

MEMORANDUM



DATE: February 12, 2002
 TO: Representative
 FROM: Rebecca Ross, Senior Economist *RR*
 RE: Executive Proposed State Education Tax Changes

In response to your request, State Education Tax (SET) changes proposed by the Governor are provided for two taxpayer cases or examples. The Executive Proposal includes collecting all SET revenue with July property taxes, beginning July 2003. In addition, the Executive Proposal would, for Calendar Year (CY) 2003 only, reduce the 6 mill SET to 5 mills and provide for a \$4.6 million grant to local units of government. In total, the proposal would result in an estimated \$490 million increase in the School Aid Fund (SAF) for fiscal year (FY) 2002-03.

Background

As indicated in Table 1, currently of the 1,527 local taxing units, 60% collect all of the SET revenue in December, 15% collect all of the SET revenue in July, while the remaining 25% collect the SET revenue in July and December. Under the proposal, taxpayers that currently remit all SET revenue in July would experience no fiscal impact from the timing change. However, taxpayers in taxing units that collect all or some SET revenue in December would be affected by this proposal. In addition, every taxpayer would get a 17% SET reduction due to the 1 mill decrease for CY 2003.

Table 1: Current Timing of SET Levy

July Mills	December Mills	Share of State Taxable Value	Number of Local Taxing Units	Share of Local Taxing Units
0	6	26.3%	914	59.9%
Partial	Partial	49.7%	383	25.1%
6	0	24.1%	230	15.1%

Source: Department of Treasury Survey

Methodology and Conclusions

Tables 2 and 3 depict two taxpayer examples, in which SET is currently levied either entirely or partially in December, to illustrate the impact of the Executive Proposal. The taxable value in these examples is \$75,000, which corresponds to a house with a market value of at least \$150,000. In this example, taxable value increases and inflation are 3.0% per year (annual taxable value increases are limited to the lesser of inflation or 5%, as long as the property does not change hands). The opportunity cost or the best alternative to paying SET in July would be to save the money from the December SET payment and collect interest for 6 months, which in this example is a 5% annual rate. This analysis does not take into account the effect on taxpayers that have escrow accounts.

Over a ten-year period, the interest lost by the taxpayer is \$61 in Case 1 and is \$123 in Case 2. In present value terms, or in other words, the value today of the ten-year stream of the interest lost, adjusted for inflation, would be \$54 in Case 1 and \$110 in Case 2. Combined with the 1 mill SET reduction or increase to the taxpayer of \$75 in CY 2003, the current value, of the ten year period would be net taxpayer gain of \$21 in Case 1 and a net taxpayer loss of \$35 in Case 2.

Table 2

Taxpayer Example of the Executive Recommended SET Changes

Assumptions

- * Taxable value is \$75,000, which represents a house value of \$150,000
- * Inflation is 3% per year
- * Interest is based on a 5% annual rate

Current Law

- * Case 1 - Taxpayer pays 3 mills in July and 3 mills in December of SET

	July SET/3 mills	December SET/3 mills
CY 1	\$225	\$225

Executive Proposal

- * Taxpayer pays all SET mills in July and for CY 2003 pays at a 5 mill rate

	July SET/6 mills	December SET/0 mills	Real Interest Case 1
CY 1	\$375	\$0	(\$4)
CY 2	\$464	\$0	(\$6)
CY 3	\$477	\$0	(\$6)
CY 4	\$492	\$0	(\$6)
CY 5	\$506	\$0	(\$6)
CY 6	\$522	\$0	(\$6)
CY 7	\$537	\$0	(\$6)
CY 8	\$553	\$0	(\$7)
CY 9	\$570	\$0	(\$7)
CY 10	\$587	\$0	(\$7)
Total 10 Year Real Interest			(\$61)
Present Value of 10 Years			(\$54)
1 Mill SET Reduction			\$75
Total 10 Year Taxpayer Net Impact			\$21

Conclusions

- * Total 10 year interest lost is \$61, in present value terms is \$54
- * The 1 Mill SET reduction is a taxpayer gain of \$75
- * Total 10 year taxpayer net impact is a gain of \$21

Table 3

Taxpayer Example of the Executive Recommended SET Changes

Assumptions

- * Taxable value is \$75,000, which represents a house value of \$150,000
- * Inflation is 3% per year
- * Interest is based on a 5% annual rate

Current Law

- * Case 2 - Taxpayer pays 6 mills in December of SET

	July SET/0 mills	December SET/6 mills
CY 1	\$0	\$450

Executive Proposal

- * Taxpayer pays all SET mills in July and for CY 2003 pays at a 5 mill rate

	July SET/6 mills	December SET/0 mills	Real Interest Case 2
CY 1	\$375	\$0	(\$9)
CY 2	\$464	\$0	(\$11)
CY 3	\$477	\$0	(\$11)
CY 4	\$492	\$0	(\$12)
CY 5	\$506	\$0	(\$12)
CY 6	\$522	\$0	(\$13)
CY 7	\$537	\$0	(\$13)
CY 8	\$553	\$0	(\$13)
CY 9	\$570	\$0	(\$14)
CY 10	\$587	\$0	(\$14)

Total 10 Year Real Interest	(\$123)
Present Value of 10 Years	(\$110)
1 Mill SET Reduction	\$75
Total 10 Year Taxpayer Net Impact	(\$35)

Conclusions

- * Total 10 year interest lost is \$123, in present value terms is \$110
- * The 1 Mill SET reduction is a taxpayer gain of \$75
- * Total 10 year taxpayer impact is a net loss of \$35

I hope this information is helpful. Please contact me if you have any additional questions.

Cc: Mitch Bean, Director House Fiscal Agency
 E:\economic\ross\requests\repgosselin.doc