

TAX REFORM ???

45 Questions and Answers

About the Proposals of

the

New Jersey Tax Policy Committee

Bureau of Government Research

RUTGERS UNIVERSITY
The State University of New Jersey

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GENERAL QUESTIONS1. Why should New Jersey consider a change in tax policy?

The Tax Policy Committee looked at recent trends and concluded that the present tax system has two major flaws:

(1) They said that the present system is not "elastic" -- that is, as the state and its communities grow and need more money, the tax system does not produce this money without increasing tax rates:

-- the need for state government revenue, including state aid for local schools, was observed to be rising much faster than revenue, with a gap estimated for 1980 at from \$670 to \$970 million.

-- the need for local government revenue (counties, municipalities, schools) also was found to be increasing more rapidly than local taxes can expand, with a gap of \$342 million predicted for 1980 -- a gap which could only be met by steadily increasing the property tax rates which are already among the highest in the country.

(2) In the Committee's view, the present system does not distribute the tax burden fairly. The Committee found that when all New Jersey taxes are taken together, they take:

20% of the income of persons earning under \$3,000 per year,

This set of questions and answers has been prepared as a public service by the Bureau of Government Research of your State University in order to help clarify some of the issues raised by the New Jersey Tax Policy Committee. Where differences of opinion have appeared, an effort has been made to present fairly the opposing viewpoints.

CAUTION: As with most changes in public policy proposed by a study commission, the recommendations of the Tax Policy Committee are presented in general language. To become effective, they must be translated into very detailed State laws, which may differ in their effect from the Committee proposals. The answers provided here are based on the Committee proposals and the bills as they were introduced into the State Legislature in May, 1972. It is quite possible, of course, that some bills may never be enacted and that others may be changed before the Legislature enacts them into law. If this happens, some of the answers stated here may no longer be accurate.

14% of the income of persons earning \$7,500 to \$10,000 per year, and

7% of the income of persons earning over \$25,000 per year.

This is mainly because New Jersey relies very heavily -- far more than most states -- on property taxes, which are not directly related to income.

The Tax Policy Committee also concluded that use of the property tax as a local tax for local purposes causes great variation from place to place, with some communities having large amounts of taxable property from which to raise the money they need, and other communities being very poor.

The New Jersey Superior Court, in January, 1972, ruled that the present tax system violates both the federal and State constitutions because it results in more money being available for public schools in rich communities than in poor communities.

The Court ordered several deadlines which, if upheld by higher courts, will require change in the way local public schools are financed in order to provide equal educational opportunities for pupils in all school systems, regardless of the wealth of the community in which they are located. The first deadline is January 1, 1973, after which no State school aid can be distributed to more than 300 of the wealthier school districts in New Jersey unless the system is changed.

Some critics of the Tax Policy recommendations believe that higher courts will overrule the Superior Court, and no change will be necessary.

2. In general, what is proposed?

The Tax Policy Committee proposed that emphasis be shifted away from the property tax -- which now produces over 54% of all state and local tax revenue in New Jersey -- to a system in which about:

one-third of the money would be raised by property taxes,

one-third would be raised by taxes on income, and

one-third would be raised by taxes on sales.

The Committee reported that such a system would increase the elasticity of the tax system, so that it would be more likely to produce needed additional funds in the future without frequent changes in tax rates.

They also concluded that such a proposed system would be fairer, since its burden would be distributed more in proportion to income than the present tax system. Calculations made for the Tax Policy Committee show that the proposed changes would result in taxes which would take:

16% of the income of persons earning under \$3,000 per year,

14% of the income of persons earning \$7,500 to \$10,000 per year, and

12% of the income of persons earning \$25,000 per year.

At the same time, the Committee proposed a long list of changes which they believed would make these taxes more effective and more fairly distributed.

Critics of the Committee's proposals fall into two broad groups. Some say that the recommendations do not go far enough, since the proposed system still appears to favor persons with higher incomes, although not as much as the present tax structure. Other critics believe that the suggested tax system either would be too drastic a shift, that it would require undesirable new taxes to reduce the property tax, or that it is unfair to some groups in the population.

Governor Cahill supported the general recommendations of the Tax Policy Committee, although differing with the Committee on some details. Proposed laws which have been introduced into the State Legislature would put the Governor's recommendations into effect.

3. Is this just a way to raise more money?

The Tax Policy Committee foresaw the need for more tax money in the future, as the state and its communities grow. They indicated the desirability of providing a balanced tax system which would be elastic enough to provide these funds without continual new taxes and increases in tax rates.

Just as important, however, in the Committee's view, was the goal of providing a new system which would distribute the tax burden more fairly among the taxpayers than the present system.

4. Who would gain and who would lose by the proposed tax changes?

The major proposals of the Tax Policy Committee involve reducing the property tax and obtaining new funds from a personal income tax, from an extension of the sales tax to some items not now taxed, and from additional taxes of business activity.

Therefore, the taxpayers most likely to benefit are those who are now paying high property taxes, especially for schools, but who have low to moderate incomes.

Taxpayers who would probably pay more under the proposals are those having relatively high incomes, those who own little property, and those whose property is in places where property taxes now are rather low.

The accompanying table, based on the Tax Policy Committee's report, gives a very rough comparison of what the net effect would have been in 1971 of the reduced property tax, the new income tax, and the extended sales tax. The table is for a family of 5 persons who own a home worth twice their gross annual income.

A number of changes in the proposals have been suggested since the Tax Policy Committee reported, so that the figures in the table are not precisely accurate. However, the general effect of the legislation under consideration is still substantially indicated by the table.

5. Would there be a "windfall" to business?

Some critics of the proposals believe that there would be a "windfall" under the original Committee recommendations because the property taxes paid by business taxpayers would be reduced more than their other taxes, such as the corporation income tax, would be increased. If this were so, the proposals would result in a shift in tax burden away from business taxpayers and towards individuals, who would have to pay the new personal income tax.

The Tax Policy Committee concluded that there might be a "windfall" for some businesses, depending on the municipality in which they were located and the relative importance of taxable property among their assets, but the Committee felt that there would not be a general "windfall" to all business taxpayers.

Nevertheless, Governor Cahill went beyond the Committee recommendations by proposing an "excess gains" tax on business. Each business taxpayer would be required to report annually for three years the amount by which total state and local taxes differed from the amount of such taxes paid in the last year before the program went into effect (the base year). If the taxpayer found that the new taxes were less than the taxes in the base year -- in other words, if a "windfall" had been received -- this amount would be paid as an "excess gains" tax to the State of New Jersey. An exception was included for business taxpayers located in municipalities having especially high tax rates where, it was suggested, some over-all tax reductions were justified for business.

The proposed "excess gains" tax has met some of the objections of the "business windfall" argument, but debate continues on the effectiveness of

Estimated Impact of Tax Policy Proposals in 1971 on Family of 5 Owning Home Worth Twice Their Gross Annual Income

Gross Family Income	Value of Home	Estimated Taxes Now Paid						
		Property Taxes			Total Taxes			
		Newark	Middle-Ridge-wood	Sales Tax	Newark	Middle-Ridge-wood	Sales Tax	
\$ 5,000	\$ 10,000	\$ 750	\$ 350	\$ 400	\$ 100	\$ 850	\$ 450	\$ 500
10,000	20,000	1,500	750	850	200	1,700	950	1,050
15,000	30,000	2,200	1,100	1,250	300	2,500	1,400	1,550
20,000	40,000	2,950	1,450	1,700	400	3,350	1,850	2,100
25,000	50,000	3,700	1,850	2,100	500	4,200	2,350	2,600
30,000	60,000	4,450	2,200	2,550	600	5,050	2,800	3,150
50,000	100,000	7,400	3,650	4,200	1,000	8,400	4,650	5,200

Gross Family Income	Value of Home	Estimated Proposed Taxes						Estimated Net Change in Taxes				
		Property Taxes			Total Taxes			Newark	Middle-Ridge-wood	Middle-Ridge-wood		
		Newark	Middle-Ridge-wood	Sales Tax	Newark	Middle-Ridge-wood	Sales Tax					
\$ 5,000	\$ 10,000	\$ 400	\$ 200	\$ 300	\$ 150	\$ ---	\$ 550	\$ 350	\$ 450	\$ -300	\$ -100	\$ -50
10,000	20,000	850	400	600	300	100	1,250	800	1,000	-450	-150	-50
15,000	30,000	1,250	600	950	450	250	1,950	1,300	1,650	-550	-100	+100
20,000	40,000	1,700	800	1,250	600	400	2,700	1,800	2,250	-650	-50	+150
25,000	50,000	2,100	1,000	1,550	750	650	3,500	2,400	2,950	-700	+50	+350
30,000	60,000	2,550	1,200	1,850	900	900	4,350	3,000	3,650	-700	+200	+500
50,000	100,000	4,250	2,000	3,100	1,500	2,150	7,900	5,650	6,750	-500	+1,000	+1,350

the solution, on the exception for business in the high tax rate communities, and on the number of years for which the tax should continue.

6. What is property tax classification?

Property tax classification is a means of requiring the owners of one kind of taxable property to pay higher or lower taxes than owners of other kinds of property. Classification can be put into effect in two ways:

- (1) by using different assessment ratios (for example, residential property might be assessed at 50% of its market value, and commercial property at 100% of market value), or
- (2) by using different tax rates (for example, residential property might be taxed at a rate of \$2.00 per hundred dollars of market value, and commercial property at \$3.00 per hundred dollars).

Critics of the Tax Policy Committee proposals, who fear that business will gain a "windfall", have suggested property tax classification as a method of preventing this.

7. Would there be a "windfall" to landlords?

If property taxes were reduced on rented houses and apartments, and nothing done to reduce rents, this might result in a "windfall" for landlords.

The Tax Policy Committee concluded that much of the "windfall" to landlords would be recaptured by taxes on increased property values resulting from property tax rate reductions.

Critics of the Tax Policy Committee proposals

have said that this approach is inadequate. In order to meet such criticisms, Governor Cahill proposed an "excess gains" tax on rented residential property.

Each landlord would be required to report annually for three years the amount by which current property taxes differed from property taxes in the last year before the program went into effect (the base year). If the landlord found that the new property taxes were less than the property taxes in the base year, a payment of 75% of the difference would be paid to the State of New Jersey.

8. What would happen to taxes paid by people who rent their living quarters?

If a new personal income tax were imposed on individuals, and rents were not reduced, tenants would suffer a net tax increase.

The Tax Policy Committee believed that lower property taxes would eventually bring lower rents. In addition, they proposed that tenants be allowed to deduct 20% of their rent from their gross income when calculating their income tax.

These proposals have been criticized as too slow and too unsure. Instead, Governor Cahill suggested that the "excess gains" tax payable by each landlord to the state (See answer to #7) be returned to the tenants. This would be done by permitting tenants to deduct from their income tax payment their share of the landlord's "excess gains" tax. If the tenant's share of the "excess gains" tax is larger than the income tax due, a rebate for the difference would be paid by the state directly to the tenant.

9. Why not raise the money needed by off-track betting and casino gambling?

The Tax Policy Committee gathered information on off-track betting in New York, and on casino gambling in Nevada and other locations around the world. They concluded that estimates of revenue from these sources were very unreliable, but that even the most optimistic predictions fell far short of the revenue gap described in the answer to Question #1.

10. Is this a plan to help cities at the expense of the suburbs?

The Tax Policy Committee proposals generally would help poorer communities and groups in the population. Since the money to do this must be raised somewhere, wealthier communities and groups would bear a somewhat heavier burden.

While the older central cities are among the poorest of communities in relation to the size of their population, there are many older suburbs, small towns, and rural areas which also are poor and which would benefit.

On the other hand, many suburbs are relatively wealthy, and their residents might wind up paying more taxes.

In each case, however, the final answer depends not only on where a person is located, but also on that person's own financial situation (See table in answer to Question #4).

11. When are these changes intended to go into effect?

The bills being considered by the Legislature are intended to become effective, in most cases, on January 1, 1974.

12. Do all of the proposed tax changes have to be adopted to make the system work?

The Tax Policy Committee indicated that its recommendations were intended as parts of a new total tax system for New Jersey in which all of the parts were interrelated. However, no one has argued that every one of the proposals must be adopted to make the system work.

Some of the Committee proposals have already been set aside by the Governor, who has not recommended them to the Legislature. Of the proposals which remain, some clearly are more important to the operation of the tax system than others.

Probably, the basic parts of the system are the proposals for:

- (a) state financing of public schools (See Questions #22 to 31),
- (b) state financing of public welfare (See Question #16),
- (c) state financing of county courts (See Question #16),
- (d) a municipal block grant system (See Question #32), and
- (e) a personal income tax (See Questions #34 to 40).

THE PROPERTY TAX

13. Is there anything really wrong with the property tax as it is now?

The Tax Policy Committee had three principal criticisms of the property tax as it now stands in New Jersey:

- (1) it is regressive -- that is, the property tax takes a far higher proportion of the income of poor persons than it takes of wealthier persons. The figures quoted by the Committee indicate that property taxes in New Jersey take:

15% of the income of persons earning under \$3,000 per year,

8% of the income of persons earning \$7,500 to \$10,000 per year, and

3% of the income of persons earning over \$25,000 per year.

- (2) it is excessive -- that is, New Jersey relies far more heavily on the property tax than most states. By some comparisons, New Jersey has the highest property taxes in the country; by other comparisons, New Jersey is near the top.

Since the property tax is not a very "elastic" tax -- that is, the amount of money it produces does not respond quickly to changes in the economy -- the heavy use of it in New Jersey keeps the whole tax system from being "elastic" (See answer to Question #1).

- (3) it's burden is not distributed equally -- that is, some communities have very high property taxes and some have very low tax rates. The difference in many cases is not because the high tax community spends more or has better services, but because the high tax community has very little taxable property and must place a relatively high burden on each taxpayer. The wealthier municipality can raise the same amount of money with a lower tax rate, because there is more property to carry the load.

In addition, the Committee observed that the heavy use of the property tax had undesirable side effects by:

- (4) discouraging the construction of new housing and the renovation of existing housing, and
- (5) creating competition between communities to attract industrial ratables, while turning away residential development.

Critics of the tax policy proposals have questioned the validity of the figures showing regressivity. They also point out that the property tax is a very stable and substantial producer of money and, in their opinion, is more desirable than the personal income tax, which has been suggested as a partial alternative.

14. Would there still be a property tax?

Yes. While the Tax Policy Committee recommended reducing the property tax, they did not propose that it be eliminated. Some of the costs of running county and municipal government would be taken over by the state, but the property tax would still be used to pay for a large part of the costs which

remain at the local level. In addition, while the state would pay most of the costs of running the public schools, there would be a uniform, state-wide property tax which would be used for about half of these public school operating costs.

15. How would my property tax change?

This depends on where you live and how much your property is worth. Based on figures in the Tax Policy Committee report, the property tax would be reduced in almost every community. However, in 45 places out of the total of 567 municipalities, property taxes would be increased. These are generally very small communities which, for one reason or another, have had low property tax rates in the past.

The amount that your property tax would change again depends on where your property is located. If you are now in a community with high taxes and fairly low services, your property taxes may be reduced a great deal. However, if you are now paying property taxes which are relatively low, you may not receive much of a reduction. Overall, the average reduction in property taxes has been estimated at from 35 to 40% (See Table in Question #4).

Tables in Volume 3 of the Tax Policy Committee report give estimates of the property tax change in every community of the state. Although the proposals being considered by the Legislature are not exactly the same as the recommendations of the Committee on which the tables are based, the figures there are still reasonably good indicators of what would happen if the proposals were adopted.

16. How would property taxes be reduced?

The Tax Policy Committee proposed three different approaches to reduce property taxes:

- (1) by transferring the cost of some services, which are now largely financed by local governments through property taxes, to the state government, where they would be financed from other kinds of taxes.
- (2) by having the state government raise money in other ways, and send some of this money to the local governments for local use, so that they would not have to raise so much in property taxes, and
- (3) by doing away with some programs which cost money now raised through property taxes.

Under the first of these approaches, the Committee suggested that the state government take over the financing of:

- (a) a large part of the cost of operating public schools. Even though the state would levy a property tax of its own to pay for part of the school program, the net effect was estimated by the Committee to reduce property taxes by \$608 million in 1971 costs.
- (b) county and municipal welfare costs. The proposed transfer of these costs to the state government would have amounted to \$75 million in 1971.
- (c) senior citizens' tax relief. The Committee's proposal would relieve other local taxpayers of \$12 million in senior

citizens' tax deductions in 1971, with the state government paying the cost in the future under a rather different plan.

- (d) county judicial costs. The judicial activities recommended for transfer from county to state financing cost \$30 million in 1971.
- (e) county board of taxation costs. A total of \$1.5 million would have been taken off county costs by this Committee proposal in 1971.

In the second approach, the Committee proposed that the state government establish financial aid programs which would provide local governments with funds to substitute for some property taxes now raised to provide local public services. Included here were:

- (a) a municipal block grant program to municipalities having low levels of property tax resources. The cost for 1971 was estimated at \$75 million.
- (b) a program for state payments in place of property taxes to communities where large amounts of tax-exempt state-owned property are located. The 1971 costs were estimated at \$13.5 million.

Finally, the third approach included a recommendation that the \$50 property tax reduction now granted to veterans should be abolished, thus relieving the other local property taxpayers of a cost of \$22 million at 1971 levels.

Legislation recommended by Governor Cahill and under consideration by the Legislature would

carry out all of these proposals with the exception of the abolition of the veterans' tax deduction.

17. Isn't the state property tax an additional new tax?

In the sense that we have not had a state property tax in New Jersey for more than 20 years, the answer is, yes, this is a new tax.

However, since this state property tax, at a uniform rate of \$1.00 per hundred dollars of property value, replaces most of the local property tax for schools, which now averages over \$2.00 per hundred, the state property tax could be considered a reduction of an existing tax.

18. What would happen to the \$50 tax deduction for veterans?

The Tax Policy Committee recommended that this deduction be abolished in order to reduce the property tax for non-veteran property owners.

However, Governor Cahill rejected this proposal, and no legislation is being considered.

19. What would happen to the \$160 tax deduction for senior citizens?

The Tax Policy Committee proposed a substantial change in the present system for senior citizen tax relief.

Instead of receiving a direct deduction from the property tax, the qualified senior citizen in the future would pay property taxes just as every other taxpayer, but would receive an income tax reduction or a rebate if the tax reduction exceeded the income tax due.

Any person 65 years of age or older, who had lived in New Jersey for one year, and had an income of \$7,100 or less from all sources, including social security, would be eligible.

The amount of the reduction would depend on several factors. A senior citizen could choose to claim the reduction in one of two ways:

- (1) a table could be used, in which the amount of the tax reduction is related to the senior citizen's income, ranging from a \$160 reduction for persons with incomes of \$5,000 or less, down to a reduction of only \$.40 for persons with incomes of \$7,100,

or

- (2) a more complicated formula could be used, in which the tax reduction is the smaller of:
- (a) all state and local school property taxes paid by the senior citizen, or
- (b) the figure of \$500 multiplied by: the effective tax rate of the municipality where the property is located, and
divided by: the median effective tax rate in the entire state,
- (the effect of this approach is that the \$500 limit becomes higher in communities with higher-than-average tax rates, and lower in low-tax-rate communities, but it may not go above \$700, nor below \$300)

in either case (a) or (b), 7% of the senior citizen's annual income is subtracted to find the final amount of tax reduction.

The senior citizen who rents living quarters is eligible under this proposal on the same terms as the senior citizen who owns a dwelling. Such a senior citizen tenant would determine his or her school property taxes paid as a proportion of all such taxes paid by the property in which they live, based upon their share of the area of the building.

The entire cost of this proposed program would be paid by the state government, rather than being partially borne in each community by the other local taxpayers, as is now the case.

In most aspects, the Committee recommendations, which are included in the income tax bill now before the Legislature, are liberalizations of the existing provisions for senior citizen tax relief. However, critics of the proposals have pointed out that it is possible for some persons now receiving a \$160 tax deduction to receive less in the future because social security payments would be counted as income.

20. What would happen to reduced taxes now paid on farmland?

The Tax Policy Committee made several recommendations intended to reduce "windfalls" to speculators under the present farmland assessment law, which provides for taxation of farmland on the basis of its agricultural value, rather than its value for other purposes:

- (1) In addition to the present requirement that the farm produce at least \$500 of gross income annually, it would be required to yield an additional \$25 per acre for every acre over five.

- (2) Tax assessors would be required to show on their records the value of farmland both for agricultural purposes and for any other uses to which it might be put.
- (3) Reduced property tax provisions would apply only to farmland owned by persons receiving at least 25% of their income from farm operation.
- (4) Under present "roll-back" provisions, the owners of an inactive farm which had received reductions in property taxes now have to repay the amount of their tax reduction for the last three years before farming ended. Under the Committee proposal, this would be extended to the last five years.

Governor Cahill recommended, and the Legislature is considering, only the first two points above, and the gross income provision has been reduced to \$500 for the farm, plus \$5.00 for each additional acre, or \$.50 for woodland and wetlands.

21. Could the property tax, itself, be improved?

In addition to the proposals already described, the Tax Policy Committee suggested a long list of detailed changes which they believed would improve the property tax. In general, they fall into three broad categories:

- (1) proposals to reduce the number of tax exemptions, thereby "broadening" the use of the tax, and reducing the burden on individual taxpayers,
- (2) proposals to limit tax rates, so that the tax reductions made when the proposals are first

put into effect will not be quickly absorbed by rising expenditures (See Question #33), and

- (3) proposals to improve the administration of the tax, so that it is distributed fairly.

A number of bills have been recommended to the Legislature for carrying out many of these proposals.

PAYING FOR PUBLIC SCHOOLS

22. What is meant by "State funding of schools"?

By these words, the Tax Policy Committee meant that the state government would be responsible for providing enough money so that every community in New Jersey could provide a "standard quality" education for its public school students, regardless of the wealth or poverty of the community.

The state funding proposals of the Committee cover only the money necessary for current operating expenses. They do not include the costs of capital construction or debt service (payments of principal and interest on bonds and other debts), which would still have to be paid from a combination of state funds and local property taxation.

Some critics of the report feel that by ignoring capital and debt service costs, the Committee has not provided for equal educational opportunities in all communities.

Legislation substantially covering the Committee's recommendations has been suggested by Governor Cahill and is now under consideration.

23. How would the basic State funding be determined?

Under the Tax Policy Committee proposals:

- (1) in the Fall of each year the state Commissioner of Education, with the approval of the State Board of Education and the Legislature, would determine the amount of money "per weighted pupil" (See Question #24) which, in his opinion, would be necessary in order to provide for a "thorough and efficient" educational program during the school year beginning the following Fall, and
- (2) every school district would be entitled to that amount of money for each "weighted pupil" actually enrolled when school started in September.

24. What is meant by "weighted pupils"?

The Tax Policy Committee concluded that it costs more to educate some pupils than others. Therefore, they recommended using a weighting plan which is already part of the existing law for distributing state money to local school districts.

An elementary school pupil in grades one through six is counted as 1.0. Kindergarten pupils count less; upper grade pupils count more than 1.0, with vocational school students counting even more because of the high costs of equipment and technical instruction.

In addition, this weighting plan reflects the view that children from low income families need special educational help, so an extra 0.75 weighted pupils is added for each child who is receiving assistance under the aid to dependent children program.

25. Could a community spend more than the basic state funding if it wished?

Yes. Under the Tax Policy Committee proposal, any local school district, by becoming a "local leeway" district, could spend more per weighted pupil than the amount provided as a basic grant by the state. If the district had been spending above the basic grant per weighted pupil in the past, it could continue to spend at that per pupil level by action of the local board of education. If the school district wished to increase its spending level per pupil even more, it could do so only after approval by the voters in a referendum.

The money necessary to permit any district to spend above the basic state grant level would be raised through a combination of state and local funds. A proposed formula for determining the state share and the local share is set up in such a way that the local taxpayers in a school district of average wealth would pay half of the extra cost, and the state government would pay the other half. The poorer the community, the larger the share of the extra costs which would be paid by the state; the wealthier the community, the smaller the state share. In communities having twice the state-wide average taxable property per pupil, the local taxpayers would have to pay the full cost of any extra "local leeway" expenditures, and the state would pay nothing.

One restriction on this formula is that the state government would pay nothing beyond a local school expenditure per weighted pupil which is 33% above the basic state grant.

The effect of the formula is that the extra property tax rate required to raise this "local leeway" money would be the same in every community

which decided to spend at a given level per pupil, regardless of how rich or how poor the community is. The only exceptions would be in a few very wealthy places having more than twice the average taxable property values per weighted pupil.

Criticisms of the proposal have come from two directions. Some say that no community should be allowed to spend more on the education of its children than any other community, and that to permit it to do so violates the constitution. Other critics say that every community should have the right to spend its wealth as it sees fit, and there is no need for equality of expenditures or equality of tax burden.

26. What would happen to communities which have been spending less than the state basic grant level?

The Tax Policy Committee felt that better education would not necessarily be achieved by immediately providing large sums of money to school districts which have been spending far below the basic state grant level. These districts would be limited to an increase of 20% per year in their expenditures per weighted pupil, but with the guarantee that they could reach the basic state grant level within 5 years, and that they could go beyond this level thereafter by using the "local leeway" provisions (See Question #25).

Some critics of the proposal believe that this restriction is a denial of equal educational opportunities to the poorer communities of the state.

27. How would "state funding of schools" be paid for?

In 1971, about \$1.3 billion dollars of property taxes were raised for New Jersey's public schools. Roughly 8% of this went to pay the local cost of capital construction and debt service (a state building aid program provided about \$30 million additional). The rest was used to operate the schools.

Under the Tax Policy Committee proposals, the local share of capital and debt service costs would still be covered by local property taxes, but the rest of the existing local school property tax would be abolished, and it would be replaced by two levies:

- (1) a uniform state-wide property tax of \$1.00 per hundred dollars of true property value, and
- (2) in those communities which decide to spend more per weighted pupil than the state provides (See Question #25), an additional local property tax to pay the local share of "local leeway" costs.

The net effect would be a reduction of several hundred million dollars in property taxes for schools, and the Tax Policy Committee proposed that this amount of money should be made up by a state personal income tax.

28. Would the proposals meet constitutional requirements for financing the public schools?

This depends on what people think the courts have said and what they think will be said in the future. The Tax Policy Committee concluded that

the courts have not said that exactly the same amount of money must be spent on each pupil, but rather that the financing system should make it equally possible for every community, regardless of its wealth, to have the kind of schools it wants. The Committee argues that the proposed system does this, since:

- (a) there is a uniform basic funding level per pupil provided by the state at a uniform level of taxation, and
- (b) there is an opportunity for any community to go beyond this basic funding level if it wishes, with a formula which eliminates the financial advantages for most wealthy communities and the financial handicaps for all poor districts.

Some people, however, believe that the courts have said, or will say, that it is unconstitutional for one community to spend more per pupil than any other community. In other words, those school districts now spending below the state funding level must immediately be brought up to that level, and those spending above that level must be told to reduce their spending.

29. What if I send my children to private school?

The Tax Policy Committee made no specific recommendation with regard to financial assistance for private school children.

However, the income tax bill suggested by Governor Cahill includes a provision for a tax credit, to be deducted from the income tax, of:

- (a) \$50 per year for each child in private school in kindergarten through grade 8, and

- (b) \$100 per year for each child in grades 9 through 12.

In no case can the credit be larger than the amount of tuition actually paid to the private school.

Critics of this proposal contend that it is an unconstitutional use of public funds.

30. Would the proposed changes reduce local control of the schools?

The Tax Policy Committee expressed the opinion that local control of public schools was both desirable and feasible, even with state funding. They pointed out that the local board of education would still be responsible for:

- (1) establishing educational programs,
- (2) determining staffing ratios,
- (3) appointing personnel,
- (4) selecting and implementing auxiliary services,
- (5) establishing conditions of work and work assignments, and
- (6) the administration and management of the school system.

In addition, the local community, through the "local leeway" proposal, would have the choice of exceeding the basic state funding per weighted pupil, if it chose to do so (See Question #25).

Some critics of the proposals, however, believe that placing the financial responsibility largely on

the state government inevitably would result in some shift in emphasis from local independence toward conformance with state standards.

31. Will the proposals result in better schools?

The Tax Policy Committee recognized that expenditures per pupil is not a very adequate device for measuring the quality of education, but that it is the only device now readily available. In the hope of correcting this in the future, the Committee recommended that the state Commissioner of Education be required to develop an evaluation system for public schools, and that he be given the authority, with the approval of the state Board of Education, to develop "appropriate remedies" where a local school district fails to show enough progress. Provisions along these lines are included in the legislation now being considered.

Critics of the proposals point to these provisions as specific evidence that local control of the public schools might be in danger.

PAYING FOR LOCAL GOVERNMENT SERVICES

32. Do the proposed changes give any help to communities in providing police and fire protection, better streets, and other local services?

New Jersey now has an "urbanaid" program under which the state government provides about \$25 million per year to 24 of the largest municipalities with high tax rates, to help them provide essential public services.

The Tax Policy Committee decided that this type of assistance was desirable, but that it should not be limited to large communities. Instead, the Committee recommended a "municipal block grant" program which would provide financial aid on a sliding scale for every municipality in the state -- urban, suburban, or rural -- which has below-average amounts of taxable property per capita.

Under the proposal, a very poor community might receive from the state as much as half the amount of the property taxes which were levied for municipal purposes in the previous year. Estimates by the Committee were that 236 municipalities out of 567 would have been eligible for a grant under the proposal in 1971. The total cost was estimated at about \$100 million annually, with a net cost to the state of \$75 million, since this proposal would replace the urbanaid program now in existence.

As proposed by the Committee, the municipal block grants would have to be used in the first year to reduce taxes. In future years, use of the funds would be at local discretion, subject to withholding if they are clearly misused (See Question #33).

Bills are before the Legislature to establish the municipal block grant program substantially as suggested.

Critics of the proposal say that the program would merely pour more money into inefficient and corrupt local governments.

33. What's to keep the politicians from just spending more?

Politicians generally spend more because people want more services. The best method for holding down spending is for the citizens of a community to make their elected public officials continually aware that they want low-cost government -- if this is what they truly want.

Nevertheless, members of the Tax Policy Committee were aware that the removal of some costs from the local property tax might encourage local government officials to increase the rate of spending.

Several recommendations were made in an effort to keep spending rates down:

- (1) In the municipal block grant program (See Question #32), the Committee suggested that the state establish a system for evaluating the effectiveness and efficiency of local municipal government activities, with the possibility of withholding block grant funds if wastefulness is discovered. This proposal has been included in the legislation now being considered by the Legislature.

This requirement has been criticized as interference with local home rule.

- (2) In the school funding proposals, the Tax Policy Committee recommended that the state government negotiate binding salary contracts with employee organizations on a regional basis, on behalf of the boards of education in the region.

The legislation now being considered does not go as far in this direction as the Committee proposal. Instead, the bill under consideration permits local boards of education to join together into regional negotiating units in order to bargain with teachers and other employee groups. Another proposed piece of legislation does give the Commissioner of Education the right to approve or reject contracts between school boards and employee organizations, but only in "local leeway" districts where the state government pays more than half of the extra "local leeway" costs (See Question #25).

These limits have been criticized by persons who feel that they are undesirable restrictions on the collective bargaining process.

- (3) In addition, the Committee proposed that limits be placed on the tax rates which could be imposed for county and municipal government purposes. The tax rate limit for county government would be \$.50 per hundred dollars of property true value, and the tax rate limit for municipal government would be \$1.50 per hundred dollars of true value. In both cases, the cost of debt service would be outside the limits. Bills are before the Legislature to establish these limits as proposed.

Some critics of the Tax Policy proposals believe that the tax rate limits would unduly restrict municipal officials in trying to meet demands for public services. Other persons feel that the limits are too high to have much effect.

THE PERSONAL INCOME TAX

34. Why have a personal income tax in New Jersey?

The main reason given by the Tax Policy Committee for a personal income tax in New Jersey is that its use would permit reduction of the property tax. This change, in itself, the Committee concluded, would result in a tax system which is more elastic and more equitable (See Questions #1 and #2).

A second reason given for a personal income tax is that it would permit recapture of more funds which are paid by New Jersey residents to the Federal government. In the case of a homeowner, who might find his New Jersey income tax raised the same amount as his property tax is lowered, there would be little advantage. However, in the case of large numbers of tenants, whose contributions to their landlords' property tax payments are now buried in their rent payments, and, therefore, are not deductible for Federal purposes, there may be a significant Federal tax advantage.

A third, and more speculative, advantage of the personal income tax is that some proposed Federal revenue-sharing legislation gives advantages to states having personal income taxes.

35. How much would my State income tax be?

This depends on your income and your deductions. The tax rates proposed by the Tax Policy Committee and included in the legislation now being considered range from a rate of 1% for a taxable

income of less than \$1,000 up to 7¹/₂% at \$25,000, and to 14% at a taxable income of \$500,000.

A number of deductions and credits are permitted in figuring the tax due (See Question #38). Taking all of these into account, the estimated income tax for a typical family of 5 is shown for various income levels in the table attached to Question #4.

36. Could I deduct my New Jersey income tax from my income in figuring my Federal income tax?

Yes. The Tax Policy Committee estimated that the Federal income tax "saving" for that typical family of 5 would be:

Family Gross Income	Federal Tax Benefit of Deduction of N. J. Income Tax
\$ 5,000	\$ --
10,000	17
15,000	50
20,000	95
25,000	164
30,000	258
50,000	903

37. What would happen if I work outside New Jersey?

Under the Tax Policy Committee proposal, you would still pay income taxes to the state or city where you earn your income, but your New Jersey income tax would be reduced by a "credit" for the taxes you pay to the other state or city.

The amount of the "credit" is the amount of the tax paid to the other state or city, multiplied by a fraction made up of the taxable income earned in that state or city, divided by your total taxable income.

The income tax bill before the Legislature has the added limitation that you must pay to New Jersey at least the income tax which would be due if all your income earned outside the state were ignored, and you paid only on the income earned in New Jersey.

38. What exemptions and deductions could I take?

In general, the Tax Policy Committee suggested that deductions for interest, other taxes, medical expenses, charitable contributions, etc. should be similar to those available under the Federal income tax law.

However, they recommended that instead of the \$750 personal exemption granted in the Federal law for each dependent -- which is subtracted from the taxpayer's income in figuring the tax -- the New Jersey law should provide a \$15 per person tax credit -- which would be deducted from the tax due. The Committee's reasoning was that the use of a tax credit, which is the same for all taxpayers, is fairer to low income persons than a tax exemption, which increases in real value as the income of the taxpayer rises.

The income tax bill before the Legislature follows this general approach and, in addition, includes provisions for:

- (1) a tax credit for tenants (See Questions #7 and 8),
- (2) a tax credit for senior citizens (See Question #19),
- (3) a tax credit for parents of private school pupils (See Question #29), and
- (4) a deduction from taxable income of not more than \$2,000 for the parents of a college student.

39. What's to keep the income tax rates from being raised in the future?

The Tax Policy Committee expected that the tax system they proposed would provide enough money through normal growth to meet the anticipated needs of the state and local governments without changes in tax rates.

If there is some significant new public spending policy, however, there might be need for more or less money. In that case, the Legislature has the authority to alter the tax system to meet the need, including making changes in income tax rates. Possible actions of this sort mentioned by the Committee include a shift to substantial public funding of private schools, a major expansion of public institutions, or a large aid program for private colleges and universities.

If strict limits on public spending are really desired by the people of New Jersey, the only

really effective method is to elect legislators and other public officials who will reflect that desire.

40. Why not replace the property tax entirely with a bigger personal income tax?

The Tax Policy Committee listed several reasons for not doing this:

- (1) If it is desirable to have an independent and vital local government, then it may be necessary to provide that local government with some independent source of money to finance at least a part of its activities. The property tax is the best source of local tax money, because the real property being taxed is relatively immobile. Other things which might be taxed locally -- income, sales, other business activity -- are much more mobile, and could more readily be moved from community to community to avoid local taxation.
- (2) In order to replace the property tax entirely, a personal income tax more than triple that now proposed would be necessary, and this would have to be at the highest rates in the country.
- (3) A property tax is a desirable part of a balanced tax system because it is a stable source of revenue. The move toward elasticity in a tax system, which the Committee recommends (See Questions #1 and 2), could be over-done by going all the way and abandoning property taxes entirely. In that case, a downturn in economic trends might result in too little money being raised.

THE SALES TAX

41. Why should we keep the sales tax?

The Tax Policy Committee favored retaining the sales tax and broadening the list of items on which it is levied because they could see no good way to raise the money which would be lost if the sales tax were abandoned.

Moreover, the Committee concluded that the argument usually directed against the sales tax -- that it is regressive because it hits low income families the hardest -- is not nearly as true as has been assumed in the past. Figures compiled for the Committee showed that the New Jersey sales tax, because it exempts food, clothing, and other necessities, comes fairly close to having zero regressivity. That is, it takes almost the same percentage of each family's income, regardless of the wealth of the family.

42. Why not just increase the sales tax to get the money we need?

The Tax Policy Committee recommended against increasing the present sales tax rate of 5%, although they did suggest broadening the base of the tax (See Question #43). The Committee concluded that the 5% rate was in line with similar taxes in other nearby states, and to increase it would be to establish an unbalanced tax system.

If the sales tax were increased in order to avoid a personal income tax, the New Jersey tax system would consist largely of one very regressive tax -- the property tax, and one relatively neutral

tax -- the sales tax. As a whole then, the system would remain regressive, with low income families paying a larger share of their income than wealthier persons. The Committee preferred a three-way tax system combining the regressive (but stable) property tax, the roughly neutral sales tax, and the progressive income tax.

43. How would the sales tax be changed?

Although the Tax Policy Committee recommended keeping the sales tax with its rate of 5%, they did suggest that the tax should apply to more goods and services:

- (1) first, so that it would bring in more money, and
- (2) second, because the changes in the tax could be used to make it even less regressive than at present.

The specific changes proposed were to apply the tax to clothing and building materials, which are now exempt, and to various services not now taxed -- construction contractors' fees, the practice of law, laundry and dry cleaning services, the practice of architecture and engineering, and the practice of accounting.

Since the extension of the sales tax to clothing might make the tax more regressive, the Committee proposed that in families having incomes of less than \$1,300 per person, a credit of \$5.00 per year be allowed from the personal income tax to make up for the sales tax on clothing. The Committee felt that the other goods and services to which the sales tax would be extended are more

generally purchased by upper income persons, and their inclusion under the tax would actually make the tax less regressive than in the past.

The Committee also recommended removing the sales tax from machinery and equipment used in manufacturing. Machinery and equipment of this sort had been exempt under the original sales tax law passed in 1966, but became taxable under an amendment in 1970. The Committee felt that taxation of such machinery and equipment was having a negative effect on the state's efforts to attract and keep industry in New Jersey.

The bill proposed to the Legislature by Governor Cahill follows most of the Tax Policy Committee's recommendations, with the exception of the extension of the sales tax to clothing.

44. Why didn't the sales tax reduce property taxes before?

This question has been raised frequently since the Tax Policy Committee issued its report. Although members of the Committee were aware of the history of the sales tax, and experience with it undoubtedly influenced some of their proposals, their report does not attempt to answer the question directly. Therefore, the answer below is based largely on other information.

Many people today assume that the sales tax was intended to reduce property taxes. A review of public statements made by proponents of the tax at the time it was enacted does not support this opinion.

New Jersey's present sales tax was adopted in April, 1966 as a substitute for a personal income

tax proposed earlier in that year by Governor Richard J. Hughes. In suggesting the tax, Governor Hughes recommended that only \$90 million of the money anticipated annually should be earmarked for increased state aid to local schools in the hope that it would "...moderate the pressure of rising local taxes..." The rest of the money was to be used for a variety of other purposes -- construction of colleges and other state institutions, construction of state and local highways, aid to commuter transportation, college scholarships, increased local health services, and the construction of new sewerage systems.

Thus, the amount of property tax relief which might be expected was fairly small, especially when examined in the light of a total property tax levy which was growing at an average annual rate of more than \$75 million per year. Not much more than one year's relief should have been anticipated.

In fact, there was one year's relief. The enactment of the sales tax was accompanied by a law which distributed \$63 million of the new state school aid funds in such a way that the money had to be used in 1966 for property tax reduction. In that year the overall state-wide average property tax rate dropped from \$3.04 per hundred dollars of true value in the previous year to \$2.95.

By 1967, however, the average tax rate was \$3.11, and it has gone up steadily since then, with the annual increase in tax levy rising from the \$75 million of the early 1960's to about \$250 million by the end of the decade. The question remains as to why property tax rates rose so rapidly in the latter part of the period, and whether anything in the Tax Policy Committee

proposals would prevent this in the future. There probably are many reasons, but three seem to stand out:

- (1) The changes in state aid programs enacted at the time the sales tax was adopted did nothing to change the basic pattern of responsibilities for financing local government. While more money was made available each year, costs were rising at \$75 million per year. The new money might set the property tax increase back a year, but so long as the same local services had to be financed locally with rising costs, the upward trend of the property tax was bound to resume shortly.

In contrast, the Tax Policy Committee proposals do make some change in the basic pattern of financing, with the responsibility for a number of programs being transferred from local government to the state government (See Question #16).

- (2) Inflation, which had been a factor in the early part of the decade, became more and more important after 1965. The cost of all goods and services, both in private business and in government, became more expensive as the value of the dollar dropped.

The Tax Policy Committee attempted a solution to the inflation problem through the design of a tax system which they believed would be more elastic, therefore producing more money in times of rising costs (See Questions #1 and 2).

- (3) Enactment of the sales tax coincided roughly with growth in the organization of public employees and an increase in collective bargaining on salaries and other personnel matters. It is significant that the average

teacher's salary in New Jersey rose less than \$300 per year between 1962-63 and 1966-67, but increased an average of more than \$600 per year from 1966-67 to 1970-71. Where some might say that public employees were demanding and receiving excessive pay, others would argue that only through militant action were public personnel gaining a fair wage which had been denied them earlier.

An attempt was made by the Tax Policy Committee to limit undue salary increases for public employees, particularly in the educational area, by calling for regional collective bargaining (See Question #33).

TAXES ON BUSINESS

45. How would taxes on business change?

Some of the proposals of the Tax Policy Committee which would have an impact on business have been described in other questions. The reduction in property taxes obviously would affect property owned by business as well as all other property in a community (See Questions #13 to 21). Changes in the sales tax also would apply to purchases of goods or services by businesses (See Questions #41 to 44).

In addition, the Tax Policy Committee proposed modification of some taxes specifically applying to business enterprises:

- (1) New Jersey corporations now pay taxes both on their net income and on their net worth. The Committee suggested that neither of these bases should be abandoned, but that the emphasis should be shifted more toward net

income as a better indicator of the corporation's ability to pay taxes.

Therefore, the specific recommendation was made that the rate of the corporation net income tax should be increased from $4\frac{1}{4}\%$ to $7\frac{1}{4}\%$, while the tax rate on net worth should be left unchanged.

The Committee also proposed that a net income tax be levied against "second-tier" corporations -- those incorporated in another state, but deriving a part of their income from business conducted in New Jersey.

- (2) Business now pays to the state a property tax of \$1.30 per hundred dollars of value on personal property -- primarily machinery and equipment. The value of such property is figured for tax purposes at one-half of its acquisition cost.

One recommendation of the Committee was to abolish the sales tax on such property (See Question #43) because this sales tax might hold business back from new purchases. In order to recoup the money lost by this change, the Committee suggested raising the business personal property tax rate from \$1.30 to \$2.00.

- (3) Unincorporated businesses now pay a tax of $\frac{1}{4}$ of 1% on their gross receipts.

The Tax Policy Committee felt that this sort of tax has no relationship to any measurement of ability to pay. It measures neither the value of property owned, nor the profitability of the business. Therefore, the recommendation was made for abolition of the tax.

- (4) Certain large retailers are currently required to pay a retail gross receipts tax of 1/20 of 1% on gross sales.

The Committee believed that this tax constituted unfair discrimination against a particular class of taxpayer, and that it should be eliminated.

All of these proposals are included in bills now being considered by the Legislature, although the proposed increase in corporation net income tax rates has been made more gradual, going to 5 $\frac{1}{2}$ % immediately, and to 7 $\frac{1}{2}$ % in 1974. In addition, the excess gains tax developed in answer to the business "windfall" issue (See Question #5), while not part of the Tax Policy Committee proposals, is included in the bills now before the Legislature.

These questions and answers are intended to provide a brief summary of the proposed changes in the New Jersey tax system. Obviously, they do not cover all of the details included in the six volumes of the Tax Policy Committee report or in the more than 50 bills introduced thus far into the State Legislature.

Staff members of the Bureau of Government Research will attempt to provide further information upon request, or to refer inquiries to appropriate authorities. The Bureau is located in Building 4053, Kilmer Area, Rutgers University, New Brunswick, New Jersey, 08903; Telephone, 201-932-3640.