

Supreme Court Finds Current School Tax System Unconstitutional

The Texas Supreme Court has ruled that the current school tax system is unconstitutional because school districts do not have “meaningful discretion” in setting local property tax rates. The Supreme Court upheld a district court decision that the local property tax cap of \$1.50 per \$100 of valuation has evolved into a statewide property tax, which is prohibited by the Texas Constitution. In a ruling issued November 22, 2005, the court extended the effective date of the district court’s injunction against the current system until June 1, 2006, to give the Legislature time to address the problem.

The Supreme Court reversed the district court’s finding that the state is in violation of the Constitution because of inadequate funding for public education and lack of equal access to facilities funding. While this aspect of the decision went against a trend in other states to require more education funding in response to “adequacy” lawsuits, the court did not rule out a future adequacy challenge. The court noted that “it remains to be seen whether the system’s predicted drift toward constitutional inadequacy will be avoided by legislative reaction to widespread calls for changes.”

Background

Over that past three decades, the Texas public school finance system has evolved through a series of legislative responses to legal challenges by school districts and taxpayers. A series of *Edgewood* decisions beginning in 1989 confronted the issue of equity, or how to resolve disparities in revenue-raising capacity and funding between property-wealthy and property-poor districts. In 1993, the 73rd Legislature enacted SB 7 by Ratliff and created the current recapture system, which essentially shifts money from richer districts to poorer districts to help equalize educational funding. In 1995, the Supreme Court upheld the constitutionality of this system.

Summary of Speaker’s Interim Charges to House Committees

Speaker Tom Craddick on October 19 issued his charges to House committees to conduct interim studies of issues likely to be considered by the 80th Legislature when it convenes in January 2007. The charges are summarized briefly below, with the [complete list](#) available on the House Web site. The committees also were assigned general oversight and monitoring responsibility over the agencies and programs under their jurisdiction.

Agriculture and Livestock – duplicate certification authority for graduates of foreign veterinary colleges; regulation of non-veterinary animal care practitioners; agricultural energy sources, including ethanol, biodiesel, and biomass; water conservation and supply enhancement (jointly with Natural Resources).

The current school finance lawsuit (*West Orange-Cove Consolidated ISD, et. al., v. Neeley, et. al.*) originally was filed in 2001 by four property-wealthy school districts asserting that they had lost discretion in setting local tax rates for the maintenance and operation of schools. In the original appeal, the Supreme Court held that a school district must have “meaningful discretion” in setting the rate for its local ad valorem tax or it would be considered

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Appropriations – performance review of state agencies and institutions; state automated information and technology systems; state employee compensation and benefits; state budget process and controlling growth in state spending; implementation of the driver responsibility program that levies a surcharge on certain traffic offense fines; service coordination and administration of health and human services waiver programs.

Border and International Affairs – border economic development and tourism; increased international trade impact on state markets and contracts and security of data transfers; coordination of border-related entities and programs and a comprehensive border information clearinghouse; acceptance by state agencies of identification documents held by foreign nationals (jointly with Defense Affairs and State-Federal Relations); enhancing trade corridors through increased use of technology; border and coastal infrastructure enhancement (both jointly with Transportation).

Business and Industry – implementation of HB 1813, 79th Legislature, protections for those buying homes under “rent-to-own” or “contract-for-deed” procedures; identity theft (jointly with State Affairs); implementation of HB 7, 79th Legislature, workers’ compensation revisions (jointly with Insurance); authority of homeowners associations (jointly with Land and Resource Management).

Civil Practices – governmental immunity from contract claim disputes; staffing needs for multidistrict litigation courts; reimbursement of defense costs under Insurance Code 21.55, prompt payment of insurance claims; multiple plaintiff trials in tort cases other than those concerning asbestos and silica; liability risks associated with privatization of child welfare services and civil liability limits for non-profits involved in substitute care or care management services.

Corrections – organizational structure of the Texas Department of Criminal Justice (TDCJ), in conjunction with Sunset review; probation system, including graduated sanctions and specialized courts to reduce revocations and recidivism; comparison of Texas’ correctional health care system to those in other states for greater accountability and competition among providers; programming needs

for TDCJ special populations; operation and organization of the Windham School District; adequacy of the state accountability system in measuring the effectiveness of Disciplinary Alternative Education Programs (jointly with Public Education); effectiveness of after-school and other prevention programs in reducing juvenile crime (jointly with Juvenile Justice and Family Issues).

County Affairs – graduated ordinance-making authority for counties of over one million population; dormancy of office and abolition of local constitutional offices; sale of fireworks; county government cost drivers.

Criminal Jurisprudence – crime victim restitution payment, collection, and disbursement; reciprocal discovery in criminal cases; criminal and civil liability of persons using force against persons who unlawfully and with force enter residences, dwellings, or vehicles; use of nuisance abatement authority by the city of Dallas (jointly with General Investigating and Ethics).

Culture, Recreation and Tourism – Texas Cultural Endowment Fund status; desecration of archeological sites and cemeteries; Texas State Library and Archives Commission assistance to public school libraries; promotion of economic development through increased tourism.

Defense Affairs and State-Federal Relations – Base Realignment and Closure (BRAC) 2005 decisions and state assistance of redevelopment efforts in affected communities; implementation of HB 3112, 79th Legislature, state government computer network security; veterans’ benefits, including federally funded nursing care facilities, job training, educational benefits, and return-to-work issues; acceptance by state agencies of identification documents held by foreign nationals (jointly with Border and International Affairs).

Economic Development – use of the Development Corporation Act of 1979 to support development or expansion of specialized higher education facilities; use of the Skills Development Fund and the alternative funding mechanism created in HB 2421, 79th Legislature; the Texas Enterprise Zone program’s contributions to state economic development; utilization of the Unemployment Insurance Fund; effectiveness of the Texas Economic Development Act and extension of its December 31, 2007, Sunset date; effectiveness of the Texas Enterprise Fund in promoting economic development.

Elections – implementation of the federal Help America Vote Act of 2002 (HAVA); prevalence of election fraud in Texas, including prosecution rates and preventive measures; use of technology in campaigns and election administration; improving uniformity and efficiency in local elections, including market practices for leasing voter equipment.

Energy Resources – effects of universal bonding on the oil and gas industry, including the population of operators, economic consequences, and the number of abandoned wells in the Oil Field Cleanup Fund; economic incentives to promote plugging of inactive wells; alternatives to increased appropriations to the Railroad Commission, including administrative functions funded by the Oil Field Cleanup Fund; incentives for use of technological advancements in the energy industry; remediating natural resources affected by oil and gas operations; feasibility of additional nuclear-generated power in Texas (jointly with Regulated Industries).

Environmental Regulation – State Implementation Plan for controlling air pollution, including adequacy of data collection and necessity for mid-course corrections to move the state closer to federal Environmental Protection Agency requirements; streamlining the permitting process, including public notice requirements and use of the Internet for permit applications and renewals; evaluation of environmental enforcement, including whether streamlined permitting would add enforcement resources that would lead to greater compliance, and the effectiveness of stronger incentives for high performers and improvements in the compliance history program.

Financial Institutions – consolidation of state financial regulatory agencies; predatory lending practices involved with subprime mortgage lending, primarily in the border areas, including patterns of mortgage fraud and the relationship between mortgage brokers and residential borrowers.

General Investigating and Ethics – education agency actions regarding anabolic steroid use among public school students; local government and school board use of taxpayer money to lobby the Legislature and attempts by school district officials to skirt competitive bidding requirements through the use of improper procurement

contracts with associations or other school districts for facility renovation and construction (jointly with Public Education); use of nuisance abatement authority by the city of Dallas (jointly with Criminal Jurisprudence).

Government Reform – state agency performance and public accountability measures; synergies between state agencies and private non-profits performing state functions, including assistance to non-profits with operations, procurement, and information technology and management; consolidation of existing health profession licensing boards.

Higher Education – state-supported financial aid programs; formula funding models for higher education institutions; higher education accessibility and identification of state areas underserved by bachelor's and associate's degree programs; allocation of state resources for higher education facilities funding; modification of community college service areas to reflect population or other demographic changes.

Human Services – foster care preparation for adult living, including likelihood of secondary education completion or maintenance of trade skills and correlation of foster care adult-preparation programs and school drop-out patterns, job maintenance, and poverty; mental health and mental retardation services, including identification of best practices in crisis intervention, residential treatment, and aftercare and successful mental health services delivery models in other states; effect of federal Food Stamp Program changes on participation in Texas.

Insurance – availability and affordability of insurance for Texans suffering from eating disorders such as anorexia and bulimia; implementation of HB 7, 79th Legislature, workers' compensation revisions (jointly with Business and Industry).

Judiciary – compensation of county court-at-law judges; journalist shield law.

Juvenile Justice and Family Issues – Texas Youth Commission capacity and policies on abuse and neglect; authorization to conduct marriages; adequacy of child support guidelines and formulas and child support for college costs; courts' handling of truancy cases; presumption of parentage and relief to presumed parents who are

child support obligors and assert paternity fraud claim; effectiveness of after-school and other prevention programs in reducing juvenile crime (jointly with Corrections).

Land and Resource Management –

appropriateness of non-elected bodies exercising eminent domain power to condemn property; single and uniform approach to situations involving overlapping extraterritorial jurisdictions; authority of homeowners associations (jointly with Business and Industry).

Law Enforcement –

Department of Public Safety trooper training; manufacture of methamphetamines, including the implementation of HB 164, 79th Legislature, and the distribution and sale of prescription and non-prescription drugs; stable funding sources for the University of North Texas Missing Persons DNA database; implementation of SB 568, 79th Legislature, concerning law enforcement response to private home alarms; law enforcement training program for small or rural police agencies.

Licensing and Administrative Procedures –

regulation of certain occupations that may pose a significant threat to public health, safety, and welfare; making Texas' racetracks more attractive to Texans and tourists; enforcement of laws against underage drinking; sale of lottery tickets at alternative locations; implementation of SB 1850, 79th Legislature, restricting proliferation of bars and cantinas near residences, schools, churches, and daycare centers in Harris, Dallas, and Tarrant counties and possible application to other counties.

Local Government Ways and Means –

appraisal of property located in more than one appraisal district; central appraisal districts, including board makeup, consolidation, methodology in arriving at appraised values, and impact of Comptroller's Office audits; comparison of county and school district methods of levying property taxes, including effective tax rate, rollback tax rate, and rollback elections; impact on cities of unfunded mandates by state and federal governments.

Natural Resources –

municipal utility districts (MUDs), including grant of other special district powers, impact on economic growth and development and tax implications, provision of municipal and county services on MUD residents, and MUD public disclosure and notification

requirements and bonding authority; landscape water conservation and its potential for outdoor water savings; state wastewater re-use policies; environmental flows commission and adequacy; water conservation and supply enhancement (jointly with Agriculture and Livestock).

Pensions and Investments –

regulation of actuaries who monitor the financial health of public pension plans; criteria for the Pension Review Board to signal a major change in a public pension system's financial condition; creation of a large, consolidated risk pool and other strategies for statewide relief to governmental entities from high health care premiums for employees and retirees; eligibility criteria for the Law Enforcement and Custodial Officers Supplemental (LECOS) retirement program; impact of targeted investment strategies on state retirement funds; proportionate retirement programs and their effect on state pension funds.

Public Education –

school choice programs; compensation of central school administration and superintendents and its correspondence to student performance; allocation of funds by different types of high performing districts among instruction, instructional support, operations, and district administration; review of Education Code, ch. 21, programs and protections concerning educators; school district budgeting practices, including enhancing trustees' role in budget design and making school budgets more accessible and transparent to the public; performance-pay system for education professionals in Texas, including examining successful programs in other states; improving high-school performance for post-secondary readiness; local government and school board use of taxpayer money to lobby the Legislature and attempts by school district officials to skirt competitive bidding requirements through the use of improper procurement contracts with associations or other school districts for facility renovation and construction (jointly with General Investigating and Ethics); adequacy of the state accountability system in measuring the effectiveness of Disciplinary Alternative Education Programs (jointly with Corrections). The chairman also has directed the committee under its general oversight authority to study school district consolidation issues.

Public Health –

scope of practice issues involving health professions; the state's role and approach to Medicare Part D, concerning payment for prescription drugs, and its

impact on Texas Medicaid clients; prevention of hospital-acquired infections; end-of-life situations when a physician refuses to honor an advance directive under Health and Safety Code, sec. 166.046; regulation of laser hair removal facilities and certification of individuals performing such removal; cigarette manufacturers' compliance with the 1998 Tobacco Settlement concerning sales to minors, progress toward meeting the state's tobacco use goals, and the cost to the state of tobacco use (jointly with State Affairs).

Redistricting – modification of districts of state district courts.

Regulated Industries – generation capacity and fuel diversity in the Texas electric market and encouragement in emerging energy markets of new investment and technological innovation such as clean coal and next-generation nuclear technologies; effect of retail competition in the Texas electric market; implementation of the new state-issued cable and video franchise system and encouraging competition in the Texas broadband cable and video market; effects of incumbent telecommunications deregulation on local level competition and pricing and service offerings and encouraging further deregulation; repayment mechanisms to counties or municipalities for utility relocations in public rights-of-way; compensation to municipalities for use of public rights-of-way; feasibility of additional nuclear-generated power in Texas (jointly with Energy Resources).

State Affairs – merging or streamlining functions of agencies under the committee's jurisdiction; stem cell research scientific advances; rule-making implementation of the new parental consent requirement for abortion by minors; identity theft (jointly with Business and Industry); cigarette manufacturers' compliance with the 1998 Tobacco Settlement concerning sales to minors, progress toward meeting the state's tobacco use goals, and the cost to the state of tobacco use (jointly with Public Health).

Transportation – Texas Department of Transportation (TxDOT) regulation of utility access and placement of utility facilities along edge of the road rights-of-way; private and public airports, including the relationship of TxDOT with federal agencies and airport funding and capacity needs; transportation planning and coordination of land use, including for large transportation corridors; sale by rental car companies of used rental vehicles at locations, such as credit unions, not continuously used for such sales; rail relocation needs and funding for major metropolitan areas; enhancing trade corridors through increased use of technology; border and coastal infrastructure enhancement (both jointly with Border and International Affairs).

Urban Affairs – implications of the Texas Department of Housing and Community Affairs (TDHCA) tax credit and private activity bond programs for new construction in Houston, Dallas-Fort Worth, and Austin; replacing the lottery system for allocating housing tax credit awards through the private activity bond program with an alternative allocation system; the home ownership rate for low-income Texans and improvements in such rates for underserved populations; comparison of the TDHCA housing tax credit program with best practices elsewhere; determination by TDHCA of annual low income housing credits statewide; effectiveness of current TDHCA underwriting methods for its programs; municipal regulation of mobile food vending vehicles.

Ways and Means – business tax alternatives to reduce state reliance on local property taxes to fund public education and business taxes paid by various industries; the process used by Comptroller's Office and Legislative Budget Board to evaluate and provide information on the impact of tax legislation.

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a state property tax prohibited by Art. 8, sec. 1-e of the Texas Constitution. The Supreme Court remanded the case to district court to determine whether school districts had lost meaningful discretion in setting tax rates in order to meet minimum education standards.

More than 300 school districts subsequently signed on to the lawsuit as part of three different plaintiff groups. In a six-week bench trial before Travis County District Judge John Dietz, plaintiffs asserted that, in addition to the tax cap violation, the state's school finance system fails to meet the standard in Art. 7, sec. 1 of the Texas Constitution, which requires the Legislature to create an "efficient" system for providing a "general diffusion of knowledge." The plaintiffs also argued that the current system does not meet constitutional standards for equity because school districts do not have equal access to funding for maintenance and operations or facilities funding. (For a detailed background, see "School Finance Litigation Update," *HRO Interim News*, Number 78-4, April 7, 2004.)

Judge Dietz issued his detailed findings on November 30, 2004, ruling that the current school finance system violates the Constitution because districts lack meaningful discretion in setting their tax rates – the combined result of the \$1.50 statutory cap and legislative and constitutionally imposed requirements. Judge Dietz said that a district has meaningful discretion only if it can devote at least 10 percent of its taxing capacity, or about 15 cents of tax effort, to raise additional revenue to enrich its programs beyond what is required to provide a general diffusion of knowledge and to comply with state and federal mandates.

Judge Dietz also found that the state was in violation of Art. 7, sec. 1 of the Constitution because it did not provide funding adequate to meet constitutional standards for a "general diffusion of knowledge" and that the system for funding school facilities does not meet constitutional standards for equity in Art. 7, sec. 1. (See *Court Rules School Finance System Unconstitutional*, HRO Focus Report Number 79-6, February 21, 2005.)

The Supreme Court, in a 7 to 1 decision written by Justice Nathan Hecht, upheld Judge Dietz's finding of a constitutional violation of Art. 8, sec. 1-e – the prohibition

of a statewide property tax – but reversed the rulings regarding adequacy of funding and access to facilities funding. The court warned, however, of impending constitutional violations in this area and found that there was not yet enough evidence to prove that property-poor districts' lack of access to facilities funding has reached the level of a constitutional violation. The court pointed out that while the Legislature has discretion in establishing and maintaining the structure of the public education system, the judiciary continues to play a role in ensuring that the system meets constitutional standards.

Adequacy of funding

Judge Dietz, on the basis of Education Code, sec. 4.001(a) and sec. 28.001, found that "to fulfill the constitutional obligation to provide a general diffusion of knowledge, districts must provide *all Texas children ... access* to a quality education that enables them to achieve their potential and fully participate now and in the future in the social, economic, and educational opportunities of our state and nation. ... Districts satisfy this constitutional obligation when they provide all of their students with a *meaningful opportunity* to acquire the essential knowledge and skills reflected in curriculum requirements," such that upon graduation students are prepared to "continue to learn in postsecondary educational, training, or employment settings" [emphasis added by the court].

The Supreme Court agreed, with a caveat: "The public education system need not operate perfectly; it is adequate if districts are *reasonably* able to provide their students the access and opportunity the district court described."

The court added that these provisions from the Education Code "cannot be used to fault a public education system that is working to meet [the statutes'] stated goals merely because it has not yet succeeded in doing so."

While the court acknowledged that schools and districts are struggling to teach an increasingly demanding curriculum to a population with a growing number of disadvantaged students, it pointed to the improvement in standardized test scores as evidence that the structure of the public education system meets the standards of adequacy outlined in the Education Code.

The court also acknowledged that in not finding a constitutional violation at this time it was being deferential to the Legislature, but pointed out that the standard can be violated:

There is substantial evidence, which again the district court credited, that the public education system has reached the point where continued improvement will not be possible absent significant change, whether that change take the form of increased funding, improved efficiencies, or better methods of education. ... But an impending violation is not an existing one, and it remains to be seen whether the system's predicted drift toward constitutional inadequacy will be avoided by legislative reaction to widespread calls for changes."

Meaningful discretion

In upholding the district court's finding of a violation of the constitutional prohibition against a statewide property tax, the Supreme Court emphasized that the issue is the school districts' lack of "meaningful discretion" in setting their local tax rate for maintenance and operations to provide an accredited education. The court noted that "the current situation has become virtually indistinguishable from one in which the State simply set an ad valorem tax rate of \$1.50 and redistributed the revenue to the districts."

While the court did not reject the current recapture system, commonly known as "Robin Hood," it noted that "the number of districts and amount of revenue subject to recapture have almost tripled since 1994. The State's control of this local revenue is a significant factor in considering whether local taxes have become a state property tax."

Referring to recent legislative efforts to reduce local property taxes, the court warned against simply compressing tax rates to a lower level:

Various legislative proposals during the past year to remedy perceived problems with the public education system and its funding would reduce the maximum ad valorem tax rate and allow it to be exceeded for certain purposes. While we express no view on the appropriateness of any of these

proposals, we are constrained to caution, as we have before, that a cap to which districts are inexorably forced by educational requirements and economic necessities, as they have been under Senate Bill 7, will in short order violate the prohibition of a state property tax.

Local enrichment

Affirming Judge Dietz's determination that a district has meaningful discretion only if it can devote at least 10 percent of its taxing capacity to raise revenue for enrichment, the court noted that "local supplementation is not a constitutional right, but it is part of the purpose of FSP [Foundation School Program] funding." Citing Education Code, sec. 42.301, the court pointed out that the purpose of the guaranteed yield component of the funding structure is to give each school district the opportunity to supplement the basic program at a level of its own choice. Thus, "local supplementation is made a core component of the system structure."

One of the three plaintiff groups, the Edgewood intervenors, contended that local supplementation of funding beyond that required for an adequate education violated constitutional standards for efficiency, which the court has long equated with equity. But the court, citing previous *Edgewood* decisions, rejected this position:

As long as efficiency is maintained, it is not unconstitutional for districts to supplement their programs with local funds, *even if* such funds are unmatched by state dollars and *even if* such funds are not subject to statewide recapture. We caution, however, that the amount of "supplementation" in the system cannot become so great that it, in effect, destroys the efficiency of the entire system. The danger is that what the Legislature today considers to be "supplementation" may tomorrow become necessary to satisfy the constitutional mandate for a general diffusion of knowledge.

The court added: "Supplementation must be just that: additional revenue not required for an education that is constitutionally adequate. For such supplementation we have never held that districts must have substantially equal access to funds."

Structure of the system

The constitutional standards of Art. 7, sec. 1 – adequacy, efficiency, suitability – do not dictate a particular structure that a system of free public schools must have, the court said. But the court commented on the lack of efficiency created by the current system, which is made up of 1,031 independent school districts, more than four times the number of counties (254) in Texas, ranging in size from Houston ISD, the largest district with more than 211,000 students, to the Divide ISD, the smallest district with 10 students. According to the court:

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 cannot[ing] the use of resources so as to produce results with little waste.” – as required by article VII, section 1 of the Constitution. ...

... The large number of districts, with their redundant staffing, facilities, and administration, make it impossible to reduce costs through economies of scale. Bigger is not always better, but a multitude of small districts is undeniably inefficient. The justification offered for this situation is that as a matter of public policy, public schools should be locally controlled, although it has never been clear why the legitimate benefits of local control are so entirely inconsistent with efficiency in funding.

Deadline

Judge Dietz's injunction, as modified by the Supreme Court, establishes a deadline of June 1, 2006, to “allow the state ample time to fully consider structural changes in the public education system, and to allow the system time to adjust to those changes.” After that date, the state will be prevented from distributing any money under the current school finance system or from enforcing chapters 41 and 42 of the Education Code, which govern the distribution of state funding, until the constitutional violation is remedied.

– by Betsy Blair

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