# *ILLINOIS ECONOMIC*
# *and*
# *FISCAL COMMISSION*

# *EDUCATION FUNDING:*
# *Fair or Flawed?*

*OCTOBER 2002*
*703 STRATTON BUILDING*
*SPRINGFIELD, ILLINOIS 62706*

# ILLINOIS ECONOMIC and FISCAL COMMISSION

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## *EDUCATION FUNDING: Fair or Flawed?*

## EXECUTIVE SUMMARY

The issue of school funding is consistently a hot topic for governments throughout the country. Debate over the best way to finance elementary and secondary education is primarily the reason, with school financing varying from state to state and from school district to school district. Although, the financing of schools comes from a combination of state, local, and federal sources, the Illinois Constitution states that, *"The State has the primary responsibility for financing the system of public education."*

Across the country, state governments have used a combination of income taxes, sales taxes, and other sources to fund education. Local governments fund education primarily through local property taxes. The question that arises is which government entity should play the larger role in financing schools. In most states today, the majority of educational funding comes from state sources. However, Illinois is different as it relies mostly on the local property tax to finance education in this State.

There are many who feel that Illinois relies too heavily on the property tax as a revenue source to fund schools. They believe that the State should assume more responsibility in funding education to relieve some of the financial burden placed on local governments who have to impose high property taxes to collect the necessary funds to financially survive. Others feel that transferring the financial burden onto the State would diminish the role of local governments and their decision making process for financing their school districts. This would, in their opinion, undermine local control and accountability.

The intent of this report is not to determine which viewpoint is correct; but rather lay out the pros and cons of each format to allow for a better understanding of this controversial subject. The report begins by offering an overview of the property tax system in Illinois, including an explanation of how property assessed in Cook County is calculated differently than the rest of the State. The report then provides property tax statistics to show the extent that Illinois relies on local property taxes to fund education.

Also discussed is the disparity that exists in the amounts residents pay for property taxes. Explanations for why there is such vast disparity from county to county, city to city, or even between two districts in the same city are included in this section. Maps and charts illustrating the disparity in tax rates, per capita amounts, and per pupil State aid levels are included, as well as an analysis on how the varying property tax rates and amounts affect the tax structure and economic value of a district. From this, the report describes why many believe that the State should assume a greater role in funding education.

The report then examines how the State funds education and gives an overview of how the State's general state aid is calculated. Included in this section are examples of how a district can receive thousands of dollars more per pupil than another district. The

report then discusses why many believe that a heavy reliance on property taxes is necessary because it gives districts more local control and creates accountability.

Also provided in the report is a summary of the Governor's Commission on Property Tax Reform, as well as a summary of the recently-released preliminary recommendations of the State's Education Funding Advisory Board. Included in these summaries are descriptions of the various tax swap proposals being discussed and the costs associated with these changes. In addition, this section defines the "winners" and "losers" that would be created in a tax swap. The report concludes by analyzing how other states fund schools and the recent changes that have been made by neighboring states. Highlights of the report are summarized below.

- The local property tax is the major source of revenue for approximately 6,000 taxing districts and is used to finance the majority of services provided by counties, townships, municipalities, schools, and other special taxing districts.

- For most counties, Illinois property, excluding farmland and buildings, is assessed at one-third (33 1/3 percent) of its fair cash value. However, Cook County allows particular types of property to be assessed at rates other than the statutory level.

- Illinois is one of the highest property-taxing states in the country collecting the 5th highest amount of state and local property tax revenue in 1999, based on total collections. On a per-capita basis, Illinois collected the 10th highest amount of property taxes in the country at $1,163 per capita.

- Of the amounts collected through property taxes in Illinois in 1999, school district extensions made up the largest percentage of all property tax extensions at 58.0%. City extensions made up the next highest percentage at 12.8%, followed by counties at 9.1% and park districts at 4.2%.

- During the 1999-2000 school year, 61.5% of all revenue for Illinois schools came from local sources, 30.8% came from State funds, while 7.7% came from federal funds. In comparison, in the U.S., local governments made up 42.9%, state governments made up 49.5%, while 7.3% came from federal sources.

- During the 1997-1998 school year, Illinois collected the 7th highest amount of local tax revenue per pupil in the nation at $4,606. However, on a state revenue per pupil basis, the State collected the 48th highest amount per pupil at $2,018.

- Tax rates vary dramatically throughout the State. In tax year 1999, average county property tax rates ranged from 4.00% in DeWitt County to 9.75% in Winnebago County. Much of the difference between rates is due to the varying tax rates of school districts.

- In 1999, educational property tax per-capita figures ranged from $107 per capita in Hardin County to $1,281 per capita in Grundy County. The highest per

capita tax collections generally occurred in the northern part of Illinois, while southern Illinois had much lower per-capita levels.

- Illinois uses the general state aid formula to redistribute funds to public schools throughout the State. Three different formulas are used to calculate the amount of aid for a particular school district and are set up to distribute more aid to the poor districts, while entitling the wealthy districts a minimum amount per pupil.

- Wealthy districts are, in effect, penalized for being able to provide financial support to their districts causing them to receive very little State aid. These districts feel that an increasing reliance on State taxes would make the system even less fair to them, because they would get back only pennies out of every dollar sent to the State.

- Some feel that if local control were weakened, student achievement would suffer. They claim that local control creates accountability. They feel that a "one cost fits all" foundation level by the State would mean losing knowledge of a district's financial needs resulting in inefficiencies, unfilled needs, and waste.

- In 1998, Governor Edgar established the Governor's Commission on Property Tax Reform. It sought to develop a simple tax swap proposal to reduce local property taxes and replace it with an increase in State sources. The commission found that a simple tax swap proposal that is fair and equitable to all taxpayers is not possible until certain State and local tax policy issues were addressed.

- A preliminary report from the Education Funding Advisory Board recommends an increase in the foundation level of State funding to a range of $5,665 to $6,680 per pupil per year and a reduction in local property taxes by 25 percent to 50 percent. To do so would require a $4.1 billion to $8.2 billion increase in State revenues, which would come mostly from higher income taxes and a broader sales tax.

- The idea of using the income tax as an increased source to fund education should be considered not without risk as long as the economy continues to struggle. Any tax swap proposal that relied on the income tax to fund education must factor in that these sources are much more volatile than the property tax.

- Other states have addressed the concern over high property taxes to fund schools. Michigan reduced their property taxes primarily by raising their sales tax. Indiana recently lowered their property taxes by adjusting several sources, including the income tax and the sales tax.

## ***The Property Tax System in Illinois***

A property tax is simply a tax levied against the value of property owned. In Illinois, as in most other states, the property tax is a local tax. As such, it is imposed by local government taxing districts and administered by local officials. Therefore, it is the major source of revenue for approximately 6,000 taxing districts and is used to finance the majority of services provided by counties, townships, municipalities, school districts, and numerous special taxing districts.

### *Property Tax Cycle*

The property tax is administered according to the property tax cycle. This cycle spans two years and is responsible for assigning a value to specified property, levying a tax on that property, and collecting the tax. The first phase consists of the assessment, review and equalization of real property. The second phase includes the levy, extension, collection, and distribution of property tax moneys. The assessment of property takes place in the first year, and the assessed value reflects the property value as of January 1st of the given year. Property taxes are paid in the second year; therefore taxes extended in 2001 are actually paid in 2002.

- The assessment is the official act of identifying the real property within a jurisdiction, listing it, appraising it, and placing a value for it on the tax rolls. The assessed value is the value placed on property for tax purposes.

- The review process allows taxpayers who believe that their assessments are unjust an opportunity to appeal.

- The levy is the amount of money a taxing body certifies to be raised from the property tax.

- The extension is both (1) the process in which the County Clerk determines the tax rate needed to raise the revenue (levy) certified by each taxing district in the county and (2) the actual dollar amount billed to property taxpayers in a district.

- The collection occurs when taxpayers actually pay their property tax bills.

- The distribution and use of tax collections by local governmental units is the final step of the property tax cycle. Distribution procedures may vary from county to county, but the distribution is commonly made on a percentage basis.

All Illinois property, excluding farmland and buildings, is assessed at one-third (33 1/3 percent) of its "fair cash value." The Illinois Supreme Court has interpreted this value to be the price that "*…the property would bring at a voluntary sale where the owner is ready, willing and able to sell but not compelled to do so, and the buyer is ready, willing and able to buy but not forced to do so*." However, farm property is assessed

according to its ability to produce income or its "agricultural economic value." While this value is determined by the Department of Revenue, it is a component of soil productivity, market conditions, production costs, and interest rates.

The 1970 Illinois State Constitution provided an additional exception to the standard assessment level by allowing counties with populations exceeding 200,000 the option of classifying property for assessment purposes. Classification allows particular types of property to be assessed at rates other than 33 1/3 percent, so long as the county's aggregate assessment is equalized at the statutory level. Furthermore, the assessment level for any class of property may not exceed 2 1/2 times the class of property with the lowest assessment level. To date, Cook is the only county that assesses property on the basis of classification. In its present form, the system includes eleven property classifications that range from 16 to 38 percent.

**Table 1: COOK COUNTY PROPERTY TAX ASSESSMENT CLASSIFICATIONS**

| Class | Description | Assessment Level |
|---|---|---|
| 1 | Unimproved Real-Estate | 22 percent |
| 2 | Residential, Farms, Small Apartments, Co-Ops | 16 percent |
| 3 | Other Residential Property | 33 percent |
| 4 | Non-Residential Property (Not-for-Profit) | 30 percent |
| 5a | Commercial Property | 38 percent |
| 5b | Industrial Property | 36 percent |
| 6b | Industrial Property (newly constucted or rehabilitated buildings) | 16 percent; for 10 years after which it reverts to the applicable classification under the ordinance |
| 7a | Commercial Property (newly constructed or rehabilitated commercial property in an area in need of development (less than $2 million) | 16 percent; for 10 years after which it reverts to the applicable classification under the ordinance |
| 7b | Commercial Property (newly constructed or rehabilitated commercial property in an area in need of development (more than $2 million) | 16 percent; for 10 years after which it reverts to the applicable classification under the ordinance |
| 8 | Commercial or Industrial Real-Estate (located in a severely blighted area) | 16 percent; for 12 years after which it reverts to the applicable classification under the ordinance |
| 9 | Residential Real-Estate (multi-family for low to moderate income persons) | 16 percent; for an initial 10 year period, renewable for two additional 10 year periods |

**SOURCE: Illinois Department of Revenue - 1999 Property Tax Statistics**

*Property Tax Exemptions*

Under Illinois law, general tax-exempt status is accorded to numerous organizations and institutions. These include school property, property used for religious purposes, Federal, State, and local property, charitable institutions, housing authorities, certain parks or conservation districts, public building cooperatives, not-for-profit retirement and nursing homes and certain veterans' organizations.

Aside from these general exemptions, a number of partial exemptions and special assessments have been enacted to provide homeowner relief, promote pollution control and conservation, and encourage property maintenance and rehabilitation. The measures have had a significant impact on the local tax base and have resulted in a shift in the tax base.

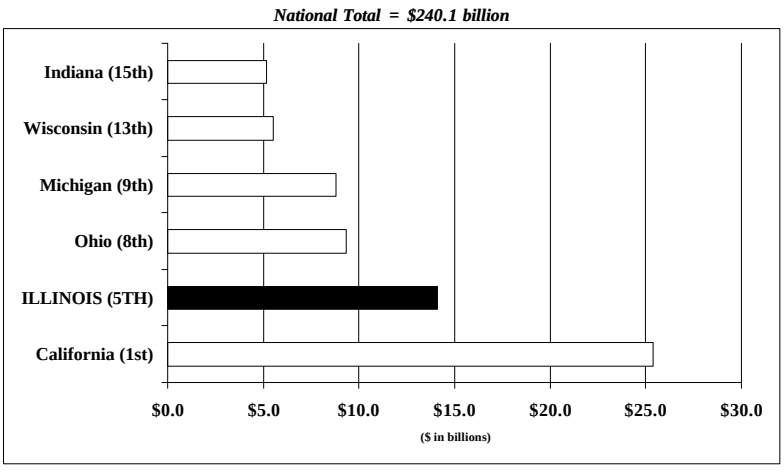
## ***The Role of Property Taxes in Funding Education***

The property tax in Illinois is considered by many as the least popular and most complicated tax in the State. Its wide range of rates and vast disparities in the amounts residents pay has caused the property tax system to be classified as inequitable by many Illinois taxpayers. A majority of the revenue generated by the local property taxes is used to fund education. There are those who feel that the State relies too much on local property taxes to fund education, believing that the State should presume a larger role in this funding. There are others, though, who believe that school funding should be strongly supported by local governments and view this large reliance on local property taxes to fund education as a necessary tax burden.

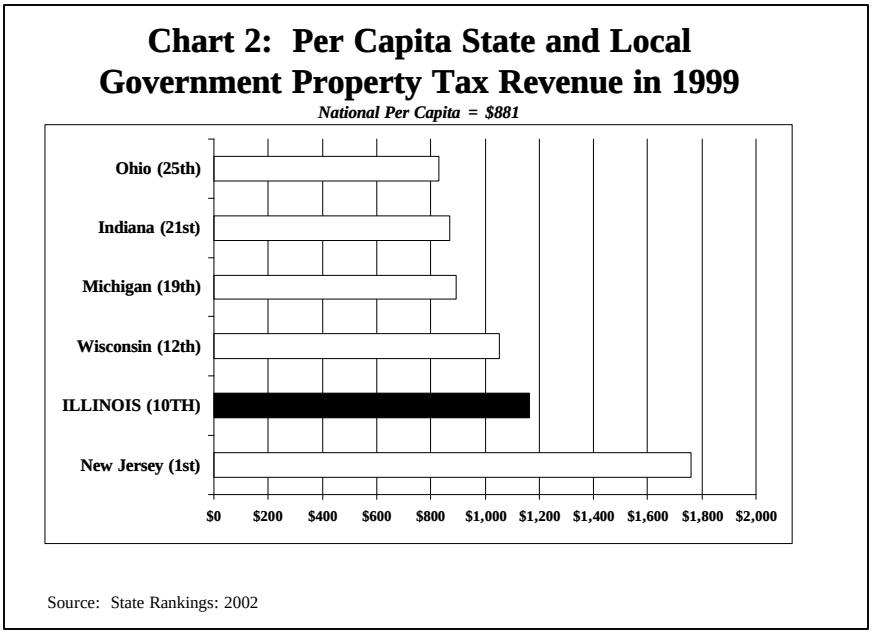
Before discussing in detail these different viewpoints, background information of the statistics surrounding the State's property tax system and its relationship to school funding is discussed. These statistics show why Illinois' high reliance on property taxes to fund education has become a controversial issue for lawmakers.

**Illinois is one of the highest property-taxing states in the country**. According to *State Rankings 2002*, Illinois collected the 5th highest amount of state and local property tax revenue in the nation in 1999, based on total collections. Only California, New York, Texas, and New Jersey collected more. On a per capita basis, Illinois collected the 10th highest amount of property taxes in the country at $1,163 per capita. This is higher than the national per-capita rate of $881. The following two charts show how Illinois' ranking in these two categories compares to the top ranked state, as well as other states in the Great Lakes Region.

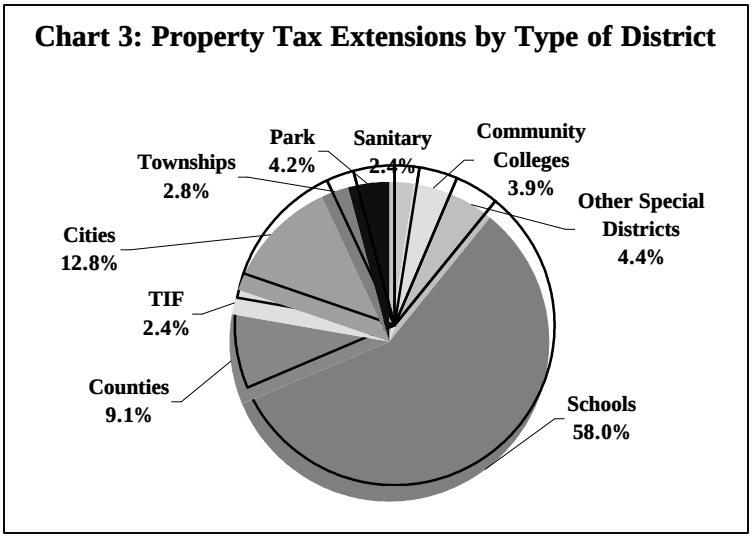
Chart 1: State and Local Government Property Tax Revenue in 1999




Source: State Rankings: 2002




Of the amounts collected through property taxes in Illinois, the majority are collected to fund education. According to the Department of Revenue's *1999 Illinois Property Tax Statistics*, school district extensions comprised 58.0% of all property tax extensions in 1999. City extensions made up the next highest percentage at 12.8%, followed by counties at 9.1% and park districts at 4.2%. A chart displaying the percentage breakouts of all tax extensions is shown below.

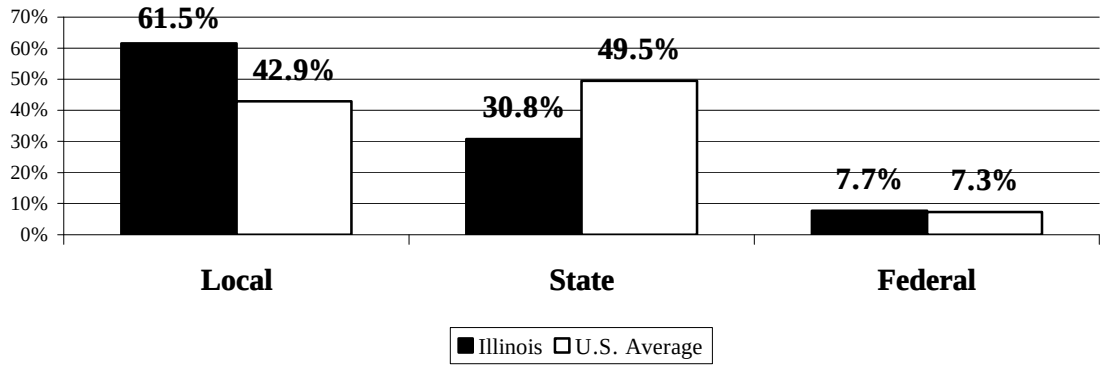



As illustrated, education funding is the main contributor to Illinois' high property tax totals. So does Illinois rely more on local property taxes to fund education than other states? The answer to this question is yes. According to the National Center for

Education Statistics, during the 1999-2000 school year, 61.5% of all revenue for public elementary and secondary schools in Illinois came from local sources, such as the property tax. Only 30.8% came from State funds, while the remaining 7.7% came from federal funds.

In comparison, on average in the United States, local governments made up 42.9% of all education funding; state governments comprised 49.5%, while the federal government funded 7.3% of all elementary and secondary education revenue nationwide. As shown in Chart 4, Illinois' local government portion of education funding was nearly 20 percentage points higher than the national average. In fact, only Nevada had a higher percentage of education funded through local sources at 65.8%.

**Chart 4: Percentage Distribution of Revenue for Public Elementary and Secondary Schools, by Source School Year 1999-2000**

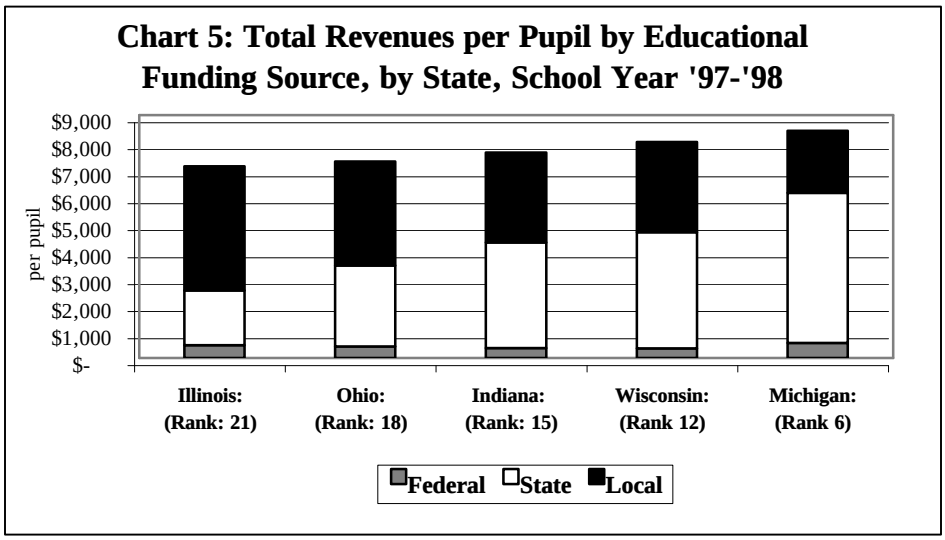



Illinois' reliance on local property taxes to fund education also can be seen by looking at revenue per-pupil statistics. During the 1997-1998 school year, Illinois collected the 7th highest amount of local tax revenue per pupil in the nation at $4,606. However, on a state revenue per-pupil basis, the State collected only the 48th highest amount per pupil at $2,018. This was well below the national average amount of $3,418 per pupil. As for total revenues per pupil (federal, state, and local sources combined), Illinois ranked 21st at $7,103 per pupil, higher than the national average of $7,067 per pupil. The highest ranked state was New Jersey at $10,550 per pupil.

Although Illinois' total revenue ranking of 21st was higher than most states, it was still lower than other states in the Great Lakes Region (Ohio 18th, Indiana 15th, Wisconsin 12th, and Michigan 6th). A graph comparing Illinois' total per-pupil spending with other states is displayed in Chart 5.

This graph emphasizes that, even though Illinois collected a large amount of local revenues to fund education, when combined with other sources, the State still funded

less per pupil than other states in the region during the 1997-1998 school year. The graph also shows how Illinois is more reliant on property taxes to fund education than the other neighboring states. (*It should be noted that the 1997-1998 data was the most recent available on the National Center for Education Statistics' May 2002 report: Financing Elementary and Secondary Education in the States: 1997-1998. Any improvements in the State's funding of education since that time would not be seen in this and other related graphs. However, no dramatic changes to the education funding structure have taken place that would require significant alterations to these graphs*).




*Property Tax Rates*

The previous data and charts identify Illinois as a state that relies heavily on the local property tax as a revenue source to fund elementary and secondary education. The question that arises is whether this reliance on local property taxes is an inequitable taxing format or a desired local decision-making luxury. The answer to this question is highly debatable and has an abundance of varying viewpoints.

Because Illinois allows local governments the control to collect what they feel is sufficient to fund education in their district, tax rates vary dramatically throughout the State. According to the 1999 edition of *Illinois Property Tax Statistics*, in tax year 1999, average county property tax rates ranged from 4.00% in DeWitt County to 9.75% in Winnebago County. A graph depicting the vast disparities in average tax rates by county is shown on page 8.

Not only can there be a wide range of tax rates between counties, but also between two neighboring cities in the same county. For example, the city of Cahokia in St. Clair County has one of the highest aggregate tax rates in the State at a rate of 13.043. In contrast, the city of Fairview Heights, only 15 miles away, has an aggregate tax rate of only 6.289 or 6.116 (depending on the elementary school district of origin). The main

**Chart 6: Average Total Property Tax Rates by County in Tax Year 1999**

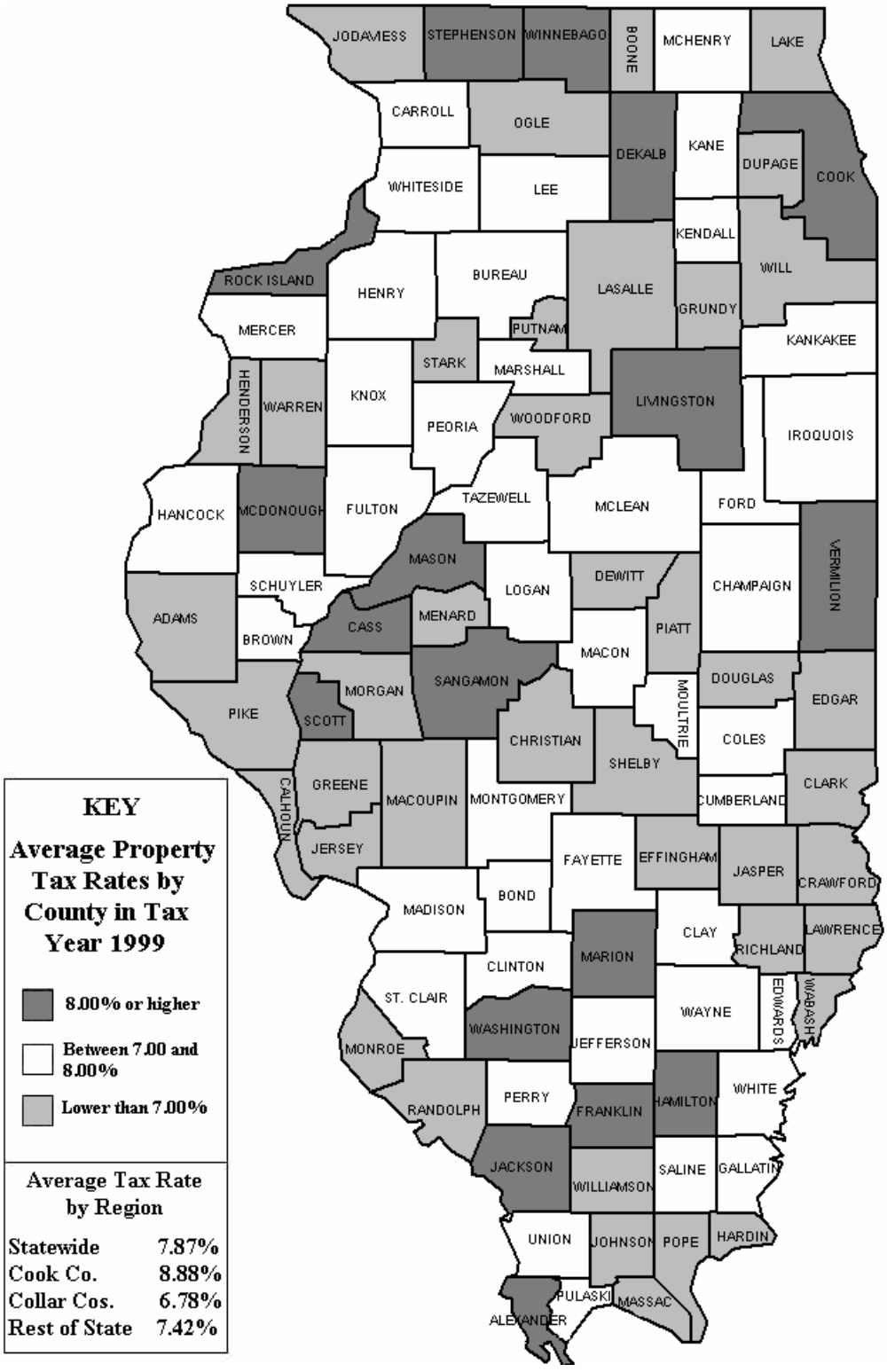


**Table 2: Average Property Tax Rates by County in Tax Year 1999**

| *Rank* | *County* | *Total Tax Rate* | *Rank* | *County* | *Total Tax Rate* |
|---|---|---|---|---|---|
| 1 | Winnebago | 9.75 | 52 | McHenry | 7.21 |
| 2 | McDonough | 9.29 | 53 | Knox | 7.19 |
| 3 | Franklin | 9.21 | 54 | McLean | 7.18 |
| 4 | Cook | 8.88 | 55 | Hancock | 7.16 |
| 5 | Alexander | 8.87 | 56 | Cumberland | 7.15 |
| 6 | Hamilton | 8.66 | 57 | Lee | 7.15 |
| 7 | Marion | 8.51 | 58 | Schuyler | 7.14 |
| 8 | Jackson | 8.39 | 59 | Brown | 7.13 |
| 9 | Sangamon | 8.38 | 60 | White | 7.11 |
| 10 | Stephenson | 8.30 | 61 | Clinton | 7.03 |
| 11 | Vermilion | 8.28 | 62 | LaSalle | 6.97 |
| 12 | Mason | 8.24 | 63 | Woodford | 6.97 |
| 13 | Washington | 8.19 | 64 | Edgar | 6.96 |
| 14 | Livingston | 8.17 | 65 | Henderson | 6.96 |
| 15 | Rock Island | 8.17 | 66 | Lake | 6.94 |
| 16 | DeKalb | 8.09 | 67 | Johnson | 6.91 |
| 17 | Scott | 8.08 | 68 | Christian | 6.90 |
| 18 | Cass | 8.03 | 69 | Will | 6.89 |
| 19 | Fulton | 7.99 | 70 | Lawrence | 6.80 |
| 20 | Saline | 7.99 | 71 | Shelby | 6.79 |
| 21 | Bond | 7.96 | 72 | Warren | 6.79 |
| 22 | Ford | 7.93 | 73 | Boone | 6.76 |
| 23 | Macon | 7.85 | 74 | Stark | 6.76 |
| 24 | Pulaski | 7.78 | 75 | Macoupin | 6.73 |
| 25 | Coles | 7.71 | 76 | Menard | 6.71 |
| 26 | Edwards | 7.66 | 77 | Pike | 6.69 |
| 27 | Marshall | 7.66 | 78 | Richland | 6.69 |
| 28 | Jefferson | 7.65 | 79 | Putnam | 6.67 |
| 29 | Kankakee | 7.61 | 80 | Calhoun | 6.66 |
| 30 | Montgomery | 7.59 | 81 | Wabash | 6.66 |
| 31 | Peoria | 7.59 | 82 | Douglas | 6.63 |
| 32 | Union | 7.59 | 83 | Crawford | 6.57 |
| 33 | Champaign | 7.52 | 84 | Clark | 6.54 |
| 34 | Bureau | 7.51 | 85 | Greene | 6.54 |
| 35 | Kendall | 7.51 | 86 | Piatt | 6.52 |
| 36 | Whiteside | 7.49 | 87 | Williamson | 6.49 |
| 37 | Perry | 7.48 | 88 | Morgan | 6.44 |
| 38 | Moultrie | 7.47 | 89 | Pope | 6.42 |
| 39 | Mercer | 7.45 | 90 | Adams | 6.39 |
| 40 | Tazewell | 7.42 | 91 | JoDaviess | 6.37 |
| 41 | Madison | 7.40 | 92 | Ogle | 6.37 |
| 42 | Clay | 7.35 | 93 | DuPage | 6.36 |
| 43 | Iroquois | 7.35 | 94 | Randolph | 6.31 |
| 44 | Kane | 7.35 | 95 | Effingham | 6.23 |
| 45 | Fayette | 7.33 | 96 | Massac | 6.19 |
| 46 | Wayne | 7.33 | 97 | Jasper | 5.88 |
| 47 | Logan | 7.30 | 98 | Grundy | 5.67 |
| 48 | Carroll | 7.27 | 99 | Monroe | 5.52 |
| 49 | Gallatin | 7.27 | 100 | Jersey | 5.30 |
| 50 | St. Clair | 7.27 | 101 | Hardin | 5.17 |
| 51 | Henry | 7.25 | 102 | DeWitt | 4.00 |

**Source: 1999 Illinois Property Tax Statistics**

reason for this difference is that Cahokia's school district collects a tax rate of 8.060, compared to Fairview Heights' school districts, which collect a total school rate of 4.294 or 4.447 (again, depending on the elementary school district of origin).

The previous example also shows how tax rates can vary, even within city limits. Another example of disparity within an individual town is the village of Hoffman Estates. Within this village are four different township districts with each township having its own tax rate. In addition, the village is split between four different elementary/unit school districts, two of which have an additional high school district. Because of these various taxing districts, the aggregate tax rates in the village range from 6.979 to 9.801. Again, much of the difference is due to the taxing rate of the school district.

These examples lead to one concern with property taxes; that is, the reliance on property taxes to fund education has created what some believe to be an inequitable system. A significant factor to this concern is that students who live in a school district with high property wealth typically have far greater resources available to them than those from the relatively property-poor districts. A Governor-appointed commission discussing the issue wrote, "Even when excluding the extremes, high property wealth school districts can raise between 12 and 15 times the property tax revenues per student of their property poor counterparts."

Without the local resources available to provide an adequate property tax base, property-poor districts have to impose higher tax rates to make up for lower property wealth. A study from the Metropolitan Planning Council confirmed this occurrence finding a strong and statistically significant negative correlation between the tax base and operating tax rates. The report states, "Higher tax rates are strongly associated with smaller tax bases, which means school districts with low property values must increase their tax rates to secure the necessary dollars to provide basic education services. Conversely, school districts with greater property wealth are more likely to have lower rates." This provides a reason for the disparities in the tax rates in the school districts mentioned earlier.

School districts struggling with small tax bases and high tax rates are seeing an alarming trend. Many families in poor districts are moving to schools that are able to provide what they believe is a better education with lower property taxes. As these families move, the school districts they leave are further harmed by the resulting loss of property taxes and children in their district. This has been a common occurrence in portions of the city of Chicago as families are leaving the city to move to a school within the city or out in the suburbs that they believe will provide a better education for their children. A similar pattern is taking place with families moving from older to newer suburban areas.

Not only does the disparity in the tax rates of school districts become an issue for funding local schools, but it also can impact economic development patterns as well. Areas that impose higher tax rates to fund education create a disincentive for future development in their community. Businesses looking to relocate do not want to pay for property taxes at high rates, so they look elsewhere. This entices businesses and residents to relocate into previously undeveloped areas, or developed property-wealthy districts with lower property tax bills. As a result, property-wealthy districts with low tax rates have a competitive advantage over property-poor districts in not only their ability to spend more on schools, but also in obtaining future economic development.

Those opposed to relying on property taxes to fund the majority of educational funding believe that the State should provide an increase in educational funding to make the system more equitable. They believe State funding would allow revenues to be redistributed to schools throughout the State in a manner that would improve school funding equity. In order to accomplish this, future State-spending increases may need to be accompanied by reforms to the current revenue structure. What exactly these reforms should be is an issue unto itself, which will be discussed later in the report.

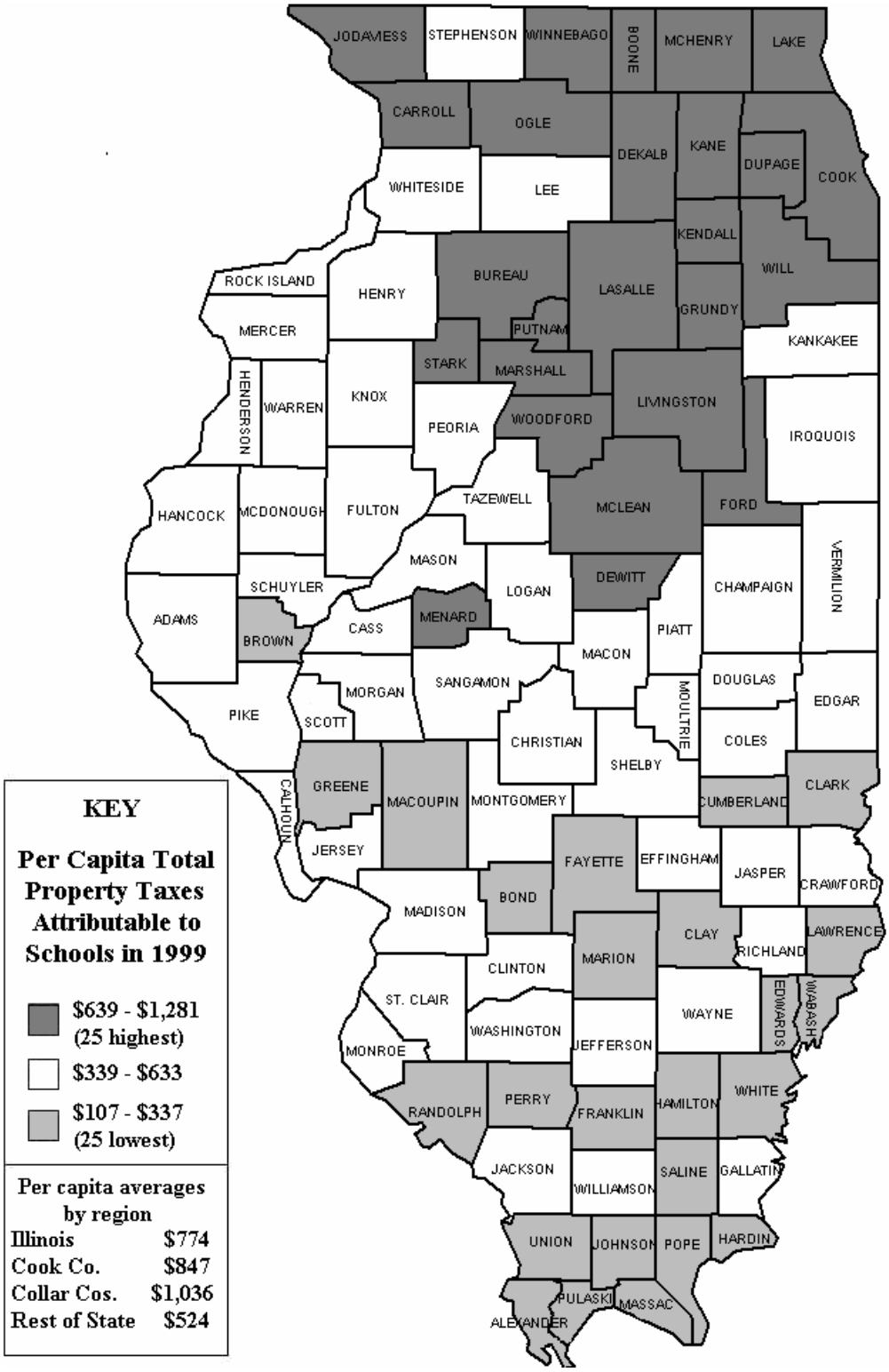
The State's share of public school funding has risen over the last several years. This is due to two primary reasons: increases in State education appropriations, and limits on local property taxes. During the 1990s, Property Tax Extension Limitation Laws (PTELL), or "tax caps" as they are commonly referred, were legislated for areas to hold down local property tax growth to 5% or the rate of inflation. These tax limitations keep the increase in local resources at a minimum, which subsequently raises the relative State share of total education funding. However, the effects that tax limitations and State education appropriation increases have had on State funding are not nearly enough in the eyes of property tax opponents.

*Per-Pupil Funding*

An educational funding system primarily based on local property taxes also creates a wide range of per-pupil spending levels. Property-wealthy school districts benefit from a rich property tax base, enabling them to spend at a high per-pupil level for education, while at the same time keeping a relatively low tax rate. Property-poor districts, which do not have the luxury of a rich property tax base, must raise their taxes to the point where they feel they are able to provide an adequate education and still keep their tax rates at a minimum. However, even with higher taxes, these poor districts many times have per-pupil levels that are well below the property-wealthy school districts.

An example of the educational per-pupil spending disparity can be seen in the Chicago area. According to information reported by the Metropolitan Planning Council, school district operating per-pupil expenditures in the Chicago region ranged from $4,517 to $13,366 in 1998. They also report that the average tax capacity per household in the six-county region surrounding Chicago in 1998 was $747. (*Tax capacity is defined as the amount of revenue a municipality could raise if it taxed each household at the*

**Chart 7: Per Capita Total Property Taxes Attributable to Schools in Tax Year 1999**




Source: Taxpayers' Federation of Illinois

**Table 3: Per Capita Total Property Taxes Attributable to Schools in Tax Year 1999**

| *Rank* | *County* | *$* | *Rank* | *County* | *$* |
|---|---|---|---|---|---|
| 1 | Grundy | $1,281 | 52 | Crawford | $441 |
| 2 | Lake | 1,206 | 53 | Montgomery | 440 |
| 3 | DeWitt | 1,173 | 54 | Effingham | 437 |
| 4 | DuPage | 1,125 | 55 | Shelby | 434 |
| 5 | McHenry | 1,018 | 56 | Schuyler | 432 |
| 6 | Ogle | 945 | 57 | Madison | 430 |
| 7 | Kendall | 919 | 58 | Mercer | 430 |
| 8 | JoDaviess | 863 | 59 | Calhoun | 428 |
| 9 | Cook | 847 | 60 | Pike | 427 |
| 10 | Will | 836 | 61 | Mason | 420 |
| 11 | Kane | 822 | 62 | Hancock | 419 |
| 12 | LaSalle | 759 | 63 | Knox | 418 |
| 13 | DeKalb | 748 | 64 | Vermilion | 410 |
| 14 | Woodford | 710 | 65 | Fulton | 390 |
| 15 | Winnebago | 707 | 66 | St. Clair | 390 |
| 16 | Putnam | 707 | 67 | Cass | 388 |
| 17 | McLean | 705 | 68 | Adams | 383 |
| 18 | Stark | 691 | 69 | Macon | 377 |
| 19 | Boone | 681 | 70 | Clinton | 376 |
| 20 | Livingston | 674 | 71 | Gallatin | 373 |
| 21 | Ford | 664 | 72 | Williamson | 361 |
| 22 | Marshall | 650 | 73 | Richland | 354 |
| 23 | Carroll | 646 | 74 | Jefferson | 352 |
| 24 | Bureau | 645 | 75 | Jackson | 343 |
| 25 | Menard | 639 | 76 | Jersey | 341 |
| 26 | Lee | 633 | 77 | Wayne | 339 |
| 27 | Piatt | 617 | 79 | Macoupin | 337 |
| 28 | Sangamon | 609 | 78 | Massac | 337 |
| 29 | Iroquois | 599 | 80 | Greene | 335 |
| 30 | Jasper | 589 | 81 | Randolph | 329 |
| 31 | Champaign | 580 | 82 | Edwards | 327 |
| 32 | Tazewell | 578 | 83 | White | 327 |
| 33 | Stephenson | 566 | 84 | Clark | 326 |
| 34 | Logan | 564 | 85 | Cumberland | 322 |
| 35 | Rock Island | 562 | 86 | Wabash | 318 |
| 36 | Douglas | 521 | 87 | Bond | 310 |
| 37 | Peoria | 520 | 88 | Hamilton | 309 |
| 38 | Kankakee | 519 | 89 | Brown | 300 |
| 39 | Monroe | 519 | 90 | Saline | 297 |
| 40 | Edgar | 511 | 91 | Perry | 295 |
| 41 | Moultrie | 507 | 92 | Marion | 281 |
| 42 | Henderson | 501 | 93 | Fayette | 276 |
| 43 | Whiteside | 499 | 94 | Clay | 264 |
| 44 | Warren | 482 | 95 | Union | 256 |
| 45 | Morgan | 477 | 96 | Johnson | 253 |
| 46 | Henry | 471 | 97 | Lawrence | 223 |
| 47 | Coles | 470 | 98 | Franklin | 220 |
| 48 | McDonough | 469 | 99 | Pope | 192 |
| 49 | Christian | 451 | 100 | Alexander | 184 |
| 50 | Scott | 447 | 101 | Pulaski | 135 |
| 51 | Washington | 445 | 102 | Hardin | 107 |

**Source: Taxpayers' Federation of Illinois**

*regional average property and sales tax rates, and is considered a good measure of a community's ability to pay for public services such as education*). They also reported that tax capacity per household rate inequities ranged in the Chicago area from $107 in Robbins to $6,954 in Oak Brook.

From a different perspective, local educational funding differences also can be seen by looking at the amount of local property taxes collected for schools on a per-capita basis. An illustration of this disparity can be seen from the map on page 12. As shown, in 1999, educational property tax per-capita figures ranged from $107 per capita in Hardin County to $1,281 per capita in Grundy County. This map helps illustrate that the highest per-capita tax collections occurred in the northern part of Illinois, while southern Illinois had much lower per-capita levels.

The Collar Counties (Lake, McHenry, DuPage, Kane, and Will) per-capita rate was $1,036, higher than Cook County at $847 per capita, and much higher than the rest of the State's per-capita rate of $524. The State average per-capita rate was $774. A significant part of the difference between the northern and southern areas is likely due to higher costs of living in northern Illinois. A list of all Illinois county per-capita rates is provided on page 13.

The information provided thus far emphasizes that large amounts of local revenue collected for education do not necessarily mean a district imposes a high tax rate. The Collar Counties have the highest per-capita rate for property taxes attributable to schools, yet their region has the lowest property tax rate. However, by living near areas of wealth that is able to provide low-taxed educational funding at a high per-capita rate, poor districts must then significantly increase their tax rates to levels where their educational spending approaches the spending of the neighboring wealthy districts. If the poor districts are not able to adequately fund education compared to their wealthy neighbors, they will risk losing families to other districts, thereby lowering their tax base, and making a bad situation even worse.

***The Inequities of State Educational Funding***

Few would argue the point that inequities in local school funding exist. However, just because the system provides disparities, does not mean that every district would be open to change. For example, why would a school district that is able to provide for their local schools with relatively low property tax rates want to alter the way schools are currently funded?

Districts that are self-sufficient point out that inequities in school funding do not necessarily always benefit the wealthy districts. This is especially true when analyzing how the State funds elementary and secondary education through the current general state aid formula. In order to understand these inequities, a basic understanding of the formula is necessary.

Illinois' general state aid formula is often considered complicated due to its various formulas and multiple variables, but its essence can be rooted in just two variables: the Equalized Assessed Value (EAV) of property within a school district, and the district's Average Daily Attendance (ADA). The EAV is the main contributor in determining a district's Available Local Resource (ALR) amount, while the ADA determines the number of students that will receive a calculated per-pupil amount. A brief description of all of the pertinent items and formulas that make up the general state aid formula are shown below.

| | |
|---|---|
| Gen. State Aid EAV | Equalized Assessed Value of property within a particular school district |
| Adjusted Real EAV | EAV after adjustments for Enterprise Zone, PTAB, etc. |
| ADA | Average Daily Attendance of a particular school district; or<br>the average of the attendance data for the 3 preceding school years, whichever is greater. |
| Low Income Count | Latest Census Low Income Count |
| CPPRT | Corporate Personal Property Replacement Taxes |
| Calculation Rate | Statutorily Defined Rates: Unit = .0300, Elem. = .0230, High School = .0105 |
| Limiting Rate | Rate calculated by County Clerk only for districts subject to Property Tax Extension Limitation Law |
| OTR | Operating Tax Rate |
| Foundation Level | Statutorily Defined Level: 2001-2002 School Year and thereafter = $4,560 |
| ELR | Extension Limitation Ratio: $\frac{\text{(Latest Original EAV x Latest Limiting Rate)}}{\text{(Prior Year Original EAV x Prior Year OTR)}}$ |
| ALR | Available Local Resources:<br>if Adj. Real EAV is less than Prior Year Gen. State Aid EAV x ELR, or<br>if the ELR = NA, then:<br>ALR = (Adjusted Real EAV / Calc. Rate) + CPPRT)<br>else:<br>ALR = (General State Aid EAV x ELR / Calc. Rate) + CPPRT) |

These variables decide which of three formulas are used to calculate the amount of aid for a particular school district. The three formulas are the foundation formula, the alternate formula, and the flat grant formula.

*Foundation Formula*

The most common formula, called the foundation formula, was used for 757 of the 960 school districts in determining the amount of aid entitled to districts for the 2002-2003 school year. To be eligible for this particular method, a district's Available Local Resources (ALR) per Average Daily Attendance (ADA) percentage of the foundation level must be less than 93%. This formula then calculates a school district's gross General State Aid (GSA) entitlement by subtracting the ALR from the product of the Foundation Level and the ADA.

For example, School District A has an ADA level of 15,000 and an ALR amount of $45.0 million. As a result, the ALR per ADA figure is $3,000. This amount makes up 65.8% of the statutorily defined foundation level of $4,560. Because this percentage is less than 93%, the foundation formula is utilized. The ALR amount of $45.0 million is then subtracted from $68.4 million (the product of the Foundation Level and an ADA of 15,000) resulting in a Gross GSA entitlement of $23.4 million.

*Alternate Formula*

If the ALR per ADA percentage of the foundation level is greater than 93% but less than 175%, then the Alternate Formula is used. This alternative method was used for 160 of the 960 school districts in determining the amount of aid entitled to districts for the 2002-2003 school year. It is intended for those districts not quite wealthy enough to qualify for a flat grant, which will be discussed next. Under this linear method, the calculated GSA per ADA declines in direct linear fashion from 0.07 times the Foundation Level, for a school district with ALR equal to the product of 0.93 times the Foundation Level, to 0.05 times the Foundation Level, for a school district of 1.75 times the Foundation Level. This amount is then multiplied by the ADA, resulting in the gross GSA entitlement.

For example, School District B is calculated to have a percentage of foundation level of .99 or 99%. This falls between 93% and 175%, so the alternative method is used. The minimum percentage of .93 is then subtracted from District B's percentage of .99 for a value of .06. This number is then divided by .82 and then multiplied by .02 for a value of .0015. This value is then subtracted from .07 and then multiplied by the foundation level of $4,560 to come up with the amount per ADA, which is $313. Finally, this number is multiplied by School District B's ADA of 1,000 students, resulting in a gross GSA entitlement of $313,000.

*Flat Grant Formula*

School districts that are considered comparatively wealthy (have a percentage of foundation level greater than 175%), utilize the flat grant formula. This method was used for 43 of the 960 school districts in determining the amount of aid entitled to them for the 2002-2003 school year. This formula simply gives school districts a flat grant rate of $218 times the ADA. Therefore, if School District C has an ALR per ADA level of, say, $8,500, which is 186% of the foundation level, they must use the flat grant formula because their percentage of foundation level is greater than 175%. As a result, School District C's ADA value of 2,000 is multiplied by the flat grant rate of $218, resulting in a gross GSA entitlement of $436,000.

The three different general state aid formulas are set up to distribute more aid to the poor districts, while only giving the wealthy districts a minimum amount per pupil. This system gives poor districts a crucial amount of funds without which they could not survive. The idea of helping the poor districts is not necessarily the issue that concerns the districts that prefer local funding, it is the reality that tax dollars generated in one area are taken away from its place of origin and redistributed elsewhere.

To understand this more clearly, compare a rich district like Hinsdale Township H.S. District 86 in DuPage County with a poor district like East St. Louis School District 189 in St Clair County. Hinsdale, one of the richest districts in Illinois, has a large amount of available local resources for funding education so they qualify for the Flat Grant formula. As a result, they receive the minimum amount of $218 per pupil. On the other hand, East St. Louis, a district with approximately 96% of its students considered as low-income students, is one of the poorest districts in the State. The small amount of local resources they receive qualifies them for the foundation formula. This foundation formula allows them to receive approximately $3,988 per pupil from the State for the 2002-2003 school year. This is $3,770 more per student than rich districts like Hinsdale will receive.

*The Poverty Grant*

The three formulas previously discussed are not the only ways that State aid can be distributed to districts. The General State Aid Formula also enables itself to supplement additional aid to school districts that need further help that the base portion of the formula does not provide. This additional aid comes through two formats: the poverty grant and the hold harmless aid.

The poverty grant gives school districts with low-income students additional aid to provide for their district. It is calculated by dividing the district's latest census low-income count by the school district's ADA. The resulting amount, called the Low Income Concentration (LIC), is used in the following formula to determine the amount of poverty grant that a district will receive.

| Parameter | Poverty Grant per Low-Income Student |
|---|---|
| If LIC < 10% then | $355 |
| If 10% < = LIC < = 20% then | $675 |
| If 20% < = LIC < = 35% then | $1,330 |
| If 35% < = LIC < = 50% then | $1,362 |
| If 50% < = LIC < = 60% then | $1,680 |
| If LIC < = 60% then | $2,080 |

Because of East St. Louis's high low-income concentration level of 96%, they are set to receive a poverty grant amount of $2,080 per low-income student for the 2002-2003 school year. This equates to an additional $18 million in State aid for the East St. Louis school district. In comparison, Hinsdale with a low-income concentration level of only 2%, will only receive $24,140 in additional aid.

*Hold Harmless Aid*

The other method of supplemental assistance comes through the hold harmless portion of the General State Aid (GSA) formula. This provision assures that no school district will receive less GSA than it did in FY 1998. The hold harmless provision began during the 1996-1997 school year to help school districts that were losing GSA funding due to changes in the GSA formula. For the 2002-2003 school year, East St. Louis did not qualify for hold harmless funding, but Hinsdale is set to receive an additional $56,057 in State funds.

By looking at the total State aid entitled to these two districts for the 2002-2003 school year, the differences in the distributive amounts becomes even more pronounced. Total aid for the East St. Louis school district (aid from base formula, poverty grant, and held harmless aid) is $55 million, which equates to $6,008 per pupil. Compare this to the total State aid per pupil amount of $239 that Hinsdale is granted, and the large disparity in State school funding levels can easily be seen.

Provided on page 20 is a map of the average General State Aid per pupil by county. The map illustrates that the southern region of Illinois, generally, receives more State aid per pupil than the rest of the State. On a statewide basis, Illinois students received $1,708 in total State aid on average. The Collar Counties were entitled the smallest amount of aid by region at $1,019 per pupil, while Cook County was entitled $1,596 per pupil. The rest of the State on average was entitled a much higher amount of aid at $2,342 per pupil. A list of the amount of GSA per county is provided on page 21.

The inequities in school funding from a State funding standpoint is that wealthy districts are, in effect, penalized for being able to provide financial support to their districts. They create more revenue for their school districts, which causes them to receive very little State financial support. Wealthy districts bring in significant tax dollars for their local governments, as well as creating significant revenues for the State. As a result, the taxes they pay are supporting not only their local schools, but also schools throughout Illinois.

Wealthy districts feel that an increasing reliance on State taxes would make the system even less fair to them, because they would get back only pennies out of every dollar sent to the State. But this is only part of the reason that these districts are generally against the concept of increasing the role of the State in funding education. Although there are redistribution concerns with a property tax swap, it is not likely that any credible property tax swap proposal would allow a school district to function on less money than they are used to receiving on an annual basis to fund their schools. The major concern that they have with property tax reductions is that decreasing the role of local governments would undermine local control and accountability.

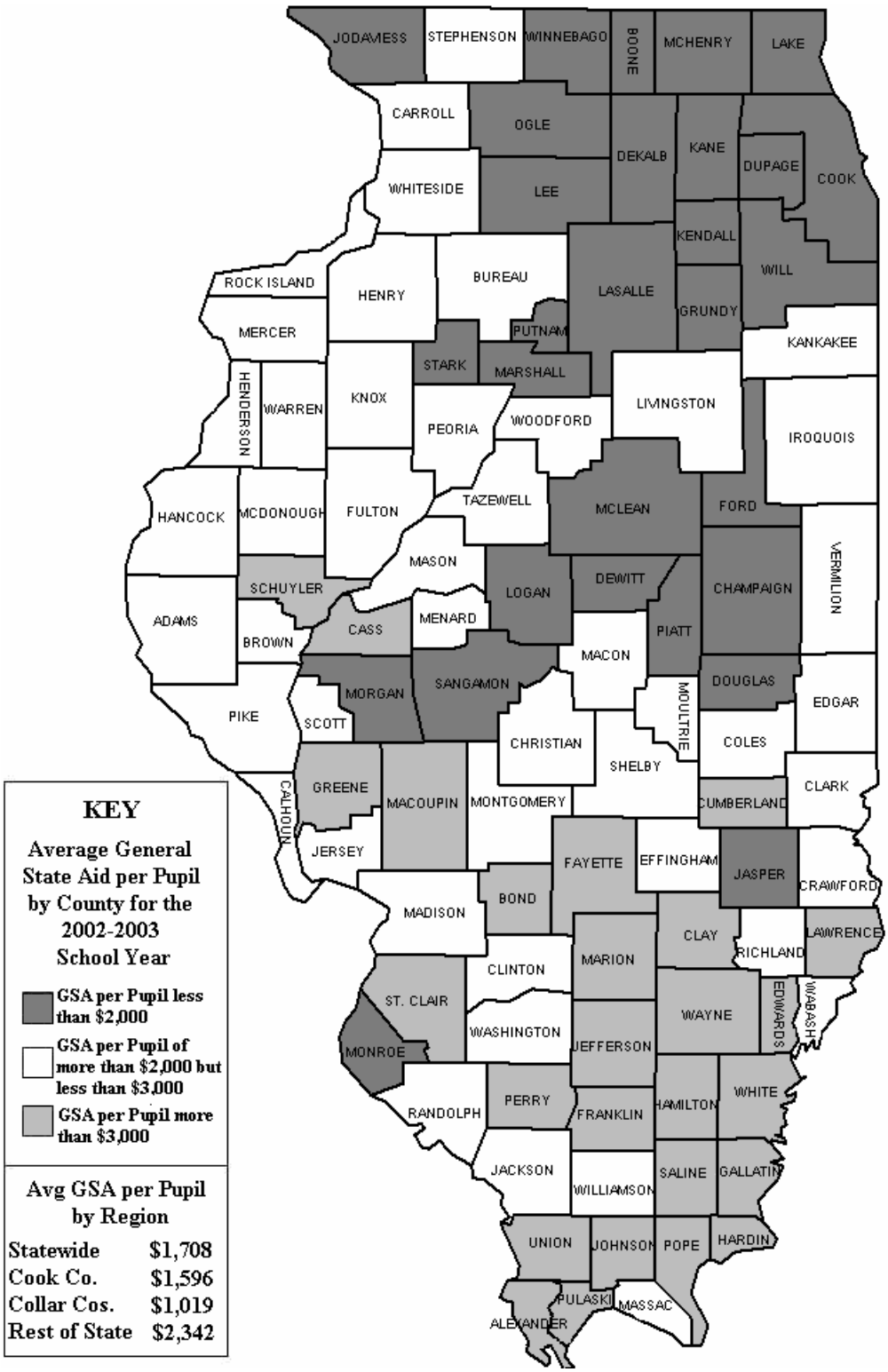
**2002-2003 General State Aid Entitlement Statistics**

| | |
|---|---|
| GSA Formula: | $2,735,550,155 |
| Poverty Grant: | $388,216,297 |
| Hold Harmless Aid: | $64,158,199 |
| **TOTAL*:** | **$3,187,924,651** |

*Prior Year adjustments and other supplemental grants are not included in the above figures.

## Chart 8: Average Total General State Aid per Pupil on a County Basis

***2002-2003 General State Aid Entitlement Statistics***



## Table 4: Average Total General State Aid per Pupil on a County Basis

**2002-2003 General State Aid Entitlement Statistics**

| *County* | *GSA Amt. (in millions)* | *Applied ADA* | *GSA per Pupil* | *County* | *GSA Amt. (in millions)* | *Applied ADA* | *GSA per Pupil* |
|---|---|---|---|---|---|---|---|
| DuPage | $72.211 | 147,105 | $491 | Jersey | $7.284 | 2,879 | $2,530 |
| Grundy | $4.880 | 8,186 | $596 | Henderson | $2.781 | 1,098 | $2,533 |
| DeWitt | $1.808 | 2,901 | $623 | Edgar | $8.468 | 3,295 | $2,570 |
| Putnam | $0.591 | 922 | $641 | Fulton | $14.001 | 5,433 | $2,577 |
| Piatt | $3.122 | 3,190 | $979 | Christian | $12.914 | 5,009 | $2,578 |
| Lake | $118.480 | 119,546 | $991 | Effingham | $16.056 | 6,174 | $2,601 |
| McHenry | $43.030 | 42,942 | $1,002 | Henry | $22.966 | 8,813 | $2,606 |
| McLean | $31.341 | 22,592 | $1,387 | Brown | $1.968 | 751 | $2,621 |
| Will | $112.290 | 79,873 | $1,406 | Randolph | $11.412 | 4,353 | $2,622 |
| DeKalb | $20.843 | 14,393 | $1,448 | Macon | $42.971 | 16,372 | $2,625 |
| Kendall | $16.587 | 11,032 | $1,504 | Montgomery | $12.796 | 4,783 | $2,675 |
| JoDaviess | $4.905 | 3,244 | $1,512 | Massac | $5.993 | 2,235 | $2,681 |
| Kane | $148.936 | 96,169 | $1,549 | Shelby | $10.388 | 3,828 | $2,714 |
| Jasper | $2.521 | 1,623 | $1,553 | Clinton | $14.470 | 5,237 | $2,763 |
| Cook | $1,170.216 | 732,993 | $1,596 | Warren | $7.981 | 2,845 | $2,805 |
| Ogle | $15.944 | 9,781 | $1,630 | Jackson | $20.362 | 7,237 | $2,814 |
| Sangamon | $44.709 | 26,121 | $1,712 | Calhoun | $1.888 | 670 | $2,818 |
| Champaign | $38.359 | 21,975 | $1,746 | Richland | $7.107 | 2,495 | $2,848 |
| Monroe | $7.748 | 4,397 | $1,762 | Scott | $2.725 | 954 | $2,856 |
| LaSalle | $28.821 | 16,141 | $1,786 | Hancock | $10.450 | 3,647 | $2,865 |
| Winnebago | $71.540 | 39,835 | $1,796 | Wabash | $5.664 | 1,950 | $2,905 |
| Logan | $6.471 | 3,585 | $1,805 | Williamson | $26.321 | 8,825 | $2,983 |
| Morgan | $9.284 | 5,131 | $1,809 | Pike | $8.404 | 2,817 | $2,983 |
| Douglas | $5.184 | 2,865 | $1,809 | Clark | $8.942 | 2,994 | $2,987 |
| Boone | $13.623 | 7,473 | $1,823 | Vermilion | $39.392 | 13,142 | $2,997 |
| Lee | $9.369 | 5,124 | $1,828 | Greene | $6.954 | 2,310 | $3,010 |
| Marshall | $2.853 | 1,516 | $1,882 | Bond | $6.873 | 2,251 | $3,053 |
| Ford | $4.447 | 2,272 | $1,957 | Edwards | $3.067 | 998 | $3,073 |
| Stark | $2.195 | 1,120 | $1,960 | Gallatin | $2.948 | 945 | $3,120 |
| Livingston | $14.008 | 6,915 | $2,026 | Jefferson | $19.110 | 6,109 | $3,128 |
| Tazewell | $37.816 | 18,624 | $2,030 | Cumberland | $6.080 | 1,942 | $3,131 |
| Woodford | $14.666 | 7,155 | $2,050 | Johnson | $5.260 | 1,679 | $3,133 |
| Rock Island | $48.432 | 22,601 | $2,143 | Cass | $6.511 | 2,061 | $3,159 |
| Moultrie | $4.281 | 1,977 | $2,165 | Schuyler | $3.363 | 1,055 | $3,188 |
| Peoria | $57.466 | 26,356 | $2,180 | Macoupin | $29.074 | 9,006 | $3,228 |
| Carroll | $6.375 | 2,882 | $2,212 | Perry | $9.478 | 2,904 | $3,264 |
| Coles | $14.671 | 6,541 | $2,243 | Wayne | $8.924 | 2,702 | $3,303 |
| Whiteside | $21.847 | 9,648 | $2,264 | Fayette | $9.672 | 2,893 | $3,343 |
| Bureau | $12.964 | 5,647 | $2,296 | Marion | $24.934 | 7,382 | $3,378 |
| Adams | $20.618 | 8,959 | $2,301 | White | $8.490 | 2,507 | $3,387 |
| Menard | $5.957 | 2,559 | $2,328 | Clay | $8.313 | 2,438 | $3,410 |
| McDonough | $8.704 | 3,736 | $2,330 | St. Clair | $144.325 | 41,984 | $3,438 |
| Crawford | $7.650 | 3,271 | $2,339 | Union | $11.273 | 3,233 | $3,487 |
| Madison | $93.409 | 39,861 | $2,343 | Pope | $2.097 | 583 | $3,597 |
| Iroquois | $11.887 | 5,000 | $2,377 | Hamilton | $4.638 | 1,288 | $3,601 |
| Mercer | $3.767 | 1,566 | $2,405 | Saline | $14.467 | 3,969 | $3,645 |
| Kankakee | $40.820 | 16,804 | $2,429 | Lawrence | $8.684 | 2,264 | $3,836 |
| Stephenson | $17.539 | 7,217 | $2,430 | Franklin | $24.176 | 6,184 | $3,909 |
| Mason | $8.027 | 3,275 | $2,451 | Alexander | $6.361 | 1,429 | $4,451 |
| Washington | $5.356 | 2,174 | $2,464 | Hardin | $2.884 | 622 | $4,637 |
| Knox | $18.610 | 7,493 | $2,484 | Pulaski | $5.867 | 1,253 | $4,682 |
| | | | | Other Districts* | $11.533 | 2,560 | $4,505 |
| | | | | **Grand Total:** | **$3,206.238** | **1,876,693** | **$1,708** |

*** Other Districts include regional offices of education (ROE) and districts encompassing multiple counties.**

## ***Local Control Issues***

According to the Heartland Institute, studies conducted in other states show that when local control is weakened, student achievement suffers. A February 2000 article reports,

> *"national studies…indicate that when the state assumes responsibility for school finance, average test scores go down. Centralizing funding does not raise the average score for the low-income places. If you look at the statewide figures, you find that the averages have gone down for the states that have centralized school finance—averages on SAT scores, on NAEP scores, and on Armed Forces Qualification tests."*

Without local control, those opposed to increasing the State's portion of funding education claim that citizens have less reason to closely monitor local school spending if the school is spending "someone else's money". In contrast, pressure from voters and taxpayers ensures that they are held accountable for how locally-raised funds are spent. They also feel that local officials are more likely to have knowledge of a community's specific needs, opportunities, resources, and choices, and, therefore, are able to determine the best price to pay for high-quality schools in their area. They believe that a "one cost fits all" foundation level by the State would mean losing much of this information, resulting in inefficiencies, unfilled needs, and waste.

Opponents to a larger State role also fear that moving away from local funding and local control will give rise to a welfare mentality among those districts receiving State subsidies. Their argument is that dependency on State funding reduces the willingness of local government officials and taxpayers to invest in, or to supervise, their own schools. These are possible reasons why the studies reported by the Heartland Institute have shown student achievement to suffer when local control is weakened.

Another argument for keeping the current local control status is that local property tax funding creates an incentive for a district's residents to monitor the local public schools and see that a good education is being provided. This is because homeowners in districts with successful schools are rewarded with rising property values, whereas residents in districts with unsuccessful schools often experience falling property values. Those against a larger State role in education funding believe that this incentive causes school personnel to strive to provide high quality and efficient schools. This concept creates a competition between school districts to provide the best education possible, or risk losing students, as well as tax dollars, to better-performing districts.

Equalization proponents argue that it is unfair for wealthy districts to generate revenue for education with lower property tax rates because it forces poor districts to set a higher tax rate to generate a comparable amount of funds. However, wealthy districts contend that even though their property tax rates are lower, higher home values require them to pay a large amount of property taxes, and subsequently, higher mortgage payments. Districts with high property tax rates may be paying a relatively high amount of property taxes, but their lower home values yield lower mortgage payments. Therefore, those advocating a heavily local funded system believe that the property market may offset the benefits of the wealthy district. The extent of this offset remains a subject of debate.

## ***Report of the Governor's Commission on Property Tax Reform***

The issue of increasing the State's role in financing education has been discussed for several years. In fact, in January of 1998, Governor Edgar formed a commission to take a hard look at the pros and cons of decreasing the local property tax and replacing it with a State funded revenue source. The commission discussed several different ways in which a property tax swap might be accomplished. In doing so, implementation obstacles were realized that go beyond the general arguments for and against a property tax swap that have been discussed so far. The following section summarizes the commission's findings and discusses the problems that would hinder a property tax reduction proposal from becoming a reality.

When Governor Jim Edgar established the Governor's Commission on Property Tax Reform, he asked them to identify problems with the State and local tax structure and recommend potential solutions to those problems. Specifically, he charged its members to: ". ..examine options on local property tax reform and to submit recommendations on how to achieve reform, including the possibility of a tax swap."

The early commission meetings focused on information gathering and included the Department of Revenue, the Bureau of the Budget, the State Board of Education, the Cook County Assessor's Office, and the University of Illinois. Utilizing the data gathered at these meetings, the commission developed and investigated several taxing models. Following this initial step, the commission divided into working groups aimed at determining the framework for implementing a tax change. In response, the commission sought to focus its attention on models capable of providing roughly $2.0 - $2.5 billion in property tax relief, delivering relief through a swap of elementary and secondary education property taxes, and paying for the swap primarily through an increase in individual and corporate income taxes.

Given this framework, the commission examined three hypothetical models that met the criteria outlined by the working groups. These models included Option A, Option B, and Revised Option A. These models are described in the following paragraphs.

*Option A*

Option A would have provided $2.425 billion in property tax relief, which was to have been delivered by having the State pay the first $1.50 of each unit district's education fund tax rate and the first $0.75 for each elementary and high school district's education fund tax rate. It would have generated a subsequent amount of additional revenue. The revenue growth would have been achieved by increasing the individual income tax rate from 3.0 to 3.6 percent and increasing the corporate income tax from 4.8 to 5.76 percent ($1.643 billion), using existing revenue and growth ($400 million), and generating additional revenue from other sources ($383 million).

Although Option A met the specified criteria, the commission objected to the gap that emerged between taxes paid and relief received by the different classes of property taxpayers. Under this option, individuals and farms would have received net tax relief of $80 million, while corporations would have received net tax relief of $703 million. This discrepancy was primarily the result of three factors: (1) the amount of property taxes paid by corporations relative to the amount of income taxes paid; (2) Cook County's classification system that shifts a larger property tax burden onto commercial and industrial property taxpayers; and (3) the constitutional limitation on the corporate income tax (no more than an 8 to 5 ratio above the individual rate) that limits the amount of money that can be raised through the corporate tax.

*Option B*

Option B was offered as a means of addressing the concern over the discrepancy between individuals and businesses. This model eliminated corporations from the income tax increase and limited the property tax relief to residential and farm properties. Specifically, the model proposed $1.792 billion in property tax relief, which was to be achieved by requiring the State to pay the first $1.80 of the education fund rate for residential and farm property only. This proposal would have increased revenue by approximately $1.792 billion. This growth would have resulted from an increase in the individual income tax from 3.0 to 3.6 percent ($1.415 billion) and the use of existing revenue and growth ($377 million).

Despite the intent of both proposals, each yielded “losers” given a property tax/income tax swap. Used in this context, “losers” were defined as areas within the State in which taxpayers would pay more in increased income taxes than they received in property tax relief. For example, the city of Chicago stood to lose under the provisions of each model. Under Option A, individual income taxpayers in Chicago would have paid $112.8 million more in income taxes than they received back in property tax relief. Under Option B, Chicago individual income taxpayers stood to lose $80.3 million, primarily as a result of the large number of residents living in rental properties. Although downstate taxpayers were shown as collective winners in both options, there were pockets of areas across downstate that would have lost given a tax swap. As a result, the commission sought a third option.

*Revised Option A*

In an attempt to address the discrepancies in tax relief associated with Option A, the Cook County Assessor's Tax Policy Forum zeroed in on Cook County and devised Revised Option A. This option would have yielded $2.164 billion in property tax relief. To do so, it would have generated a similar amount of new revenue. This growth would have been generated by increasing the individual income tax from 3.0 to 3.6 percent and increasing the corporate income tax from 4.8 to 5.76 percent ($1.643 billion), using existing revenue and growth ($400 million), and generating additional revenue from other sources ($121 million).

In order to achieve these goals, Revised Option A relied on four primary components. First, the local assessments for each class of property would have been adjusted from their actual levels to reach the ordinance levels. Second, because the assessment levels for all classes of property would increase, the multiplier for Cook County would decrease from 2.15 to approximately 1.54. Third, businesses' new multiplier would result in a lower equalized assessed value (EAV), thereby resulting in lower property taxes. Fourth, the increased assessment and revised multiplier associated with residential property taxpayers would result in higher property taxes, so that was offset by the creation of a new flat homestead exemption of $15,000 per property. These changes sought to shrink the discrepancy in net tax relief in Cook County and thereby reduce that discrepancy statewide.

*Findings*

Although the commission sought to develop a simple, straightforward tax swap proposal, none of the proposals adequately addressed the principles the commission set forth. During the extensive deliberations, unrelated tax issues were continuously faced because of several significant challenges associated with Illinois' tax structure. Therefore, the Governor's Commission on Property Tax Reform agreed that the charge of developing a simple "tax swap" proposal that is fair and equitable to all taxpayers was not possible until certain state and local tax policy issues were addressed.

Most importantly, each of the models studied exhibited an imbalance between current tax payments and potential reductions for businesses and individuals, amplified by the classification of property in Cook County. As the models pointed out, an overall tax swap addressing all classes of taxpayers in the State results in disparities of benefit between those classes. Businesses pay approximately half of all property taxes in the State, but produce less than one-fifth of revenue through the corporate income tax. This notion is amplified in Cook County where commercial and industrial properties pay a tax on a higher percentage of value than homesteads. Since businesses pay more than half of the property taxes in Illinois, a straight income-property tax swap would allow businesses to receive half of the relief while contributing much less in new income tax revenue.

Furthermore, the classification of property in Cook County presented other problems. The interaction between classification and State equalization has magnified the differences among different types of taxpayers in Cook County and has created differing tax burdens between Cook County businesses and their counterparts in the surrounding counties. The most difficult issue associated with property tax reform relates to the concurrent problems of classification in Cook County and the Illinois Department of Revenue's multiplier, which is derived from its sales ratio studies, on those assessments.

In addition, the commission identified five less obvious factors that would hinder the transition associated with an income for property tax swap. These factors included the

following: (1) the lack of a reliable mechanism capable of guaranteeing that property taxes would not increase over time following a property tax reduction; (2) the fact that geographic balance of property tax relief and new revenue sources was unlikely; (3) the notion that education funding reform that helps produce a more balanced model throughout different regions of the State is absent in a straight swap; (4) a proliferation of local taxing authorities in Illinois has led to higher property taxes and makes it more difficult to control local government spending and thus local property tax collections; and (5) the lack of public pressure for reform. As a result, the commission chose to release their findings without endorsing any single tax swapping plan.

## ***Recommendations of the Education Funding Advisory Board***

In August of 2002, the Education Funding Advisory Board released a preliminary report entitled, "Recommendations for Systemic Reform of Funding for Elementary and Secondary Education in Illinois." The report contained several recommended changes to Illinois' education system, which included topics such as minimum enrollment levels, increased consolidations, and transportation issues. However, the major change recommended by the Board was a reduction in local property taxes coupled with a higher State income tax and broader State sales tax, along with an increase in the foundation formula.

The Education Funding Advisory Board contends that changes in the property tax system are necessary to "result in a fairer, more equitable structure that promotes affordable housing, creates an attractive tax climate for new jobs, and ensures a high standard of educational opportunities." To assist in accomplishing this goal, the Board had several recommendations. The first was to conduct a Cook County Classification Study to find alternatives that would minimize or eliminate the negative impacts of classification while observing the unique nature of Cook County's properties and property distribution.

The Advisory Board also recommended that property taxes for education purposes in Illinois should be reduced between 25% and 50%. This would imply property tax reductions between $2.3 and $4.6 billion. The Board reported that this should be accomplished through a tax abatement program with abated revenues provided by the State. The following is their suggestions to how the program would work:

- *Based on increased revenues described below, each year the General Assembly would appropriate funds for a School District Property Tax Relief Grant.*

- *In December of each year, the Department of Revenue would calculate the amount of property tax abatement for each school district. The amount of the abatement for each district would be in the same proportion as the district percentage of Education fund revenues calculated as the product of the district EAV for the preceding year multiplied by the 2000 Education fund tax rate. The tax rate used in the calculation would remain constant through time.*

    - *Education fund revenues statewide totaled $6.1 Billion for the 2000 tax year. If, for example, the statewide tax relief grant were $4.6 Billion, and an individual district had 2000 Education fund revenues of $20,000,000 that district would receive .328% ($20,000,000 divided by $6.1 Billion) of the $4.6 Billion statewide grant. The tax relief for that district would be $15.09 Million.*

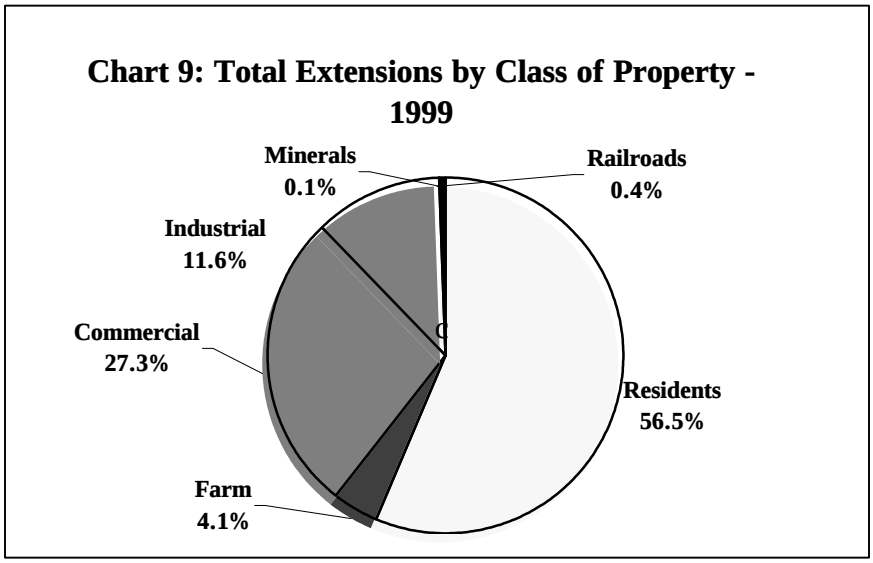
- *Mechanically, the abatement would be implemented as follows. The Department of Revenue would calculate and send the State grant proceeds to the county or counties, based on the percentage of EAV in each county, designated for the individual district. This would be transparent to the district, which would continue to file its levy in December of each year. The county clerk(s) upon receipt of the education fund levy, would calculate the tax rate of the district for education purposes subject to all legal restrictions (authorized authority, PTELL, etc.) that exist. Once the Education fund extension was determined, that amount would be reduced by the amount of the State grant. Education fund rates would be recalculated to a lower level, given the reduced extension, and tax bills distributed.*

To fund these changes, the Board recommended that the State income tax should be increased. They reported that raising the individual income tax rate from 3% to 4%, with a corresponding increase in the corporate income tax, would generate approximately $2.8 billion in additional revenues. They also suggested closing tax loopholes and removing special incentives and exclusions and graduating personal exemptions, based on adjusted gross income. In addition, they believe further revenues should be raised from the sales tax by broadening the sales tax base, and from gaming revenues by increasing its taxes.

Another recommendation of the Education Funding Advisory Board is to increase the General State Aid formula foundation level to a range of $5,665 to $6,680 per pupil, up from the current level of $4,560. Increasing the foundation level would cost the State an additional $1.8 billion, to $3.6 billion, depending on the level of choice. As stated in their report, "Given the ranges of property tax relief and increased General State Aid foundation level described above, the total increase in State revenues would range between $4.1 Billion and $8.2 Billion."

## ***Other Related Issues***

Even though several legislative sessions have been completed since the time of the Governor's Commission on Property Tax Reform report, the factors that were discussed that would hinder the transition associated with an income for property tax swap still exist. The latest property tax statistics show that residential property made up 56.5% of total property tax extensions in tax year 1999, followed by commercial property at 27.3%, industrial property at 11.6%, and farm property at 4.1%. A chart showing this breakout is provided below.




In addition, the latest income tax totals show that corporations (s-corporations not included) paid just 18.2% of total income tax revenues in FY 2002 (individual income tax, corporate income tax, and corporate replacement tax). Individuals paid the majority at 81.8%. Because individuals pay nearly 82% of the income taxes, but only 56.5% of property taxes, most property tax swap proposals that increase income taxes and lower property taxes would greatly benefit the business sector.

Another factor that may hinder the idea of using the income taxes as a revenue source during a swap is the fact that the income tax has been a volatile source as of late. Corporate income tax net revenues declined 35% between FY 2000 and FY 2002. The individual income tax just experienced a 6.6% decline in net revenue in FY 2002. As the economy struggles, so do these revenue sources. Any tax swap proposal that relied on the income tax to fund education must factor in that these sources are much more volatile than the stable property tax.

The sources most discussed in a tax swap are the individual and corporate income taxes and the sales tax. The two tables on page 30 are provided as useful tools in calculating the amount of increased revenue and its corresponding increased tax rate to its

respective revenue source. The first table shows how much net revenue can be generated by increasing a tax source by a certain percentage point. The second table shows how much a tax source's tax rate would have to increase to generate a specified amount of net revenue. The figures in both tables are based on the IEFC's July '02 FY 2003 estimates. All figures are based on individual tax swaps, not a combination of sources.

**Table 5: Additional Net Revenue Generated by Increasing Tax Rates by a Specified Amount**

| *Tax Rate Increase* | *Resulting Individual Income Tax Rate* | *Additional Ind. Income Tax Net Revenue Generated ($ mil)* | *Resulting Corporate Income Tax Rate* | *Additional Corp. Income Tax Net Revenue Generated ($ mil)* | *Resulting Sales Income Tax Rate* | *Additional Sales Tax Revenue Generated ($ mil)* |
|---|---|---|---|---|---|---|
| **0.0% (Current Rate)** | 3.00% | $0 | 4.80% | $0 | 5.00% | $0 |
| **0.5%** | 3.50% | $1,289 | 5.30% | $86 | 5.50% | $637 |
| **1.0%** | 4.00% | $2,578 | 5.80% | $171 | 6.00% | $1,273 |
| **1.5%** | 4.50% | $3,866 | 6.30% | $257 | 6.50% | $1,910 |
| **2.0%** | 5.00% | $5,155 | 6.80% | $342 | 7.00% | $2,546 |
| **2.5%** | 5.50% | $6,444 | 7.30% | $428 | 7.50% | $3,183 |
| **3.0%** | 6.00% | $7,733 | 7.80% | $514 | 8.00% | $3,819 |

***Note: All increases are based on individual tax swaps, not a combination of sources. Figures are based on IEFC July '02 FY03 estimates, and include current income tax refund percentages of 8% for individual and 27% for corporate.***

**Table 6: Tax Rate Needed to Obtain a Desired Amount of Net Revenue**

| **Additional Net Revenue Needed (in billions)** | ***Resulting Individual Income Tax Rate*** | ***Resulting Corporate Income Tax Rate*** | ***Resulting Sales Income Tax Rate*** |
|---|---|---|---|
| **$0.0 (Current Rate)** | 3.00% | 4.80% | 5.00% |
| **$1.0** | 3.39% | 10.64% | 5.79% |
| **$2.0** | 3.78% | 16.48% | 6.57% |
| **$3.0** | 4.16% | 22.32% | 7.36% |
| **$4.0** | 4.55% | 28.16% | 8.14% |
| **$5.0** | 4.94% | 34.00% | 8.93% |
| **$6.0** | 5.33% | 39.84% | 9.71% |
| **$7.0** | 5.72% | 45.68% | 10.50% |
| **$8.0** | 6.10% | 51.52% | 11.28% |
| **$9.0** | 6.49% | 57.36% | 12.07% |
| **$10.0** | 6.88% | 63.20% | 12.86% |

***Note: All tax rates are based on individual tax swaps, not a combination of sources. Resulting tax rates are based on IEFC July '02 FY 2003 estimates, and include current income tax refund percentages of 8% for individual and 27% for corporate.***

Over the last several years, a handful of legislative bills have been introduced that create a property tax swap, but all have failed rather quickly. The latest legislation (HB 3331) increased the individual income tax rate to 3.75%, while providing a property tax

abatement in an amount determined by an allocation factor associated with a taxpayer's equalized assessed valuation. The bill also proposed an individual income tax deduction equal to 15% of the total amount of rent paid. It also included an education property tax relief fund. The bill, however, did not make it out of committee.

As mentioned, included in this legislation was a tax deduction for renters. Some legislators are adamant that some type of tax break must be given to renters if property tax reductions are to take place. The fear is that owners of rental property would have their property taxes dramatically lowered, but would not pass this savings on to their renters. A renter tax break, like the one previously discussed, would ensure that renters would also benefit from a property tax reduction. This type of tax break would be especially beneficial for the residents of the city of Chicago where there is a large rental property market.

## ***What Other States Have Done***

Illinois is not the only state to address the concern of relying on the property tax to fund schools. Several states have recently passed legislation to change the way education is funded. These states included two in the Midwest, Michigan and Indiana. These changes are summarized in the following sections.

### *Michigan*

In the early 1990s, Michigan was among the nation's top five states for average property tax paid. Given this fact and the state's climate for education funding reform, the Michigan legislature eliminated local school property taxes in July 1993. This change reduced annual funding for Michigan's public schools by nearly $7 billion beginning in the 1994-1995 school year. As a result of this decrease, the legislature began examining a means of replacing this revenue. This examination culminated six months later with the legislature's passage of legislation permitting Michigan's voters to choose between two revenue proposals—(1) Proposal A and (2) the Statutory Plan—that reduced reliance on local property taxes.

The legislature placed Proposal A on the ballot for a March 1994 vote and provided that should Proposal A fail, the Statutory Plan would take effect. Proposal A increased the state sales tax from 4.0% to 6.0%, limited future assessment level increases, and allowed different classes of property to be taxed at different rates for school operating purposes. In addition, the approval of Proposal A would trigger a package of related tax changes, including a state education property tax for school operations and an income tax decrease from 4.6% to 4.4%. In contrast, the Statutory Plan would have increased the income tax from 4.6% to 6.0%, increased the personal exemption, implemented a state education property tax of 12 mills on nonresidential property, and increased the business tax rate from 2.35% to 2.75%.

Michigan voters approved Proposal A on March 15, 1994, a decision that dramatically shifted the source of education funding from local to state sources. Between FY 1994 and FY 1995, the state's share of kindergarten through twelfth grade funding increased from 37% to 80%. This increase resulted in a simultaneous decrease in local funding, as the property tax portion decreased from 63% to 20%. Additional research confirmed that Michigan's reforms substantially reduced disparities between low revenue and high revenue school districts. The disparity between low revenue and high revenue districts dropped by 20% from 1994 to 1997.

Although Proposal A successfully addressed the shift from local to state sources, a recent study has questioned its overall impact on education funding. This study, commissioned by the Michigan Association of School Administrators, the Michigan Association of School Business Officials, and the Michigan Association of School Boards, found that the adjustments to dozens of state tax laws since 1994 resulted in nearly $2 billion in lost revenue for schools—nearly $550 million in FY 2002 alone.

While the report agreed that the changes made "good common sense and good economic sense," it concluded that legislators did not understand the full impact of the tax cuts when they approved the plan. Although these findings have been challenged, they are noteworthy as they highlight the miscellaneous taxing issues that accompany reform.

*Indiana*

During the 2002 special session, the Indiana General Assembly significantly altered the State's tax structure with the passage of House Bill 1001 (SS). The Act created a new state aid program for schools that removed 60% of the school tax levy from the property tax and replaced it with new state revenues. In addition, the legislation increased the homestead credit from 10% of tax bills to 20%, made Indiana a market value assessment state, increased the standard property tax deduction for homeowners from $6,000 to $35,000, and made other various tax changes to reduce the property tax burden.

To ensure that local property taxes will not increase under a court-mandated reassessment, a simultaneous offset with new state revenues was necessary. A portion of this increase will be funded by increasing sales taxes from 5% to 6%, increasing cigarette taxes from 15.5 cents to 55.5 cents per pack, increasing gasoline taxes from 15 cents to 18 cents per gallon, and increasing wagering taxes. In addition, the bill made other changes including, overhauling the state's corporate income tax structure, creating a more generous earned income tax credit, increasing the income tax renters deduction, revising the property tax controls on non-school local taxing districts, and imposing spending growth controls on state government.

Although Michigan and Indiana are highlighted, they are only two of several states that have recently addressed the topic of education funding. Nationwide, states as diverse as Kentucky, New York, and Texas (etc.) have all undertaken some type of reform. While different states construct solutions that best serve their individual needs, the majority of proposals appear to shift the funding burden away from the local property tax and toward increased state funding. As was seen in the previous examples, this shift has not always been the result of a simple tax swap, but rather a combination of tax changes. Regardless, the overall success of these reforms will depend on whether or not the revised formulas are capable of reducing funding disparities while maintaining acceptable levels of local control.

## *CONCLUSION*

As the disparity in the amounts Illinois residents pay for property taxes continues to grow, so will the amount of pressure put on lawmakers to change how education is funded. The inequities that exist in local school funding have prompted legislators to take a closer look at education funding and into the possibility of a property tax swap. This swap would mean an increase in State taxes, but would give the State government a greater role in the funding of education. State revenues would then be redistributed in what some consider as a more equitable manner.

Unfortunately, a simple property tax swap with a State revenue source is not as easy as it sounds. This is because any tax swap scenario would create "winners" and "losers". Determining the "winners" and "losers" in a property tax swap, of course, depends on the type of proposal created. As discussed previously, every model that the Governor's Commission on Property Tax Reform examined benefited some, while hurting others. The very difficult task for legislators is to come up with a plan that will relieve some of the inequitable tax burdens that are afflicting Illinois residents, while simultaneously minimizing the number of "losers".

A successful property tax swap will be one that is able to lower property taxes and is able to replace lost revenue with an equitable amount of State funds. The system must allow self-reliant school districts to be able to receive the same amount of funding they are used to receiving, or the proposal would be considered a failure. At the same time, State funds must be redistributed to poor districts in a way that will allow their per-pupil spending levels to near those of the wealthy districts to create a more equitable system. How this will be accomplished is unfortunately still unknown.

In the end, changes in the Illinois tax structure may need to be addressed for a formidable property tax swap plan to work. The Cook County classification system will continue to be a problem in creating an equitable tax swap as long as their system continues to shift a larger property tax burden onto commercial and industrial property taxpayers. In addition, the constitutional provision that corporations may not be taxed higher an 8 to 5 ratio above individuals may need to be altered if a plan is desired that allows individuals a proportionally same amount of property tax relief as corporations.

As inequitable as the property tax system appears to be, there are many that feel that property tax reform is not a good idea. The local control that accompanies local property taxation allows school districts to make their own decisions on financial decisions regarding their schools. They feel that lowering property taxes and replacing this revenue with State sources would undermine local control and accountability. They also fear that student achievement would suffer as a result of weakening this local control.

The arguments for and against a property tax swap appear to be valid. There is little argument that inequities exist in educational funding and in local property taxation. The question becomes, are these inequities worth the political headaches of reforming the system, or should Illinois citizens make the best of the system they currently have. Lawmakers will have the unenviable task of answering these questions in the months and years to come.

# BACKGROUND

The Illinois Economic and Fiscal Commission, a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

1) Preparation of annual revenue estimates with periodic updates;

2) Analysis of the fiscal impact of revenue bills;

3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;

4) Periodic assessment of capital facility plans; and

5) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes two primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

Reports can also be accessed from our Webpage:

**http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html**