Introduction

New Jersey faces a new millennium with a tax structure whose centerpiece is a creaky, outmoded relic from colonial times. More than any other state, we continue to tax the value of property to get most of the money we spend for schools and a host of local services. We do this even though we know that calculating the worth of your home is not the best way to
measure your ability to pay taxes. We do it even though the result is a tax burden that takes a higher percentage of a lower-income family's earnings or net worth than it takes from the wealthiest.

There are strong signs that people want this changed. In October of 1999 The New Jersey School Boards Association released a statewide poll it commissioned from The Eagleton Institute of Politics at Rutgers University. The findings made headlines: more than half the people in New Jersey said they believe the local property tax is the state's least fair tax. What's more, nearly 60 percent said they would support an increase in the state income tax if the money went for school funding and there was an offsetting reduction in property taxes.

The public shows a marked willingness to think things through, to consider alternatives, to see the problem whole. If policy makers catch up with the public, a substantive, honest, real debate can replace a narrow, hemmed-in discussion framed by the notion that tax increases, no matter how much they might improve things for average people, are philosophically taboo or politically suicidal.

The report Judith C. Cambria has prepared on the pages that follow examines New Jersey's tangled web of property tax relief measures in terms of their scope, adequacy and equity. This work can be an instrumental part of that debate. It is a primer and a call to action rolled into one. In the first section, New Jersey's patchwork of property tax relief programs are identified and explained in detail. Reading this makes it clear just what a confusing and at times counterproductive system we have. Aspects of it give the most assistance to the people who need it the least. Redundancies co-exist with unconscionable gaps in who is covered.

It is hard to read this and not conclude that New Jersey's years-long intertwining of politics and policy on property tax relief has taken us about as far as we can get. It will take boldness that means major changes in how we think about and pay for property tax relief if further relief is to be realized and current inequities made right. As the author's analysis of the new NJ SAVER program points out, this can no longer be a zero-sum endeavor, not if it is going to offer people meaningful, fair relief from the burden of property taxes. It is time to get beyond the politics of the moment and take a hard look at how New Jersey raises the revenues it needs. The amount of money available to provide property tax relief has to be expanded.

The second part of this report deals with what can be done. First, increase state support for education. As the report shows, no public service paid for by the local property tax in New Jersey costs more than schools. Relying more on the state income tax and less on property taxes to fund education would make ours a far more just system than it is now. Second, restructure the state's existing property tax relief programs to disburse the money now available more effectively and more efficiently.

Judy Cambria shows us that it is time to stop nibbling at the edges of this problem. Years of doing so have turned New Jersey's property tax relief system into something of a monster, the care and feeding of which keeps us from the larger issues that the system was supposed to solve in the first place.
NJPP is grateful to the author for putting her years of expertise and insight to work in a report that helps show the way to reform New Jersey's property tax relief system. This is the second piece in NJPP's property tax project. The first came in 1998, when David C. Mattek analyzed the Senior Citizen Property Tax Freeze and concluded that such a piecemeal approach would produce less than the desired and promised results. Our next report will outline an alternative to the NJ SAVER program that builds on some of Judy Cambria's lessons. NJPP is committed to help frame the debate on this crucial issue, and confident that an informed public will lead the way.

- Jon Shure -

The property tax burden in New Jersey

It is no surprise that reducing property taxes is always a hot topic in New Jersey. Our tax structure depends much more heavily than most states on taxing the value of land and buildings to pay for schools and for government services at the local and county level. New Jerseyans in 1998 paid $13 billion in property taxes. This was 42.5 percent of all revenue collected at the state and local level, significantly above the national average of 33 percent. Indeed, New Jersey's property tax overburden gives the state the number one ranking in the nation when measuring property taxes per capita, and number two for property taxes as a percentage of personal income.

New Jersey citizens see twice as much of their earnings spent for property taxes as the average across the United States. And this doubling of the tax burden affects every income level, from the poorest to the wealthiest. The average property tax on each residence in New Jersey has reached $4,000.

Regressive Nature of Property Tax

Because the property tax is levied on an essential need-shelter-no homeowner or renter in New Jersey can escape paying. But not everyone is affected equally, because someone's ability to afford the cost is not factored in. The essential nature of taxing property is that the lower someone's income is, the higher percentage of that income they have to pay. The 20 percent of non-elderly families in New Jersey with the lowest income pay, as a percentage of income, three times more than the wealthiest: 9 percent versus 3 percent. Include low income senior citizens in the group and the disparity grows even higher.

This is clearly not a flat tax, which takes the same percent from every income group. And it is the opposite of a progressive tax, that calls on those making more to pay a higher percentage.

Fragmentation of Government Exacerbates Inequity

More than just the tradition of relying on property taxes accounts for New Jersey's situation. The excessive fragmentation of government plays an inescapable role. Having a state with 21 counties, 566 municipalities and more than 600 school districts, each setting its own property tax rate, results in enormous disparities in those rates. Flight from the cities (by businesses and people), great economic stratification among municipalities and the
continuing existence of poor rural towns has exacerbated the mismatch of wealth and needs which is reflected in the significant differences in property tax rates across the state.

The total property tax rate ranges from less than $1.50 per $100 of assessed value in 31 municipalities to $1.50-to-$1.99 is 91, $2.00-to-$2.99 in 353, and $3.00-to-more than $10 in 95. Because of these disparities, a homeowner in one town can pay up to four times more in property taxes than someone living in a house worth the exact same amount in another town.

Having fewer and larger taxing jurisdictions would, at the very least, reduce disparities in tax rates among municipalities and school districts. In addition, some reduction of costs through economies of scale would be likely. However, regionalization of schools and consolidation of municipalities have proved to be difficult or impossible to accomplish because no elected state official will support mandatory measures and when proposals come to a public vote they usually fail. Even if accomplished, such changes in the governmental structure would help relieve some of the unfairness and the burden, but would not correct the more fundamental problem: New Jersey's overuse of property taxation.

Catalysts for Property Tax Reduction

New Jersey's history through mid-20th century was one of very low state taxation. Trenton asked for little and provided little, so virtually no state aid went to schools, municipalities and counties. Neither a sales nor personal income tax were levied by the state. Property taxes paid virtually all local and county service costs.

The major impetus for increasing state aid was the growing cost of education as schools were inundated by the post-World War II baby boom. As enrollments rose, the percentage of state aid declined to 21 percent. Governor Richard Hughes made education an election issue in the 1960s, and while he failed in his effort to get a state income tax through the Legislature, Hughes did succeed in enacting a sales tax. A new school aid law resulted and then in the 1970s a legal challenge to New Jersey's school funding system brought about massive change. The New Jersey Supreme Court declared the state's method for funding schools-which relied so heavily on the property tax-to be unconstitutional.

It took four years to pass and fund a new school aid system, which in turn served as a catalyst for new actions to reduce the property tax burden. Forced to come up with a new source of revenue to increase school funding and meet the court's demand for a system that relied less on the inequities of property taxation, elected leaders were determined to assure the money would be used for property tax relief. When the income tax was approved in 1976, a provision included conducting a public vote on amending the state constitution to guarantee that every penny collected from the state income tax would be put into a Property Tax Relief Fund. The money could be used in very limited ways: to fund schools, municipalities, and counties or in other ways reduce property taxes. As part of the package, the Homestead Rebate was created. This was the first far-reaching property tax reduction program for individuals in New Jersey (a smaller veterans rebate had been passed earlier).

Court challenges to the constitutionality of subsequent school funding laws continued to play a major role in mitigating property taxes by means of increasing aid to education.
Overall though, property taxes continued to increase, leading officeholders to devise additional relief programs for local governments and individuals.

This report examines the extent of these programs, as well as their adequacy and equity.

**Tax equity: a definition**

Equity is defined as just, impartial and fair. But when it comes to defining tax equity, what is fair and just frequently is debatable, even inflammatory. A progressive income tax is considered just by some because it is based on ability to pay and takes a higher proportion of the income of more affluent citizens who will not be so negatively affected. For exactly the same reason, it is considered unjust by others who see no reason why the wealthy should pay proportionately more for services enjoyed by all.

The debate is not quite so divided concerning property taxation, but universal agreement still does not exist. The unfairness of levying a substantial tax on an essential need, regardless of ability to pay, lies at the heart of the argument against property taxation. This is a relatively recent objection, because in the early years of property taxation only the most well off citizens had property to tax. So the impact of a tax on property was similar to a tax on income or wealth.

Today there are many inherent problems with property taxation that undermine any argument that it is equitable. Difficulties with assessing value and keeping assessments current seem insurmountable. Large disparities in the tax burden among income groups are clearly documented. And in New Jersey the extremely uneven distribution of real property wealth from town to town and among counties, plus disparities in the population, number of school children and value of tax-exempt property lead to inequities in the actual dollars paid by citizens for property taxes. This is particularly troubling in the case of such widely used, essential public services such as education and the courts.

There are even more distressing realities. Reliance on property taxation to fund schools contributes to differences in educational quality from place to place. In some cases property taxation can force people from their homes and out of the state because they cannot afford to stay. Added to that is the contribution of our property tax system to sprawl, destruction of open space and natural habitat and traffic congestion as municipalities embrace development in hopes that somehow the increase in assessed value will lower residents' property taxes.

Opponents of major reform argue that eliminating property taxes would mean raising other taxes to intolerable levels. This is a red herring because no one seriously tries to make the case for entirely doing away with property taxes. What is needed is a public policy response broader than any to date. It should be aimed at:

- Reducing property taxation to the lowest possible level
- Adopting state measures to better equalize property taxes among municipalities and school districts
- Enhancing tax equity by assuring that state revenue devoted to individual property tax
Reduction is targeted to those suffering with the heaviest tax burdens.
- Conserving and wisely managing difficult-to-raise state resources by recognizing that the politically popular scheme of giving property tax relief to everyone, regardless of need, wastes money and dilutes the relief for people who need it most.

**State property tax relief programs in 1999-2000 budget**

The $8.4 billion in direct property tax relief programs in the fiscal year 2000 budget represents 43 percent of the state's annual spending. Another $400 million in indirect relief from the state takeover of costs for social services and county-level courts pushes property tax relief to 45 percent of the state budget. The major revenue source to fund these programs is New Jersey's personal income tax, constitutionally dedicated to property tax relief.

**Growth of Income Tax Revenue**

The extraordinary economic good times of the late 1990s has greatly increased revenue from New Jersey's two broad-based state taxes. Sales tax receipts rose by $1.382 billion from 1996 to 2000, and the "take" from the state's tax on personal income grew by an even more phenomenal $2.13 billion-despite a 30-percent cut in rates. High employment, wage increases for higher income workers, and a booming stock market's capital gains bounty for individual taxpayers accounted for the increased revenue.

In the current fiscal year, the state anticipates $6.8 billion in revenue from the personal income tax. This money flowing into the Property Tax Relief Fund provides more than three-quarters (77 percent) of what is to be spent for property tax reduction programs. The rapid increase in income tax revenue has enabled the administration and Legislature to increase school aid significantly to comply with the state Supreme Court's order for parity in funding for poor urban districts and additional aid elsewhere. It also made it possible creation of NJ SAVER, the new program that gives homeowners back some of the property taxes they paid toward schools. Even with this extraordinary revenue growth, NJ SAVER will have to be phased in over 5 years because of its high cost, which is to reach $1 billion annually starting in 2004.

<table>
<thead>
<tr>
<th><strong>Direct and Indirect Relief</strong></th>
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<tbody>
<tr>
<td>State Aid for School Districts</td>
<td>$6.0 billion</td>
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<tr>
<td>State Aid to Counties and Municipalities</td>
<td>1.6 billion</td>
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<tr>
<td><strong>Individual Property Tax Reduction Programs</strong></td>
<td></td>
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<tr>
<td>Homestead Property Tax Rebate</td>
<td>348 million</td>
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<tr>
<td>School Assessed Value Exemption Rebate (1999)</td>
<td>170 million</td>
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<tr>
<td>Deduction of Property Tax from Income Tax</td>
<td>250 million</td>
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<tr>
<td>Senior Citizen Property Tax Freeze (1998) level</td>
<td>23 million</td>
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<tr>
<td>Veterans Property Tax Deduction</td>
<td>17 million</td>
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<tr>
<td>County Social Service/Court Costs</td>
<td>400 million</td>
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<tr>
<td>TOTAL</td>
<td>$8.8 billion</td>
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NOTE: school aid includes payments to Teachers Pension and Annuity Fund (TPAF), Social Security, payment of health insurance costs for retirees and debt service payments on $2.8 billion in pension bonds which total $700 million. Because TPAF is fully funded, the state is making no payment into that pension fund in FY 2000.

Aid to education

These pages do not include an in-depth analysis of the Comprehensive Educational Improvement and Financing Act of 1996, New Jersey's current school funding law. We will, however, review how and why $5.3 billion in direct school aid is distributed as it is. This aid is designed to assure adequate fiscal resources to provide quality education, not to provide property tax relief for everyone. Two overriding factors shape the allocation of school aid in New Jersey.

1. A long history of "home rule" accompanied by a fragmented municipal and school governance structure which results in enormous disparities in numbers of students to be educated, the socioeconomic background of students in different districts and the wealth available to support their education.

2. New Jersey Supreme Court decisions in school finance cases based on the New Jersey Constitution which requires a "thorough and efficient system" of education.

The long and ongoing struggle over school finance in New Jersey has brought about the following distribution in the current budget.

Foundation/Equalization Aid

Almost half of all direct school aid, $2.6 billion, is distributed in an attempt to equalize the fiscal resources available to school districts. The objective is to make sure each has the financial capacity to provide the educational and other services for students to achieve state core curriculum content standards. The effect of this policy is to direct a major portion of state money to school districts lacking sufficient property and income wealth to provide adequate funds to educate the children residing there. This aid includes $243.5 million as a result of the state Supreme Court's mandate that New Jersey fund 30 poor urban districts at the level of average spending in the state's wealthiest districts.

Statistics help to illustrate the disparity that exists. While the poorest districts serve 30.6 percent of all students-about 390,000 children-they account for only 16.4 percent of the state's property value, and 16.5 percent of personal income. Because of this profound imbalance, 60.1 percent of state aid for equalizing fiscal resources goes to these districts. The less affluent out of a large group of middle-income districts get almost all the rest, 35.9 percent.

Special Education and Transportation Aid
All school districts benefit from state aid for special education students and transportation costs. This accounts for 17 percent of school aid, or $921 million. A large group of middle-income districts gets 49 percent of this aid, while the wealthiest get 14.6 percent and the poorest, 33 percent.

**Early Childhood Education and Demonstrably Effective Program Aid**

State Supreme Court decisions in 1990, 1997 and 1998 recognized the greater needs of disadvantaged children in poor urban districts. They required the state to fund additional educational programs plus health and social services needed to address these needs. The 1996 school aid law expanded the number of districts eligible for aid for special programs for disadvantaged students to all schools with a specified proportion of low-income students. The law also mandated half-day preschool and full day kindergarten programs in all these districts. Now the poorest school districts receive $408.3 million for "Demonstrably Effective" programs and preschool and full-day kindergarten. The less affluent among the middle-income districts receive $73.8 million.

**Pension, Social Security**

The state pays 100 percent of the costs for the Teachers Pension and Annuity Fund (TPAF), Social Security, health benefits for retirees and debt service payments on $2.8 billion in pension bonds. Because of asset growth in TPAF, the state did not have to make any payment to that fund this year for retirement benefits. Costs in FY 2000 are $700 million. School districts which pay higher salaries receive greater benefits from this form of indirect state aid.

**Debt Service Aid**

State debt service aid helps districts with their capital construction costs. The wealthiest districts get no aid, and others receive aid in the same proportion as the state aid they get for regular education costs. However, it is not uncommon for the state to fail to fund debt service at 100 percent. When this occurs, payments to districts are reduced by the percentage that the state underfunds the total debt service.

The new School Facilities and Financing Act under consideration as this is written will make changes affecting eligibility for debt service aid.

**Recent changes affecting distribution of school aid and school tax rate**

The 1996 school finance law changed the method for allocating foundation/equalization aid, giving the state Commissioner of Education power to determine how much it costs to provide the "thorough and efficient" education guaranteed under the state constitution. As a result, some school districts lost eligibility for this aid, and others saw their proportion of aid reduced.

Significant changes in eligibility for equalizing aid resulted from two other factors. The
base for determining the wealth of districts measured in terms of personal income was changed from 1989 census data to 1996 state income tax data, reducing the number of districts eligible for assistance. Soaring growth in personal income from 1996 to 2000 continues to reduce that number. The effects of these changes were so severe that the Legislature added new state aid categories in an attempt to ameliorate the loss of state aid to a number of districts.

Meanwhile, dependence on the local property tax to support schools has increased. From 1994 to 1999, the average state property tax for schools rose by 13.4 percent, to $1.34 from $1.16 for $100 of assessed property value. Differences in average property tax rates among four groups of school districts were reduced to 10.6 cents from 16.6 cents, or 36 percent. The school tax burden of "Other Poor" districts increased the most, by 22.5 cents. The "Middle" districts saw their rate increase by 20.7 cents, and the "Wealthiest" by 15.7 cents. The special needs, poor urban districts had the smallest increase, 9 cents.

These figures show two trends, one negative and one positive. In general, the continuing increase in dependence on property taxes to support schools intensifies the negative effects of such taxation, increasing the inequities among income levels and municipalities. Citizens with lower incomes are most negatively affected since the proportion of family income spent on property taxes increases as income decreases. However, the reduction in disparities in school tax rate among districts indicates that changes in the distribution of school aid have somewhat reduced systemic inequities in the school tax burden.

### Aid to counties and municipalities

In FY 2000, the state is devoting $2 billion to reducing municipal and county property taxes. Of this, $1.6 billion is direct aid and $400 million indirect.

The largest single program, at $750 million, is funded by the Energy Receipts Tax, formerly the Gross Receipts Tax. The Gross Receipts Tax was a levy on utility companies, based on the value of the infrastructure they had in each municipality. Consequently, the beneficiaries of this tax, and its successor Energy Receipts Tax, are those communities in New Jersey where major facilities owned by utilities are located.

<table>
<thead>
<tr>
<th><strong>Direct and Indirect State Aid</strong></th>
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<tbody>
<tr>
<td>Energy Receipts Tax Program</td>
<td>$750 million</td>
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<tr>
<td>Consolidated Municipal Property Tax Relief Program</td>
<td>$768 million</td>
</tr>
<tr>
<td>Municipal Block Grand (per capita revenue sharing)</td>
<td>$33 million</td>
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<tr>
<td>Extraordinary Aid (for smaller municipalities)</td>
<td>$30 million</td>
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<tr>
<td>Indirect State Aid to Counties</td>
<td>$400 million</td>
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As its name implies, the $768-million Consolidated Municipal Property Tax Relief Program is a compilation of a variety of tax relief programs adopted over the years. No specific state revenue source supports this program. Rather, most of the money comes from general
revenues. Within this category are a variety of programs designed to address fiscal problems of New Jersey's large cities with their low property tax bases, low personal income and large numbers of tax-exempt property owned by houses of worship, government and other non-profit entities. A revenue-sharing program, with varied per capita amounts which reflect the local property tax burden, also is included in this group.

The Municipal Block Grant program sends revenue to local governments on a per capita basis. At $33 million, it provides minimal property tax relief. The last category of direct assistance, called Extraordinary Aid, totals $30 million and provides money to smaller municipalities.

This year a new law was enacted to increase the amount of direct property tax relief to local government each year based on inflation. The inflator is applied to the actual dollar amount of aid provided to each municipality. In its first year this measure increased municipal aid statewide by $11.3 million.

Property tax relief also results when the state takes over responsibility for programs and services formerly run by counties or municipalities. The latest of these takeovers were the state's assumption of costs for courts and some social services in counties. This indirect form of relief reduced the amount that would have had to be raised from property taxes in FY 1999 by $400 million.

**Individual property tax reduction programs**

The programs listed above are far less than what would be needed to significantly reduce the burden and inherent inequities of property taxes. As a result, New Jersey has over the years adopted a number of programs targeted to help individual property tax payers. Three very large and two smaller programs make up this effort.

The basic purposes of individual property tax reduction programs should be to reduce property tax inequities among citizens and to target relief to those citizens suffering from excessive property taxation. Such relief should be based on two principles: creating the greatest amount of fairness in the tax system and conserving hard-to-come-by state tax resources for essential needs.

<table>
<thead>
<tr>
<th>Individual Property Tax Relief</th>
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<tbody>
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<td>Homestead Rebate</td>
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<td>$23 million</td>
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<td>Veterans Property Tax Rebate</td>
<td>$17 million</td>
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**Circuit Breakers and Homestead Exemptions**
The two major strategies for simultaneously reducing property taxes and equalizing differences in the property tax burden among taxpayers are the "circuit breaker" and the homestead exemption.

Taking its name from a mechanism that prevents electrical circuits from overloading, a property tax circuit breaker "trips" when those taxes reach a certain percentage of a taxpayer's income.

How much this type of property tax relief costs the state depends on the percentage of their income someone has to pay in property taxes before being eligible for relief. A "pure" circuit breaker does not give relief to everyone, so the cost to the state is likely to be significantly lower. The state also can control cost by setting an upper limit to the amount of relief it will give a household, even if someone's property tax burden as a percentage of their income theoretically qualifies them for higher levels of relief.

The cost of a circuit breaker escalates rapidly if elected officials choose the politically popular route of giving all taxpayers some relief. The greater cost of this "something for everyone" approach usually forces the government to set lower limits on the amount provided to any one household. This in turn dramatically reduces the ability of the program to reduce excessively high tax burdens and undermines the goal of better equalizing individual property taxes.

A homestead exemption, in effect, shields or makes exempt from property taxes some portion of the value of everyone's home. This type of program is more widespread in the United States than the circuit breaker. Every homeowner benefits from the exemption. To do anything more than just shift the property tax burden within a community, an exemption must be accompanied by state funds to replace the money not being collected for schools and local government services. With state replacement the exemption system reduces disparities among municipalities and also gives the greatest relief to homeowners who need it most. The following chart explains.

<table>
<thead>
<tr>
<th>The Homestead Exemption</th>
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<tr>
<td>The exemption system helps to equalize the tax burden because it does two things:</td>
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<tr>
<td>1. The amount of tax relief is pegged to someone's property tax rate, so it helps to reduce disparities among municipalities, as shown below.</td>
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<tr>
<td>&quot;Value&quot; of Exempting First $10,000 of a Home's Worth</td>
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<tr>
<td>TAX RATE</td>
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<td>$2</td>
</tr>
<tr>
<td>$3</td>
</tr>
<tr>
<td>$4</td>
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</table>
2. The proportional reduction in an individual taxpayer's property tax is greatest for those in the lowest valued homes and decreases steadily as the value of the home increases. Effectively, this gives greater proportional relief to less affluent homeowners in lower value homes, combating some of the regressive nature of property taxes.

<table>
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<tr>
<th>HOME VALUE</th>
<th>TAX REDUCTION</th>
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<tr>
<td>$50,000</td>
<td>20% tax reduction</td>
</tr>
<tr>
<td>$100,000</td>
<td>10% tax reduction</td>
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<tr>
<td>$200,000</td>
<td>5% tax reduction</td>
</tr>
<tr>
<td>$400,000</td>
<td>2.5% tax reduction</td>
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The drawback of the homestead exemption, in terms of tax equity and the cost to the state, is that it provides relief to every homeowner regardless of income, need, or tax burden. It provides relief in very low property tax areas as well as high. The goal of increasing tax equity is undermined by the design of the program. And, the cost in state revenues is higher.

Many citizens will receive no relief unless a circuit breaker or homestead exemption covers renters as well as homeowners. Landlords pass on their property taxes to tenants as part of the rent, and many renters are low income citizens for whom that additional rent is a serious burden.

New Jersey's circuit breaker-the Homestead Rebate- and its homestead exemption-NJ SAVER-are structured in ways which weaken their ability to reduce the inequities in property tax burden among individuals in different income groups and municipalities.

**The Homestead Rebate: New Jersey's Circuit Breaker**

Aside from a property tax rebate for veterans enacted after World War II, New Jersey's oldest and largest individual property tax reduction program is the Homestead Rebate, originally enacted in 1976 as a companion measure to passage of the personal income tax. At its origination the Homestead Rebate was a combination program, providing a rebate for all but very-high-income residents and a circuit breaker feature which gave additional relief to those for whom property taxes exceeded 5 percent of income.

Among the positive features of this program was that it covered younger homeowners and renters as well as senior citizens. On the negative side, a relatively high amount of relief was given even to those whose property tax was less than 5 percent of income. The revenue demands of the "something-for-everyone" feature necessitated a relatively low cap on the amount of relief provided to those carrying the highest tax burden. The circumstances under which this program was conceived and approved account for its design: legislators voting to impose a state income tax for school funding wanted to reduce the political consequences by spreading property tax relief to as many citizens as possible.
The Homestead Rebate has never been immune to political and partisan considerations. When party control of both houses of the Legislature shifted in 1991, and the new majority voted to reduce the state sales tax to 6 percent, money had to be found to close the ensuing revenue gap. As a result, the Homestead Rebate was revised to eliminate benefits for everyone under 65 years of age, except for the disabled and those with annual incomes below $40,000. The program now in place provides rebates for the lower-income group of $90 for homeowners and $30 for renters. Benefits for homeowners over 65 include a $100 or $150 minimum payment for those with incomes up to $100,000. For senior tenants the minimum payment is $35 or $65. The maximum payment for both homeowners and tenants over 65 is $500 per household. Benefits for tenants are based on 18 percent of rent paid.

Many higher income seniors actually receive rebates above the minimum they would be eligible for based on actual income received. This bonus occurs because the state income tax provides a number of exemptions for seniors in determining taxable income. Seniors are allowed an extra $1,000 personal exemption, they don't have to report income from Social Security, and they can deduct $7,500 (single) or $10,000 (couple) of retirement income from taxable income. A recent law doubles the retirement income deduction in future years. The impact of this is that seniors with relatively high gross incomes have significantly lower taxable income. Their property tax might then be more than 5 percent of their taxable income, tripping the circuit breaker and giving them more than the minimum allowable relief. This results in a disparity where, for example, a senior citizen couple with income in excess of $50,000 can receive a $500 rebate while younger families with children earning less than $40,000 receive $30 (tenant) or $90 (homeowner) because they are unable to take advantage of deductions to reduce their taxable income to the same point as the seniors'.

Under the current Homestead Rebate, the majority of benefits go to senior citizens, with a substantial portion going to relatively high income senior citizens.

The Homestead Rebate program comes with no guarantee, as evidenced by this statement found on state income tax forms: "Rebate amounts and qualifications for eligibility are subject to change due to budgetary restrictions." The cost of Homestead Rebates this year was $348 million.

**NJ SAVER: New Jersey's Homestead Exemption Program**

The newest, and potentially largest, program aimed at property tax reduction for individuals is NJ SAVER, which stands for School Assessed Value Exemption Rebate. Beginning in 1999 it authorizes an exemption of a portion of the value of a home from the school property tax. The value of the exemption is to be phased in over five years, starting at $9,000 in 1999 and increasing to a maximum of $45,000 in 2004.

The key features of the program are that it provides relief to every homeowner and that property taxes levied by municipalities and counties or for other limited purposes are not included in the exemption.

The cost of this program was estimated by the administration to be $200 million in 1999 and to increase incrementally to $1 billion when fully phased in. However, actual spending
in the Fiscal Year 2000 budget is $170 million. Despite the massive cost of $1 billion, which could consume as much as five percent of the entire state budget, NJ SAVER was passed by the Legislature and signed into law by the Governor unaccompanied by a tax increase or any other means to pay for it. For this reason, NJ SAVER can only be described as potentially the largest property tax relief effort in New Jersey; whether it will fulfill that promise is questionable. The increasing demand for revenue to pay for the program could be impossible to meet in light of other state needs and ballooning annual payments of interest on the state debt.

The design of the NJ SAVER program, limiting the tax exemption to the school property tax, raises a serious problem of equity. Fragmentation of government in New Jersey contributes to a situation in which property tax rates in general and the percentage of a homeowner's overall property tax bill that goes toward schools vary widely across the state.

<table>
<thead>
<tr>
<th>1998 School Tax Rates and Total Property Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Municipalities by School Tax rate</td>
</tr>
<tr>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>1</td>
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<tr>
<td>0</td>
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<tr>
<td>1</td>
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<tr>
<td>14</td>
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<tr>
<td>56</td>
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<tr>
<td>157</td>
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<tr>
<td>156</td>
</tr>
<tr>
<td>97</td>
</tr>
<tr>
<td>57</td>
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<tr>
<td>26</td>
</tr>
</tbody>
</table>

In municipalities served by more than one school district (for example, a local K-12 system and a regional high school) the school tax rate is determined by combining the tax rates for each school district. Special districts such as county vo-tech and special education schools are not included.

As the chart indicates, 82 percent of New Jersey school districts have school tax rates between $1.00 and $1.99 per $100 of assessed home value. On the other hand, the total property tax rate in 79 percent of New Jersey's municipalities exceeds $2.00. It is clear that using the total tax rate instead of the school tax rate would have provided more relief.

More important, limiting the exemption only to school tax significantly skews the distribution of tax relief. Significantly larger rebates will go to more affluent citizens in suburban municipalities than to the lower income residents in poor urban cities because school taxes make up only 34.0 percent of overall property taxes in New Jersey's 12 largest
cities, but make up 55.1 percent in the rest of New Jersey. Despite their lower school tax rate, the overall property tax rate is higher in cities and average family income is far lower ($33,705 compared to $67,730). (The Politics of Property Tax Rebates, Mark J. Magyar, *New Jersey Reporter* 2/99) The rebates of many city residents will be reduced even further because their homes are valued at less than $45,000.

The amount of rebate varies significantly as the school tax increases. Using figures for 2004, if the tax rate increases from $1.00 to $1.50 the rebate increases 50 percent, from $450 to $675. If the rate goes up to $2.00, the rebate doubles to $900.

NJ SAVER was created in such a way as to guarantee that the greatest amount of tax relief goes to homeowners in high spending, high school tax rate, suburban municipalities in North Jersey. The lowest rebates go to homeowners in poor cities. For example, the average rebate for homeowners in Camden when the rebate is fully phased in would be only $150 compared to $900 in the kinds of suburban districts described above. Other homeowners getting the "short end of the stick" under this program live in South Jersey communities with lower school spending and lower school tax rates. Rebates in the shore resort communities will be very small, some even less than those in cities.

**Deduction of Property Tax from State Income Tax**

Unlike the federal and many state personal income taxes, New Jersey's income tax is a "gross" tax, with relatively few deductions allowed. One such deduction added long after the 1976 passage of the income tax was the deduction of the individual's property tax from income when computing the amount of income tax owed. This deduction has come and gone, and then returned again. It originally was enacted during the 1980s only to be eliminated in the early 1990s and restored in 1996.

This income tax deduction turns upside down the notion that property tax relief measures should be aimed at undoing the unfair, regressive aspects of local property taxes. Instead, it only exacerbates the problem by providing no relief at all to our poorest citizens and increasingly greater relief as income rises.

By 2001, as many as 600,000 of New Jersey's poorest households will not receive a dime's worth of the tax relief provided by the property tax deduction. These are people who don't make enough money to have to pay the state income tax so they have no ability to take any deductions from that tax. At present, about 340,000 NJ residents earning less than $7,500 pay no state income tax. By 2001, a change in the income tax law exempting single taxpayers making less than $10,000 and couples and families making $20,000 or less will take another 261,000 households off the income tax rolls. Exempting the working poor from state income tax is a positive step, but as we see, it also prevents such people from enjoying tax-relief benefits offered only to the more financially well off.

The following chart illustrates how the amount of tax relief to taxpayers increases as income grows.

<table>
<thead>
<tr>
<th>TAXABLE INCOME</th>
<th>$35,000 (married)</th>
<th>$45,000 (married)</th>
<th>$95,000 (married)</th>
<th>$25,000 (single)</th>
</tr>
</thead>
</table>

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The cost of the deduction of property taxes is $250 million. This is a "tax expenditure," which means that even though money is not actually given to the taxpayers who take this deduction, the impact on the state budget, the loss of $250 million, is the same as if it were.

### Senior Citizen Property Tax Freeze

In January 1998, a new law initiated another individual property tax relief program, a property tax "freeze" that provides a reimbursement to those senior citizens and disabled persons who live in homes they own, or in mobile homes, and who meet certain income requirements. Eligible participants are to be reimbursed by the state for the share of their property taxes that exceeds the amount they paid in 1998 or, for future participants, in the year they enter the program after 1999. Initially, approximately one-sixth of the state's senior citizens will qualify for the tax freeze.

The fiscal note prepared by the Office of Legislative Services (OLS) for the Legislature indicated that 149,000 persons would be beneficiaries of the program, and projected a declining number of participants as the years go on. However, an analysis by David C. Mattek for New Jersey Policy Perspective ("The Senior Tax Freeze: Piecemeal Property Tax Reform Comes at a Price" 8/98) found that the program can be expected to cost in excess of $340 million in the year 2010, more than twice as much as the projections contained in the Legislature's fiscal note.

Payments to beneficiaries are to be made from the tax on casino gross revenues. This revenue is designated for the state's Casino Revenue Fund, which is constitutionally dedicated "to be applied solely for the purpose of providing funding for reductions in property taxes, rental, telephone, gas, electric, and municipal utilities charges...and for additional or expanded health services or benefits or transportation services or benefits to eligible senior citizens and disabled residents." NJPP's analysis of the growth of Casino Revenue Fund revenues and the growth rate of spending for existing programs concluded that the tax freeze would likely push other programs out of the Casino Revenue Fund and into general state revenues shortly after fiscal year 2000.

### Restructuring New Jersey's tax system to reduce use of property taxes and increase equity

It is essential to take some major facts of New Jersey tax policy and spending into...
consideration when proposing changes in New Jersey's tax structure and discussing how best to allocate tax resources:

- In FY 2000, 43 percent of the annual state budget, or $8.4 billion, goes toward property tax relief. If the NJ SAVER program is fully phased in by 2004, the total will increase to $9.2 billion.
- State policy for the past six years has focused on reducing taxes, while at the same time costly new program initiatives have been approved and are being phased in. By July 2000, tax savings for individuals and businesses will total $9.8 billion from 22 tax cuts (NJ Treasury Department, August 1999).
- State borrowing repayable from the General Fund through annual debt service payments will exceed $15 billion in 2000, an increase of more than $10 billion in recent years. Debt service will consume an increasingly larger share of the state budget. Debt repayments of $250 million in 1992 have ballooned to $1.4 billion in 2000, and will increase as repayments begin on new borrowing.

These facts lead to the inescapable conclusion that New Jersey has gone about as far as it can go with property tax relief as presently configured—yet property taxes are still too high and the burden is still unfairly distributed. No additional programs aimed at property tax relief can be initiated unless action is taken to increase the total amount of annual tax revenue available to the state for use in property tax relief efforts. In fact, it is problematic whether there will be sufficient revenue to fund the $800 million increase in the cost of the NJ SAVER program by 2004.

What options are available to restructure the tax system to reduce the overuse of the property tax and/or to reduce the tax inequities caused this overuse?

The two strategies explained below have the most potential to reduce the proportion of property taxation to overall state and local taxation of New Jerseyans and to make ours a fairer tax structure that more equitably spreads the tax burden among municipalities and individual citizens.

**Increase State Support for Education**

No public service funded by property taxes costs more than schools. The logical source of money for this essential function is the state income tax, already constitutionally dedicated to property tax relief.

Over the years, nothing has had a greater effect on reducing and equalizing the property tax burden, and promoting high-quality education, than state aid. As a proportion of total school funding in New Jersey, state aid has grown from 21 percent in the 1960s, to more than 40 percent today. Excessively high school tax rates in less affluent rural, urban and suburban communities have been reduced as the state increased aid designed to equalize financial resources. State aid also has helped to keep property taxes down with support for categorical programs.

But, as discussed in the section on Education, dependence on the property tax to support schools started to spike upward again in 1994, with the average state property tax rising by
13.4 percent. The effect of the formula for providing equalizing aid and the new method for determining the cost of regular education is to steadily make more school districts ineligible for equalizing aid and debt service aid. Today, 250 districts, 40 percent of all districts, are not eligible for such aid.

While it is neither fiscally nor politically feasible for the state to take over all education costs, there is a strong case to be made for increasing the proportion of school costs funded by the state. Obviously this would mean an increase in revenues to the state. And that should mean looking to the income tax, which already is set up to be progressive. In other words, it calls upon people to pay based on their ability to pay, quite unlike the local property tax. Indeed, a statewide poll by the Eagleton Institute of Politics at Rutgers University found in 1999 that 71 percent supported raising the state's share of school funding to 50 percent of costs, and 57 percent supported increasing the state income tax if accompanied by a decrease in local property taxes.

An examination of the distribution of income in New Jersey shows clearly that increasing income tax rates on the most affluent households is a reasonable way to reduce negative impacts of heavy property taxation and achieve greater tax fairness.

In 1997, the 372,474 New Jersey households making more than $100,000 received $85.6 billion of the state's total $184.9 billion in income. In other words, almost half (46 percent) of all personal income went to only 10.8 percent of New Jersey households. The change in distribution among income groups in the decade between 1987 and 1997 is astounding. In 1987, the over $100,000 group received 25 percent of income, or $28.7 billion. The average increase over ten years is 20 percent annually. Over the same decade, taxpaying households with incomes of less than $50,000 saw their proportion of the state's total income decline to 25 percent from 46 percent. The 2.3 million households making up this group (two-thirds of all taxpayers) saw their amount of income drop to $46.6 billion from $52.5 billion.

Personal income continues to grow rapidly in New Jersey. Growth in 1998 was 5.7 percent. The estimate for 1999 was 5.8 percent and for 2000 another 6.1 percent. If the decade-long pattern of shifts in income distribution continues, the relatively small group of New Jerseyans making more than $100,000 a year would see their income increase by $63 billion to $147 billion by 2000. This would mean they account for 67 percent of New Jersey's total personal income of $219 billion.

In addition to indicating the need to make the state income tax more progressive at the top end, these figures also suggest that another progressive tax with the potential to provide significant revenue for reducing property taxation and increasing tax equity is a tax on "intangible" assets, such as stocks, bonds, trusts and business equity. In fact, distribution of such assets among New Jersey citizens is even more skewed than is the case with income. An earlier estimate by the Office of Legislative Services indicated that the wealthiest 10 percent of New Jersey households own $358 billion of these assets, an amount almost equal to the entire value of all homes in the state (the major asset of the majority of households).

A third source of additional state revenue worth examining is a restructuring of taxation on business to reflect today's modern, service-based economy. This has the potential not only to increase state revenue, but also to eliminate existing inequities in the present structure.
Because New Jersey's neighbor states have similarly inequitable and obsolete business
taxes, regional action would be necessary in order to "equitably and similarly broaden the
tax base of each state".

Restructure Existing Individual Property Tax Relief Programs

By 2004, assuming that the NJ SAVER program continues and is fully funded, revenues
devoted to New Jersey's five individual property tax relief programs will exceed $1.8
billion. The earlier discussion of these individual programs pointed out serious problems in
their design. Instead of increasing the tax fairness of property taxes, they either ignore
portions of the citizenry or actually increase tax inequities.

The following changes would treat all citizens, regardless of age, more fairly than the
existing programs.

- Eliminate the property tax deduction from the income tax and direct the $250 million
  in tax relief it provides to fund individual property tax reduction programs which
  increase tax fairness.
- Make the following changes to the Homestead Rebate: return it to the original design,
  which included taxpayers of all ages, rather than restricting a huge proportion of tax
  relief to senior citizens and disabled citizens. Eliminate minimum payments for
taxpayers whose property tax does not exceed 5 percent of income. Raise the
maximum rebate well above the present $500 to provide more adequate tax relief for
taxpayers with excessively high property tax payments in relation to income. Use the
increased income tax revenue created by eliminating the deduction of property tax
from income and eliminating the minimum Homestead Rebate payments to increase
funding for the program and pay the higher maximum rebates.
- Revamp NJ SAVER to exempt a portion of the assessed value of residences from the
total property tax rather than only the school tax. Vary the size of the property tax
exemption based on income, with lower-income homeowners being allowed to
exempt from taxation a higher portion of their home's value. Such changes would help
to correct the present bias of the program toward residents of suburban communities.
In addition to providing greater tax fairness among citizens, these changes would
reduce the drain on the state treasury and help fund the larger amount needed to
expand the rebate to cover the total property tax.
- Eliminate the property tax freeze for low-income senior citizens and use the savings
  (the cost may reach $340 million in ten years) to fund the Homestead Rebate and NJ
  SAVER program at levels which will provide sufficient relief to actually reduce, not
  just freeze, the property taxes paid by lower income senior citizens.
- The cost of the Veterans Rebate, which will increase five-fold from its present $17
  million as the new $250 rebate is phased in, will begin to decline as the large number
  of recipients who served in World War II pass on. Any savings should be earmarked to
  fund one of the other property tax relief programs.
- The four separate programs which send out individual tax rebates to eligible citizens
  require a massive and expensive bureaucratic operation at the state level. New Jersey
could save substantial money by eliminating rebates by mail and folding them into the
state income tax program.
Conclusion

The time for patchwork solutions is over. New Jersey's pattern of adding property tax relief programs on top of each other has created a complicated system that neither delivers enough relief nor targets that relief to the middle-class and lower-income residents who need it most, regardless of their age or where they live.

What's more, our willingness to live with this inadequate, inequitable system has only put off the day when serious debate will begin on overhauling New Jersey's tax structure. This should and can be done in a way that recognizes the new realities of how income is distributed in our state and what are the most just ways of calling upon people to pay their fair share in support of society.

Let that debate begin.

About the author

Judith C. Cambria has been involved with tax, budget and education analysis in New Jersey for nearly 30 years as Fiscal Policy and Education Specialist for the New Jersey League of Women Voters. She also has served as executive director for the Citizens Coalition for Tax Reform and the Committee for a Responsible Legislature. In her affiliation with New Jersey Policy Perspective she is working on property tax reform and issues relating to the magnitude of state borrowing.