



GOVERNOR'S OFFICE OF  
BUDGET AND PROGRAM PLANNING

## Fiscal Note 2009 Biennium

**Bill #** HB0701

**Title:** Generally revise school funding

**Primary Sponsor:** Glaser, Bill E

**Status:** As Introduced

- |  |  |  |
|--|--|--|
| <input checked="" type="checkbox"/> Significant Local Gov Impact | <input checked="" type="checkbox"/> Needs to be included in HB 2 | <input checked="" type="checkbox"/> Technical Concerns   |
| <input type="checkbox"/> Included in the Executive Budget        | <input type="checkbox"/> Significant Long-Term Impacts           | <input type="checkbox"/> Dedicated Revenue Form Attached |

### FISCAL SUMMARY

	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
<b>Expenditures:</b>				
General Fund (01) - Distribution to Schools	\$211,913,672	\$229,275,530	\$225,395,418	\$224,384,624
<b>Revenue:</b>				
General Fund (01) - Distribution to Schools	\$2,195,308	\$5,327,117	\$6,236,709	\$6,325,007
<b>Net Impact-General Fund Balance:</b>	<u>(\$209,718,364)</u>	<u>(\$223,948,413)</u>	<u>(\$219,158,709)</u>	<u>(\$218,059,617)</u>

**Description of fiscal impact:** HB 701 increases the direct state aid percentage from 44.7% of the basic and per-ANB entitlements to 80% of the basic and per-ANB entitlements. The net effect of inflating the basic and per-ANB entitlements; increasing direct state aid; eliminating guaranteed tax base aid for the district general fund; eliminating district isolation status; creating a dropout prevention payment; creating a classroom payment; creating a gifted and talented payment; eliminating the per educator payment; and eliminating school district block grants is to increase state costs for K-12 BASE aid by \$211.91 million in FY 2008 and \$229.26 million in FY 2009. HB 701 also reduces state and local property taxes for schools. HB 701 also reduces state and local property taxes for schools. Taxpayers who take an itemized deduction for property taxes will have smaller deductions, increasing income tax revenue to the general fund.

### FISCAL ANALYSIS

#### Assumptions:

#### **Office of Public Instruction**

1. HB 701 increases the direct state aid percentage from 44.7% of the basic and per-ANB entitlements to 80% of the basic and per-ANB entitlements and eliminates the need for guaranteed tax base aid to support school district BASE budgets.

2. HB 701 redefines the BASE budget to include:
  - a. 80% of the basic and per-ANB entitlements
  - b. Per-classroom payment
  - c. At-risk payment
  - d. Indian Education for all payment
  - e. American Indian achievement gap payment
  - f. Dropout prevention payment
  - g. Gifted and talented per-student payment
  - h. State special education payment
3. Current law includes 140% of the state special education payment in the BASE budget. The reduction in the special education portion of the BASE budget will reduce school district BASE budgets by \$14.95 million in FY 2008 and \$14.95 million in FY 2009 unless the appropriation for state special education is increased by \$14.95 million per year.
4. HB 701 adds three new general fund payments, which include a per-classroom payment, a dropout prevention payment, and a gifted and talented per-student payment. The bill repeals the existing quality educator payment.
5. HB 701 increases the at risk payment from \$5.0 million to \$9.5 million per year.
6. A new middle school entitlement of \$55,500, defined in HB 701 for the school funding formula replaces the current pro-ration between the elementary and high school basic entitlement.
7. Under current law, the average number belonging in K-12 public schools will be as follows:

	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
<b>K-6 ANB</b>	72,763	72,001	71,899	72,530	73,704
<b>7-8 ANB</b>	24,643	23,745	22,980	22,199	21,821
<b>9-12 ANB</b>	<u>49,613</u>	<u>49,187</u>	<u>48,613</u>	<u>47,910</u>	<u>46,798</u>
	147,019	144,933	143,492	142,639	142,323

8. HB 701 provides inflation be applied to the basic and per-ANB entitlements at a cost of \$13.9 million in FY 2008 and \$28.6 million in FY 2009. The basic and per-ANB entitlements and other general fund payments will be set as follows:

	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
Basic entitlement EL	\$20,718	\$21,290	\$21,929	\$21,929	\$21,929
Basic entitlement MS (middle school)	\$0	\$55,500	\$55,500	\$55,500	\$55,500
Basic entitlement HS	\$230,199	\$236,552	\$243,649	\$243,649	\$243,649
Per-ANB entitlement EL	\$4,456	\$4,579	\$4,716	\$4,716	\$4,716
Per-ANB entitlement HS	\$5,704	\$5,861	\$6,037	\$6,037	\$6,037
Quality Educator payment	\$2,000	\$0	\$0	\$0	\$0
Per-classroom payment	\$0	\$10,000	\$10,000	\$10,000	\$10,000
Indian education for all payment	\$20.40	\$20.40	\$20.40	\$20.40	\$20.40
American Indian achievement gap pmt	\$200	\$200	\$200	\$200	\$200
Dropout prevention payment	\$0	\$65 – minimum \$1000/district	\$65 – minimum \$1000/district	\$65 – minimum \$1000/district	\$65 – minimum \$1000/district
Gifted and talented per-student payment	\$0	\$31 – minimum \$350/district	\$31 – minimum \$350/district	\$31 – minimum \$350/district	\$31 – minimum \$350/district
At risk payment	\$5,000,000	\$9,500,000	\$9,500,000	\$9,500,000	\$9,500,000
DSA Percentage	44.7%	80%	80%	80%	80%

9. Direct State Aid will be \$636.03 million in FY 2008 and \$648.43 million in FY 2009. County retirement GTB costs will be \$28.77 million in FY 2008 and \$29.68 million.
10. The general fund payments defined in 20-9-328 through 20-9-330, MCA, At-risk student payment, Indian education for all payment, and American Indian achievement gap payment, will total \$15.72 million in FY 2008 and \$15.68 million in FY 2009.

- 11. HB 701 eliminates the quality educator payment in 20-9-327, MCA.
- 12. The state special education appropriation is estimated to be \$39.35 million in each year of the 2009 biennium.
- 13. Consistent with HJR 2 legislative revenue estimates, the statewide taxable valuations will increase by 3.18% in FY 2008 and 3.22% in FY 2009 and beyond.
- 14. HB 701 repeals school district block grants established in 20-9-630, MCA. In FY 2007, school districts received \$48.81 million in school district block grants. Of this total, \$43.69 million was required to be allocated to the school district general fund. Under current law, the block grants for FY 2008 through FY 2011 are anticipated to be as follows.

<b>School Block Grants</b>	<b><u>FY 2008</u></b>	<b><u>FY 2009</u></b>	<b><u>FY 2010</u></b>	<b><u>FY 2011</u></b>
General Fund	\$44,019,074	\$44,353,619	\$44,690,706	\$45,030,355
Transportation	\$1,814,665	\$1,828,457	\$1,842,353	\$1,856,355
Combined	<u>\$3,346,324</u>	<u>\$3,371,756</u>	<u>\$3,397,382</u>	<u>\$3,423,202</u>
Total	\$49,180,063	\$49,553,832	\$49,930,441	\$50,309,912

- 15. HB 124 block grants to the county transportation fund are not eliminated by HB 701.
- 16. Fund balance reappropriated and non-levy revenue that school districts currently use to reduce the BASE budget levy will be available to reduce the over-BASE levy. It is estimated that \$17.4 million in fund balance re-appropriated and non-levy revenue will be available annually to reduce over-BASE levies. Due to actual current mill levies being less than the fund balance reappropriated amount in some districts, the actual reduction of levies is anticipated to be \$13.9 million.
- 17. HB 701 creates a per-classroom payment of \$10,000. Each elementary district will have a minimum of one classroom unit. Each high school district will have a minimum of five classroom units. It is estimated that there will be 8,320.4 classroom units in FY 2008 and 8,271.3 classroom units in FY 2009. The cost of the per-classroom payment is \$83.20 million in FY 2008 and \$82.71 million in FY 2009.
- 18. The dropout prevention payment created in HB 701 at \$65 per ANB or a minimum of \$1,000 per district will cost \$9.45 million in FY 2008 and \$9.36 million in FY 2009.
- 19. The gifted and talented per-student payment of \$31 per ANB or a minimum of \$350 per district will cost \$4.50 million in FY 2008 and \$4.46 million in FY 2009.
- 20. HB 701 eliminates the BASE budget levy for non-isolated elementary school districts as provided in 20-9-302, MCA, which mandates districts meeting certain considerations will receive one-half of the calculated direct state aid funding.
- 21. The change in definition of one-quarter time enrollment from 181 hours to 180 hours is not anticipated to have a fiscal impact.

**Department of Revenue**

**Property Tax**

- 22. Combined with the local mill levy impact shown in the section titled “Effect on County or Other Local Revenues or Expenditures” the total reduction in property tax is \$143.14 million for FY 2008, \$141.51 million for FY 2009, \$140.33 million for FY 2010, and \$139.55 million for FY 2011.

**Individual Income Tax**

- 23. Individual taxpayers who take an itemized deduction for property taxes will have a smaller deduction beginning with calendar year 2007 because of this bill. The average percent reduction in property taxes due to the lower state-wide mills and local school mills will be 15.18%. Property taxes for a year are due in November of that year and May of the following year. Thus, in 2007, taxpayers will pay the last half of their 2006 taxes, which are not reduced by this bill, and the first half of their reduced 2007 taxes. Property

tax deductions for 2007 will reflect half of the property tax reduction in this bill, and the full reduction will be reflected in property tax deductions beginning in 2008.

24. The income tax revenue estimating program was run with the 2005 income tax returns database but with itemized deductions for property taxes reduced by 7.59% for 2007 and by 15.18% for 2008 and later years.
25. Compared to the results of running the program with the un-modified 2005 income tax returns database, tax liability was higher by \$1.334 million in 2007, \$2.753 million in 2008, \$2.828 million in 2009, and \$2.945 million in 2010. These changes in tax liability are due to changes in deductions that will be calculated when taxpayers file their returns in the spring following the tax year. Therefore, the corresponding revenue increases caused by the changes in the deductions will occur in FY 2008 through FY 2011.
26. This bill will not affect the Department of Revenue’s costs of administering the individual income tax.

**Corporation License Tax**

27. With lower property taxes, businesses will have lower property tax expenses to deduct in calculating taxable net revenue. Businesses would receive 53.5% of the property tax reductions from lower statewide mills and lower local school mills.
28. Corporations that do business in Montana and other states are required to report their Montana property on their corporation license tax returns. Of this property, 66.65% was reported by corporations that had positive taxable income. It is assumed that the same proportion of total business property is owned by businesses with positive net income.
29. Each calendar year, the reduction in business property taxes is half of the reduction for the same numbered fiscal year plus half of the reduction for the next fiscal year. The reductions are \$25.52 million for 2007 (53.5% x 66.65% x ½ x \$143.14 million), \$50.75 million for 2008 (53.5% x 66.65% x (½ x \$143.14 million + ½ x \$141.51)), \$50.25 million for 2009 (53.5% x 66.65% x (½ x \$141.51 million + ½ x \$140.33)), and \$49.90 million for 2010 (53.5% x 66.65% x (½ x \$140.33 million + ½ x \$139.55))
30. The corporation license tax rate is 6.75%. It is assumed that the average marginal tax rate on business income reported on individual income tax returns is also 6.75%.
31. The change in tax liability will be \$1.722 million for tax year 2007 (6.75% x \$25.52 million), \$3.426 million for tax year 2008 (6.75% x \$50.75 million), \$3.392 million for tax year 2009 (6.75% x \$50.249 million), and \$3.368 million for tax year 2010 (6.75% x \$49.899 million).
32. Corporations frequently use the option for an extended deadline for filing tax returns. Because of this, the changes in tax liability in assumption 22 will be reported on tax returns filed over the course of the following calendar year, with half of the change coming in the fiscal year including the last half of the tax year and half coming in the next fiscal year. General fund revenue will increase by \$0.861 million in FY 2008 (0.5 x \$1.723 million), by \$2.574 million in FY 2009 (0.5 x \$1.723 million + 0.5 x \$3.426 million), by \$3.409 million in FY 2010 (0.5 x \$3.426 million + 0.5 x \$3.392 million), and by \$3.38 million in FY 2011 (0.5 x \$3.392 million + 0.5 x \$3.368 million).

**Total Revenue**

33. The following table shows the changes in general fund revenue:

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
Income Tax Deductions:	\$1,334,000	\$2,753,000	\$2,828,000	\$2,945,000
Corporation Tax	\$861,308	\$2,574,117	\$3,408,709	\$3,380,007
<b>TOTAL</b>	<u>\$2,195,308</u>	<u>\$5,327,117</u>	<u>\$6,236,709</u>	<u>\$6,325,007</u>

	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
<b><u>Fiscal Impact:</u></b>				
<b><u>Expenditures:</u></b>				
<b>Local Assistance to Schools</b>				
Direct State Aid	\$290,424,047	\$306,538,090	\$304,377,322	\$303,189,231
Guaranteed Tax Base Aid	(\$108,860,797)	(\$106,694,593)	(\$107,578,624)	(\$106,905,369)
County Retirement	\$2,593,896	\$2,675,804	\$2,760,297	\$2,847,460
Per Educator Payment	(\$24,715,598)	(\$24,715,598)	(\$24,715,598)	(\$24,715,598)
Classroom Payment	\$83,203,518	\$82,712,985	\$82,251,196	\$82,078,362
Gifted & Talented Payment	\$4,499,679	\$4,455,584	\$4,429,296	\$4,419,345
Dropout Prevention Payment	\$9,448,990	\$9,357,090	\$9,301,970	\$9,281,105
At Risk Payment	\$4,500,000	\$4,500,000	\$4,500,000	\$4,500,000
HB 124 Block Grants in Dist GF	(\$44,019,074)	(\$44,353,619)	(\$44,690,706)	(\$45,030,355)
HB 124 Block Grants in Dist Other	(\$5,160,989)	(\$5,200,213)	(\$5,239,735)	(\$5,279,557)
<b>TOTAL Expenditures</b>	<b>\$211,913,672</b>	<b>\$229,275,530</b>	<b>\$225,395,418</b>	<b>\$224,384,624</b>

**Funding of Expenditures:**

General Fund (01)	\$211,913,672	\$229,275,530	\$225,395,418	\$224,384,624
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**Revenues:**

General Fund (01)	\$2,195,308	\$5,327,117	\$6,236,709	\$6,325,007
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**Net Impact to Fund Balance (Revenue minus Funding of Expenditures):**

General Fund (01)	(\$209,718,364)	(\$223,948,413)	(\$219,158,709)	(\$218,059,617)
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**Effect on County or Other Local Revenues or Expenditures:**

1. Due to the increase in direct state aid percentage to 80% and the reduction in BASE budget portion for special education, school district levies to support the BASE budgets are projected to decrease by \$116.35 million in FY 2008 and by \$114.55 million in FY 2009 with an on-going tax savings in FY 2010 and FY 2011.
2. Districts will be allowed to use non-levy revenue to reduce over-BASE levies by approximately \$11.33 million annually statewide.
3. Districts will be allowed to use fund balance reappropriated to reduce over-BASE levies by approximately \$13.9 million annually statewide.
4. Due to the elimination of the school district block grants, levies for the transportation fund and other budgeted funds may increase by \$5.16 million in FY 2008 and by \$5.20 million in FY 2009.
5. In school district BASE budget, authority will be reduced by \$15 million annually due to the reduction in percentage of special education from 140% in BASE to 100% special education in BASE.
6. The maximum general fund budget includes the same amount of special education budget authority as current law.
7. The elimination of \$116 million (annually) in BASE budget levies will have the effect of lowering the local contribution rate used for determining the eligibility of school districts for federal impact aid. This could reduce the federal impact aid that flows to Montana school districts by an unknown amount.
8. Voter approval is required for any increase to district general fund over-BASE levies.

9. With the non-levy revenue being available in the over the BASE budget, it is estimated that 30 districts will have over-BASE general fund Oil, Gas, and Coal revenues in to the district general fund that exceed the over-BASE area below the maximum budgets. The Oil, Gas, and Coal revenues of these 30 districts are an average of \$4,255 per ANB, a maximum of \$14,133 per ANB, with a minimum of \$1,093 per ANB. No levies will need to be passed by the voters in order to expend these funds.

**Long-Range Impacts:**

**Department of Revenue**

1. HB 678 lowers property taxes for all classes and the overall value of property in Montana is expected to continue to rise, causing an increasing impact in future years.

**Technical Notes:**

**Office of Public Instruction**

1. The middle school entitlement would need to be set at \$56,300 in FY 2008 in order to be cost neutral. Inflating the middle school entitlement by 3% for inflation in FY 2009 yields a middle school entitlement of \$58,000.
2. HB 701 removes the authority for school districts to permissively levy (using the BASE budget levy) to meet the local match requirement for state special education. Amendments will be necessary for Section 20-9-321, MCA to eliminate the match requirement.
3. Section 20-9-321, MCA allocates 25% of state special education payments to districts for high cost reimbursements. Amendments will be necessary for 20-9-321, MCA because a district is not eligible to receive high cost reimbursements until it has met its match requirement.

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*Sponsor's Initials*

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*Budget Director's Initials*

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