

February 12, 2009

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative related to increasing the sales tax for education purposes (A.G. File No. 08-0021, Amendment #1-S).

Background

The current base statewide sales and use tax (SUT) rate is 7.25 percent of each dollar—5 percent dedicated to the state General Fund, 2 percent dedicated to local governments, and 0.25 percent dedicated to repaying voter-approved economic recovery bonds. (On top of the statewide tax rate, localities can enact up to an additional two cents per dollar in voter-approved local sales taxes.) In 2007-08, the state collected about \$26 billion in General Fund revenues from SUT.

Currently, K-12 schools and community colleges are largely funded by the General Fund and local property taxes. These monies count toward the Proposition 98 funding requirement. Proposition 98 is a constitutional amendment passed by voters in 1988, which establishes a minimum annual funding level for K-14 education. Proposition 98 funding constitutes around three-fourths of total K-14 education funding. These funds support general education purposes as well as specific education purposes (such as professional development, instructional materials, and student support).

Proposal

Increases the Statewide SUT. This measure adds a new section to the Constitution permanently increasing the statewide SUT rate by one cent—from 7.25 percent to 8.25 percent—starting January 1, 2010.

Uses Tax Proceeds to Establish a Special Fund to Supplement K-14 Education Funding. The revenues generated by the one-cent increase in the statewide SUT would be

deposited into a new, constitutionally established Public School Investment and Accountability Fund. This special fund would provide additional funding for K-12 schools (including the state special schools and Division of Juvenile Facilities schools) and California Community Colleges (CCC), on top of the constitutionally guaranteed minimum funding level determined by Proposition 98. Of the monies deposited in this fund, the measure annually would allocate 89 percent of the proceeds to school districts and 11 percent to CCC districts.

Specifies Allowable K-12 Activities. Under the measure, the special fund monies received by K-12 school districts must supplement, not substitute for, existing state funding and be used exclusively to support “instructional improvement and accountability” activities. The measure prohibits districts from using the special funds to cover administrative costs. The measure defines K-12 instructional improvement and accountability as:

- Class size reduction in kindergarten through twelfth grade.
- Instructional supplies, equipment, materials, and support services ranging from technology support for classrooms to health-related services.
- School safety programs.
- Direct student services, such as counselors, librarians, and nurses.
- Staff development designed and implemented with teachers.
- Collaborative planning time for teachers.
- Academic enrichment programs, such as art, music, and career and vocational education.
- Salary and benefits for teachers and other nonmanagement school staff.

Supports Similar CCC Activities. Similarly, CCC districts must use the new special fund monies to supplement existing state funding and may not use funds to cover administrative costs. The special fund monies received by CCC also must be used for instructional improvement and accountability activities. In the case of CCC, the measure defines these activities as:

- Individual student assessment and counseling.
- Instructional supplies, equipment, materials, and related support services.
- Faculty development.
- Salary and benefits for faculty and counseling staff.

Allocates Monies Monthly on a Per Pupil Basis. The measure directs the State Controller to distribute funds on a monthly basis. School districts would receive an equal

amount per student based on average daily attendance (ADA). Likewise, CCC districts would receive an equal amount for each full-time equivalent (FTE) enrollment in a CCC district.

Requires State Oversight of Funds. The measure requires school and CCC districts to conduct an annual independent audit showing how they spent their special fund monies. District audits are to be reviewed by the Controller. The Controller would be required to report any compliance failures to the Superintendent of Public Instruction, the Board of Governor's of CCC, and the Attorney General, as well as make the report publicly available. In addition, the Attorney General would be required to investigate any compliance failures identified by the Controller. The Attorney General may seek civil or criminal penalties for any misuse of special fund monies. While the measure would allow districts to cover their costs for audits with the new sales tax monies, it does not make such funding available for state-level oversight activities.

Fiscal Effects

The measure's fiscal effects are described below.

SUT Revenue. The measure would generate \$2.5 billion in 2009-10 and \$5.1 billion annually thereafter for the Public School Investment and Accountability Fund.

Loss of State and Local Revenue. The measure also would reduce revenues from the existing SUT and other state taxes affected by sales (such as excise taxes). This is because the higher overall tax rate would deter some consumption that otherwise would have occurred. The exact amount of such reductions are unknown and would depend on individuals' consumption behavior. However, on a full-year basis, beginning in 2010-11, we estimate the increased SUT rate could reduce state and local government tax revenues by hundreds of millions of dollars annually. Reduced revenues in 2009-10 would be about one-half of these amounts (as a result of the measure going into effect halfway through the year).

Administrative and Oversight Costs. We estimate the cost of the state's additional administrative activities and oversight responsibilities would be in the low millions of dollars annually. Given the measure provides no funding to cover these administrative and oversight costs, it would result in increased General Fund spending. In addition, districts would face administrative costs associated with managing and expending the special funds at the local level. These costs are unknown and would depend on districts' implementation decisions.

Relatively Small Impact on Proposition 98 Guarantee. The required minimum guarantee for Proposition 98 would not directly be affected by the new revenues generated from this initiative because the initiative explicitly stipulates that revenues derived from the one-cent tax increase would not count in the Proposition 98 calculation for K-14 education. The minimum guarantee, however, could be indirectly affected to the ex-

tent that existing General Fund SUT revenues decline. Compared to overall Proposition 98 funding any such effect would be relatively small.

Summary of Fiscal Effects

This measure would have the following major fiscal impacts:

- Increased revenues of \$2.5 billion in 2009-10 and \$5.1 billion annually thereafter from a one-cent per dollar increase in the sales and use tax. Revenues would be dedicated to specific K-12 education and community college programs.
- Decreased revenues to state and local governments from a reduction in sales-related tax revenues due to decreased overall consumption. The amount of the decreased revenues could be hundreds of millions of dollars annually.

Sincerely,

Mac Taylor
Legislative Analyst

Michael C. Genest
Director of Finance