
# Education and Property Taxes

## A Texas-Sized Conundrum

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## Executive Summary

Texas' school finance system has undergone more than four decades of litigation challenging its constitutionality. A leading driver for legal challenges has been the system's reliance on ad valorem taxes, or property taxes, as a revenue source.

Education funding is treated as a shared responsibility between state and local governments, with the addition of some federal funds. In the 2017-18 school year, Texas allocated $63.16 billion for the public education system to operate public schools. In the same school year, the state educated roughly 5.4 million students and employed about 350,000 teachers (TXSmartSchools).

Since Texas' inception in 1836, the state's education system has seen significant transformation. Changes were very gradual for most of the state's history, and the system was largely administered by local governments until the first significant effort to make it more centralized through the passage of the Gilmer-Aikin Laws in 1949. After 1949, there was little large-scale action on the education system until the Legislature passed the Educational Opportunity Act of 1984, which continued to pursue the centralization of Texas public education. Since then, the primary means of further centralizing the system has been through lawsuits reaching to the Texas Supreme Court, resulting in seven Supreme Court decisions, and the Legislature's response to those cases; the Texas Supreme Court has ruled the system unconstitutional four times.

With the increased centralization and increased funding of the public school system over the years, a core tension lies at the heart of our modern school finance system—local property taxes paying for a statewide system.

The state's reliance on local property taxes to fund education started low. Over time that reliance has increased to the point where locally collected taxes make up more than 50 percent of education funding in the 2017-18 school year. Local property wealth, however, is not equally distributed across districts. This variation in local district ability to collect revenue was the initial cause of school finance litigation in Texas and has been central to it ever since.

Though the state has banned the use of a statewide property tax in Article VIII of the constitution, the state still requires school districts to levy local property taxes in order to receive their full entitlement of state funding (Texas Education Code). To some, that requirement has the feel of a state property tax—enough so that districts have sued the state on multiple occasions for that reason. Yet Texas courts have found that the requirement does not violate the statewide property tax ban.

The Foundation has identified two viable options for the state to drastically reduce or replace local property taxes as a funding mechanism for education.

### Key Points

- A reliance on local property taxes to fund education has been at the heart of its constitutional challenges for the better part of four decades.
- Relying on local property taxes creates funding disparities that are hard to avoid in a statewide system with vast differences in local property wealth.
- While the Texas Supreme Court has made it clear that efficiency is not impossible to attain while using local property taxes to fund the system, it pointed out the difficulty that inevitably comes along with doing so.
- "Defects in the structure of the public school finance system expose the system to constitutional challenge. Pouring more money into the system may forestall those challenges, but only for a time. They will repeat until the system is overhauled" (*WOC II*, 8).

The state could either:

- Limit the growth of state spending and use the excess revenue from existing taxes to buy down the school maintenance and operations (M&O) tax over a period of about 10 years, or
- Increase the state sales tax and use the new revenue to eliminate the M&O tax immediately.

In the Texas Supreme Court's *Edgewood III* opinion, the court held that the Legislature should make fundamental changes to the system, without endorsing any particular way over another:

> *Although parsing the differences may be likened to dancing on the head of a pin, it is the Legislature which has created the pin, summoned the dancers, and called the tune. The Legislature can avoid these constitutional conundra by choosing another path altogether (*Edgewood III, *23).*

We hope this paper will be a resource to those looking for answers on realistic reforms to the school finance system that will move the state away from the "constitutional conundra" presented by using property taxes to fund education.

## A Brief History of Education Funding in Texas

It is essential to look back on the history of school finance in Texas to understand how the system arrived where it is today. The following section summarizes that history with a focus on the role that both the statewide property tax and local property taxes played in our state's past. Less attention will be paid to aspects of the history that do not directly impact the use of property taxes as a funding mechanism for education.

### *19th Century School Finance in Texas*

Texas declared its independence from Mexico on March 2, 1836. The Mexican government's failure to provide a system of public education was one of the grievances listed in the Texas Declaration of Independence (Texas State Library and Archives Commission).

Later that year, the Constitution of the Republic of Texas was adopted. Its only mention of education was in Section 5 of the General Provisions:

> *It shall be the duty of Congress, as soon as circumstances will permit, to provide, by law, a general system of education (Tarlton Law Library).*

However, the Republic of Texas did not take immediate action to establish an education system. According to Stephen B. Thomas and Billy Don Walker in their report *Texas Public School Finance*, "There exists no clear evidence that the Republic ever wanted a state-supported and state-controlled system of schools" (Thomas and Walker, 225).

After annexation into the United States, the state of Texas adopted the constitution of 1845, which included a new provision directing the Legislature to establish free public schools and fund them with a statewide property tax (Thomas and Walker, 226).

The first legislation that allowed for the use of *local* property taxes to fund education came about in 1846 and was limited to two cities. The cities of Corpus Christi and Galveston held elections to impose local property taxes to fund schools. In Corpus Christi, the vote failed. In Galveston, they abandoned the tax after two years due to hostility from disgruntled taxpayers. According to Eby, some Texans did not oppose the concept of using of state tax dollars to fund education, but they "bitterly opposed" the use of dollars collected through a new local property tax for that purpose (Eby, 108-9).

The Civil War placed a significant financial burden on Texas. The balance of the Permanent School Fund (PSF), which had been established by the Legislature in 1854 to fund education on a per capita basis, was ultimately transferred to the war effort. Along with this came a hiatus on per capita funding (Thomas and Walker 228).

By the time the war ended, state provision for public education was nearly non-existent in Texas (Eby, 150). After the war, the state was placed under martial law, and the federal government rendered Texas' most recent constitution, the constitution of 1866, inoperable (Thomas and Walker 229).

In 1869, during Reconstruction, Texas was required to adopt a new constitution under the Congressional Reconstruction Acts of 1867. The new constitution created a highly centralized education system that was widely objected to by the citizenry of the state. A new Available School Fund was created to fund state administration (Thomas and Walker, 229). The new fund was supplemented with revenue from, among other things, a local property tax. Imposed by the School Law of 1871, this tax was initially set at a rate of $1.00 for every $100 of property value. Many Texans refused to pay the tax, calling it "robbery and confiscation." Texans objected so heavily to the tax, that only 26 percent of the total levy was ever collected. The state only levied the tax for two years (Eby, 163).

In 1875, as Reconstruction came to an end, a constitutional convention met to replace the constitution of 1869 with the constitution of 1876, which remains the Texas Constitution to this day. This constitution would provide per capita funding for students at a flat rate through the Available

School Fund, which took in revenue from the restored Permanent School Fund and a maximum of one-quarter of general tax revenue. While this was virtually the only state aid for education until the early 20th century, some schools were controlled by incorporated cities that had local taxing authority for education as well. The new constitution did not have a provision for a statewide tax on property, as had existed before the Civil War and Reconstruction (Thomas and Walker, 231).

In 1883, the constitution was amended to, among other things, give rural school districts the ability to levy a maintenance and operations tax of up to 20 cents per $100 of property value. This meant that now all school districts could levy local property taxes, though at different rates. The amendment also set up the framework for Independent School Districts. The year 1883 also saw the return of the statewide property tax (Eby, 195).

At this stage, local governments had the option to levy taxes to raise funds for education or not, and the state was contributing money across the state at a per capita rate. This meant districts that chose to levy a tax would have more money to fund their schools than those who did not.

***Early 20th Century School Finance in Texas***

In 1908, a group of educators and citizens met to form the Conference for Education in Texas. That conference made recommendations for a constitutional amendment which, when passed by the Legislature and ratified by the people, removed a long-standing two-thirds vote threshold for local governments to increase property taxes. The adoption of the amendment meant that only a simple majority would be required to increase local taxation (Eby, 222-23). This, in conjunction with another amendment which more than doubled the maximum rate that districts could tax, made it significantly easier for local governments to increase tax burdens on their citizens.

In 1915, the state made its first significant expansion of state aid since 1876, providing additional aid for new rural high schools. Additionally, the state made its first foray into the realm of wealth equalization, though the earliest attempt was very different from what we think of today. The state allocated $1 million for rural schools, provided those districts were taxing at the constitutional maximum of $.50 per $100 evaluation. The goal was to provide additional funds for districts unable to raise as much money as other districts (Thomas and Walker, 235).

In 1920, the constitution was amended to remove a constitutional cap on local taxation, leaving the limitation of tax rates to the discretion of the Legislature. This decision allowed for local taxpayer payments for education to increase, in addition to the per-capita funding from the state (Thomas and Walker, 236).

***The Gilmer-Aikin Committee, 1947-49***

Until the 51st legislative session in 1949, state funding for education was distributed almost entirely on a per capita basis, with an exception for some funds going to textbooks and equalization aid for rural schools. School districts could levy local property taxes, though not all of them did (Thomas and Walker, 238). Many chose to rely on state aid alone. School finance reform became a significant focus for the state leading into 1947 when Gov. Beauford Jester and other advocates of increasing taxpayer funding for schools pushed for the formation of the Gilmer-Aikin Committee (Thomas and Walker, 239).

The Gilmer-Aikin Committee, made up of legislators, superintendents, and other community members, periodically met during 1947 and 1948 to research school finance measures. The committee also created citizen advisory committees in 254 counties to advise on issues and gather data (Gilmer-Aikin Committee on Education, 2). Under the leadership of Sen. A. M. Aikin, Jr., and Rep. Claud Gilmer, and after fourteen and a half months, the committee presented its findings in a report entitled *To Have What We Must* (Gilmer-Aikin Committee on Education).

**The Gilmer-Aikin Laws**

During the 51st Texas Legislature, three separate bills were filed in the Senate that incorporated aspects of the report: Senate Bill 115, Senate Bill 116, and Senate Bill 117. Because of these bills, Texas would go from a state with a very limited education framework to a much more centralized and structured system.

The Gilmer-Aikin Laws enacted the following:

- **Senate Bill 115** created a central authority on education. This was done through the creation of the Central Education Agency, which was comprised of the State Board of Education, the State Board for Vocational Training, the commissioner of education, and the State Department of Education.
- **Senate Bill 116** established the new Minimum Foundation Program (MFP). The goal of the MFP was to provide a minimum threshold for education in Texas. It would guarantee that every Texas student would have access to a standardized education nine months each year. The bill created a system where local governments would raise 20 percent of the funding for the MFP, and the state would provide the other 80 percent. The MFP would require all school districts to raise local property taxes to fund their portion of the program. The amount each district would raise toward that goal would be

determined by the district's ability to raise funds, which was determined using a complex economic index.

- Finally, **Senate Bill 117** created the Foundation School Fund Budget Committee. The committee had the responsibility to make sure that the MFP was adequately funded with federal, state, and local dollars (Texas Education Agency, 61).

Importantly, Senate Bill 116 required every local school system to levy a local property tax to fund the new MFP. The MFP was also the state's latest foray into local fund equalization, which would later become a crux of issues for school finance litigation.

The system created by the Gilmer-Aikin Laws would serve as the state's school finance system, with minor changes along the way, until 1971.

In the 1970-71 school year, under the Gilmer-Aikin Laws, school districts were providing about 20 percent of school funding and the state was providing the other 80 percent, at least theoretically. However, this total did not account for the additional funds that districts were raising in enrichment dollars. According to the Senate Committee to Study Urban Education in Texas, when accounting for enrichment funds, the state was providing about 54 percent of the total funding and the districts were contributing 46 percent through local property taxes (Committee to Study Urban Education, V).

***Education Belongs to the States:* Rodriguez v. San Antonio Independent School District *(1973)***

In 1971, a three-judge district court in San Antonio, Texas, handed down a ruling in *Rodriguez v. San Antonio Independent School District* holding that the current system discriminated against people in poorer school districts in favor of people in wealthy school districts. The district court held that the system allowed citizens in wealthier districts to provide higher-quality education at a lower tax rate than could the less affluent districts. Therefore, the district court reasoned that the law denied equal protection based on economic status.

On appeal by the defendants, the United States Supreme Court added the case to its docket, deeming the case to have presented "far-reaching constitutional questions" (*Rodriguez*, 6). The U.S. Supreme Court ultimately held that public education is not a constitutional right and that the system, while creating disparities in funding, did not "operate to the peculiar disadvantage of any suspect class" (28). Accordingly, the Texas school finance system did not violate the Equal Protection Clause.

While this meant that the system was not federally unconstitutional, *Rodriguez* would serve as a template for seeking more funding for public schools through state-based lawsuits, which would prove to be more successful.

## Centralization Continues: House Bill 72, the "Educational Opportunity Act of 1984"

In 1983, Gov. Mark White appointed a select committee to study public education in Texas and detail its findings and recommendations. As a result, the Legislature passed House Bill 72, a massive bill which enacted sweeping changes to the school finance system and education in general. House Bill 72 took a system which had previously been a mostly localized system across the state and turned it into a much more centralized system. Among other changes, HB 72:

- Shifted state funding from a staff-centric model of allocation toward a more student-based system of allocation focused on Average Daily Attendance;
- Created special allotments for eligible students, such as those with specific learning disabilities; and
- Introduced a series of funding adjustments for geographical variations in cost and district size (Texas Education Agency, 65-66).

In total, HB 72 increased state aid to public education by 26 percent, from $3.6 billion to $4.5 billion (Hegar).

## The Era of Litigation: 1984-2016

**Edgewood I, *1989***

**Origin:** *Edgewood I* was the first in a series of court cases that reached the Texas Supreme Court and challenged the constitutionality of the school finance system, mainly based on efficiency and equity. Efficiency and equity, as will become apparent, are directly tied to the use of local property taxes as a funding mechanism.

**Complaint:** In *Edgewood I*, Edgewood Independent School District (ISD), along with dozens of additional districts and individuals, sued the state, claiming that the current school finance system violated the constitution.

**Ruling:** The district court held that the system violated multiple provisions of the Texas Constitution, including the Equal Rights and Equal Protection provisions in Article I, Section 3 and Article I, Section 19, respectively. It also ruled that the system violated Article VII, Section I, ruling that the system was inefficient.

The Texas Supreme Court ruled that the system was constitutionally inefficient under Article VII, Section 1. Therefore, it chose not to consider the other constitutional arguments brought before it.

It is important to highlight that the court's definition of "efficiency" here is more complex and subjective than what might immediately come to mind. In its ruling, the court provided a common definition of efficiency as well as the court's additional definition of efficiency specific to school finance, which set the standard by which future cases would measure efficiency:

> *There is no reason to think that "efficient" meant anything different in 1875 from what it now means. "Efficient" conveys the meaning of effective or productive of results and connotes the use of resources so as to produce results with little waste; this meaning does not appear to have changed over time. ...*
>
> *Efficiency does not require a per capita distribution, but it also does not allow concentrations of resources in property-rich school districts that are taxing low when property-poor districts that are taxing high cannot generate sufficient revenues to meet even minimum standards. There must be a direct and close correlation between a district's tax effort and the educational resources available to it; in other words, districts must have substantially equal access to similar revenues per pupil at similar levels of tax effort (*Edgewood I, *7-12*).

The second efficiency question is directly tied to the use of local property taxes as a funding source. The Supreme Court found evidence that there were large disparities in the ability of districts to raise local funds with property taxes. These disparities meant that many property-poor districts were required to tax at a higher tax rate than other districts to raise fewer dollars. Held the court,

> *The lower expenditures in the property-poor districts are not the result of lack of tax effort. Generally, the property-rich districts can tax low and spend high while the property-poor districts must tax high merely to spend low. In 1985-86, local tax rates ranged from $.09 to $1.55 per $100 valuation. The 100 poorest districts had an average tax rate of 74.5 cents and spent an average of $2,978 per student. The 100 wealthiest districts had an average tax rate of 47 cents and spent an average of $7,233 per student (*Edgewood I, *3*).

The court held that these types of disparities violated the constitution's mandate that the system be efficient. Therefore, the system was ruled unconstitutional, and the Legislature was directed to make necessary policy changes within a limited time frame. In order to satisfy the court's definition of efficiency, the Legislature would spend significantly more in the attempt to equalize public education funding.

### *Edgewood I*: First Legislative Response—SB 1019, 71st Legislature, 1989

In 1989, in anticipation of the ruling of the Supreme Court in *Edgewood I*, the Legislature passed Senate Bill 1019.

Senate Bill 1019 established a new second tier in the Foundation School Program (FSP). This new tier was designed to ensure that each district would have "access to a substantially equalized program of financing in excess of basic costs for certain services…." The bill created the first guaranteed yield program, guaranteeing districts that they would receive a certain amount of funding from the state for each student, beyond the basic cost of education (Senate Bill 1019). The guaranteed yield program exists to this day, though it has undergone significant changes over the years.

### *Edgewood I*: Second Legislative Response—SB 1, 6th Called Session, 1990

Senate Bill 1 provided equalization funding for districts educating 95 percent of Texas students while excluding the top 5 percent. This would ultimately be a pitfall for the system in *Edgewood II*. The top 5 percent were excluded because the cost to equalize district revenues to the level of the wealthiest ISDs in the state would have been more than the sum of Texas state government expenditures several times over (*Edgewood II*, 6-7).

More particularly, Senate Bill 1:

- Increased the basic allotment of funding per student from $1,477 to $2,128 over the next two years.
- Made "programs, services, facilities, and equipment" eligible for state financial aid under the FSP.
- Established a second tier of the FSP, creating a "guaranteed yield program" to close the equity gap between ISDs with higher or lower taxable property wealth.
- Established a quasi-"third tier" of the FSP to ensure every school district was able to have a similar standard of facilities.
- Created eight extensive biennial studies designed to ensure the state was maintaining a system that provided efficiency, as defined by the courts (Senate Bill 1).

### Edgewood II, *1991*

**Origin:** The follow-up case to *Edgewood I* would determine whether the constitutional shortcomings of the school finance system were resolved by the passage and enactment of SB 1, from the 71st Legislature. Again, dozens of districts and individuals sued the state, claiming that the inefficiencies had not been resolved. The 250th District Court, and then the Texas Supreme Court, ultimately ruled that they had not and that the system still lacked efficiency in violation of the Texas Constitution (*Edgewood II*).

**Complaint:** The plaintiffs argued that SB 1 maintained the previous system with few meaningful changes. The bill also limited the new equalization funding formula to apply to 95 percent of students, excluding the 5 percent of students who lived in the state's wealthiest districts. The state argued that the extensive studies required by SB 1 would ultimately result in increased state funding and, eventually, equity.

**Ruling:** The Supreme Court determined that the changes made by SB 1 did not remedy the constitutional violation described in *Edgewood I*. The court held,

> *Even if the approach of Senate Bill 1 produces a more equitable utilization of state educational dollars, it does not remedy the major causes of the wide opportunity gaps between rich and poor districts. It does not change the boundaries of any of the current 1052 school districts, the wealthiest of which continues to draw funds from a tax base roughly 450 times greater per weighted pupil than the poorest district. It does not change the basic funding allocation, with approximately half of all education funds coming from local property taxes rather than state revenue. And it makes no attempt to equalize access to funds among all districts. By limiting the funding formula to districts in which 95% of the students attend school, the Legislature excluded 132 districts which educate approximately 170,000 students and harbor about 15% of the property wealth in the state. A third of our students attend school in the poorest districts which also have about 15% of the property wealth in the state. Consequently, after Senate Bill 1, the 170,000 students in the wealthiest districts are still supported by local revenues drawn from the same tax base as the 1,000,000 students in the poorest districts (Edgewood II, 8).*

While the Supreme Court did recognize that SB 1 made strides toward constitutionality, the court held that the changes made and the use of studies to try and reduce the wide gaps between levels of district revenue were insufficient to alleviate the constitutional shortcomings of the system.

This observation by the court again points to the fundamental issue of relying on property wealth as the basis for raising revenue to fund education. The court made clear that the system created a situation where most taxpayers had to "…bear a heavier tax burden to provide a less expensive education…" than others (*Edgewood II*, 8).

### *Edgewood II*: Legislative Response—SB 351, 72nd Legislature, 1991

Senate Bill 351 changed the way local property taxes were collected and distributed. The bill created 188 County Education Districts (CEDs), which would each consist of multiple ISDs. The Legislature did this exercising its power outlined in Article VII, § 3-e of the Texas Constitution: "The Legislature may authorize an additional ad valorem tax to be levied and collected within all school districts for the further maintenance of public free schools"(149-50).

County education districts functioned as follows:

- CEDs levied an additional ad valorem property tax for public schools. Funds raised by CEDs would constitute a third tier of the FSP.
- CEDs did not execute any educational duties; those continued to be the responsibility of the independent school districts.
- Levying, collecting, and distributing property taxes, as directed by the Legislature, was the sole purpose of the CEDs.
- CEDs did not set their tax rate; the Legislature determined the tax rate.
- A system of recapture was constructed between school districts within the same CED to equalize school funding.

### Edgewood III, *1992*

**Origin:** In the third *Edgewood* case, five direct appeals were heard by the Supreme Court. Dozens of districts and individuals filed suit against the state, claiming the system remained unconstitutional. The primary claim against the system concerned CEDs.

Proponents saw CEDs as an opportunity to equalize school funding by consolidating the tax bases of multiple districts by placing them in the same CED. They believed this would help level the playing field for all districts.

**Complaint:** However, opponents of SB 351 saw it as a violation of the Texas Constitution, which prohibits a statewide ad valorem tax.

CEDs were required by the state to levy property taxes at a rate set by the state. The state also directed how the districts would spend those funds. The state had total control over the actions of the districts, while the districts executed their duties. The plaintiffs challenged the system on the basis that the function of the CEDs created a state property tax in violation of the constitution's prohibition on such a tax.

**Ruling:** The case was ultimately heard by the Supreme Court, which ruled in favor of the plaintiffs, agreeing that CEDs were, in essence, an arm of state government and were, therefore, levying a state property tax.

> *If the state mandates that a tax be levied, sets the rate, and prescribes the distribution of the proceeds, the tax is*

> *a state tax, regardless of the instrumentality which the State may choose to use (Edgewood III, 18).*

Some additional statements made in the Supreme Court's ruling would serve as a foreshadowing of the next case to come, *Edgewood IV*.

> *An ad valorem tax is a state tax when it is imposed directly by the state or when the state so completely controls the levy, assessment and distribution of revenue, either directly or indirectly, that the authority employed is without meaningful discretion (Edgewood III, 23).*

The court wrote about how this determination would be made on other future questions of constitutionality when the state requires a property tax be used to raise revenue,

> *How far the State can go toward encouraging a local taxing authority to levy an ad valorem tax before the tax becomes a state tax is difficult to delineate.* ... Each case must necessarily turn on its own particulars. *Although parsing the differences may be likened to dancing on the head of a pin, it is the Legislature which has created the pin, summoned the dancers, and called the tune (Edgewood III, 23; emphasis added).*

### *Edgewood III*: Intervening Legislation - SB 7, 73rd Legislature, 1993

Senate Bill 7 abolished the CEDs that were found unconstitutional in *Edgewood III*. To limit the amount of wealth school districts could have, SB 7 required that ISDs with taxable property wealth per student exceeding $280,000 were given five options. Any funds over the $280,000 cap were subject to what has become known as "recapture."

If a school district did not choose one of the following options to reduce its wealth per student, the commissioner of education had the power to detach property from the district's tax base or consolidate the wealthy school district with at least one other school district. The five options were:

- Consolidation with another school district.
- Detachment and transfer of territory.
- Purchasing average daily attendance credits.
- Contracting to educate nonresident students.
- Consolidation of tax base with another school district.

Most districts elected to purchase additional attendance credits.

### Edgewood IV*, 1995*

**Origin:** Property-poor and property-wealthy districts both sued the state after the passage of SB 7, alleging that the new law had not made sufficient changes or had created a new undue burden. *Edgewood IV* was the first deviation from what was becoming the norm for the Texas Supreme Court on the school finance system's constitutionality. It was the first time the court ruled in favor of upholding the system.

**Complaint:** Property-poor districts contended that the system, with the implementation of SB 7, still had substantial inefficiencies in revenue and tax disparities between themselves and property-wealthy districts.

Property-rich districts contended that the system was unconstitutional because of the implementation of a $280,000 per-student cap on a district's taxable wealth. Additionally, they argued that the system imposed a statewide ad valorem tax, much like the one that existed before *Edgewood III*.

**Ruling:** In response to the assertion of the property-poor districts, the court ruled that the system was constitutional. The court considered whether the system now provided for "substantially equal access to a level of funding that would achieve a general diffusion of knowledge" (Weintraub, 9). The court determined that the system met that standard with the implementation of SB 7. Held the court,

> *All districts are able to provide for a general diffusion of knowledge, but property-poor districts must tax at a slightly higher rate than property-rich districts to do so. When the focus is placed on the rate differential rather than on the gap in funding, it becomes evident that the existing disparity in access to revenue is not so great that it renders Senate Bill 7 unconstitutional (Edgewood IV, 32).*

The state's guaranteed yield rate drastically reduced tax rate disparities for 85 percent of students in the state. This, the court believed, was enough to satisfy the constitutional requirement that the system be efficient and provide for a general diffusion of knowledge (Weintraub, 9).

In response to the assertion of the property-wealthy districts, the court ultimately ruled that the cap on per-student property wealth was within the broad scope of jurisdiction of the Legislature and that it met the required "suitable provision" mandate.

The court also rejected the argument that the new system provided for a state-mandated property tax. They did so on the basis that the new system provided for "meaningful discretion." The court acknowledged that the Legislature did limit the district's discretion in setting tax rates by setting a minimum and maximum rate, but that the room in between provided for enough discretion to meet the acceptable standard set by *Edgewood III*.

The court made an important note on this when it held,

> *… if the cost of providing for a general diffusion of knowledge continues to rise, as it surely will, the minimum rate at which a district must tax will also rise. Eventually, some districts may be forced to tax at the maximum allowable rate just to provide a general diffusion of knowledge. If a cap on tax rates were to become in effect a floor as well as a ceiling, the conclusion that the Legislature had set a statewide ad valorem tax would appear to be unavoidable because the districts would then have lost all meaningful discretion in setting the tax rate (*Edgewood IV, *40).*

This shows, once again, the precarious nature of a reliance on local property taxes to fund an efficient system of education. Finding the system constitutional was in no way an endorsement of the system by the court. In fact, the court made the opposite clear.

### West Orange-Cove (WOC) I *and* II, *2003 and 2005*

#### *WOC I*

**Origin:** *WOC I* was a decision determining plaintiff standing. The case was dismissed by both the 250th District Court and the 3rd District Court of Appeals but was returned to the district court by the Texas Supreme Court, which determined that the plaintiffs did have standing.

**Complaint:** Four school districts sued the state, claiming the existence of a statewide ad valorem tax in violation of the constitution. They asserted that they and "…other districts have been forced to tax at maximum rates set by statute in order to educate their students" (*WOC I*, 1).

**Ruling:** While the district and appeals courts both determined the plaintiffs had no standing, the Supreme Court disagreed. Ultimately, the court rejected the state's reasoning for why the districts should not be able to plead a constitutional violation. The Supreme Court reversed the appeals court's judgment and remanded the case back to the district court for trial.

#### *WOC II*

**Origin:** After the case was returned to the district court, that court ruled that the finance system was, in fact, unconstitutional. The Supreme Court upheld the judgment of the district court in part.

**Ruling:** The Supreme Court held that the evidence made clear that the current state of affairs had once again caused the local property tax burden to become a state tax as more and more districts were "forced" to tax at the maximum rate to provide an adequate education. Therefore, the tax was deemed to violate Article VIII of the constitution:

> *We now hold, as did the district court, that local ad valorem taxes have become a state property tax in violation of article VIII, section 1-e, as we warned ten years ago they inevitably would, absent a change in course, which has not happened (*WOC II, *8).*

The Supreme Court, however, did not hold that the system violated the constitution because it was inefficient. The court established the two measures of efficiency as "qualitative" (general) and "quantitative" or "financial" (specific to funding). These are analogous to the two definitions listed previously in *Edgewood I*. In this case, the court could only rule on the question of quantitative efficiency and not on the issue of qualitative efficiency. (Justice Brister filed a dissenting opinion addressing the issue of qualitative efficiency.)

The Supreme Court reversed the lower court's ruling on this issue and held,

> *Although the districts have offered evidence of deficiencies in the public school finance system, we conclude that those deficiencies do not amount to a violation of article VII, section 1 (*WOC II, *8).*

The court would go on to reiterate its concerns with the fundamental defects within the existing system, pointing out that the same flaws, though not enough to form a violation of the constitution at the time, left the system open to future challenges. Reiterating this point, and that merely adding additional funds would not solve the problem, the court held:

> *We remain convinced, however, as we were sixteen years ago, that defects in the structure of the public school finance system expose the system to constitutional challenge. Pouring more money into the system may forestall those challenges, but only for a time. They will repeat until the system is overhauled (*WOC II, *8).*

Justice Hecht, in writing this opinion, took the time to thoroughly address the many issues brought before the court. The 88-page opinion laid out the court's findings in detail. Near the end of the opinion, the court described the reliance on local property taxes as a major funding mechanism in this way:

> *Such reliance, especially given the multitude and diversity of school districts,* inevitably makes it difficult to achieve efficiency because of the vast disparities in local property wealth, *but efficiency is not impossible (*WOC II, *76; emphasis added).*

While the court's decision did make it clear that efficiency (similar revenue at similar rates) is not impossible to attain

while using local property taxes to fund the system, they once again showed the difficulty that inevitably comes along with doing so.

***Dissent:*** Justice Scott Brister filed a dissenting opinion in this case, and while dissenting opinions bear less importance compared to the majority opinion, it contained an important perspective on the school finance system. The dissent looked at the issue of efficiency, specifically qualitative efficiency (the ability to attain results with little waste). He wrote that the districts did not adequately display that they were "forced" to tax at or near the maximum rates to provide education. Essentially, Justice Brister showed that qualitative efficiency also matters when discussing potential violations of Article VIII, not just Article VII.

Justice Brister, in evaluating whether districts were forced to tax at or near the maximum rate noted:

> *Finally, because fundamental reforms were never considered, we do not know whether they might allow districts to drop rates below the tax ceiling. School districts cannot spend money inefficiently (subverting Article VII) to force themselves to the tax ceiling (subverting Article VIII), as these articles must be construed consistently to give effect to both. School districts may have good reasons to avoid consolidating, or starting school later in the year, or increasing class size so that teachers' salaries could be increased too. But they are forced to make current expenses only if saving money through such alternatives was impossible, not just unpopular (*WOC II, *122-23).*

The issue of qualitative efficiency has remained relatively unexamined in the opinions of the court. Justice Brister offered a reminder that efficiency is a two-sided coin. One considers efficiency essentially as a function of equity, concerned with the distribution of revenue in a statewide system. The other considers the results achieved by expenditure of that revenue. The first is directly impacted by the practice of funding public education through local property taxes, and thus we give it prominence in this paper. The second, however, is a vastly important question for the effectiveness of the public education system. Education funding, from whatever source, must be efficiently leveraged in order to gain the outcomes Texans desire. This question grows only more important with time and increased education spending. Reducing reliance on local property taxes will help resolve problems of quantitative efficiency and could position the state to better address the unresolved questions of qualitative efficiency.

### WOC II: *Intervening Legislation - HB 1, 79th Legislature, 3rd Called Session, 2006*

In response to the ruling handed down in *WOC II*, the Legislature passed House Bill 1, which included provisions to satisfy the rulings of the court in that case. Specifically, the bill compressed maintenance and operations property tax rates by 33 percent, meaning far fewer districts would be forced to tax at or near the maximum allowed rate to provide a basic education.

### *The Texas Taxpayer and Student Fairness Coalition vs. Morath,* 2016

**Origin:** In 2011, the Texas Taxpayer and Student Fairness Coalition filed suit against the state, claiming that the school finance system was once again unconstitutional. The coalition consisted of more than 400 school districts, representing 1.5 million students.

**Complaint:** The plaintiffs in the case argued once again that the existing system violated the constitution on the grounds of adequacy and suitability, that the funding scheme imposed a statewide ad valorem tax, and that the system violated the financial efficiency requirement of article VII.

**Ruling:** Texas Supreme Court Justice Willett wasted very little time in his criticism of the school finance system, writing in the first paragraph of the Court's opinion that to call the system "Byzantine" would be generous. He then laid out the court's responsibility in the case, stating,

> *Judicial review… does not licence [sic] second-guessing the political branches' policy choices, or substituting the wisdom of nine judges for that of 181 lawmakers (2).*

Justice Willett explained that, despite imperfections within the current funding scheme, the system was constitutionally sound in that it met the minimum requirements placed on it. He showed that the plaintiffs could not provide enough evidence of inadequacy, underfunding, or inefficiency. Finally, the court ruled that local property taxes did not constitute a statewide property tax.

The court reiterated its previously stated belief that each question of whether or not the tax constituted a state-mandated tax "must necessarily turn on its particulars" (*Edgewood III*, 23).

When the court had last ruled that there existed a state ad valorem tax in *West Orange-Cove II*, nearly half of districts serving 59 percent of Texas students were taxing at the maximum rate. But when *Texas Taxpayer* was ruled on, only 24 percent of districts with 13 percent of students were taxing at the new maximum rate. The ISD plaintiffs argued that the new cap of $1.17 should not be used as the barometer for meaningful discretion in setting tax rates. Instead, ISDs

were required to hold elections for increases over the $1.04 level, and more than 90 percent of districts were taxing at or about $1.04 (*Texas Taxpayer and Student Fairness Coalition vs. Morath*, 91).

The Supreme Court ruled that the requirement to hold an election to increase local taxes beyond a certain level was within the jurisdiction of the Legislature and ruled in *Edgewood IV* that it is irrelevant to the statewide ad valorem tax issue.

Justice Willett ended his writing in the opinion with this:

> *Our Byzantine school funding "system" is undeniably imperfect, with immense room for improvement. But it satisfies minimum constitutional requirements. Accordingly, we decline to usurp legislative authority by issuing reform diktats from on high, supplanting lawmakers' policy wisdom with our own.*
>
> *The Texas Legislature, the center of policymaking gravity, is not similarly bound. And smartly so. Our Constitution endows the people's elected representatives with vast discretion in fulfilling their constitutional duty to fashion a school system fit for our dynamic and fast-growing State's unique characteristics. We hope lawmakers will seize this urgent challenge and upend an ossified regime ill-suited for 21st century Texas (99-100).*

Made clear from his writings is that even though the system was determined to meet the constitutional requirements, that was in no way an endorsement of the system. The court pointed out the lacking nature of the system time and time again. The school finance system remained flawed, though

**Table 1.** Texas Supreme Court school finance rulings

| DATE | CASE | PRIMARY COMPLAINTS | SUPREME COURT RULING | RESULT |
|---|---|---|---|---|
| 1971-73 | *Rodriguez v. San Antonio ISD* | Plaintiffs argued that the Texas school finance system violated the 14th Amendment to the U.S. Constitution (Equal Protection Clause). | The U.S. Supreme Court ruled that the system did not violate the 14th Amendment of the United States Constitution. | Constitutional |
| 1987-89 | *Edgewood I* | Plaintiffs argued that the system violated Article I, Section 3 (Equal Rights); Article I, Section 19 (Equal Protection); and Article VII, Section 1 (Efficiency) of the Texas Constitution. | The Texas Supreme Court ruled that the system was unconstitutional under Article VII, Section 1 (Efficiency). The court did not consider the other challenges. | Unconstitutional |
| 1990-91 | *Edgewood II* | Plaintiffs argued that the Texas School Finance System continued to violate Article VII, Section 1 (Efficiency) of the Texas Constitution. | The Texas Supreme Court ruled that the system continued to be unconstitutional under Article VII, Section 1 (Efficiency). | Unconstitutional |
| 1991-92 | *Edgewood III* | Plaintiffs argued that the system violated Article VII, Section 1 (Efficiency); Article III, Sections 56 & 64 (Vote on Taxation); and Article VIII, Section 1-e (Statewide Property Tax) of the Texas Constitution. | The Texas Supreme Court ruled the system was unconstitutional under Article III (Vote on Taxation) and Article VIII (Statewide Property Tax). | Unconstitutional |
| 1994-95 | *Edgewood IV* | Plaintiffs argued that the system violated Article VII, Section 1 (Efficiency) and Article VIII, Section 1-e (Statewide Property Tax) of the Texas Constitution. | The Texas Supreme Court ruled that the system was constitutional and did not violate Article VII (Efficiency) or Article VIII (Statewide Property Tax). | Constitutional |
| 2001-04 | West Orange-Cove I | Plaintiffs argued that they had standing to bring suit against the state, claiming that the school finance system violated Article VIII, Section 1-e (Statewide Property Tax). | The Texas Supreme Court reversed the dismissals of the lower courts, ruling that the districts had standing to file suit. | N/A |
| 2005-07 | West Orange-Cove II | Due to the ruling in *WOC I*, plaintiffs had standing to argue that the school finance system violated Article VII, Section 1 (Efficiency) and Article VIII (Statewide Property Tax). | The Texas Supreme Court ruled that the system was unconstitutional because it violated Article VIII (Statewide Property Tax), but not Article VII (Efficiency). | Unconstitutional |
| 2014-16 | *Texas Taxpayer and Student Fairness Coalition v. Morath* | Plaintiffs argued that the school finance system violated Article VII, Section 1 (Efficiency, Adequacy, Suitability) and Article VIII (Statewide Property Tax). | The Texas Supreme Court ruled that the system was constitutional and did not violate Article VII (Efficiency, Adequacy, Suitability) or Article VIII (Statewide Property Tax). | Constitutional |

constitutional, and the use of property taxes contributed to those flaws.

## The Problems with Local Property Taxes Financing Education

***A system where "each case must turn on its own particulars" is an unstable system***

On four separate occasions, the school finance system was challenged on the accusation that it relied on a state-mandated property tax in violation of Article VIII of the constitution: *Edgewood III* and *Edgewood IV*, *West Orange-Cove II*, and *Texas Taxpayer and Student Fairness Coalition vs. Morath*. The court ruled that the tax was in violation of the constitution in two of those cases, *Edgewood III* and *WOC II*.

In its opinion on *Edgewood III*, the Supreme Court held that

> *An ad valorem tax is a state tax when it is imposed directly by the State or when the State so completely controls the levy, assessment and disbursement of revenue, either directly or indirectly, that the authority employed is without meaningful discretion. How far the State can go toward encouraging a local taxing authority to levy an ad valorem tax before the tax becomes a state tax is difficult to delineate (*Edgewood III, *23).*

(Bear in mind that the state requires school districts to levy local property taxes at a minimum rate set by the Legislature in order to be eligible for full entitlement funding.)

Later in the same case, the Supreme Court provided a statement regarding future concerns on whether local property taxes constitute a state tax:

> *How far the State can go toward encouraging a local taxing authority to levy an ad valorem tax before the tax becomes a state tax is difficult to delineate...* Each case must necessarily turn on its own particulars. *Although parsing the differences may be likened to dancing on the head of a pin, it is the Legislature which has created the pin, summoned the dancers, and called the tune (*Edgewood III, *23; emphasis added).*

The merits of the challenges to the tax in the other cases were determined by the ability of the plaintiffs in each case to provide enough convincing evidence that the tax met those descriptions:

> *The Legislature's decision to rely so heavily on local property taxes to fund public education does not in itself violate any provision of the Texas Constitution, but in the context of a proliferation of local districts enormously different in size and wealth, it is difficult to make the result efficient — meaning 'effective or productive of results and connot[ing] the use of resources so as to produce results with little waste' — as required by article VII, section 1 of the Constitution (*WOC II, *11-12).*

A reliance on district property taxes to fund education has historically left our school finance system open to certain constitutional challenges. The Legislature has used, on nearly every occasion, reforms that Justice Willett described as "Band-Aid on top of Band-Aid" rather than real, transformational changes. Justice Willett noted it best in his opinion from *Texas Taxpayer and Student Fairness Coalition vs. Morath* when he noted,

> *They [Texas school children] deserve a revamped, non-sclerotic system fit for the 21st century (*Texas Taxpayer and Student Fairness Coalition, *2).*

Funding education for more than 5 million Texas schoolchildren with a system that relies heavily on a tax that could at any point, given certain circumstances, become an unconstitutional tax, leaves that system and the people it serves in a vulnerable position. Texas can change the system so that it no longer relies so heavily on local property taxes.

***The Court's definition of efficiency will always be difficult to achieve when relying on local property taxes for revenue***

The school finance system could be described as a blended system. Over the years, school finance in Texas transformed, often very suddenly, from a less centralized system to a more centralized system. This has resulted in a *statewide* system that relies heavily on *local* taxation.

The school finance system's history of litigation has made clear that establishing long-term quantitative efficiency as defined by the courts is improbable, if not impossible, with local property taxes.

Property tax revenue depends entirely on the value of property located within a school district's set boundaries. Every district has a unique total value and therefore a unique pool of resources from which to draw revenue. The school finance system has, for decades, relied on those pools of locally taxable property to fund varying levels of the school finance burden, typically providing more than half of the dollars spent.

Due to that high level of reliance on district property taxes, the disparities between districts' ability to raise revenue at similar tax rates have varied widely. The courts ruled multiple times that the Legislature had to take action to reduce the disparities that result from using property taxes to fund education.

The court defined efficiency in *Edgewood I*. The definition of efficiency was a crucial factor in the ruling that the Supreme Court would hand down in that case. The court determined that for the system to be considered financially efficient, "… districts must have substantially equal access to similar revenues per pupil at similar levels of tax effort" (*Edgewood I*, 12).

In its findings, the court showed that by this definition, the system was inefficient because local property taxes at that time allowed property-wealthy districts to tax low and spend high, while property-poor districts were forced to tax high and spend low.

The court made a similar finding in *Edgewood II* after the Legislature's previous response had left the wealthiest 5 percent of districts out of reforms. The result was that property owners in lower property wealth districts were still paying higher tax rates than wealthier districts even though their schools spent less money per student. In short, the court held that previous legislation did not remedy the constitutional violation.

The court stated that to be efficient, "… a funding system that is so dependent on local ad valorem property taxes must draw revenue from all property at a substantially equal rate" (*Edgewood II*, 9). Meeting this requirement has been challenging for the Legislature, to say the least.

In three cases, including the most recent case, the system was ruled to meet the constitutional requirement of efficiency. However, the court made clear on each occasion that the system met the minimum requirement to be called efficient. The court did not give a glowing review of the system.

Local property taxes do not lend themselves to statewide efficiency, as defined by the court. With the constitution requiring an efficient system, it is problematic to rely on a tax that is inherently inefficient due to its dependence on property values which vary so widely across a state the size of Texas.

***Texas' system based on district property taxes depends on a controversial recapture system***

One tool the Legislature has used to rectify the disparities in the system has been recapture, or "Robin Hood." Recapture was devised after the *Edgewood III* ruling, which required the abolition of CEDs.

In response to *Edgewood III*, the Legislature passed SB 7, a finance reform bill that sought to rectify the constitutional woes of the finance system. SB 7 capped local property tax rates at $1.50 per $100 of evaluation. It also created "Robin Hood" by placing a new cap of $280,000 in taxable property wealth per student.

Because district property taxes inherently lend themselves to inefficiency, the Legislature chose to rely on the redistribution method of recapture to make the system efficient. By taking revenue above a certain amount per student away from wealthy districts and giving that revenue to less affluent districts, the state cobbled together a system that was ruled efficient by the Supreme Court in *Edgewood IV*.

However, recapture has been an unpopular and controversial system. Property-wealthy districts and their citizens are often opposed to it as they watch locally collected tax dollars leave the district, rather than go to their neighborhood schools.

If a tax is collected locally, it stands to reason that the revenue should be spent locally. Unfortunately, to meet the constitutional requirement to maintain an "efficient system," our reliance on local property taxes has led to a dependence on the recapture system.

***Local property taxes themselves are burdensome to Texas taxpayers***

According to the Texas Constitution, public education's purpose is to secure a "general diffusion of knowledge" because that is "essential to the preservation of the liberties and rights of the people." With this singular purpose in mind, we should consider that public education is instituted by the state to serve the people.

The people also appear to oppose property taxes particularly. Property taxes are not popular among Texans and have not been throughout history. In the 1800s, many Texans called a $1.00 property tax on every $100 of property value "confiscation and robbery" (Thomas and Walker, 230).

Property taxes carry consequences. The burden of property taxes disproportionately impacts elderly property owners who cannot keep up with ever-rising valuations and rates. In *Abolishing the "Robin Hood" School Property Tax* by the Texas Public Policy Foundation, authors point out this disparity:

> *The consequences of high and fast-growing property taxes are numerous. Taxes can discourage economic growth, distort investment decisions, and depress job creation. The rising burden from property taxes is worse for housing-rich but income-poor elderly homeowners. For example, elderly homeowners must move more often to reduce their property tax burden, which is an additional cost of owning a home for those who can least afford to move (*Belew et al., 6*).*

Today, an overwhelming majority of Texans believe that property taxes constitute a significant burden on their families. According to surveys conducted by the Texas

Public Policy Foundation in 2019, 72 percent of likely voters agreed that property taxes are a significant burden. That same survey shows that most Texans want major reforms and lower property taxes (WPA Intelligence).

## Recommendations for Change

Given the challenges of using local property taxes to fund the level of spending today, it is time that Texas move away from funding its public schools through local property taxes. To make the school finance system more structurally sound and further reduce the chances of another lawsuit, the Texas Legislature should consider eliminating the reliance on local property taxes to fund education. Continuing to use property taxes will result in continuing concerns about equity and efficiency across the state.

One way to accomplish this is for the Legislature to buy down school maintenance and operations (M&O) property taxes over approximately a decade. This could be done by restricting state spending growth and using the resulting budget surpluses for the buydown.

This plan is outlined in the Foundation's *Abolishing the "Robin Hood" School Property Tax* (Belew et al.):

> *In order to eliminate the M&O property tax, estimated to raise $51.3 billion during the state's 2018-19 fiscal biennium, Texas will need to restrain spending growth. This would generate a surplus of state revenue to be used to replace property tax revenue and thus decrease the property tax each year. Our plan would limit biennial increases on GRR appropriations growth to 4 percent. Within this limit, the Legislature would be free to appropriate funds for any purposes for which it can legally do so, including for increases in education funding to cover enrollment growth and other purposes. … [T]he spending restraint would create a surplus of state funds averaging approximately 60 percent of new GRR funds per biennium. Ninety percent of this surplus will be used to eliminate school property taxes (7).*

Using the surplus in funds to buy down property taxes would allow the state to eliminate the M&O property tax within about 10 years.

Another way that the state could eliminate the use of property taxes is known as a "tax swap."

In *The Freedom to Own Property: Reforming Texas' Local Property Tax*, a study published by the Texas Public Policy Foundation in 2015, authors Kathleen Hunker, James Quintero, and Vance Ginn laid out a plan for abolishing the property tax by replacing the lost revenue with an increased sales tax. Though this proposal recommends the elimination of the entire property tax, it could be adjusted to focus just on the M&O property tax (Hunker et al., 8).

Eliminating just the M&O property tax by either broadening the base of the state sales tax, increasing its rate, or a combination of both is the focus of former senior economist of the Texas Public Policy Foundation Vance Ginn in *Paths to Real Property Tax Cuts* (Ginn).

Ginn points out that with a broadened base and eliminating $42 billion in exemptions to the sales tax, the sales tax rate would rise less than two percentage points in order to fill the revenue gap created by eliminating M&O property taxes (2).

Ginn lays out the multiple options available to effectively execute the tax swap plan, including the option to swap the taxes over time. However, he does point out the inherent concern with swapping them over time, which is that without strict spending limitations, both property and sales taxes could rise in the future. This is why an immediate and complete tax swap, such as the plan mentioned in Hunker et al., would be preferable to a gradual swap.

Even so, any swap presumes an increased sales tax rate. In this respect, the "buy down" plan using surplus dollars with no tax increases is better for Texas taxpayers.

These two options are possibilities that the Texas Public Policy Foundation has explored in recent years. There are likely other options for eliminating the property tax and shoring up the constitutionality of the school finance system.

## Conclusion

Our school finance system has undergone more than four decades of continual litigation. Even though that appears to have come to an end, at least for now, the system that has recently passed the Supreme Court's constitutional test has not done so with anything resembling flying colors. On the contrary, each affirmative ruling came with warnings about the instability of the system and the distinct possibility that the state would again find itself in court defending a flawed system.

The 86th Texas Legislature made notable strides to reduce the M&O property tax burden on Texans. As a consequence, the school finance system's reliance on that revenue was also decreased. While House Bill 3 and Senate Bill 2 worked in tandem to reduce property taxes, there is still work to be done. To that end, in HB 3 the Legislature required the Legislative Budget Board to study methods to reduce school district M&O property taxes. Eliminating school M&O property taxes and the school finance system's reliance on them would alleviate a continuing structural concern of the school finance system and provide Texans with the property tax reforms they seek.

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