, this chapter sets the stage for the remainder of the report.

Chapter Three examines the major problems and issues addressed by the Commission. These issues can be broken down into two general areas: 1) the extent to which the state relies on local governments to provide and finance services; and 2) the impact of the current tax system on households and firms within the state. The two areas are, of course, related. Several specific issues are analyzed that indicate an over reliance on local government in the state. First, New Jersey finances a smaller portion of total education expenditures than the average state. Second, local government in New Jersey help to finance several services that are, in fact, state services. Finally, the responsibilities assigned to local governments in New Jersey are greater in general than the resources available to those governments to finance those responsibilities. This last problem is particularly severe for the large urban areas in the state.

The problems of the State's tax system can also be grouped into two categories. The first concerns the distribution of tax burdens among taxpayers. Do household tax burdens reflect their relative abilities to pay? Are businesses in similar situations treated similarly and fairly by the State's tax system? The second category deals with the impact of the tax system on current and future development activity within the state. Can we continue to be competitive within the region and the country in competing for households and jobs? Does the State's tax system distort the advantages or disadvantages of locating in different areas within the State?

These are among the questions examined in Chapter Three. A major finding is that, not surprisingly, the property tax is a common thread that runs through the problems confronting the state: the imbalances in the State's fiscal system.

Chapter Four presents the Commission's recommendations for restoring the proper balance to the State's fiscal system. The strategy involves both spending and tax reforms. The expenditure reforms fall into three groups: local school finances, realignment of service responsibilities, and state aid. School finance reforms cover several areas including a change to current-year financing for equalization aid, setting minimum spending levels for uncertified school districts, a redesign of the manner in which compensatory aid is distributed, and increased state assistance for debt service.

Commission proposals to realign service responsibilities pertain to five services: the trial court system, public assistance, payments for patients in state mental institutions, the office of the prosecutor, and the operation of county colleges. In each instance, the Commission proposes a greater State role and reduced use of local resources to meet State responsibilities.

The system of state aid to local government should be revised so that local resources are more in line with local resources. The Commission has developed a municipal equalization aid plan that ensures that each municipality will have adequate resources to provide essential services.

These proposals will reduce fiscal burdens on local school districts, counties and municipalities. The Commission has also adopted a plan to ensure that these reduced local fiscal burdens result in property tax relief to taxpayers.

Revenue reforms discussed in Chapter Four pertain to all of the major revenue instruments used in the state. They make the overall revenue system simpler, more comprehensive, less intrusive on private decision making, and more equitable. In addition, these reforms produce revenues that are adequate to finance the state services and property tax relief recommended by the

Commission. The recommendations reduce the reliance on the property tax and place more emphasis on broad-based state taxes. The regressivity of the property tax and of consumption taxes is reduced through refundable credits introduced through the State's gross income tax.

Chapter Five presents Commission proposals that will preserve the benefits of the revenue and spending reforms once they have been initiated. These recommendations include strategies for economic development programs, budget process reforms and local management efficiencies.

The complete set of Commission recommendations are summarized in Chapter Six. Chapter Seven then presents information on the impacts of the Commission's proposals for selected households and municipalities.

II. CURRENT CONDITIONS AND TRENDS

NEW JERSEY'S ECONOMY

From 1982 through 1987 New Jersey experienced a period of sustained economic growth which exceeded the nation's in almost every category. Several aspects of the state's economy are worthy of note, including:

* New Jersey is the fastest growing state in the region with a cumulative population increase of 2.7 percent from 1980 to 1985, more than double the rate of growth in New York or Pennsylvania.

* New Jersey's per capita income, second only to Connecticut's, grew from \$13,823 in 1982 to \$18,626 in 1986. In 1986, per capita income rose 6.3 percent in New Jersey compared to 5.2 percent for the rest of the nation.

* While the state ranks ninth in population, it ranks third both as the location of Fortune 500 company headquarters and as the location of the Forbes 200 wealthiest small companies. This includes companies in pharmaceuticals, chemicals, scientific equipment, aerospace, forest products, and food.

* In November 1987, New Jersey had 3.8 million jobs. While New Jersey's population increased by 220,000 between 1981 and 1986, the State has seen 450,000 new jobs have been created since 1981. Over 100,000 new jobs were created between November 1986 and November 1987.

* From 1982 to 1987, New Jersey had a 13.6 percent growth in resident employment, almost 3 percentage points higher than the nation's employment growth. Its unemployment rate dropped from 9.0 percent in 1982 to 3.6 percent in November 1987, well below the November 1987 national rate of 5.9 percent.

* Between 1982 and 1986, almost 133,000 new business corporations were formed in New Jersey, a 30 percent increase over the preceding five years. During the first eight months of 1986, business incorporations rose 12 percent over the previous year, a rate that was more than double the national average.

* Over 262,000 new housing starts occurred in New Jersey between 1982 and 1986. In 1987, the state added 59,500 units, up from 18,890 in 1982. The growth rate for housing starts for the 1982-1987 period was 215.0 percent, more than double the 87.6 percent growth rate for the nation.

Will New Jersey's economy continue to expand? Its job base is expected to increase almost 37 percent by the year 2000, and its unemployment rate is expected to remain well below that of the nation. Continued economic strength depends in part upon the ability of state and local governments to provide the essential services and amenities that make New Jersey an attractive place to live and work. Given the present and projected strength of the state's economy, there are no obvious or critical problems that cannot be addressed.

NEW JERSEY GOVERNMENT STRUCTURE

The state of New Jersey has 1,765 units of government including 21 counties, 567 municipalities, 616 school districts, and many special districts and independent authorities. New Jersey has traditionally been governed mainly

at the local level by a myriad of small units financed by a locally imposed property tax.

New Jersey's Governments, 1985

State Government	1
State-level public authorities and special taxing districts	24
Local Government	
Counties	21
Municipalities	567
School districts	616
Local public authorities and special taxing districts	536
Total local	1,740
Total State and Local	1,765

New Jersey was one of the last states to impose a broad-based state tax when it introduced the three percent sales tax in 1966. This tax, which was increased to 5 percent in 1970 and to 6 percent in 1983, helped to finance a substantial growth in government services provided by the state or by local governments with state aid. Local governments continued to provide the services that State law authorized them to provide, such as education, police and fire protection, sanitation, public works, and recreation. However, the growth of state government functions resulted in a much more centralized government structure, where centralization is defined as the ratio of state spending to total state and local spending. Between 1969 and 1982, New Jersey moved from the least centralized, ranked 50th among all the states, to among the most centralized, ranked 20th.

The shift of government responsibility from the local to the state level gained additional impetus in the school finance crisis of the early 1970s. This crisis culminated in the enactment of a new school aid formula in 1975 and

the state's income tax in 1976. These changes were part of a financial reform program in the early 1970s which markedly changed the fiscal picture in New Jersey. While the sales tax financed the growth in state government functions, the income tax financed the growth in state aid to local governments, school districts, and taxpayers. Indeed, an amendment to the State Constitution dedicated all income tax revenues to property tax relief.

THE STATE BUDGET: WHERE THE MONEY GOES

In fiscal year 1988, which ends June 30, 1988, the state anticipates spending \$10.5 billion for direct services, state aid to local governments and school districts, capital construction, and debt service. This figure does not include the \$2.5 billion in federal aid which the state receives nor almost \$1 billion in non-budgeted funds, most of which consist of utility taxes collected by the state and distributed to municipalities. The amount budgeted for 1988 is 122 percent greater than the \$4.7 billion spent in fiscal 1980, an average increase of 10.5 percent annually.

More than 90 percent of the budget is concentrated in the 15 major programs (Table 1). By far the largest area of spending, more than one-third of the total, is for aid to local governments and school districts. These grants totaled \$3,884 million in fiscal 1988. Medicaid, public assistance, Homestead Rebates, and Lifeline and Pharmaceutical Assistance account for an additional \$1,505 million or 14 percent of the budget. Total spending for these programs and state aid has declined to 51 percent of the overall state budget from 60 percent in 1980.

Operating State institutions and other programs for higher education, human services (the mentally ill and retarded), and corrections takes 16 percent of the budget. An additional ten percent is for public safety, protective services for children and the elderly, and transportation, including capital spending for the state's road network. The budget for employee benefits, rent, debt service, and capital spending for state facilities (but not transportation) was \$1,261 million, or 12 percent of total spending in fiscal 1988, up from 9 percent in fiscal 1980.

Table 1

MAJOR BUDGET PROGRAMS - 1980, 1984, 1988
(Does not include federal funds.)

	----- 1980 -----		----- 1984 -----		----- 1988 -----		Average
	Expended	Pct. of	Expended	Pct. of	Budgeted	Pct. of	Annual
	(\$M)	Budget	(\$M)	Budget	(\$M)	Budget	Growth
	-----	-----	-----	-----	-----	-----	Rate
							(80-88)
TOTAL BUDGET	\$4,730.6		\$7,229.8		\$10,497.3		10.5%
MAJOR PROGRAMS:							
Aid to Local School Districts	\$1,476.5	31.2%	\$2,159.3	29.9%	\$3,151.0	30.0%	9.9%
Aid to Municipalities and Counties	474.5	10.0%	544.2	7.5%	732.7	7.0%	5.6%
Medicaid	296.4	6.3%	476.2	6.6%	712.9	6.8%	11.6%
Public Assistance	247.1	5.2%	263.1	3.6%	297.6	2.8%	2.4%
Lifeline/Pharmaceutical Assistance	57.9	1.2%	128.2	1.8%	188.8	1.8%	15.9%
Homestead Rebates	276.6	5.8%	287.3	4.0%	305.5	2.9%	1.2%
Higher Education	371.0	7.8%	491.2	6.8%	773.8	7.4%	9.6%
Mental Health and Developmental Disabilities	252.6	5.3%	356.3	4.9%	556.3	5.3%	10.4%
Transportation	250.8	5.3%	319.1	4.4%	546.8	5.2%	10.2%
Law & Public Safety	131.4	2.8%	209.3	2.9%	358.4	3.4%	13.4%
Corrections	87.6	1.9%	207.7	2.9%	383.3	3.7%	20.3%
Youth and Family Services	56.1	1.2%	82.3	1.1%	192.4	1.8%	16.7%
State Employee Benefits	237.3	5.0%	460.4	6.4%	653.8	6.2%	13.5%
Leases and Debt Service	187.0	4.0%	311.1	4.3%	453.2	4.3%	11.7%
Pay-as-you-go Capital	18.8	0.4%	18.5	0.3%	154.7	1.5%	30.1%
Total, Major Programs	\$4,421.6	93.5%	\$6,314.2	87.3%	\$9,461.2	90.1%	10.0%
Personnel:							
Total number of employees	67,945		68,496		75,038		
Direct salary expenses	\$703.9	14.9%	\$1,045.4	14.5%	\$1,676.2	16.0%	11.5%

10A.

MUNICIPAL AND COUNTY BUDGETS

Municipalities budgeted \$4,186 million and counties budgeted an additional \$2,413 million in fiscal 1987. Of this amount, municipalities anticipated raising \$1,711 million, or 41 percent of the total, through property taxes, while counties anticipated raising \$1,640 million, or 68 percent through property taxes. The 1987 municipal budgets represent a 65 percent increase over the amount actually spent in 1980, including the reserve for uncollected taxes, while the county budgets for 1987 were 56 percent higher.

Six programs account for 83 percent of municipal expenditures on average, with most of the direct spending concentrated in public safety and public works. In 1985, the most recent year for which detailed data are available, approximately 28 percent of the budget was for public safety, although the percentage varies depending upon whether the municipality has a paid fire department. An additional 9 percent was spent on waste removal (trash and garbage, plus sewers and sewerage), and these expenses have been increasing more rapidly than average. In 1985, municipal governments spent slightly over 7 percent of their budgets on streets and drainage, a decline from the 9 percent spent in 1980. Debt service (10 percent of all spending), general government (19 percent), and pensions and benefits (10 percent) all increased more rapidly than the overall budgets.

The county budget is spread among a wider set of programs, with 8 programs accounting for 75 percent of the expenditures in 1985. Spending for various health programs, including the maintenance of patients in state institutions, accounted for 18 percent of total expenditures. Judicial costs, including the courts, prosecutors, and corrections, made up an additional 14 percent, with other public safety expenditures, primarily for the sheriff's office, another 3 percent. Spending for all of these programs has grown more rapidly than the total county budget. By contrast, spending for roads and bridges (4 percent of the total) and the welfare board (7 percent, consisting of AFDC benefits and administration) have grown less rapidly than average. As in the municipalities, debt service (8 percent of the total budget), pensions and

fringe benefits (9 percent), and general government (12 percent) have also increased more rapidly than the total budget.

III. MAJOR ISSUES

While New Jersey has had a political tradition of home rule, local governments are creatures of the state. Their existence, functions, and powers are prescribed by the State Legislature. New Jersey's recent prosperity did not obscure several very real and significant problems in the state's fiscal system. First, several studies revealed that the school finance system had not produced its intended results. School districts with smaller tax bases were still taxing more and yet spending less per pupil to educate their students than districts with larger tax bases. Second, these poor municipalities were facing annual fiscal crises, deteriorating public services and facilities, and ever higher property tax rates.

The two problems were, of course, related. In Robinson v. Cahill, the New Jersey Supreme Court declared that a thorough and efficient school system could not be provided as long as "municipal overburden" inhibited poorer school districts from availing themselves fully of the funding power afforded them under the school aid formula.

New Jersey contains some of the nation's richest and poorest local jurisdictions. The extreme poverty, deprivation, joblessness, racial isolation, homelessness, and crime in some of the state's major cities are national symbols of misery --- even as New Jersey itself has become a national symbol of economic success. Based on an index that uses census data, the most recent research shows that eight of the nation's 25 most distressed cities are located in New Jersey. While changes may have occurred in some cities since 1980, it is likely that the general patterns have not been significantly altered.

Even in areas of the State that are not considered to be distressed, New Jersey's heavy reliance on local government and local taxes encourages ratable chasing and discourages more orderly economic development.

In addressing more specific issues below, the Commission focused on the intergovernmental aspects of the state's fiscal system --- the role of the state and its local governments in delivering and financing services. Problems with the current fiscal relationships between and among units of government in New Jersey are the greatest threat to the continued ability of the public sector to accommodate the future needs of its residents. The issues addressed by this Commission are not new and they reflect ongoing political debates. The ultimate resolution of these issues will require the development of a political consensus.

RELIANCE ON LOCAL GOVERNMENTS AND LOCAL TAXES

New Jersey's excessive reliance on local governments and local taxation pervades the delivery of public services. The State's reliance on local resources in education is currently being challenged in a major court case, Abbott v. Burke. Local governments, especially counties, are forced to pay a large part of the costs of providing several state services. In addition, there are significant disparities in the size of the tax base available to finance services provided locally.

Local School Finances

The New Jersey school system is, in effect, two school systems. While many school districts provide an excellent education, other school districts, including many of those in urban areas, do not. The school districts where pupils do least well on measures of performance are school districts with few resources and low current expenditure levels, with have trouble attracting the best teachers, maintaining their physical facilities, and delivering good educational services.

In the legislation that established the Commission, we were asked to conduct a comprehensive study of the ways in which state financing of education has been implemented and to recommend structural changes in the education aid formulas consistent with the state's goals of providing a thorough and

efficient education, equalizing local funding resources and addressing the special needs of students.

Education expenditures per pupil vary significantly among school districts within the state, ranging in 1986-87 from a high of \$12,719 to as little as \$2,269. The statewide average is \$5,230. One-tenth of the school districts spend less than three-quarters of the state average per pupil while about one-fifth of the districts spend more than 125 percent of the state average.

There is no question but that some public school districts in New Jersey provide an education as fine as can be secured anywhere. We make no proposals that would jeopardize the programs of these schools. However, we find that the problems that prevent poor districts from reaching the state average in their educational program are worsening and must be addressed now before more serious decline takes hold. Because local taxes are the major source of funding for county and municipal governments as well as school districts, school expenditures must compete with other services and are often held down to avoid excessive total tax rates.

The Commission is aware that experts disagree about the effects of spending on educational performance. But we are convinced that we will not see educational improvements unless we reduce school spending disparities.

Despite some exceptions, school districts with high drop-out rates and low student performance are school districts with low resources and low expenditure levels. Of 19 school districts cited by the Department of Education as having been uncertified for more than two years in 1986-87, 16 had below-average budget levels.

The Present State Education Aid System. State aid accounts for 45 percent of all elementary and secondary education expenditures in New Jersey, which is below the national average of 53 percent for the state share of elementary and secondary public school spending. This figure has been going up in New Jersey and nationally in recent years as state governments have increasingly taken a stronger leadership role in the current education reform movement.

The present system seeks to assure that all districts have access to equal resources for their locally determined programs and to pay for capital improvements and debt service. The state also subsidizes the additional cost of educating children with special needs that prevent them from succeeding in regular school programs, including children who have academic, social, economic or environmental problems.

The present school aid system has not met its goals. Aid for the locally determined programs and capital spending is based on the previous year's budget. Each district must therefore pay for necessary increases solely from its own resources. While this is not a problem in the poorest districts, this prior-year funding discourages spending for needed programs and facilities. The system also fails to compensate districts adequately for preventive and remedial programs for students at risk of failure. The compensatory aid formula is now being changed to recognize the increased cost of remedial training in multiple skill areas for children with more than one deficiency. At the same time, however, the aid for each area is being cut proportionately.

State aid for capital facilities assists school districts in paying debt service. As with equalization aid, these payments are a percentage of the prior year's debt service payments, with the percentage varying inversely with the wealth of the school district. Because state aid only covers a percentage of the prior year's debt service, school districts must bear the entire cost of starting a capital facilities program from their own property tax base, working a hardship on those districts that have trouble raising funds for their day-to-day efforts.

ALLOCATION OF SERVICE RESPONSIBILITIES

The current assignment of service responsibility between the state and local government does not always promote accountability, equity, and efficiency. Several services currently provided and financed by local governments, especially counties, could be better provided by the state.

The present fiscal structure exacerbates the problems of distressed areas and over reliance on local taxes:

- o Expenditures on these services, such as the courts and public assistance, are a large and growing component of county budgets and therefore increasingly serve to limit expenditures on discretionary local services.
- o There are significant variations in the levels, costs and quality of services among local jurisdictions with the highest caseloads and costs and lowest service quality generally associated with the poorest jurisdictions.
- o There is inadequate accountability in that the jurisdictions that make the ultimate decisions about spending levels are not the same as the jurisdictions that bear the burden of raising revenues to finance the services.

Public Assistance

New Jersey's fragmented public assistance system is characterized by large disparities in caseloads and expenditures among counties and municipalities, by a lack of coordination among agencies providing related services or serving similar clientele, and by a lack of incentives to enable recipients to become more self-sufficient.

The history welfare reform efforts has taught the country that income redistribution cannot be a local function. Even large better-off communities with diverse economies cannot implement public assistance programs effectively, and small and impoverished jurisdictions certainly cannot. Yet New Jersey's system of public assistance requires even distressed municipalities to pay a large share of welfare costs.

How the System Works. Public assistance in New Jersey consists of several components (see table below). The State of New Jersey pays for 75 percent of the non-federal costs of Aid to Families with Dependent Children (AFDC)

benefits; counties pay 25 percent of benefit costs plus all non-federal administrative costs.

Public Assistance in New Jersey, 1986

Function	Caseload	Non-federal costs (in millions)	<u>Share of Non-federal Costs</u>		
			state	county	municipal
AFDC	367,766	\$242	75%	25%	
SSI	86,964	\$ 32	75%	25%	
GA	26,740	\$ 78	75%		25%
EMERGENCY	2,000	\$2.5	75%	25%	--
MEDICAID	283,000	\$535	100%	--	--
total costs		state	county	municipal	
		\$799	105.7	30	

Supplemental Security Income (SSI) payments are made by the state in addition to the basic federal social security grant to the aged, disabled, and blind. This is a federal payment, but many states, New Jersey included, supplement this amount. In New Jersey, the state pays 75 percent and the counties pay 25 percent of the supplement.

Another important part of our system of safety net payments for the poor is General Assistance (GA). New Jersey provides cash and medical assistance to individuals, usually adult males or married couples without children, who do not fit one of the federally defined categories for AFDC eligibility. The state pays 75 percent. The local share in this case is not a county responsibility, but is paid by municipalities. They pay 25 percent of GA benefit costs plus all administrative costs.

Medicaid, which is the largest federally aided welfare program in New Jersey as well as one of the fastest growing, pays for health care for individuals eligible for AFDC and SSI. Of the \$1 billion spent by the federal government and the State of New Jersey in 1986, nursing home care for over one-third, and in-patient hospital care accounted for another third. Both services primarily benefit the elderly.

Municipalities in Bergen, Essex, and Hudson counties are required to pay 25 percent of in-patient hospital costs for General Assistance recipients. These individuals are not covered by Medicaid. These costs account for half of Newark's and Jersey City's total expenditures on welfare benefits.

In 1985, the state spent \$262 million for all public assistance benefits; counties spent \$67 million; and municipalities spent \$20 million, exclusive of administration. These payments accounted for about five percent of all county property tax collections. All counties, however, do not bear comparable burdens. The proportion of a county's population receiving AFDC or General Assistance benefits in 1984 ranged from a low of 0.7 percent in both Hunterdon and Morris counties to a high of 13.8 percent in Essex. We are once again up against the problem of disparities: the wealthiest counties carried light caseloads, and the poorest counties bore heavy caseloads.

These fiscal disparities come to roost in local taxes. While Morris county devoted only 1.6 percent of its property tax levy to welfare, Essex spent 14 percent. Parallel disparities persist in the General Assistance program.

We focus attention on these welfare programs because of their intergovernmental implications. New Jersey is one of only 16 states relying on local governments to help finance and administer AFDC.

Trial Court System

How the Present System Works. In 1982, the Supreme Court Committee on Efficiency concluded that there is not a cohesive trial court support system in the State of New Jersey. Expenditure decisions are made by 15 assignment judges, who are state employees. Those decisions are implemented by a group of employees paid by the counties. There is no single, centralized control over the allocation or use of court resources. Rather, the trial court system is a fragmented system characterized by inefficiencies resulting from duplication of activities, restraints on the use of resources, unclear lines of supervision

and accountability, and inequities in funding and service levels. The fractionated system significantly increases costs and impedes efficiency.

Trial court costs are a large and growing portion of county budgets. Counties paid almost 82 percent of the \$240 million in total costs in 1986. The State of New Jersey pays a smaller share of trial court system costs than all but nine other states.

Service levels and costs vary significantly among the 21 counties and, again, the poor bear a higher burden than the wealthy for providing this service. The costs range from Bergen County's low of \$11.50 per capita to Essex County's high of \$32.87. Statewide average per capita costs in 1986 were \$20.53, nearly double 1980's costs of \$10.87.

Patients in State Mental Institutions

Payments for patients in state mental institutions include expenditures for the care of both the mentally retarded and the mentally ill. Per capita expenditures for these services have increased rapidly in recent years and vary considerably from county to county. The county payments support residents admitted to the nine state institutions for the retarded and to the seven state psychiatric hospitals for the mentally ill. (Five counties operate their own facilities for the mentally ill.)

How the Current System Works. County governments bear a significant fiscal burden in New Jersey's system of caring for mentally ill or developmentally disabled individuals. Some of this burden is borne willingly, through discretionary operation of county psychiatric hospitals and community-based programs for those in need of mental health services. However, the costs of institutional care for indigent patients confined to state-operated facilities are also, in large part, a county fiscal responsibility which is mandated by state law, with no county control over facility costs or patient caseload.

In 1986, counties spent \$105 million to meet their share of the costs for 2 million regular patient days. The number of patient days is spread unevenly among counties, and falls most heavily on urbanized counties with relatively few fiscal resources.

Prosecutors

Like the trial courts, the Office of the County Prosecutor is administered by an individual appointed by the state, while the expenses are paid by the county. The direct cost per capita similarly varies, from \$5.33 in Burlington County in 1985 to \$14.80 in Atlantic County. The statewide average is \$8.69. The costs of the prosecutors office have been increasing more rapidly than the average county budget.

County Colleges

The county college system was created as part of a state plan to improve post-secondary education in New Jersey. The first colleges opened in 1966 in Atlantic, Cumberland, Middlesex, and Ocean Counties. Currently, there are 19 community colleges, some covering more than one county, serving approximately one-third of total state higher education enrollment.

In 1983, the aid formula was changed to a system based on the college's operating costs, rather than a fixed dollar amount per student. The present formula calls for operating costs to be reimbursed at not less than 43 percent of total general expenditures for the base year. The base year is always two years prior to the current budget year. However, state contributions to the county colleges have consistently fallen short of the 43 percent figure.

ALLOCATING STATE AID TO LOCALITIES

In calendar year 1985 New Jersey transferred about \$1.3 billion to municipal governments in the form of grants-in-aid and reimbursements of property tax credits, thus contributing about 33 percent of municipal revenue. The state also provided grants-in-aid to county governments, contributing about

8 percent of county revenue. In the aggregate, state grants to municipalities in 1985 were about 90 percent of municipal property tax levies, while state grants to counties were about 12 percent of county property tax levies. While most state aid to municipalities is in the form of unconditional grants, nearly all state aid to county government is in categorical grants designated for such uses as county colleges, welfare, and other social and public health services.

The present state aid system tends to reinforce the current pattern of property wealth by benefiting communities with relatively large property tax bases more than communities with smaller bases. The aggregate distribution of funds from the state's 12 municipal unconditional aid programs is not related to jurisdictional needs. The wealthiest fifth of New Jersey municipalities receives \$165 a year per resident while the poorest fifth gets \$134 per resident. This municipal aid system has developed in a piecemeal fashion over a long period. It is dictated by the distribution of the two largest aid programs, public utility gross receipts and franchise taxes and business personal property tax replacement revenues. The distribution of revenues from these two programs reflects the location of properties previously taxed by local jurisdictions and is not directly related to the current needs of these jurisdictions.

IMPACT OF THE TAX SYSTEM ON HOUSEHOLDS AND FIRMS

New Jersey's recent prosperity has resulted in unprecedented surpluses in state revenues, while some local governments have seen dramatic increases in their tax bases. Local governments do not automatically reap the benefits of economic growth, nor has the growth been evenly distributed among areas.

Who Pays New Jersey's Taxes

People pay taxes, not institutions or products. People pay taxes in their roles as consumers, workers, or owners of capital.

Answering the question of who pays a tax is easier when the tax is imposed directly on the income of a household, and more difficult for taxes paid by

businesses, since business can shift the tax to consumers (through higher prices), workers (through lower wages), or owners (through reduced profits or equity). For example, the property tax is especially difficult in that there is little agreement about whether the tax is a wealth tax on property owners or an excise tax on consumption. A tax on wealth may be progressive while an excise tax on consumption may be regressive.

Several studies have shown New Jersey's overall tax system to be regressive. In calculations published in 1987, the Citizens for Tax Justice (CTJ), a Washington-based research group, estimated that the poorest families in the state paid 6.8 percent of their income in property, sales, and income taxes, while families in the top 5.0 percent paid 6.1 percent. This distribution is similar to the nationwide averages.

Using 1980 data, the Regional Plan Association (RPA) came to a similar conclusion. They estimated that a family of four with an income of \$17,000 paid 9.4 percent of its income in property, sales, and income taxes, while a family with an income of \$75,000 paid 7.3 percent. The patterns described by the CTJ and RPA are considered regressive because the effective tax burden declines as income increases.

The most comprehensive study, by Donald Phares, estimated tax incidence before the Gross Income Tax was enacted and thus ignores its moderately progressive structure. Phares, who tried to account for the shifting of taxes by businesses and the exporting of taxes to other states, concluded that, except for the estate and inheritance taxes, New Jersey's taxes were regressive.

Consumption Taxes. New Jersey's sales tax is the major revenue source for state government, yielding an estimated \$3.0 billion in fiscal 1988. The state also relies heavily on utility taxes, which are also based upon consumption. Indeed, New Jersey's utility tax burdens are the highest in the nation, measured both in dollars per capita and as a percentage of personal income. The role of excise taxes, such as those on motor fuels, cigarettes, and

alcohol, has been declining in relative terms, primarily because the tax is imposed on the quantity rather than the value of the items purchased.

It is possible to estimate the incidence of consumption taxes on the assumption that these are passed along to the individual consumer. (Consumption taxes paid by business consumers are another matter. The New Jersey Division of Taxation estimated that households with income of \$10,000 paid 4.3 percent of their income in sales, utility, and excise taxes, while households with income of \$55,000 paid an estimated 1.7 percent. This pattern is heavily influenced by the state's high utility taxes.

Property Taxes. New Jersey relies heavily on the property tax, which accounts for 98 percent of all local tax collections--substantially above the U.S. average of 75 percent. New Jersey's 1985 property tax burden of \$717 per capita was almost two-thirds greater than the national average of \$435. New Jersey's property tax collection exceeded \$6.5 billion in fiscal 87.

The New Jersey Property Tax Assessment Study Commission concluded that the distribution of property taxes in the state is regressive. The ratio of property taxes to gross income is significantly greater for individuals and families with incomes below \$10,000 than for those with incomes above \$25,000. Similar patterns are evident for a wide range of municipalities (Table 3). In each instance, the property tax burden for the highest income group (\$50,000 and over) is about half of that for the entire jurisdiction while the tax burden for the lowest income group (under \$5,000) is nearly ten times the state or municipal average.

Table 3

1984 Property Tax as a Percentage of
1984 Gross Income

1984 Gross Income	State	Newark	Belleville	Livingston
Under \$5,000	52.0%	50.7	77.9	81.0
5,000-9,999	20.6	18.9	30.5	29.6
10,000-14,999	12.8	11.1	17.5	18.9
15,000-19,999	9.3	8.0	12.5	13.7
20,000-24,999	7.4	6.4	9.8	11.0
25,000-34,999	5.6	5.0	7.4	8.2
34,000-49,999	4.4	3.7	5.5	6.1
50,000 and over	2.8	2.5	3.6	2.7
All taxpayers	4.4	5.6	7.2	3.9

The tax compounds the problems of distressed areas, however, because it reduces their ability to attract and retain businesses and residents. And, as indicated by the figures above, it may be extremely regressive.

Gross Income Taxes. The Gross Income Tax has become state government's second largest revenue source, reaching an estimated \$2.6 billion in fiscal 1988. Revenues are dedicated to property tax relief and used for state aid to school districts and municipalities and for direct property tax relief to residents.

Although New Jersey is among the top states in the nation in its reliance on the property tax, it ranked 35th in 1985 in its reliance on income taxation. Of the 43 states with an income tax, only 8 states relied less on this source of revenue than New Jersey.

The income tax is potentially among the most progressive taxes, depending upon the rate structure and the definition of the base--what may or may not be excluded or deducted from income. New Jersey's tax base permits few deductions or exclusions, and the Commission strongly believes that this broad definition is to be preferred.

The State's rate structure, however, is roughly proportional. When first enacted, the income tax had only two rates: 2 percent on taxable income under \$20,000 and 2.5 percent on income above that amount. The tax package enacted on December 31, 1982, added a third rate, 3.5 percent on incomes over \$50,000. In 1985, the effective rate -- the actual tax paid as a percentage of income -- varied from 0.96 percent for households with taxable income under \$5,000 to 2.67 percent for households with taxable income over \$100,000. Thus, the effective rates are more progressive than the rate structure might suggest.

Business Taxes. While the income of corporations is taxed by the Corporation Business Tax or similar taxes, corporations also pay utility taxes, property taxes, and sales taxes (on goods that are not used to produce other goods). The income of owners of unincorporated businesses or partnerships is taxed by the gross income tax. Regulated utilities are the major exception to the principle of taxing corporations on the basis of their net income; utilities are taxed on the basis of their gross receipts.

The Corporation Business Tax is State government's third largest revenue source, yielding an estimated \$1.4 billion in fiscal 1988. Taxes on business personal property acquired before 1977 and on savings institutions yield an estimated \$23 million each.

The utility taxes are estimated to yield slightly more than \$1 billion in fiscal 1988. These taxes have been the state's most volatile. The receipts of energy utilities are extremely sensitive to fuel prices, which tripled during the 1970s and early 1980s. The volatility of utility receipts, coupled with the high rates, has led to much criticism of the tax. The tax on the telecommunications utilities has also been criticized for treating companies differently in what has become an increasingly competitive environment.

The Effect of New Jersey Taxes on Economic Development

A major concern of the Commission is the effect of the New Jersey tax structure on the economic development of the state and its local jurisdictions. This section discusses the effect of New Jersey's taxes on the

state's competitiveness with other states, and the effect of intrastate tax differentials in the property tax on individual jurisdictions.

Interstate Competitiveness. Most economic research has found the major influences on location decisions to be such factors as proximity to markets, availability of resources (especially labor) and business climate. While early research looked primarily at manufacturing, more recent research has examined non-manufacturing activity and focused more on the role of state and local taxation.

Most studies of firm location have concluded that state and local taxes have at most only a modest influence on where firms locate, expand or contract their operations. Some studies suggest that corporate income and property taxes may be more important determinants of location for capital-intensive firms. Other research has found that tax differentials in similar or neighboring states may be a more critical determinant than the actual level of taxes within a state. In addition, personal income taxes may indirectly influence firm location by affecting household location and therefore labor availability. However, New Jersey's corporate and gross income tax effort are both the second lowest of the five neighboring states.

To the extent that firms view state and local taxes as an equitable price to be paid for services they want, the availability of such quality-of-life services as education and a clean environment may encourage relocation or expansion. However, the impact of services on firm location relative to other factors, such as labor or energy costs, remains unclear. Even less is known about the impact of state and local regulations on firm decisions.

The Commission found that tax competition among states is not a significant factor in attracting or retaining firms because 1) state and local taxes paid by businesses are deductible from federal taxes; 2) state and local tax and spending policies may attract and retain businesses by providing essential services; and 3) market demand and supply remain the principal determinants of business location.

Intrastate Tax Differentials. The Commission did find that intrastate real property tax differentials may affect the location of households and businesses. In fact, the major problem with real property taxation in New Jersey is that disparities among jurisdictions in property tax rates pose a disincentive to economic development in higher property tax rate jurisdictions.

To the extent that property taxes affect an investor's return, otherwise desirable investment may be discouraged in jurisdictions with high property taxes. Simulation models indicate that the difference in after tax rate of return on investment between low and high property tax rate areas may approach an average of one percent in certain industries. Thus the Commission's findings do not bode well for New Jersey's cities. Property taxes, and therefore the costs to a business, are higher in cities. Income, and therefore local demand for goods and services, will be relatively lower in cities. Moreover, desirable public services may be inferior to services in suburban areas. Finally, the combination of high taxes and poor services may offset any other advantages such as inexpensive and abundant labor, or access to transportation hubs, markets or suppliers.

IV. RESTORING THE BALANCE

To produce a balance in the state's fiscal system, the Commission has proposed both expenditure and revenue reforms.

EXPENDITURE REFORMS

The purpose of these expenditure proposals is first to improve the delivery of essential public service; and second, to improve the balance between local service responsibilities and the resources available to finance those services. Recommendations for expenditure reforms are proposed in the areas of local school finance, intergovernmental structure and state aid to municipalities.

Local School Finance

The Commission's package of recommendations has several components. First, we propose to increase annual state expenditures for education by \$388 million in order to provide current-year funding for state equalization aid to school districts. This change will reduce the need for school districts to finance desired increases in spending entirely from their own resources. In addition, school districts that do not meet state certification standards on student performance will be required to spend at a level at least equal to the average per pupil expenditure for districts that do meet certification requirements. We are recommending that the allocation of compensatory education aid be changed to reflect fully each area of student deficiency. To meet the sizeable backlog of capital investment needed by school districts, we are recommending that debt service aid be put on a current year basis and increased for all school districts. Indeed, such aid should cover 100 percent of debt service for the poorest school districts.

Realignment of Service Responsibilities

The second component of our expenditure recommendations sorts out the proper role of state and local government in delivering several important services: the courts, public assistance, mental institutions, the office of the prosecutor and county colleges. We propose that the state assume full financial and administrative responsibility for the trial court system. This will involve the transfer of about 5,000 workers that are currently employed by counties to the state, and will cost approximately \$151 million.

Expenditures for public assistance can be divided into expenditures for benefits to recipients and expenditures for administration. We are also proposing that the state assume full responsibility for financing the benefits portions of welfare services (including Aid to Families with Dependent Children, General Assistance, and Hospital Care). The Commission recommends that counties continue to administer the AFDC program and that they assume the responsibility for administering General Assistance. Municipalities will no longer have any role in providing welfare services. To reduce differences in

administrative costs among counties, we propose an administrative costs equalization program to offset a part of the administrative costs incurred by a county above the average for all counties. Finally, the Commission endorses the principles and objectives of the Realizing Economic Achievement Program (REACH) as a method of reducing long-term welfare dependency. The costs of our welfare reform package to the state is \$80 million.

We are proposing that the county payments to the state for patients in state mental institutions be discontinued and that these costs be assumed by the state. This will increase state spending by \$105 million.

The responsibility for financing the office of the prosecutor should be shifted from the county to the state. This will increase state costs by \$65 million.

Finally, the state should fulfill its statutory obligation to support county colleges. The statute calls for the state to provide 43 percent of the operating costs of these institutions. Current support is about 27 percent. The cost of this proposal is \$20 million.

State Aid to Municipalities

Guaranteed Tax Base. The state assigns to local government the responsibilities for providing a set of services such as public safety and solid waste disposal. The resources available to local governments to finance these services are generally inadequate. While each of our proposed reforms will reduce the revenue-raising burdens on local governments, especially counties and school districts, the expenditure responsibilities facing municipalities will remain large relative to their resources. The problem will be particularly significant for many poor jurisdictions, which also tend to face above-average service needs. Additional state aid to municipal governments will be necessary to redress these fiscal disparities.

The current system of unconditional state aid to municipalities is poorly targeted to need and does not reflect changes in local fiscal conditions. The Commission proposes that the state aid system be changed to freeze at 1985 levels the total amount and distribution of state aid from five programs: the Gross Receipts and Franchise Tax distribution, the Business Personal Property Replacement payments, the Corporation Business Tax on banks, the Financial Business Tax, and the Insurance Franchise Tax. In addition, a new guaranteed tax base (GTB) formula would be implemented, patterned after the education aid equalization program. Each municipality would have its aid calculated under the frozen program and under the GTB formula, and would receive the greater amount. The level of aid in the GTB plan is tied to state revenues.

Under this new aid program, no municipality would receive less funding than currently. The impact of the new plan is that only 13 municipalities will have total equalized tax rates above \$3 per \$100 of true market value. The added cost of the GTB plan is \$351 million.

Payments In-Lieu-Of Taxes. We propose that the existing system of state payments in lieu of taxes (PILOTs) on state-owned real property to local governments be modified to compensate local communities more fully for the costs associated with serving state facilities. The proposed changes are: (1) that the formula to calculate state compensation use the municipal purpose tax rate and the assessed value of the state facility rather than the current practice of using the equalized local rate and assessed value; (2) that the state fully fund the formula; and (3) that the PILOT program be extended to cover property leased by the state from a state authority. The changes would eliminate current inconsistencies, and result in the state distributing \$10-\$20 million more to local communities.

POTENTIAL VERSUS ACTUAL PROPERTY TAX REDUCTIONS

A major thrust of the Commission's recommendations is to reduce the revenue demands now placed on the property tax by the current allocation of functional and fiscal responsibilities and current state aid policies. Concerns have been expressed about whether it is accurate to portray various proposals as property

tax reduction measures if, in fact, the Commission does not recommend that property tax reduction be mandated upon local governments. This Commission proposes changes that will ensure that the potential property tax reductions resulting from the expenditure reforms discussed above will be realized.

The Commission recommends that local school budget limitations be modified to reduce the permissible rate of school spending growth, which has in recent years been driven upward by the increases in property value.

The county tax levy should be reduced for purposes of calculating the cap to ensure that the State assumption of costs currently borne by the county results in a reduction in the property tax levy. The county cap should be eliminated three years after the enactment of the Commission's recommendations regarding intergovernmental structural reform.

The State assumption of municipal programs or functions should result in a reduced budget base for calculating permissible spending increases. Increases in state aid received through the Guaranteed Tax Base formula and through additional payments in lieu of taxes should be included within the municipal cap, in order to achieve the maximum reduction in the reliance on the property tax. The municipal cap should be eliminated three years after the enactment of the Commission's recommendations.

REVENUE REFORMS

The Commission has reviewed each major tax imposed under state law in New Jersey and analyzed each tax using the revenue evaluation criteria previously agreed upon by the Commission. Similar criteria are commonly used in public finance policy analysis and may be applied to a single revenue instrument or to the overall revenue system. The Commission revenue evaluation criteria are:

ADEQUACY refers to the ability of state and local revenue systems to provide revenues sufficient to meet current and anticipated state and local expenditure needs based on existing policies and programs.

CERTAINTY relates to the extent to which individual taxpayers can predict future tax liabilities or recipient units of government can predict the level of aid receipts. Certainty regarding the intricacies of the tax or aid system may facilitate financial planning and decision making by businesses, households and units of government alike.

COMPETITIVENESS refers to the advantages or disadvantages in attracting or retaining desired firms and households, which a state and local tax system has relative to tax systems in other comparable or neighboring states.

COMPLIANCE/SIMPLICITY indicates the ease with which individual taxpayer liability can be determined, by both the taxpayer and the collection agency, and provisions of the tax code can be enforced.

DIVERSITY measures the extent to which the base of the individual tax or the whole of the tax system is broadly defined so that it can withstand long-run declines in importance of some components while reflecting the importance of long-run growth in other components.

ELASTICITY measures the relationship between changes in measures of economic activity or population characteristics and changes in the revenue yield of the state and local tax system or selected taxes.

EQUITY refers to the extent to which the revenue burdens of the state and local revenue system are distributed fairly based upon either the individuals's or firm's ability to pay the tax or upon the benefits it receives from services financed by the tax.

NEUTRALITY/EFFICIENCY indicates the extent to which government financing influences private economic decision making and behavior. In general, the less the influence, the more neutral the individual tax or tax system. However, neutrality may not always be preferable, as government may decide to encourage some activities while discouraging others. Neutrality also refers to the extent to which local jurisdictions have their priorities distorted or

restructured by the imposition of limits and by the form in which aid is received.

The revenue proposals are designed to improve the efficiency and fairness of the state's tax system and to offset the costs to state and local governments of lowering real property taxes. Although each tax change is discussed individually, these changes and the proposed reduction in property taxes are to be considered as a whole and not as a series of independent proposals.

Consumption Taxes

The Commission proposes a number of changes to the existing consumption taxes (the sales and use tax, utility taxes and other excise taxes). The proposed changes to the state's general and excise sales taxes will result in an increase of state revenues of approximately \$428 million. The proposed changes to utility taxes result in an increase of state revenues of approximately \$189 million, while the Gross Receipts, Franchise and Excise tax rate on gas and electric bills will be reduced from 13 percent to approximately 8 percent. A consumption tax offset is proposed to reduce the regressivity of these taxes. The consumption tax offset will provide approximately \$108 million in tax relief. The overall result of the proposed changes is to make this set of taxes more efficient and to distribute the tax burden more equitably.

Changes in General Sales and Excise Taxes. The Commission proposes that the following items be added to the list of transactions covered by the state sales and use tax: (1) admission charges not currently taxed, (2) disposable paper products, (3) soap products, (4) non-prescription drugs, (5) cable television service, (6) cigarettes, and (7) telephone equipment. These changes will make the sales tax act simpler, more comprehensive in coverage, more equitable and neutral in regard to consumer choices. For example, under the proposal paper cups, plastic cups and all items that combine plastic and paper materials, such as plastic-coated paper cups, will be taxed at the same rate.

By including paper products under the sales and use tax, the tax code will tax all plastic and paper items in the same manner.

Repealing the tax exemption on soap products will also simplify the tax. For example, shampoo and products that combine shampoo and hair conditioner are now exempt, but hair conditioner is not. Repealing the exemption on over-the-counter drugs will also eliminate confusing distinctions such as that between cough drops that are primarily candy and those that are considered medicine. The coverage of cable television service will ensure tax neutrality by taxing all forms of entertainment equally. Admission charges covered by the proposed change include boxing and wrestling matches, tennis court fees, golf club fees, and health club memberships. Currently, most activities in which the patron is not a participant are taxed, but activities in which the patron is a participant are not taxed. This change will make the tax system more equitable and simpler to administer. Lastly, the proposal to tax telephone equipment sales and use responds to recent organizational and technological changes in the telecommunications industry. Currently, all household and business appliances except phones are taxed. Now that phones can be purchased or leased from a number of providers, as opposed to leased solely from a public utility, the exemption for telephone equipment is no longer equitable. In addition, recent product innovations such as combination telephone/clock radios and telephone/telephone answering machines make the current tax difficult to administer.

Excise tax changes include imposing the sales tax on alcoholic beverages consumed on premises, extending the excise tax to all tobacco products (such as chewing tobacco), and increasing the wholesale excise tax on alcoholic beverages to 7.8 percent. These changes in what are commonly called sin taxes would raise about \$176 million in revenues for the state. Currently, such non-alcoholic beverages as milk are taxed in restaurants but alcoholic beverages are not. This is unfair and suggests the state is subsidizing the consumption of alcohol. The changes in taxation policy for tobacco products are designed to tax all tobacco products in the same manner.

Public Utility Taxes. The Commission recommends imposing the corporation business tax on all public utilities, reducing the effective tax rate on electric and gas services from 13 percent to approximately 8 percent, imposing an 8 percent tax on heating oil and other fuels, repealing the existing franchise, excise and personal property tax on telecommunication public utilities, and imposing a 6 percent gross receipts tax on all telecommunication services. These changes would produce another \$189 million in state revenues while promoting a more neutral tax system. Currently, consumers of heating oil pay no tax while consumers of gas or electric energy pay a 13 percent tax, resulting in an unjustifiable state subsidy of heating oil. By taxing all forms of energy equally the rates can be lowered, encouraging consumers to select energy services without regard to the tax implications. Additionally, telephone services provided by regulated utilities, AT&T or New Jersey Bell, are taxed, while services provided by non-regulated utilities, such as MCI or Sprint, are not. These proposals would result in a more level playing field for all providers of telecommunication services.

Consumption Tax Offset. General sales, utility and other excise taxes tend to be regressive in that low-income households pay a larger percentage of their incomes in taxes than do high-income households. To reduce the regressivity of these taxes, the Commission recommends a means-tested refundable tax credit to households on their state personal income tax for sales, utility and excise tax payments. The proposed consumption tax offset would range from \$240 for households with incomes of less than \$5,000 to \$50 for households with incomes of \$20,000. Households with incomes above \$20,000 would not receive a consumption tax offset credit.

Currently, households with incomes under \$15,000 pay approximately 3.7 percent of their incomes in consumption taxes and households with incomes over \$50,000 pay approximately 1.7 percent. After the proposed consumption tax reforms and with the consumption tax offset, the tax burden on households with incomes of under \$15,000 falls to approximately 3.3 percent and the tax burden on households with incomes over \$50,000 rises to about 2 percent. The primary reason the state is able to increase consumption tax revenues without significantly affecting household tax burdens is that a substantial amount of

the tax increases will be borne by businesses, such as the sales tax on telephone equipment.

The Gross Income Tax

The Commission proposes a number of changes in the New Jersey State Gross Income Tax, including: (1) a revision in the tax rates on gross income; (2) the replacement of the existing Homestead Relief Tax (i.e., Ford Bill) property tax deduction, the Homestead Rebate and the Homestead Tenant Credit with a means-tested circuit-breaker; (3) the repeal of the personal exemption for dependent college students; (4) a phase-out of the retirement income deduction for taxpayers who are 62 and over and have more than \$50,000 in annual income; and (5) the more uniform tax treatment for retirement plans. The changes in the gross income tax are designed to ensure that the income tax is based on a person's ability-to-pay and that people in like circumstances are treated similarly. The increase in tax rates and the adoption of a means-tested property tax circuit-breaker are discussed below.

Changes in the Tax Rate Structure. The proposed tax rates are the same as the existing law for all households with incomes under \$50,000. For households with incomes of \$50,000 to \$100,000 the tax rate increases from 3.5 percent to 4.0 percent. For households with incomes above \$100,000 the marginal tax rate increases from 3.5 percent to 4.5 percent. These rates are considerably lower than New York State rates and continue New Jersey's commitment to maintaining low tax rates on a broadly defined gross income base. The changes raise approximately \$268 million in new revenues.

A Property Tax Circuit-Breaker. The Commission proposes repealing the Homestead Relief Tax Act, the Homestead Rebate, and the Homestead Tenant Credit and replacing these programs with a means-tested property tax circuit breaker. The current mix of rebates is not equitable in that homeowners with incomes of \$50,000 or more receive an average of \$279, and homeowners with incomes of less than \$10,000 receive an average of \$272. The proposed circuit-breaker would create a refundable credit that would range from \$450 to \$186 for homeowners with incomes of less than \$30,000 and property taxes that exceed a certain

OFFSET FOR CONSUMPTION TAXES

(Sales, Utility, Excise)

HOUSEHOLDS			ESTIMATED TAX BURDEN		BENEFIT PER HOUSEHOLD	TOTAL COST (\$ mil.)	REVISED BURDEN
CASH INCOME	NUMBER (000s)	MEAN INCOME	MEAN	%			%
Under \$ 5,000	203	\$1,740	\$296	17.0	\$240	\$49	3.2
\$5,000 - 10,000	192	7,400	365	4.9	130	25	3.2
10,000 - 15,000	198	12,540	532	4.2	115	23	3.3
15,000 - 20,000	225	17,540	630	3.6	50	11	3.3
20,000 - 30,000	457	24,720	782	3.2	---	---	3.2
Over 30,000	<u>1,425</u>	67,080	1,290	2.0	---	---	2.0
TOTAL	2,700					\$108	

March 10, 1988

PROPOSED GROSS INCOME TAX RATES

Marginal Tax Rates

<u>TAXABLE INCOME</u>	<u>CURRENT LAW</u>	<u>PROPOSED</u>	<u>CHANGE</u>
0 - \$ 20,000	2.0%	2.0%	0
20,000 - 50,000	2.5%	2.5%	0
50,000 - 100,000	3.5%	4.0%	0.5%
100,000 - and over	3.5%	4.5%	1.0%

<u>FAMILY CASH INCOME (\$ 000s)</u>	<u>TAXABLE RETURNS (000s)</u>	<u>CURRENT TAX (\$ Mil.)</u>	<u>PROPOSED TAX (\$ Mil.)</u>	<u>CHANGE (\$ Mil.)</u>
\$ 0 - 5	53	3.3	3.3	--
5 - 10	108	10.4	10.4	--
10 - 15	133	20.6	20.6	--
15 - 20	180	44.7	44.7	--
20 - 30	421	159.4	159.4	--
30 - 50	699	491.4	491.4	--
50 - 100	569	840.7	902.0	61.3
100 - 200	105	381.1	455.3	74.2
200 and over	<u>36</u>	<u>511.0</u>	<u>643.5</u>	<u>132.3</u>
TOTAL	2,305	\$2,463	\$2,733	\$268

percent of that income. Homeowners with incomes of over \$30,000 would receive no credit. For tenant households the proposals would provide a credit of \$110 for households with annual incomes of less than \$40,000, with the credit phased out between \$40,000 and \$50,000. Tenant households with incomes above \$50,000 would receive no credit. As a result, only households in need of tax relief will get assistance, and they will receive more relief than under the existing system of rebates and credits. The circuit breaker would provide approximately \$266 million in total tax relief to tenants and homeowners.

Business Taxes

The Commission proposes a number of changes in business taxes. The largest revenue change would result from taxing savings institutions under the corporate business tax and repealing the savings institution tax. This change results in more similar tax treatment of all financial services and generates a net increase in revenues to the state of \$50 million. The Commission also recommends eliminating health insurance premiums from the insurance premiums tax base. The Commission recommends repealing the earmarking of the corporation business taxes paid by banking and financial corporations and the insurance franchise tax to municipalities. This results in a shift of \$38 million in revenues from municipalities to the state. The current earmarking and distribution formulas are inappropriate state-aid programs because they do not reflect current local needs or circumstances.

Federal tax reform of 1986 repealed accelerated depreciation for business investments. The Commission recommends recoupling to the federal system of depreciation, thereby reducing the costs of compliance for state taxpayers. The Commission also recommends repealing the tax on business personal property purchased prior to 1977. Currently all business personal property purchased after 1977 is exempt from the tax. The revenues lost to the state from this change would be approximately \$21 million.

Miscellaneous Taxes

The Commission also recommends: (1) the repeal of the inheritance tax in favor of a pure pick-up estate tax; (2) the repeal of the Newark payroll tax (Newark's lost revenues would be offset by the state-aid to municipalities program); and (3) increasing the state sales tax in Atlantic City to six percent, thereby raising the overall sales tax in Atlantic City to 15 percent (nine percent would continue to go to the city).

Real Property Taxation

Assessment Administration. The Commission proposes several reforms to substantially reduce the reliance on local government and therefore on the local property tax. These proposals will reduce fiscal disparities among local jurisdictions as well. Still, the current system of inefficient and inequitable property tax assessment will continue to produce inequities and inefficiencies if left unattended. Because the apportionment of county taxes, State school aid and many forms of municipal aid is based on the distribution of property value among local jurisdictions, both tax apportionments and aid allocations become inequitable when those assessed values are flawed. Assessment problems are indicated by coefficients of deviation that are high and that differ greatly among taxing districts. While revaluation cycles average 7 to 8 years across the State, revaluation has not occurred for 20 years or more in some of New Jersey largest urban areas.

The Commission proposes a separation of administrative function in real property assessment from appellate functions. The administrative functions required by law -- determining taxable status, determining taxable value, preparing tax lists, preparing tables of aggregates and equalization respectively -- will be performed by a single agency. The appellate function currently performed by the county boards of taxation will continue to be carried out by those boards. However, those boards will be fully funded by the State.

The new agency in charge of real property assessment administration will be an independent board appointed by the governor with the advice and consent of the Senate. The board should consist of seven members serving staggered five-year terms, removable only for cause during those terms. It should be bipartisan, with no more than four members from the same political party. Board members should be paid salaries fixed by law, at levels commensurate with their duties. Except for the chairman, board members will be part-time. The board will be required to meet at least monthly.

The Governor will designate one of the seven appointees to be chairman of the board and full-time chief executive officer. The chairman will appoint, subject to the approval of the full board, a district supervisor for each administrative district. The 21 administrative districts will be coterminous with county boundaries. If the board deems it necessary, additional district offices could be established in any given county.

The board will prepare a budget request annually to be forwarded to the Legislature. After the annual budget is approved, the revenue requirements will be billed back to taxing districts based on apportionment value.

Each county district supervisor will make the annual tax list and property values available for inspection in every municipality at least once a year. At this time, district staff will be on hand to answer questions and address concerns that taxpayers have about values and other property tax-related matters.

With one very important exception, the State board's personnel policies will be governed by the Civil Service system. In its initial staffing, the State board must give hiring preference to certified tenured tax assessors and county tax administrators. Furthermore, the board's employment of certified tenured local assessment personnel should be achieved as far as practicable without decrease in current compensation of those individuals. One practical limit on maintaining current pay scales is that compensation levels for assessors must be less than the chairman and district supervisors' salaries.

Part-time salaries currently paid to assessors serving more than one district would be either aggregated or projected to full-time scale and averaged.

This reform will make the State board responsible for discharging all property tax assessment duties currently performed by municipal tax assessors and county boards of taxation. County boards of taxation will continue as appellate bodies of first resort, but will be independent of this new administrative agency. Resource deployment will no longer be limited by municipal and county boundaries, but will be centrally and comprehensively determined. Counties will continue to serve as administrative districts, and taxpayers will continue to have the benefit of annual review of tax lists and consultation with appraisers. The foundation of the system will continue to be the professional assessor.

Alternatives Considered. Because of the role of property tax assessment in county apportionment and school aid allocation, and because of the proposed new municipal equalization aid program, assessment was given careful consideration by the Commission. In addition to the reform approved by the Commission, several alternatives were also closely considered. One option was particularly attractive to a large number of Commission members and merits further discussion.

This option was recommended by the New Jersey Property Tax Assessment Study Commission, also known as the Glaser Commission, which proposed retaining the current system of municipal assessment with several notable modifications, including reconstituting the Local Property Branch of the Division of Taxation as a separate, independent division within the Treasury Department. This new division would have the authority to remove local assessment personnel and license and set performance standards for revaluation firms. The new division could set minimum sizes for tax assessment districts and order consolidations among existing districts. The Glaser Commission recommended that a new state aid program for subsidizing local assessment costs be established. The new Local Property Tax Division could then develop standards for tax assessor standards, compensation and support services, and withhold state aid if those standards were not met by a local assessment district.

Property Tax on New Construction. Disparities in property tax rates pose a disincentive to economic development in higher property tax rate jurisdictions. The purpose of a separate property tax on new construction is first, to remove the incentive or disincentive effects of the present tax structure, and second, encourage development in accord with the proposed State Development and Redevelopment Plan. The two illustrative alternatives given here are proposed for adoption by the Commission with the understanding that the recommendation would be referred to the State Planning Commission for further study.

New construction is required by State statute to be assessed at the approximate market value and taxed at the same rate as all other properties in the municipality. The result is that jurisdictions with lower tax rates impose a lower tax burden on new construction than jurisdictions with higher tax rates. To the extent that property taxes affect a builder's return on investment, otherwise desirable investment may not occur. Because jurisdictions with lower tax rates tend to be suburban or rural in character, this public policy encourages development to occur outside of existing urban areas.

The Commission's proposals would significantly lower property taxes throughout the state of New Jersey. However, some differentiation between high and low-tax rate communities would continue. In addition, the proposed State Plan would encourage new development in municipalities with higher tax rates.

To encourage development in areas that are designated by the proposed State Plan as most appropriate for redevelopment and new development, the Commission recommends that mandatory State-prescribed tax rates be imposed on new construction. These rates would differ according to the State Plan growth management tiers. The proposed new tax would be implemented as follows:

1. Tax the value of new construction at a rate established by the state regardless of the local property tax rate. The land value and the appreciation of the value of construction would be taxed at the locally determined property tax rate. The total tax on the property would be calculated as follows:

$$\text{Total Property Tax Payment} = [(\text{Market Value of Property} - \text{Cost of New Construction}) \times (\text{Locally Determined Property Tax Rate})] + [(\text{Cost of New Construction}) \times (\text{State Determined Property Tax Rate})]$$

2. The state-established rate on new construction would be automatically imposed at the time of initial assessment. Thus, unlike Fox-Lance, no local determination of applicability would be required. With the adoption of this program, Fox-Lance and other tax abatements designed to encourage non-subsidized new construction would be eliminated. Existing abatement contracts would be continued through expiration.

3. The mandated state rate would be imposed for a period of 15 years, after which new development would be taxed entirely at the locally determined tax rate.

4. The state-imposed rate would apply to all new construction, broadly defined as any construction activity requiring a building permit.

5. If the state-imposed tax rate is higher than the locally determined tax rate, the difference in revenues would be diverted to a state-operated infrastructure fund pool that would be used to finance infrastructure needs throughout the state. Specifically, the distribution of revenues would be as follows:

- a. The revenues would be distributed to the municipality up to the amount that would be raised from the locally determined municipal tax rate.
- b. If revenues were not all absorbed by the municipality, the remaining revenues would be distributed to the school district up to

the amount that would be raised from the local school district tax rate.

c. If revenues were not all absorbed by the municipality and the school district, the remaining revenues would be distributed to the county up to the amount that would be raised from the local county tax rate.

d. Any revenues that were not distributed to the municipality, school district and the county would be diverted to the state-operated infrastructure fund pool.

The allocation of revenues would insure that urban municipalities were not financially penalized for securing new construction. Rural and suburban municipalities would not receive any windfall from new construction.

The Commission discussed two illustrative rate structures. Both alternatives impose tax rates that vary by the State Plan Development Tiers. The rate structures are presented in Table 1.

Table 1

Illustrative Property Tax Rates on New Construction

<u>Proposed State Plan Tiers</u>	<u>Alternatives</u>	
	<u>One</u>	<u>Two</u>
Tier 1 (Redeveloping Cities and Suburbs)	1.0	2.0
Tier 2 (Stable Cities and Suburbs)	1.5	2.0
Tier 3 (Suburban and Rural Towns)	2.0	2.5
Tier 4 (Suburbanizing Areas)	2.0	2.5
Tier 5-7 (Limited Growth Areas)	3.0	3.0

In both alternatives the state-imposed tax rate is highest in areas less targeted for growth. These proposals would presumably encourage development in designated growth areas, many of which already have adequate infrastructure. The major difference in the proposals is the concern that the tax rates in the first alternative for Tiers 1 and 2 are too low to pay for the costs imposed upon local jurisdictions in servicing the development. The two percent rate presented in the second alternative corresponds to the current Fox-Lance formula. The variation in the rate structure for new construction would violate the State's uniformity clause and would, therefore, require a constitutional amendment to implement the proposed plan.

Proposal for Farmland Preservation. The Farmland Assessment Act of 1964 provides for preferential assessment of land actively devoted to agricultural or horticultural use in order to reduce the marginal cost of farming and deter the development of existing farmland. In 1987, over 25 percent of land area in the state qualified for farmland assessments.

The program has been an ineffective deterrent to the development of farmland because the penalty for development (payment of three years worth of back taxes when the use as farmland ceases) diminishes relative to the tax subsidy received as the duration of the subsidy lengthens. The program thus subsidizes developer "land-banking," the acquisition and holding of parcels of land for eventual development. The penalty bears no relationship to the gain realized by developing the property. The Commission's proposal is intended to strengthen the deterrents to development, retain agriculture as a viable industry in the state, and preserve farmland and open space.

The Commission recommends the following approach:

1. Retain the existing differential taxation approach so that farmland is taxed at its value as farmland, rather than at market value.
2. Retain the three-year rollback period for payment of the differential between farmland taxes and market value taxes. Such funds would continue to be paid to the municipality.

3. Acquire equity in the property in exchange for preferential assessment. The acquisition of equity is proposed to strengthen the deterrent to development and to compensate the state as a whole for the subsidy conferred.

Since the preferential taxation of farmland is authorized by the State Constitution, the imposition of the proposed plan for State accumulation of equity in property in the Farmland Assessment program would require a Constitutional amendment to authorize such legislative actions.

For each year that the property has been preferentially assessed, the state would acquire a 1 percent equity right in the difference at the time of change of use between assessed value as farmland and market value. Thus, the state would own 20 percent of the differential between farm value and market value on a property that was being developed after 20 years of preferential assessment. Several options are available to implement this new approach, including:

o Exercise of state option. In exercising its equity rights when property assessed as farmland changes use, the state could select an alternative among the following:

a. Accept a cash equivalent of the state's share of the difference in value.

b. Take the equivalent in value in fee simple (a legal term that denotes land ownership of infinite duration and free of conditions or limitations) ownership of a portion of the land itself.

c. Negotiate a lower density development in exchange for the state's share of ownership.

d. Purchase the remaining development rights in the land. This would establish a state easement and would mean that the land would be permanently dedicated to agriculture. This concept already exists in

New Jersey State law under the Agriculture Retention and Development Program.

o Use of funds. The money acquired if the state selects the cash equivalent of its equity right in farm property that changes use could be used in different ways:

a. Establish a state land bank, such as a natural resources trust, for purchase of development rights or park land. Funds could be allocated for use in the municipality or county of origin if farmland is available. Because the burden of the subsidy is borne by other taxpayers in the municipality, the municipality should receive priority in the use of the equity funds.

b. Contribute to the Agriculture Retention and Development Program, under which the state contributes matching funds to counties and municipalities to purchase the development rights to farmland permanently dedicated to agriculture.

V. SAFEGUARDING THE BENEFITS OF THE NEW FISCAL SYSTEM

The recommendations discussed above will make substantial progress toward the goal of restoring balance, equity, efficiency, and accountability to the state's fiscal system. These reforms are aimed at producing results that are enduring, and not transitory. The Commission wanted to take steps to insure that once the restoration process has begun, it would be continued and preserved. These additional steps would first, facilitate orderly economic development, and second, reduce institutional impediments to effective public sector budgeting and planning activities.

ECONOMIC DEVELOPMENT STRATEGIES

The state of New Jersey offers a wide variety of economic development programs designed to encourage firms to locate or expand in the state. The Commission recommends:

o Site-specific economic development programs should be targeted to distressed areas. New Jersey has one of the healthiest economies in the United States. However, some distressed municipalities have not shared in the benefits of the current prosperity.

o The State should develop and implement systematic and independent evaluations of each of its current economic development programs. The Commission found that few, if any, of the existing economic development programs had been thoroughly evaluated to determine their effectiveness. Informed decision-making about discontinuing, expanding or modifying programs requires better information than is now available. The state's limited resources must be focused on those programs with the greatest potential for success.

o The State should develop an Industrial Development Zone Program. An industrial development zone program, modeled after the State's Urban Enterprise Zone, should include: (1) reduction or exemption from public utility and business personal property taxation; (2) targeted job training and infrastructure improvements with Economic Development Authority and Urban Development Corporation financing; and (3) the establishment of local business incubators.

o A Challenge Grant program should be established to encourage cooperation between the State's colleges and municipalities. The State Department of Higher Education's program to encourage institutions of higher education to identify and address special problems and opportunities at each college and university should be expanded.

o The State should continue the emphasis on science and technology programs. To maintain its leadership in high technology industries and employment, New Jersey must continue its efforts to maintain and attract quality teachers and students to its institutions of higher education.

o The State should examine the interrelationship among the Departments of Commerce and Community Affairs as well as the various agencies regulating commercial activities. The State should examine the institutional framework under which business regulation now occurs, streamlining and simplification of the regulatory process.

New Jersey's continued economic development depends on the availability of affordable housing for the State's workers and on the adequacy of the State's infrastructure to handle growth and changing demands. The Commission recommends:

o The State should establish a Housing Development Bank. The shortage of affordable housing will severely limit New Jersey's economic growth. The State should develop a program to assist moderate-income households purchase homes by becoming a financial partner with those households. The state could have the choice of receiving repayment of the initial financial assistance to a household either as if it were a loan or by becoming an investment partner in the housing unit's appreciation such that the state would receive a return on its initial investment at the time of the unit's resale. The program could be funded out of existing housing program funds.

o The State should ensure the adequate provision of infrastructure. The Commission examined infrastructure needs in four areas -- transportation, water supply, wastewater and solid waste -- where the state is underfunding the infrastructure it needs. In transportation State and local governments are currently spending approximately \$904 million a year in the face of needs of approximately \$1 billion annually for the period 1988 to 2000. This is a difference of almost \$100 million a year between actual and needed spending. For water supply the difference between actual spending of \$47 million and needs of \$77 million is approximately \$30 million a year. For wastewater the difference is approximately \$127 million a year (\$181 million versus \$308 million). For solid waste the difference may be as great as \$160 million a year.

o The State should continue to provide grants to local governments for the construction of wastewater facilities to augment the Wastewater Treatment Financing (Loan) Program. To reduce the costs to local municipalities, the State should provide a grant program in addition to the loan program.

Development activity in New Jersey is regulated by a number of governmental entities, some of which may have contradictory or conflicting goals and policies. To address the problem of uncoordinated and inadequate planning the State Planning Commission has developed a preliminary State Development and Redevelopment Plan, which this Commission generally supports:

o The efforts of the State Planning Commission to foster orderly development should be encouraged to reduce infrastructure and service costs and as a useful tool to promote economic development. Encourage orderly development, the State Planning Commission should develop mechanisms to promote regional planning and coordination with the State. The State Planning Commission should encourage the development of sub-State regional planning organizations to address planning and coordination issues that affect more than one municipality or county.

o The State Planning Commission should encourage the establishment of regional special improvement districts to address issues of local area planning, tax-base sharing, regulatory relief and the provision of infrastructure to promote orderly economic development, building on the precedents of the Hackensack Meadowlands Development Commission and the Pinelands Commission.

o The State Planning Commission should review the local use of development, impact and linkage fees with an eye toward limiting, standardizing and regionalizing their collection, distribution and use. Specifically, such fees may not be equitable because: (1) only a portion of businesses and households pay for facilities used by an entire community, (2) the level of fees may not be related to the actual impact of development, (3) distressed cities may need revenues for improvements associated with development but may be unable to exact such fees for fear of discouraging redevelopment activity,

and (4) such fees now only go to the jurisdiction in which a development occurs and not all jurisdictions affected by a development.

- o The County and Municipal Government Study Commission should study the development and funding of incentives to encourage the consolidation of selected services amongst jurisdictions or the transfer of selected services to counties. Fiscal disparities among New Jersey's municipalities are largely a function of governmental fragmentation. The consolidation of such services as police, fire, health and planning among municipalities or at the county level could result in increased economies of scale.

- o The Municipal Land Use Law (MLUL) should be expanded to include a requirement that all municipalities that are categorized as distressed by the state include as part of their master or comprehensive plan a community and economic development element that would be subject to the State Planning Commission's cross-acceptance process. The costs associated with the preparation of this plan element should be paid by the State. The element should address human service needs, economic development projects, and community development projects.

BUDGET PROCESSES

The purpose of the budget is to facilitate fiscal planning and control. To further these objectives, the Commission recommends several budget reforms, including: the establishment of a contingency fund; the preparation of a tax expenditure budget; the dedication of revenues; fiscal notes for proposed policy changes; and a shared arrangement for financing State-mandated local activities.

Contingency Funds

While the general purpose of a contingency or Rainy Day fund is to increase the stability of a state's revenues and expenditures, three distinct goals can be enumerated. The first is to create a cushion to cover cash flow problems that a jurisdiction may experience. The second is to provide a reserve against

unforeseen events, such as natural disasters, that cannot be anticipated in a budget but that may require an immediate response. The third purpose is to provide counter-cyclical assistance by setting aside surplus revenues during times of prosperity and using them during an economic slowdown. The funding level, method, and drawdown procedures will vary according to the specific purpose of the fund.

The Commission endorses the concept of a contingency fund. We recognize that in the event of a severe or sustained recession the fund may not be of sufficient size to eliminate the need for tax increases or expenditure reductions. However, the value of such a fund is to permit a more orderly response to the unanticipated shortfall in revenues or increase in expenditures due to recessions or emergencies.

Tax Expenditure Reporting

Tax expenditures are subsidies provided to an individual, organization, or activity through the tax code, rather than as a direct outlay. The tax expenditure may result from special exemptions, deductions, exclusions, credits, preferential rates, or deferrals. An example of a tax expenditure in New Jersey is the reduced sales tax collected in designated Urban Enterprise Zones, as this provides an indirect subsidy to businesses located in the designated zone. At the local level, the Fox-Lance tax abatement program also provides an example of a tax expenditure.

Like direct outlays, tax expenditures affect the scope of government and economic activity in the state. However, there is currently no formal accounting or systematic review of tax expenditures, nor is there an ongoing estimate of the revenues foregone nor any analysis of the costs and benefits of the subsidies provided.

To provide a comprehensive statement of New Jersey's budget, the Commission recommends that the Division of Taxation prepare an annual tax expenditure budget for those tax subsidies provided by the state. The tax expenditure budget would be additional information included in the annual Budget submitted

by the Governor to the Legislature. The Commission further recommends that fiscal notes be required for changes to the tax code, particularly those changes that result in a tax expenditure.

Dedicating Revenues

Revenues are considered dedicated or earmarked when their use is restricted to the support of a particular program. The restriction may be narrow, such as requiring that fees from parking meters be used only for maintaining the meters and collecting the fees, or broad, such as New Jersey's constitutional requirement that revenues from the personal income tax be used for property tax relief. The restrictions may be constitutional or statutory.

The Commission believes that the constitutional dedication of revenues can distort budgeting and inhibit the flexibility of lawmakers to respond to changing needs or conditions. The Commission therefore recommends: 1) that there be no further constitutional dedication of revenues; 2) that the present dedication of the proceeds of the lottery, personal income tax, and tax on casino revenues be reconsidered; and 3) that where earmarking of revenues is appropriate, it be done by statute.

The Commission is aware that some revenues, such as user fees, may appropriately be used to support a specific service or program. When these fees cover the full cost of the service, they may operate as an indirect pricing mechanism for those who enjoy the benefits of the service. In those instances where the connection between the benefits and the fee is clear, the Commission believes that the revenues may appropriately be dedicated to providing the service. The Commission recommends that the dedication be by statute rather than embodied in the Constitution so that budgetary flexibility is preserved.

Fiscal Notes

New Jersey law currently requires that an estimate of the fiscal impact of proposed legislation, called a "fiscal note," be prepared whenever requested by the sponsor of the legislation, chairman of the reference committee, or presiding officer of either house. The fiscal note estimate covers the current year and the two succeeding years and includes the impact on local governments as well as the state.

The Commission believes that the present process for initiating a fiscal note is not comprehensive enough and that fiscal notes may not be prepared in situations where they would be appropriate. One such situation, the creation of tax subsidies, has been discussed above. Other examples include changes to sentencing policy as embodied in the criminal code, changes to pension legislation, and the imposition of regulations that affect the cost of delivering local services. The Commission also believes that the two-year horizon may not be sufficient, particularly for changes in selected services such as corrections or pensions.

The Commission therefore recommends that the process for initiating a fiscal note be changed to require a note whenever a potential fiscal impact is identified by the Legislative Budget Officer and that the Legislative Budget Officer be empowered to determine the scope of the estimates that will be required.

Payment for State Mandates

Most services provided at the local level are governed by state laws and regulations. In addition, the cost of many services is shared by the state and local governments. Many of the Commission's recommendations for service realignment will alleviate the local burden of many of these costs, but the Commission is concerned that in the future new burdens may be imposed on local governments.

The Commission therefore recommends that the state share the costs of new or significantly enhanced services or regulations. This recommendation does not extend to school districts. The policy would distinguish between services or regulations that apply exclusively to local governments and those that affect all providers, public and private. For example, a requirement that there be two police officers in all patrol cars would fall within the scope of the requirement that the state participate in the cost of new or enhanced regulations. On the other hand, a change in the health or building code that affects anyone owning a building would not fall within the scope of this requirement.

For municipalities, the state compensation will be made through the proposed guaranteed tax base formula. The budgets would be adjusted to reflect the cost of complying with the mandate, and state aid would be provided in proportion to the municipality's state support ratio. If a municipality receives aid from the frozen pool of programs (business and utility tax distributions), no additional aid would be forthcoming.

Counties pose a different problem because there is no general formula aid program for counties. The Commission therefore suggests that the state develop a categorical aid program, which would be equalized according to the county's ability to pay, in the event that new or significantly enhanced service responsibilities or regulations are mandated upon counties.

TRANSITION PERIOD CONCERNS

The Commission is particularly concerned with the effect on employees of the transfer of service responsibilities to the state, such as the proposed judicial unification. Selected civil service and other employment protections often vary among local governments and between local governments and various branches of state government. This creates the potential for dual personnel systems which may result in unnecessary costs due to duplication of bureaucracies and differential treatment of comparably situated employees. Such treatment and unnecessarily inflated expenditures should be discouraged whenever practicable.

NON-FISCAL ASSISTANCE TO LOCALITIES

For many jurisdictions, the Commission's recommendations will result in the substantial infusion of additional funds. Concerns have been raised about the capacity of some jurisdictions to manage this increase effectively. The Commission shares these concerns and recognizes that some steps have already been taken in connection with the recent expansion of the distressed cities aid program. We recommend that the state take a more active role in providing technical and management assistance to local governments to ensure that funds are expended efficiently and properly. The state is in a far better position than most local government to identify state-of-the-art procedures for managing funds and implementing programs. That will ensure that residents receive maximum benefit from our recommendations and from other State and local services.

PERMANENT TAX POLICY COMMISSION

There is a long and variable cycle that characterizes the comprehensive analyses of tax policy in New Jersey. The New Jersey Tax Policy Committee (the Cahill Committee) issued its report in 1972, the New Jersey Commission on Government Costs and Tax Policy issued its report in late 1977, and now, in 1988, comes the report of the New Jersey State and Local Expenditure and Revenue Policy Commission.

The absence of an on-going independent analysis of the state's tax policy is troublesome for several reasons. First, the cumulative impact of a new tax or significant changes in an existing tax, when layered on top of the existing tax code, may not be obvious or anticipated. The new tax policy may produce effects that offset desirable features of the existing code or the effects of the tax policy change itself may be less than these anticipated when the policy was examined in isolation.

Second, the effects of a tax policy change may be difficult to decipher in light of changes in the state's economic base, demographic characteristics, political institutions, or macroeconomic conditions. The absence of an on-going independent analysis of major issues in tax policy may mean that simple problems become major concerns because they are not discovered in a timely fashion.

Comprehensive tax analysis and monitoring of tax policy effects are too important to be done sporadically. The Commission recognizes a need for a permanent, non-partisan commission, comprised of experts in the area of tax policy. This group would be available to advise the Governor and the leadership of the Legislature on matters of tax policy. More important, this group would be able to monitor the state's tax system and recommend changes in view of changing demographic, economic, or fiscal conditions. Such a body existed within state government until the late 1960s. The Commission feels that responsible tax policy decision making will be furthered if a new commission is established.

VI. SUMMARY OF COMMISSION RECOMMENDATIONS

These individual recommendations are part of a comprehensive program to restore balance to New Jersey's state and local government structure, reduce the reliance on local taxes, and level the playing fields upon which residents, taxpayers, and communities compete. The expenditure recommendations will result in an immediate improvement in the balance between local responsibilities and local resources and in the quality of services delivered to the state's residents. The revenue recommendations will make the state tax system fairer and more responsive to the present and future economy of the state, while raising the revenues needed to reduce the reliance on local taxes. Finally, there are several recommendations to ensure that New Jersey remains a dynamic, desirable place in which to live and work, with a healthy fiscal system.

EXPENDITURES

LOCAL SCHOOL FINANCE

Current Year Funding:

- (1) Current Expense Equalization Aid should be paid as a percentage of the current year's budget.
- (2) The budget cap formula should be changed to provide for a 6 percent annual growth, plus or minus an inflation factor based on the annual growth in state equalized valuation.

Minimum Budgets and Certification:

- (3) School districts which fail to meet specified standards regarding performance, breadth of program, and capital facilities should be required to budget at least at the average per-pupil level for all other districts which do meet those standards.

Compensatory Education Aid:

- (4) Compensatory Education Aid should be calculated by counting each element of the testing program on which a student is deficient and multiplying by the full additional cost factor of 0.18 and the prior year's state average Net Current Expense Budget (NCEB).

Debt Service:

- (5) Funding of Debt Service Aid should be placed on a current-year basis.
- (6) The formula for Debt Service Aid should be revised to provide for a higher state share and, upon certification of need by the state, for full state funding of all debt service requirements in school districts having less than 25 percent of the guaranteed valuation.

Teachers' Salaries:

- (7) Full state funding of the teachers' minimum salary program should be phased out gradually between 1988-89 and 1992-93, with local school district costs becoming a portion of the NCEB on which Current Expense Equalization Aid is paid.
- (8) A comprehensive survey of starting professional salaries should be authorized on a continuing basis and consideration should be given to structuring teachers' minimum salaries in relation to other starting professional salaries.

Early Childhood Education:

- (9) Full-day kindergarten programs and one year of pre-kindergarten should be encouraged in every elementary school district, with enrollment to be on a voluntary basis and the costs to be subsidized through Current Expense Equalization Aid on a current-year basis.

INTERGOVERNMENTAL STRUCTURAL REFORMS

Public Assistance:

- (10) The state should assume the full costs of benefits for all recipients of Aid to Families with Dependent Children, Supplemental Security Income, and General Assistance, including the municipal share of hospital costs for recipients of General Assistance where applicable. With state assumption of these benefit costs, the existing Welfare [Benefit] Equalization Aid program will be eliminated.
- (11) The administration of General Assistance should become a county function, thereby consolidating the administration of public assistance programs at the county level. In addition, the Department of Human Services should explore administrative solutions to the potential duplication of services

between its Division of Youth and Family Services and the County Welfare Agencies.

- (12) The state should implement an aid program to offset county administrative costs for public assistance in excess of the statewide average cost per capita. This program must be accompanied by greater accountability for management efficiency and error reduction on the part of counties.
- (13) The present public assistance system should be restructured to reduce long-term dependency by providing incentives and support services to encourage recipients to become more self sufficient. The objectives of the Realizing Economic Achievement (REACH) program embody many of the necessary reforms, including additional day care services, medical coverage, education, and job training.

Judicial Unification:

- (14) The state should assume the full financial and administrative responsibility for the trial court system.

Maintenance of Patients in State Mental Institutions:

- (15) The state should eliminate the present system whereby counties are forced to subsidize the care of indigent county residents who are patients in state institutions for the mentally ill and the developmentally disabled.

Prosecutors:

- (16) The state should assume the full financial and administrative responsibility for the Prosecutor's Office.

County Colleges:

- (17) The state should fulfill its statutory obligation to provide financial support for the county colleges.

STATE AID TO MUNICIPALITIES

Guaranteed Tax Base for Municipalities:

- (18) The state should guarantee that each municipality has an adequate property tax base to meet its residents' demands for essential services. State aid will compensate municipalities for the difference between the revenue they can raise from taxing their actual property tax base and the revenue that would be raised from taxing the guaranteed base.

To assure that no municipality receives less aid than it currently receives, the present level and distribution of revenues from the Gross Receipts and Franchise taxes, the Business Personal Property Tax, the Corporation Business Tax on banks, the Financial Business Tax, and the Insurance Premiums Tax should be frozen. Each municipality would have its aid calculated according to the guaranteed tax base and the frozen programs and would receive whichever amount is greater.

Payments in Lieu of Taxes:

- (19) The formula used to calculate state compensation to municipalities in lieu of property taxes on state-owned real property should be changed to use the municipal general tax rate and the assessed value of the state facility.
- (20) The formula should be funded in full.
- (21) The program of payments in lieu of taxes should be extended to cover property leased by the state from a state authority.

POTENTIAL VERSUS ACTUAL PROPERTY TAX REFORMS

Adjustment of the County Levy Cap:

- (22) The county tax levy should be reduced for purposes of calculating the cap to ensure that the state assumption of costs currently borne by the county results in a reduction in the property tax levy.
- (23) The county cap should be eliminated three years after the enactment of the Commission's recommendations regarding intergovernmental structural reform.

Adjustment of the Municipal Budget Cap:

- (24) The state assumption of municipal programs or functions should result in a reduced budget base for calculating permissible spending increases.
- (25) Increases in state aid received through the Guaranteed Tax Base formula and through additional payments in lieu of taxes should be included within the municipal cap, in order to achieve the maximum reduction in the reliance on the property tax.
- (26) The municipal cap should be eliminated three years after the enactment of the Commission's recommendations.

REVENUES

SALES AND USE TAX

- (27) The state should repeal the present exemptions for admissions charges (a) to boxing, sparring, or wrestling matches or exhibitions and (b) to facilities for sporting and entertainment activities in which the patron is to be a participant.

- (28) The state should repeal the sales tax exemption for purchases of disposable paper products.
- (29) The state should repeal the sales tax exemption for purchases of soap products and cleaners for household use.
- (30) The state should repeal the sales tax exemption for purchases of over-the-counter drugs.
- (31) The state should repeal the sales tax exemption for purchases of alcoholic beverages for on-premises consumption.
- (32) The sales tax should be applied to the purchase of cable television service.
- (33) The present exemption for sales of telephone and telegraph equipment should be repealed, except for purchases made by providers of telecommunications services.
- (34) The sales tax exemption for purchases of cigarettes should be repealed.
- (35) The use tax should be applied to room occupancy, restaurant meals, and amusement charges which are provided gratis.
- (36) The sales tax on advertising services should be repealed.
- (37) The purchase of building materials to be used to construct state-financed housing should be exempt from the sales tax, regardless of who makes the purchase. This exemption should be codified in the Sales and Use Tax Act.
- (38) The sales tax exemption for equipment used in the manufacturing process should be clarified by: (a) expanding the exemption to include the sales of supplies for use or consumption directly and primarily in the production of tangible personal property by manufacturing, processing,

assembling or refining; (b) repealing the one-year minimum useful life requirement for exemption of parts used in conjunction with the machinery, apparatus or equipment; and (c) extending the exemption to machinery which is used to produce production equipment, parts or other features of the production machinery itself.

SELECTIVE SALES OR EXCISE TAXES

- (39) The Alcoholic Beverages Wholesale Sales Tax rate should be increased from 7.3 percent to 7.8 percent.
- (40) The cigarette excise tax should be extended to all tobacco products and imposed at the wholesale level.
- (41) A unit-based excise tax should be imposed on the possession or sale of controlled substances.
- (42) The Departments of Treasury and Transportation should give further review and make recommendations regarding the imposition of a weight-distance tax.

PERSONAL INCOME TAX

- (43) The Homestead Rebate, Homestead Tax Relief Act (Ford Act), and Homestead Tenant Credit should be repealed.
- (44) The state should implement a targeted property tax circuit breaker for homeowners and tenants, according to which (a) homeowners would receive a rebate not to exceed \$450 per household based upon the percentage of their income paid in property taxes; (b) tenants would receive a refundable credit of \$110, which would be phased out between \$40,000 and \$50,000.
- (45) The additional personal exemption for dependent college students should be repealed.

- (46) There should be a phase-out of deductions for retirement income for taxpayers aged 62 and over whose incomes exceed \$50,000.
- (47) The rate structure should be changed, so that the rates are: 2 percent on income less than \$20,000; 2.5 percent on income between \$20,000 and \$50,000; 4 percent on income between \$50,000 and \$100,000, and 4.5 percent on income in excess of \$100,000.
- (48) The state should implement a refundable credit against personal income tax liability to offset consumption (i.e. sales, excise, and utility) taxes paid by households with income below \$30,000.
- (49) The treatment of Keogh Plan contributions should be conformed to the federal tax system.
- (50) Individuals who are not covered by an employer qualified retirement plan should be permitted to deduct contributions they make towards their retirement. Specifically: (a) deductions of contributions made under Section 401(k) of the Internal Revenue Code should be allowed only if no other retirement plan is available to the taxpayer; (b) this treatment of Section 401(k) plans should be extended to Section 403(b) plans, which cover employees of non-profit corporations; and (c) the treatment of contributions to Individual Retirement Accounts should be conformed to the federal tax system.
- (51) The state should repeal the regular exemption which may be claimed on a child's tax form when the child is also claimed as a dependent on a parent's income tax return.
- (52) The state should review the Reciprocal Personal Income Tax Agreement between the Commonwealth of Pennsylvania and the State of New Jersey to determine the present effects of the agreement.

PUBLIC UTILITY TAXES

Telecommunications Utilities:

- (53) The public utility taxes on telecommunications utilities should be changed to: (a) impose a 6 percent gross receipts tax on all telecommunications companies; (b) impose the Corporation Business Tax on all providers of telecommunications services, including regulated utilities; (c) repeal the existing franchise tax on regulated utilities; (d) repeal the existing state excise tax on regulated utilities; and, (e) repeal local property taxes on the personal property of regulated utilities.

Energy Utilities:

- (54) The public utility taxes on energy utilities should be changed by: (a) repealing the existing gross receipts, franchise, and excise taxes on gas and electric utilities; (b) imposing the Corporation Business Tax on gas and electric utilities; and, (c) applying a gross receipts tax to sales of electricity, gas, oil and other fuels at a rate to preserve the yield from the current set of taxes.

PROPERTY TAX

Assessment Administration:

- (55) The assessment of real property should be consolidated under a State Board of Equalization, with at least one office in each county, and financed through state-levied administrative fees. The administrative functions of the present county Tax Boards should be eliminated and the Boards placed under the jurisdiction of the Tax Court to hear appeals of assessments.
- (56) The existing timetable for tax sales and in rem foreclosures for all delinquent properties should be accelerated.

- (57) An accelerated timetable should be enacted for foreclosure against vacant properties with building and safety code violations.
- (58) Relief should be provided to municipalities with properties subject to foreclosure due to non-payment of taxes by: (a) granting adjustments to municipal property valuations for state aid apportionments; (b) granting adjustments to municipal property valuations for previous and current county tax apportionments; (c) granting credits against the municipal reserve for uncollected taxes; and, (d) accounting for the portion of the municipal reserve for uncollected tax attributable to the school levy in the computation of state school aid.

Farmland Assessment:

- (59) The Farmland Assessment program require program participants to yield a percentage of the development rights of the property for each year of preferential taxation.

New Construction:

- (60) A state-wide tax on the value of new construction should be implemented, with a lower rate in areas targeted for growth under the state development plan. To the extent that the revenue yield from the tax exceeds the yield from the local purpose tax rate, the state would use the excess revenues, to finance infrastructure.

BUSINESS TAXES

Corporation Business Tax (CBT):

- (61) The CBT should be expanded to include financial institutions currently subject to the Savings Institution Tax.

- (62) The CBT should be extended to income of investment companies that are chartered out-of-state and are wholly-owned subsidiaries of banks operating in New Jersey.
- (63) Banks and their subsidiaries should be prohibited from electing to be taxed as investment companies.
- (64) The earmarking of the CBT paid by banking and financial institutions should be repealed.
- (65) A new income apportionment formula should be developed for bank corporations to place greater emphasis on deposits and receipts and less emphasis on property.
- (66) The CBT should be amended to include leased property in the property factor of the three-factor formula.
- (67) Eliminate the present CBT requirement that a corporation must maintain a regular place of business in a state in order to apportion its income to that state.
- (68) The state definition of depreciation should be recoupled to the present federal definition.
- (69) The CBT should be changed to permit "interest add back" when a parent corporation serves as a conduit for a loan to a subsidiary.
- (70) Loopholes which arise from requiring separate accounting entities should be closed.
- (71) The state should pay refunds to taxpayers when an audit discovers an overpayment of taxes, even if the normal refund period has expired.

- (72) The state should pay interest on refunds of overpayment of taxes, in conformity with the Federal Tax Code, with rates of interest derived from the rate of return on the state Cash Management Fund..

Financial Business Taxes:

- (73) The Savings Institution Tax should be abolished.
- (74) The Financial Business Tax paid by unincorporated financial businesses should no longer be earmarked.

Insurance Taxes:

- (75) The Insurance Premiums Tax should not be applied to premiums from health insurance.

State Railroad Taxes:

- (76) The Class II Railroad Property Tax should be collected semiannually rather than annually.

Business Personal Property Tax:

- (77) The Business Personal Property Tax, which applies to property purchased prior to 1977, should be repealed.

MISCELLANEOUS TAXES

Inheritance and Estate Taxes:

- (78) The legal incidence of the tax should be shifted from inheritances to estates, retaining the present pick-up estate tax.

- (79) The deductions in the estate tax code should be expanded to incorporate the current system of exemptions of transfers found in the inheritance tax code.
- (80) The administration of the tax should be converted from a billed system to a self-assessed system.

Local Option Taxes:

- (81) The Newark payroll tax should be eliminated. The authorization for local taxes on parking fees should be retained and all other unexercised local option taxes should be repealed.
- (82) The Atlantic City Luxury Tax should be modified so that future extensions of the state sales tax to transactions also taxed under the Luxury Tax do not result in a loss of revenue to the state.

SAFEGUARDING THE BENEFITS OF THE NEW SYSTEM

ECONOMIC DEVELOPMENT STRATEGIES

Economic Development Programs:

- (83) Site-specific economic development programs should be targeted to distressed areas.
- (84) The state should develop and implement systematic and independent evaluations of each of its current economic development programs.
- (85) The state should develop an Industrial Zone Program to slow or reverse the decline in manufacturing activity in the state.
- (86) A challenge grant program should be established to encourage cooperation between the state's colleges and municipalities.

- (87) The state should continue the emphasis on Science and Technology programs.
- (88) The state should examine the interrelationship of economic development programs operated by the Departments of Commerce and Community Affairs as well as the various agencies regulating commercial activities.

Adequacy of Housing and Infrastructure:

- (89) The state should establish a Housing Development Bank to ensure an adequate supply of affordable housing.
- (90) The state should ensure the adequate provision of infrastructure, including transportation, water supply, wastewater treatment, and solid waste disposal facilities.
- (91) The state should continue to provide grants to local governments for the construction of wastewater facilities to augment the Wastewater Treatment Financing [Loan] Program.

State and Local Planning:

- (92) The efforts of the State Planning Commission to foster orderly development should be encouraged as a method to reduce infrastructure and service costs and as a useful tool to promote economic development. To further encourage orderly development, the State Planning Commission should develop mechanisms to promote sub-state regional planning and coordination.
- (93) The State Planning Commission should encourage the establishment of regional special improvement districts to address issues of local area planning, tax base sharing, regulatory relief, and the provision of infrastructure to promote orderly economic development.

- (94) The State Planning Commission should review the local use of development, impact, and linkage fees with an eye toward limiting, standardizing, and regionalizing their collection, distribution, and use.
- (95) The County and Municipal Government Study Commission should study the development and funding of incentives to encourage the consolidation of selected services amongst jurisdictions or the transfer of selected services to counties.
- (96) The Municipal Land Use Law should be expanded to include a requirement that all municipalities that are categorized as distressed by the state include as part of their master or comprehensive plan a community and economic development element that would be subject to the State Planning Commission's cross-acceptance process. The costs associated with the preparation of this plan should be paid by the state.

BUDGET PROCESS ISSUES

Contingency Funds:

- (97) The Commission endorses the concept of a state contingency fund to permit a more orderly response to an unanticipated shortfall in revenues or increase in expenditures due to recessions or emergencies.

Tax Expenditure Reporting:

- (98) The Division of Taxation should prepare an annual estimate of revenues foregone for those tax subsidies provided by the state.
- (99) Fiscal notes should be required for all changes to the tax code.

Dedication of Revenues:

- (100) There should be no further constitutional dedication of revenues. The present dedication of the proceeds of the Lottery, personal income tax,

and tax on casino revenues should be reconsidered. Where earmarking of revenues is appropriate, as with some user fees, the earmarking should be accomplished by statute.

Fiscal Notes:

- (101) A fiscal note should be required whenever a potential fiscal impact is identified by the Legislative Budget Officer. The Legislative Budget Officer should further be empowered to determine the scope of the estimates that will be required.

Payment for State Mandates:

- (102) The state should share in the cost of new or significantly enhanced services or regulations mandated upon municipalities or counties. The sharing of the cost with municipalities should be through the Guaranteed Tax Base aid formula. For counties, the state should develop a categorical aid program which would be equalized according to the county's ability to pay.

Full Funding of State Aid Programs:

- (103) Aid programs to local governments should be funded at the levels embodied in the law. If it becomes necessary to reduce aid for any reason, the law establishing the program or formula should be changed. These funding levels should not be determined on an annual basis through the budget process.

NON-FISCAL ASSISTANCE TO LOCALITIES

- (104) The state should take a more active role in providing technical and management assistance to local governments to ensure that funds are expended efficiently and properly.

PERMANENT TAX POLICY COMMISSION

- (105) A permanent, nonpartisan tax policy commission should be established. This commission would advise the Governor and Legislature on matters of tax policy and would monitor the tax system and recommend changes in light of changing demographic, economic, or fiscal conditions.

VII. IMPACTS AND CONCLUSIONS

(This section has not been completed.)

SUMMARY OF EXPENDITURE PROPOSALS

<u>Expenditures</u>	(in millions)	
	<u>additional</u> <u>state costs</u>	<u>cumulative</u> <u>total</u>
A. Education Finance Reform		
1) current-year funding	181	181
2) minimum budgets and certification	32	213
3) compensatory aid	71	284
4) debt service	84	368
5) phase out of minimum teachers' salary program	25	393
6) county college funding	20	413
B. Intergovernmental Structure Reforms		
1) public assistance		
a) state assumption of AFDC, GA, and SSI benefits costs	86	499
b) eliminate county (benefit) equalization aid	-15	484
c) initiate county administration cost equalization aid	9	493
2) judicial unification	151	644
3) patients in mental institutions		
a) mentally ill facilities	45	689
b) facilities for mentally retarded	60	749
4) prosecutors	66	815
C. State Aid		
1) guaranteed tax base municipal aid	335	1,150

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**SUMMARY OF REVENUE PROPOSALS
STATE TAX SYSTEM**

	<u>Change in State Revenues</u>	<u>Cumulative Total</u>
A) Sales/Use and Excise Taxes		
1) admissions	33	33
2) disposable paper products	30	63
3) soap products	25	88
4) non-prescription drugs	33	121
5) alcoholic beverages		
a) increase wholesale excise tax to 7.8%	6	127
b) on-premises consumption	150	277
6) cable television	26	303
7) telephone equipment	35	338
8) tobacco		
a) sales tax on cigarettes	70	408
b) extend excise tax to all tobacco products	20	428
B) Gross Income Tax		
1) repeal Ford property tax deduction	160	588
2) repeal Homestead Rebate Program	305	893
3) repeal Homestead tenant credit	56	949
4) repeal college exemption	6	955
5) phase out deductions for age 62 and over	6	961
C) Public Utilities Taxes		
1) telecommunications		
a) six percent gross receipts tax on all services	200	1,161
b) extend corporate business tax to all providers	61	1,222
c) repeal franchise tax on utilities	-57	1,165
d) repeal excise tax on utilities	-15	1,150
2) energy utilities	(impact of change to be revenue neutral)	
D) Corporation Business Tax		
1) extend to savings and loans institutions	76	1,226
E) Miscellaneous Taxes		
1) repeal savings institution tax	-26	1,200
2) eliminate insurance premiums tax on health insurance premiums	-10	1,190
3) replace revenues from repeal of Newark payroll tax	-15	1,175
4) repeal earmarking of financial business tax revenues	18	1,193

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THE IMPACT OF COMMISSION PROPOSALS ON SELECTED MUNICIPALITIES

This chapter discusses the impact of the State and Local Expenditure and Revenue Policy Commission's recommendations on the fiscal situation in a representative sample of New Jersey's cities and towns. The changes highlighted in this summary are the state assumption of selected county and municipal costs such as courts, welfare, prosecutors and mental health, and the increased state aid to cities, school districts and county colleges. The result of these changes is a state-wide reduction in local property taxes of \$1.2 billion. The fifteen municipalities selected as examples include several of New Jersey's large cities and a representative sample of suburban, rural and shore communities. The sample cities are discussed alphabetically.

ATLANTIC CITY

Atlantic City is an older, redeveloping shore city with a 1986 population of 36,219 and a 1985 per capita equalized property valuation of \$121,821. In 1986 Atlantic City had an actual effective real property tax rate of \$2.02 per \$100 of property value and received \$8,164,468 in state aid.

As a result of the Commission's recommendations, Atlantic City, in 1986, would have received the same amount of state aid (\$8,164,468) and would have reduced its levy by more than \$6,750,000 due to the state assumption of selected county and municipal costs and an increase of \$206,782 in school aid. The property tax in Atlantic City would have been \$1.902 per \$100. This would translate into a \$118 reduction in property taxes for the owner of a \$100,000 home.

BEACH HAVEN

Beach Haven is a developing shore community in Ocean County with a 1986 population of 1,812 and a 1985 per capita equalized property valuation of \$168,082. In 1986, Beach Haven received \$256,228 in state aid and had an effective tax rate of \$1.241 per \$100 of real property value.

If the Commission's recommendations had been in place in 1986, Beach Haven would have received the same amount of municipal state aid (\$256,228), and would have reduced its levy by more than \$213,083 due to the state assumption of selected county and municipal costs and an increase of \$1,448 in school aid. The result of these changes would be a new effective property tax rate of \$1.176 per \$100. The owner of a \$100,000 home would have received a property tax reduction of \$65 dollars.

BEDMINSTER

Bedminster is a rapidly growing rural suburban community with a 1986 population of 4,238 and a 1985 per capita equalized property valuation of \$123,417. In 1986 Bedminster had an actual effective real property tax rate of \$1.230 per \$100 of property value and received \$426,326 in state aid.

As a result of the Commission's recommendations, Bedminster, in 1986, would have received the same amount of state aid (\$426,326) and would have reduced its levy by more than \$449,000 due to the state assumption of selected county and municipal costs and an increase of \$17,107 in school aid. The property tax in Bedminster would have been \$1.138 per \$100. This would translate into a \$92 reduction in property taxes for the owner of a \$100,000 home.

BLAIRSTOWN

Blairstown is a rural community with a 1986 population of 4,890 and a 1985 per capita equalized property valuation of \$38,279. In 1986 Blairstown had an actual effective real property tax rate of \$0.902 per \$100 of property value.

As a result of the Commission's recommendations, Blairstown, in 1986, would have received the same amount of state aid (\$2,961,698) and would have reduced its levy by more than \$383,000 due to the state assumption of selected county and municipal costs and an increase of \$107,227 in school aid. The property tax in Blairstown would have been \$0.708 per \$100. This translates into a \$194 reduction in property taxes for the owner of a \$100,000 home.

CAMDEN

Camden is an older, redeveloping central city with a 1986 population of 83,265 and a 1985 per capita equalized property valuation of \$6,021. In 1986 Camden had an actual effective real property tax rate of \$5.884 per \$100 of property value and received \$9,431,694 in state aid.

As a result of the Commission's recommendations, Camden, in 1986, would have received \$22,920,068 in state aid (an increase of over \$13 million) and would have reduced its levy by more than \$3,658,000 due to the state assumption of selected county and municipal costs and an increase of \$623,335 in school aid. The property tax in Camden would have been \$2.904 per \$100. This translates into a \$2,980 reduction in property taxes for the owner of a \$100,000 home.

ELIZABETH

Elizabeth is an older, redeveloping central city with a 1986 population of 106,656 and a 1985 per capita equalized property valuation of \$14,257. In 1986 Elizabeth had an actual effective real property tax rate of \$2.961 per \$100 of property value and received \$16,494,291 in state aid.

As a result of the Commission's recommendations, Elizabeth, in 1986, would have received \$24,66,414 in state aid (an increase of over \$8 million) and would have reduced its levy by more than \$5,391,000 due to the state assumption of selected county and municipal costs and an increase of \$2,258,797 in school aid. The property tax rate in Elizabeth would have been \$2.136 per \$100. This translates into a \$855 reduction in property taxes for the owner of a \$100,000 home.

FREEHOLD BOROUGH

Freehold Borough is an older, developing city with a 1986 population of 10,107 and a 1985 per capita equalized property valuation of \$23,893. In 1986 Freehold Borough had an actual effective real property tax rate of \$2.468 per \$100 of property value and received \$773,107 in state aid.

As a result of the Commission's recommendations, Freehold Borough, in 1986, would have received \$1,455,373 in state aid (an increase of more than \$682,000) and would have reduced its levy by more than \$396,000 due to the state assumption of selected county and municipal costs and an increase of \$87,587 in school aid. The property tax rate in Freehold Borough would have been \$2.085 per \$100. This translates into a \$383 reduction in property taxes for the owner of a \$100,000 home.

HAMILTON TOWNSHIP

Hamilton Township in Mercer County is a growing suburban city with a 1986 population of 87,375 and a 1985 per capita equalized property valuation of \$23,121. In 1986 Hamilton had an actual effective real property tax rate of \$2.737 per \$100 of property value and received \$17,496,509 in state aid.

As a result of the Commission's recommendations, Hamilton, in 1986, would have received the same amount of state aid (\$17,496,509) and would have reduced its levy by more than \$5,056,000 due to the state assumption of selected county and municipal costs and an increase of \$1,957,105 in school aid. The property tax rate would have been \$2.507 per \$100. This translates into a \$230 reduction in property taxes for the owner of a \$100,000 home in Hamilton.

JERSEY CITY

Jersey City is an older, redeveloping central city with a 1986 population of 218,576 and a 1985 per capita equalized property valuation of \$10,646. In 1986 Jersey City had an actual effective real property tax rate of \$5.066 per \$100 of property value and received \$39,756,377 in state aid.

As a result of the Commission's recommendations, Jersey City, in 1986, would have received \$58,567,200 in state aid (an increase of more than \$18,810,000) and would have reduced its levy by more than \$23,165,000 because of the state assumption of selected county and municipal costs and an increase of \$9,692,219 in school aid. The property tax rate in Jersey City would have been \$3.421 per \$100. This translates into a \$1,645 reduction in property taxes for the owner of a \$100,000 home.

MONTCLAIR

Montclair is an older, stable suburban community with a 1986 population of 38,705 and a 1985 per capita equalized property valuation of \$37,106. In 1986 Montclair had an actual effective real property tax rate of \$3.518 per \$100 of property value and received \$2,721,904 in state aid.

As a result of the Commission's recommendations, Montclair, in 1986, would have received \$3,858,019 in state aid (an increase of more than \$1.1 million) and would have reduced its levy by more than \$4,550,000 due to the state assumption selected county and municipal costs and an increase of \$182,436 in school aid. The property tax rate in Montclair would have been \$3.135 per \$100. The reduced property tax rate translates into a \$383 reduction in property taxes for the owner of a \$100,000 home.

NEWARK

Newark is New Jersey's largest city with a 1986 population of 316,345 and a 1985 equalized per capita property valuation of \$7,188. In 1986 Newark had an effective property tax rate of \$4.752 per \$100 of property value and received \$60,255,023 in state aid. In addition, Newark is the only city in the state to have a payroll tax.

As a result of the Commission's recommendations, Newark, in 1986, would have received \$95,058,371 in state aid (an increase of more than \$34 million) and would have reduced its levy by more than \$36,922,000 due to the state

assumption of selected county and municipal costs and an increase of \$20,072,501 in school aid. The payroll tax would be eliminated and the state would provide the city with additional funding as part of the state aid package. The property tax rate in Newark would have been \$2.711 per \$100. This translates into a \$2,041 reduction in property taxes for the owner of a \$100,000 home.

PATERSON

Paterson is an older, redeveloping city with a 1986 population of 139,453 and a 1985 per capita equalized property valuation of \$9,594. In 1986 Paterson had an effective real property tax rate of \$3.913 per \$100 of property value and received \$8,387,473 in state aid.

As a result of the Commission's recommendations, Paterson would have received \$30,418,299 in state aid (an increase of more than \$22 million) and would have reduced its levy by more than \$5,054,000 million due to the state assumption of selected county and municipal costs and an increase of \$1,276,752 in school aid. The property tax rate in Paterson would have been \$2.055 per \$100. This translates into a \$1,858 reduction in property taxes for the owner of a \$100,000 home.

PLAINSBORO

Plainsboro is a rapidly growing suburban community with a 1986 population of 10,656 and a 1985 per capita equalized property valuation of \$63,420. In 1986 Plainsboro had an actual effective real property tax rate of \$1.761 per \$100 of property value and received \$700,674 in state municipal aid.

As a result of the Commission's recommendations, Plainsboro would have received the same amount of state aid (\$700,674) and would have reduced its levy by more than \$689,000 due to the state assumption of selected county and municipal costs and an increase of \$28,336 in school aid. The property tax rate in Plainsboro would have been \$1.670 per \$100. This translates into a \$91 reduction in property taxes for the owner of a \$100,000 home.

TRENTON

Trenton, the state capital, is an older, redeveloping central city with a 1986 population of 91,746 and a 1985 per capita equalized property valuation of \$9,308. In 1986 Trenton had an actual effective real property tax rate of \$4.845 per \$100 of property value and received \$7,910,297 in state municipal aid.

As a result of the Commission's recommendations, Trenton, in 1986, would have received \$24,354,803 in state aid (an increase of more than \$16 million) and would have reduced its levy by more than \$5,934,000 due to the state assumption of selected county and municipal costs and an increase of \$3,524,563 in school aid. The property tax rate in Trenton would have been \$2.440 per \$100. This translates into a \$2,405 reduction in property taxes for the owner of a \$100,000 home.

UPPER SADDLE RIVER

Upper Saddle River is a Bergen County suburban community with a 1986 population of 7,845 and a 1985 per capita equalized property valuation of \$77,480. In 1986 Upper Saddle River had an actual effective real property tax rate of \$1.794 per \$100 of property value and received \$1,025,001 in state municipal aid.

As a result of the Commission's recommendations, Upper Saddle River, in 1986, would have received the same amount of state aid (\$1,025,001) and would have reduced its levy by more than \$408,000 due to the state assumption of selected county and municipal costs and an increase of \$30,064 in school aid. The property tax rate in Upper Saddle River would have been \$1.732 per \$100. This translates into a \$62 reduction in property taxes for the owner of a \$100,000 home.

SUMMARY

The sample of fifteen communities demonstrates that a major effect of the Commission's recommendations is to reduce the reliance on local taxes. Every community in the State of New Jersey would have lower property taxes because no community would receive less state aid than currently, school aid would be increased substantially, and the state would assume the costs of county and municipal services such as the courts, welfare, prosecutors, and the care of indigent patients in mental institutions.

The attached table lists the fifteen communities and the impact of the Commission's recommendations on property tax rates. The actual 1986 effective real property tax rates range from \$5.884 per \$100 in Camden to \$0.902 per \$100 in Blairstown: a difference of \$4.982 per \$100 of market value or \$4,982 in property taxes on a \$100,000 home. As a result of the Commission's recommendations, the 1986 effective real property tax rates would range from \$3.421 per \$100 in Jersey City to \$0.708 per \$100 in Blairstown: a difference of \$2.713 per \$100 of market value or \$2,713 in property taxes on a \$100,000 home. The difference in the maximum and minimum property taxes paid in the selected cities is reduced by almost half.

In summary, the Commission's proposals would provide property tax relief throughout the state and significantly reduce property tax burdens in cities with high property tax rates.

IMPACT OF COMMISSION RECOMMENDATIONS ON SELECTED CITIES

Selected Municipalities	Existing Effective Tax Rate	Effective Tax Rate After Recommendations	Difference in Effective Tax Rates
Atlantic City	2.020	1.902	0.118
Beach Haven	1.241	1.176	0.065
Bedminster	1.230	1.138	0.092
Blairstown	0.902	0.708	0.194
Camden	5.884	2.904	2.980
Elizabeth	2.961	2.136	0.855
Freehold Borough	2.468	2.085	0.383
Hamilton Township	2.737	2.507	0.230
Jersey City	5.066	3.421	1.645
Montclair	3.518	3.135	0.383
Newark	4.752	2.711	2.041
Paterson	3.913	2.055	1.858
Plainsboro	1.761	1.670	0.091
Trenton	4.845	2.440	2.405
Upper Saddle River	1.794	1.732	0.062

