

A CITIZENS' ASSEMBLY ON NEW JERSEY'S TAX SYSTEM

***TRENTON, NEW JERSEY
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INTRODUCTION

HOW DID WE GET HERE?

Taxes in New Jersey stem from a series of laws passed at different times for different reasons to meet different needs—to the point where a whole system has evolved that many people feel has become plagued with too many problems. Unfortunately, changing the tax system is not easy. There is no one vote that can be cast at any level of government to change the entire tax system. Moreover, taxes are one of those topics that few political leaders are willing to touch.

The Citizens' Tax Assembly steps in to help fill this void. The Assembly is an opportunity for a cross-section of New Jersey residents to take stock of taxes in their state and talk about how to improve the system. It aims to demonstrate that New Jersey citizens can engage these issues in a meaningful way. And it aims to help policymakers better understand what is most important to citizens when it comes to taxes and tax reform.

WHAT ISSUES WILL THE ASSEMBLY ADDRESS?

This Citizens' Assembly will address the best ways to raise revenues in New Jersey to pay for government services such as roads, schools and public safety. It will help answer the question: What is the best way to raise the resources for the public services we decide we want?

Our discussions will focus specifically on state and local (not federal) taxes. Of course, we recognize that many factors influence the mix of taxes imposed, and the level of revenues collected. For example, government spending is important and may well come into the discussion if it helps people sort out their views on taxes. But such spending is not the main focus of the Assembly. This is not to say that how much we spend and what we spend it on are unimportant. On the contrary, these are vitally important questions for a democratic society to address. And, obviously, government decisions on how much to spend in a given year do affect your taxes. But spending questions come up for debate and decision each year in votes by the Legislature, local councils, school boards and, in some instances, directly by citizens themselves.

In contrast, how we organize our tax system does not come up for debate in any comprehensive fashion on a regular basis. This is not to say that individuals across the state do not voice a great deal of concern, and even anger, about problems stemming from the way we tax ourselves—that they surely do. And proposals for change in the tax system arise from time to time. But people rarely, if ever, have good opportunities to learn more about the tax system as a whole, think about the values they want it to reflect, and consider the best ways to improve it.

In sum, no matter how much we decide to spend on government in any given year, New Jersey should have a tax system that makes sense for obtaining that money, and that reflects the values of its citizens. Whether state and local budgets are large or small, how we tax ourselves to raise the money we need will bring up such issues as fairness and efficiency. We have to raise enough to meet the needs we decide are most important, and we want to do it in a way that best promotes the public good—recognizing that no system is perfect, but that important progress can be made.

HOW WE WILL ADDRESS THE ISSUES

The discussion framework that follows this introduction will help Assembly participants sort through a number of key issues surrounding New Jersey's tax system. The Assembly was conceived by the Coalition for the Public Good, a New Jersey-based nonprofit organization that concerns itself with issues of "good government." The Coalition turned to Public Agenda to help develop the discussion materials. Public Agenda is a nonprofit, nonpartisan organization based in New York that specializes in creating fair and accessible citizen education materials that have been used in thousands of communities across the country. To make sure the discussion materials would be as fair and useful as possible for everyone, Public Agenda conducted focus groups and interviews with a broad range of New Jersey citizens across the state.

As a means to help Assembly participants explore the directions New Jersey can go to improve its tax system, we will review four contrasting approaches to state and local tax policies, each with its own advantages, disadvantages and tradeoffs. The job of the Assembly will be to decide together which approach, or which parts of several approaches, are most important for policymakers to concentrate on in their efforts to improve the tax system. As part of this conversation, we will consider the kinds of taxes, and the balance among them, that will produce a system that most of us agree makes the most sense. The Assembly will conclude by summing up the lessons that we think policymakers should take from our deliberations.

THE AGENDA

To ensure that everyone has the best possible opportunities to participate, most of our discussion will take place in small groups, with carefully prepared discussion-starter materials and trained, neutral moderators. These moderators are not policy experts. They are volunteers who have been trained to facilitate the discussion, keep everyone on track and help everyone participate. Each group will also have a recorder to keep notes. The agenda is:

SATURDAY MORNING

- Large Group Brief overview of Assembly goals and format
- Small Groups Introductions and Ground Rules
- What direction(s) should we go to improve New Jersey's tax system?

SATURDAY AFTERNOON

- Small Groups Continued discussion of direction(s) to improve the tax system
- Large Group Preliminary small group reports for day 1

SATURDAY EVENING

Dinner and informal discussion among participants

SUNDAY MORNING

- Small Groups Recommendations for improving the tax system
- Large Group Final small group reports
- Summing up of Assembly deliberations

Following the Assembly, participants can continue their dialogue online. Organizers will also create an Assembly Summary Report, and all participants will receive a draft so that they can comment on it before it is finalized. Finally, organizers will keep participants informed of any reactions and responses to the Assembly and of future initiatives that participants may want to engage.

IMPROVING NEW JERSEY'S TAX SYSTEM: WHAT DIRECTION(S) SHOULD WE GO?

“The hardest thing in the world to understand is [taxes].”

*Albert Einstein,
former
New Jersey
resident*

Deliberating on government spending is important. We as a society constantly grapple over funding priorities: What should we spend to educate our children, preserve the environment, maintain roads, and support other services we expect from our government? But taxes are different. As noted earlier, they stem from a series of decisions, large and small, made at different times for different reasons to meet different needs. It is time to step back and take stock, and ask if the system that has evolved is the one we want to keep. And if it's not, how should it be changed?

A LITTLE BACKGROUND

New Jersey, like most states, relies on three main sources of tax revenues to raise funds for public services such as schools, police, roads, public health, and the like. The three main sources of tax revenues are the **state personal income tax**, the **general state sales tax**, and the **local property tax**. Together they generate about 83% of tax revenues raised in New Jersey. (Additional revenue sources include New Jersey's corporate income tax, as well as a variety of what are called “excise taxes,” which are special sales taxes on such items as gasoline and cigarettes.)

NEW JERSEY'S THREE MAIN SOURCES OF TAX REVENUES

The state's **personal income tax**, like the federal income tax, is a tax on what people earn through wages or investments. Forty-three states have income taxes, but New Jersey was relatively late in joining them, only imposing an income tax in 1976. Under the state constitution, income tax revenue may be used only for school aid, municipal aid and other forms of property tax relief.

Supporters of the income tax say it's the fairest, most “progressive” tax, because it's based on how much money you earn. The more you make, the more you pay. (State income tax rates in New Jersey range from 1.4% for those with lower incomes to 6.37% for those with higher incomes. Very poor people don't pay it at all.)

Critics, however, say the state income tax discourages economic investment by penalizing people who earn a lot. Also, states that rely heavily on the income tax find it can be undependable: During boom times it brings in a lot of money, but when there's a recession, incomes drop and so do income tax revenues. The budget crisis facing many states this year is at least partially caused by declining income tax revenues.

The **general state sales tax**, currently set at 6% in New Jersey, is paid at the cash register whenever a customer buys a taxable item. Groceries, clothes, disposable paper products, and prescription drugs are exempt from sales taxes; most other consumer items are taxed. Some services are covered as well. Only five states make do without a sales tax.

(In distinction to the general state sales tax, which covers many items that consumers purchase, are sales taxes on some special items, such as alcohol, cigarettes and gasoline. These are called “excise taxes.” While they may have a different rate from the general sales tax, otherwise they work in pretty much the same way. When an excise tax is used for social purposes, such as discouraging smoking by making cigarettes more expensive, they are often called a “sin tax.” And when they are geared toward items that only wealthy people are likely to buy, they are often called a “luxury tax.”)

Supporters of the general state sales tax say it provides a stable source of revenue, based on how much people consume. Some also point out that the state sales tax offers individuals some control over how much they pay: If you want to avoid it, just buy less.

Critics, though, say the general state sales tax is one of the most “regressive” taxes, meaning that it hits lower-income people the hardest, even when food and clothes are exempted, as is the case in New Jersey. The reason is that lower and upper income people alike need bedding, housewares and other basic products, but buying these necessities will take up a bigger percentage of a low-income person's limited paycheck than it will from that of a rich person.

The **local property tax** on real estate dates back to colonial times and was the main revenue source for state and local government in New Jersey until the 1960s. Local tax assessors determine how much buildings and grounds are worth. Then local authorities set the property tax rate, depending on how much needs to be raised and the total value of the property in the community. (The rate is usually expressed as a dollar-and-cents figure per \$100 of the assessed property value. For example, a property tax rate of \$2 per \$100 of assessed value would mean the owner of a \$200,000 house would pay \$4000 in property taxes.)

While property owners pay only one property tax bill, many property taxes appear on that single bill. Everyone pays municipal, school and county property taxes, but depending on where you live you could also pay for a regional school district, county library, fire commission or other special service.

On the plus side, people point out that property taxes are a relatively stable revenue source, since property values generally don't dip suddenly. Supporters also say that the property tax offers local voters a lot of say, since decisions about them are made at the local, municipal level.

But critics say property taxes unfairly hit low- and fixed-income people the hardest. If you lose your job, your income tax will likely go down because you don't have as much income. But a house worth \$150,000 will be taxed at the same rate whether the people living there are employed or jobless, married with kids or single, bringing in two incomes or one Social Security check. Also, wealthy towns with high property values will have more money to spend than lower-income communities, which therefore generally have the worst public services. Some also contend that the property tax encourages suburban sprawl, as towns pursue development in order to gain property tax revenues.

BALANCING THE THREE MAIN KINDS OF TAX

New Jersey is unusual in the way it balances the three main revenue streams (the state personal income tax, the general state sales tax, and the local property tax). The table below illustrates this by showing how states on average compare with New Jersey in balancing various sources of tax revenue.

TYPE OF TAX	PERCENTAGE OF ALL TAX REVENUES RAISED BY STATES ACROSS THE NATION	PERCENTAGE OF ALL TAX REVENUES RAISED IN NEW JERSEY
State Individual Income Taxes	24%	22%
General State Sales Taxes	25%	17%
Local Property Taxes	29%	44%
Excise Taxes <i>(Special sales tax on selected items such as gasoline, cigarettes or luxury items.)</i>	11%	8%
State Corporate Income Taxes	4%	4%
Miscellaneous Taxes	7%	5%

Source: "Government Finances 1999-2000," issued by the Census Bureau in January 2003.

As you can see, while most states rely fairly equally on property, income and sales taxes, New Jersey relies more heavily on local property taxes. In fact, New Jersey relies on local property taxes more than any other state except New Hampshire—a state with neither a sales nor income tax.

Does it matter that New Jersey taxes its citizens in this unusual way? Some say the system is unfair, arguing that too many residents simply cannot afford their property taxes as housing values shoot through the roof. At the same time, too many communities cannot afford decent schools, simply because their property values are depressed. Others may disagree, saying property taxes are preferable because they give local voters a lot of control over their tax bills and community affairs. Besides, they argue, rising property values just make homeowners richer. They say there are other, more important things we can do to improve New Jersey's tax system, such as giving better tax breaks to fixed-income homeowners, or giving municipalities more control and tools so they can better manage their own affairs.

WHAT VALUES SHOULD OUR TAX SYSTEM REFLECT?

Different ways of organizing the tax system will have different practical consequences and reflect different values and tradeoffs. When it comes to New Jersey's tax system, what values are most important to you?

Equity, so everyone pays their fair share of the burden—but no more or less than that.

Efficiency, so the system is streamlined and wastes as little money as possible.

Stability and predictability, so that both policymakers and taxpayers can plan with confidence.

Adequacy, so that all the services citizens and officials decide they want are funded at acceptable levels.

Simplicity and transparency, so everyone can easily understand how much they can expect to pay in taxes and how the tax revenues are being spent.

Economic soundness, so that the tax system helps New Jersey compete for business and development.

Environmental soundness, so it helps maintain New Jersey's natural resources and quality of life.

A FRAMEWORK TO GET THE DISCUSSION GOING

To help us take stock of New Jersey's tax system and how it might be changed for the better, we have created a discussion framework to aid us in sorting through the issues. The framework makes the case for four different approaches:

1. We should stick with what we've got, a tax system that maximizes local control while using state assistance to address problems.

Under the current system, which relies heavily on local property taxes, communities can make most of their own decisions, while state aid provides support for local, municipal services—most notably, aid to under-funded school districts. It may need a few minor adjustments, but it's the right general idea.

2. We should take the state out of the picture and let each community solve its own problems.

This is how it used to be, before we had a state income or sales tax and we relied almost completely on local property taxes and local decision-making. Under this system, we'd have real home rule again, and each town could figure out for itself the best ways to manage its own taxes and affairs.

3. We should give towns new ways to raise tax revenues and control costs. This could include new powers to levy local sales taxes (on parking, for instance) and new incentives from the state for neighboring towns to consolidate schools and services to contain costs. This is a more realistic way than going back to the old system to provide towns with the ability to manage their own taxes and affairs.

4. We should create a more equitable system by relying more on statewide taxes and less on the property tax. By relying more on state taxes (especially the state income tax) and less on the local property tax, we can create a better balance among the major revenue sources. In this way, we can raise revenues more fairly, distribute them more efficiently, and bring property taxes down.

These four approaches, explained on the pages that follow, offer a starting point for our discussion. They provide a framework to help Assembly participants begin to think through and discuss ways to improve New Jersey's tax system. You may also have other ideas, or see ways to combine aspects of several approaches, all of which is welcome. But as a means to help us begin to think and talk together, we'll start by reviewing the four approaches and find out which one is closest to your own views—and why.

1.

WE SHOULD STICK WITH WHAT WE'VE GOT, A TAX SYSTEM THAT MAXIMIZES LOCAL CONTROL, WHILE USING STATE ASSISTANCE TO ADDRESS PROBLEMS.

The current system relies heavily on local property taxes while using state tax revenues mostly for narrowly defined purposes. Even though this system evolved in fits and starts, there are good reasons behind it.

The state's personal income tax was created in 1976 so we could provide state school aid to low-income communities and rebates to seniors and other homeowners struggling to deal with high property taxes. At the same time, we wanted to maintain as much local control as possible. The current system may need some technical adjustments, but it has the right goals and takes the right approach — help under-funded school districts and the most vulnerable taxpayers through state aid while still letting communities make and support their own budget decisions through their local property taxes. Of course, that help from the state would have to come from state taxes.

WHAT SHOULD BE DONE:

- Adjust the state aid formula to make sure the poorest communities get the money they need to improve services. School districts, for example, should get the money they need to improve student achievement.
- Ease the property tax burden on those hardest hit, by funding programs such as the Homestead Rebate and NJSaver rebate at the highest possible level.
- Stabilize property tax relief by locking in rebate levels and tying them to inflation, rather than letting them go up or down depending on the overall state budget.

PROS:

- By relying heavily on local property taxes, this approach maintains local control and home rule while limiting state government.
- This approach uses state taxes for the right reasons: to alleviate the burdens of the most vulnerable people in our society: senior citizens and children in under-funded schools.
- Helping under-funded schools is not only required by New Jersey's Abbott court ruling requiring better school funding for poor districts, it is the right thing to do.
- Rebates to homeowners and senior citizens should be a core commitment in the state budget, not something that changes from year to year depending on financial or political circumstances.

CONS:

- These Band-Aid approaches have been tried and tried, and they haven't solved the problem. We need more far-reaching reform that more completely overhauls the system.
- Wouldn't it make more sense to lower property tax bills to begin with, rather than let taxes go up and then pay the administrative costs of sending people a rebate check later on?
- Creating a fairer overall tax system would do more for under-funded school systems and homeowners than the complicated and often unpredictable aid-and-rebate system we have now.
- We may have local control in theory under the current system, but with the state playing such a large role in education policies and municipal decisions, "home rule" has become more myth than reality.

2.

WE SHOULD TAKE THE STATE OUT OF THE PICTURE AND LET EACH COMMUNITY SOLVE ITS OWN PROBLEMS.

This is how it used to be, before we had a state personal income tax and we relied almost completely on local property taxes and local decision-making. If we return to relying more on local property taxes, we can cut or maybe even eliminate the personal state income and state sales taxes. We should also eliminate most of the rules and regulations Trenton has imposed on local governments and schools.

Under this approach, we'll have true home rule again, and each community can decide for itself what services are needed and how high their taxes should be.

WHAT SHOULD BE DONE:

- Dramatically reduce state taxes.
- Cut back most of the rules and regulations imposed by the state that determine how towns should operate.
- Eliminate the appeals process that allows state officials to overrule local voters and reinstate a rejected school budget.

PROS:

- This will give people the maximum amount of control over their government, so they can make real choices about what they want to happen in their community and how much they're willing to pay.
- This will allow communities to control government spending, which is what drives taxes.
- This way, people will see their tax revenues stay in their own community and serve needs that are important to them, and not be sent off somewhere else.
- If some communities have more resources than others, it encourages people to work harder and move to where they want to live.

CONS:

- This does nothing to address the fundamental unfairness of the property tax. In fact, low-income people and those with fixed incomes may find their tax load gets worse.
- Without help from the state, many school districts will be unable to support decent schools that raise student achievement.
- When some communities have bad schools it affects everybody, because of increased crime, poorly trained workers and higher social service bills.
- We expect more from government than we did in the 1960s, and many towns simply cannot provide the kinds of municipal services people demand without state help.

3.

WE SHOULD GIVE TOWNS NEW WAYS TO RAISE TAX REVENUES AND CONTROL COSTS.

We're asking our schools and municipal governments to do more and more, but we've only given them one way to raise money: the property tax. We need to give communities more ways to raise their own revenues, as well as new ways to cut costs. This could include new powers to levy local sales taxes (on hotels, for instance) and new incentives from the state to consolidate (that is, combine) schools and other local services to contain costs. This is a more realistic way than going back to the old system to provide towns with the ability to manage their own taxes and affairs.

WHAT SHOULD BE DONE:

- The Legislature should allow local voters to impose a “local-option” sales tax on top of the state sales tax. Also, towns should be allowed to tax parking, entertainment or other items within their own boundaries.
- The state should provide meaningful financial incentives that encourage consolidation of small school districts and other municipal services, such as police, to cut costs and save money.
- The state should also help towns be able to share in tax revenues when development in a surrounding community affects their town.

PROS:

- A big reason property taxes are so high is because local governments have no other choice when it comes to raising money. If they're given other tools, communities will be able to spread out the tax burden among other sources of revenues and shift away from the property tax.
- We already have “enterprise zones” in certain communities where the state sales tax is cut to encourage shopping. Why not also let communities create new revenue sources, such as a local sales tax, if they need the money and decide it is a good idea?
- We have far too many municipalities and school districts in New Jersey, which drives up costs. Yet we've also made it extremely complicated for communities to merge and share services. Encouraging and supporting consolidation would cut waste and duplication and drive down costs.
- Giving communities new ways to raise revenues and cut costs would strengthen New Jersey's tradition of home rule.

CONS:

- Creating a confusing patchwork of local taxes across the state will interfere with business and inhibit New Jersey's economic development.
- Some communities, particularly in rural areas, may not be able to take advantage of these new taxes—not every town can have a hotel, for example.
- This will lead to more unwanted development and sprawl as communities compete for new businesses, like hotels, that they can tax.
- The reason we have so many towns and school districts is because people like having local control. Consolidation would undermine home rule. Besides, it's doubtful it would save enough money by itself to make a big difference in most people's property taxes, and for many communities—particularly larger cities—it is not a viable option.

4.

WE SHOULD CREATE A MORE EQUITABLE SYSTEM BY RELYING MORE ON STATEWIDE TAXES AND LESS ON THE PROPERTY TAX.

The biggest problem with taxes in New Jersey is that they're fundamentally unfair. And the main reason for that is because, as a state, we rely too much on the property tax. This means many residents are "property rich, but income poor," stuck paying exorbitant taxes on modest homes they bought years ago, before property values shot up. It also means that people unlucky enough to live in poorer communities cannot afford decent schools for their children or other municipal services people in other towns take for granted.

The state needs to step in and level the playing field, using state taxes, such as the state personal income tax, to replace the property tax as much as possible.

WHAT SHOULD BE DONE:

- Raise the state income tax— and/or other state taxes that are based on one's ability to pay—and use the money for schools and other local services, to bring property taxes down.
- The state should pick up at least half of the costs of running local schools, which is the U.S. average. Right now, the state of New Jersey pays only about 40 percent.
- Make it hard to increase property taxes (through a cap, for instance) so once they are brought down, they cannot easily creep back up.

PROS:

- The income tax is much fairer than the property tax, because it's based on the individual's ability to pay. Some people, and certainly wealthier residents, will probably pay a higher income tax, but property taxes in most towns would go down for virtually everyone.
- People won't be forced to pay heavy property taxes just because they happened to buy a house decades before housing prices skyrocketed. This will enable more people to stay in their homes when they retire, instead of having to sell their homes and move to another part of the state—or even to another state altogether.
- This will even out the differences among school systems, where low-income communities end up with bad schools just because they can't raise enough money to make improvements.
- This could help check suburban sprawl, because towns will have less incentive to compete for the property tax revenue new development brings.

CONS:

- This will mean the end of home rule—if the state is passing out the money, then pretty soon the state will end up telling communities how they can spend it.
- Raising taxes on upper-income people sounds good, but it will hurt the economy by curtailing how much they buy and spend—the "trickle-down effect."
- In boom times, the income tax will bring in lots of money that government will spend, fueling the growth of government and leading to an unpredictable "boom and bust cycle" of government expenditures.
- Property tax caps don't work, as California found out with Proposition 13. They end up handcuffing local governments as vital needs go unmet.

APPENDIX: ADDITIONAL BACKGROUND DATA

NEW JERSEY STATE SCHOOL AID SELECTED DISTRICTS

SCHOOL DISTRICT	STATE AID, 2001-2002 FISCAL YEAR	STATE AID PER PUPIL, 2001-2002 FISCAL YEAR	SPENDING PER PUPIL, 2001-2002 FISCAL YEAR	ENROLLMENT 2001-2002 FISCAL YEAR	MEDIAN HOUSEHOLD INCOME, 1999
Newark [Essex]	\$435,336,754	\$9,703	\$12,600	44,867	\$26,913
Toms River Regional [Ocean]	\$61,579,024	\$3,425	\$7,647	17,978	\$55,659
Woodbridge Township [Middlesex]	\$13,278,876	\$1,023	\$8,638	12,975	\$60,683
Hopatcong [Sussex]	\$11,217,101	\$4,044	\$8,419	2,774	\$65,799
Maurice River Township [Cumberland]	\$3,613,469	\$5,842	\$8,633	618	\$43,182
Saddle River [Bergen]	\$248,619	\$662	\$17,630	375	\$134,289
New Jersey state average	\$5,867,668,326	\$4,381	\$9,598	1,339,458	\$55,146

Note: All districts are K-12 except for Saddle River and Maurice River Township, which are K-8. State aid excludes transportation aid.

*Median household income includes only Chatham Township.

Source: New Jersey Department of Education

NEW JERSEY STATE TAXES AS A PERCENTAGE OF INCOME

	LOWEST 20%	SECOND 20%	MIDDLE 20%	FOURTH 20%		TOP 20%	
	Under \$19,000	\$19,000- \$34,000	\$34,000- \$56,000	\$56,000- \$94,000	Next 15% \$94,000- \$193,000	Next 4% \$193,000- \$571,000	Top 1% \$571,000- or more
Sales & Excise Tax	7.2%	5.2%	3.9%	3.1%	2.2%	1.6%	0.9%
Property Taxes	5.6%	4.1%	4.3%	4.6%	4.2%	3.2%	1.5%
Income Taxes	-0.4%	1.0%	1.6%	2.0%	3.2%	4.7%	5.9%
Total Taxes	12.4%	10.2%	9.8%	9.7%	9.7%	9.4%	8.2%
Federal Deduction Offset	-0.1%	-0.2%	-0.6%	-1.2%	-1.9%	-2.4%	-2.5%

Note: Federal Deduction Offset is the calculation of the benefit of deducting income and property tax
Source: *New Jersey Policy Perspective*