

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
NORTHEASTERN DIVISION

INDIA LYNCH, by her parent, SHAWN KING **
LYNCH, et al., individually and on behalf of *
others similarly situated, *

Plaintiffs, *

v. *

Civil Action No.
CV-08-S-0450-NE

THE STATE OF ALABAMA; BOB RILEY, in his *
official capacity as Governor of Alabama; and *
TIM RUSSELL, in his official capacity as *
Commissioner of Revenue, *

Defendants. *

**AMENDED EXHIBIT K TO
PLANTIFFS' SUBMISSION OF EXPERT REPORTS**

Amended expert report of Dr. Daniel J. Sullivan

Date: May 25, 2009

To: James Blacksher

From: Dan Sullivan

RE: Amendment Expert Witness Report

The document which I emailed to you today entitled "Expert Witness Report of Daniel J Sullivan - amended" and dated May 24, 2009 is an amended version of my original report date May 8, 2009. The only substantive change to the report is that a fourth bullet has been added to section 5 of the report.

Respectfully,



Daniel J. Sullivan

5/25/2009
Date

Sullivan – expert witness report-amended
5/24/2009

Expert Witness Report of Professor Daniel J. Sullivan - *Lynch v. Alabama* - amended

Pursuant to Rule 26 (B) of the Federal Rules of Civil Procedure, I hereby provide the following written report:

1. My Qualifications

I am a graduate of the University of Santa Clara (B.A. in economics, magna cum laude and valedictorian) and Yale University (M.Phil. and Ph.D. in economics, with distinction). I also spent two years working and training at the Brookings Institution in Washington, DC. My areas of specialization are the economics of information and human capital, and public finance (including the financing of education and health care). I have held a range of both academic and non-academic positions. I currently am a professor and Cowles Chair in media management and economics at the University of Minnesota. I have authored or co-authored a number of books, articles and professional conference presentations, including four books on school finance (two dealing with elementary and secondary education and two with higher education). Since 1984, I have served as an expert witness on education finance for Alabama State University and the Knight Plaintiffs in *U.S. v. State*. A copy of my cv is attached to this report.

2. Previous Testimony

In May 2004 I testified before Judge Harold Murphy as an expert witness for the plaintiffs in the case of *Knight v. Alabama* in federal district court for the Northern District of Alabama.

3. Compensation

I have been compensated in the amount of \$15,000 for my work on this case.

4. Overview of Testimony

Data

My testimony will rely primarily on the following:

- Data and information provided by the defendants in response to the plaintiffs 1st discovery request
- Data from the 2000 U.S. census
- Data from the websites of the Alabama Department of Revenue and the Alabama Department of Education
- Data provided by Ira Harvey
- Data provided by the Alabama Association of School Boards
- Various other minor sources

Foundation

My opinions regarding the tax system used to fund public elementary and secondary education in Alabama and the resulting effects of that system on the delivery of elementary and secondary

Sullivan – expert witness report-amended
5/24/2009

education are built on the following 9-point foundation that represents a standard economic framework:

1. The starting point is the tax base (or what is the total assessed value of property subject to taxation).
2. Step 1 then becomes the basis for estimating tax capacity. There are two possible definitions of capacity: what is possible given the limits imposed by the lid bill, and what is possible if a district taxes itself at the actual statewide average “effort” (see below). The first is important because it is the point at which a district has to go through the override process. The second is a measure commonly used for looking at fiscal disparities across districts.
3. The next step is to establish as best as possible the tax incidence (or who actually pays the property tax). The analysis here is a combination of looking at the mix of property classes and at the ability of commercial property owners to “shift” some or all of their tax obligations onto others. This involves a number of factors. Under certain conditions, it is borne by the owners of the property, while under other conditions it can be passed on (“shifted”) to others (e.g., customers). Most studies support the following propositions that are relevant in this case: 1) homeowners bear the burden; 2) the ability of owners of rental housing to shift the burden to renters is easier the more rural a community is and the less mobile tenants are (a situation typical of low income renters); 3) regulated utilities can ultimately fully shift the burden of the tax onto their customers (depending on the process of getting rate increases, this may take time) – an issue here is what share is local and what share is not; 4) the ability of retail businesses to shift the burden depends on how easily customers can go elsewhere to shop (the usual conclusion is that the businesses’ ability to shift the burden is limited, except in very isolated communities); 5) the ability of other types of commercial property to shift the burden generally depends on their mobility and the market conditions under which they are operating – for agricultural and timber enterprises, shifting is likely to be very limited.
4. Given step 3, one can then estimate the tax burden or how much individuals must pay relative to their ability to pay – usually defined as some measure of income. This analysis is done at the household level, since for residents the property tax burden is typically borne by a household. A key issue here is the extent to which property taxes for other purposes should be included in the analysis (citizens typically view their property tax bill holistically, so they certainly impact a citizen’s willingness to vote for additional taxes). *Burden* can be viewed from both absolute and relative perspectives.
5. The next step is to look at tax outcomes (how much revenue is actually raised at various levels of burden (e.g., actual vs. the statewide average burden). In this context it is also important to look at who is willing to incur taxes. Part of the reason that taxes are shiftable is that the residents to whom they are shifted benefit from the taxes (local taxes are viewed as a form of user charges). However, when taxes are function specific, then the willingness to incur them depends on who benefits – this leads to the finding that a major predictor of school referenda is the percent of voters with children in the public schools. Businesses will support tax increases when they perceive it will benefit their business (e.g., attract new or wealthier residents). They tend to oppose taxes they perceive as putting them at a competitive disadvantage.

Sullivan – expert witness report-amended
5/24/2009

6. Since it is households (rather than individuals) that are paying the part of taxes born by residents, we can then look at revenue per household (this is better than looking at per capita revenue).
7. The effect, however, must be tied to students, so we also need to look at revenue per pupil (i.e., what benefit is created from a given tax effort).
8. Given the revenue patterns that arise from steps 6 and 7, the next step is to look at the distribution of outcomes relative to various demographic variables to identify inequities. Building the analysis step by step enables one to identify the source of those inequities.
9. Since the state is the defendant here, the last step is to look at what steps the state has taken (or can take) to offset any adverse impact.

Opinions

I plan to offer the following opinions:

- **The Alabama property tax system is unique among the fifty states.**

Comparison with Other States — National Norms

Alabama is clearly an outlier in terms of the extent to which details of the property tax are imbedded in the State's constitution. There are four basic components, or factors, that ultimately determine the amount of property tax paid by any given individual: who has the authority to levy property taxes, the tax base (what property is subject to taxation), the assessment ratio and the mill rate. The first two of these factors are fairly standard across states, and they have more impact on who pays than they do on the capacity of a state's property tax. The last two factors directly impact that capacity.

- *Taxing authority*: the ability to levy property taxes is one delegated to local jurisdictions by the state. Every state constitution has provisions that allow local jurisdictions to tax property; and about three-fourths of states also have a statewide property tax, although in most cases this is limited to certain types of property. While a few constitutions simply establish the power for the state or its subdivisions to tax property and then leave all the details up to the legislature, the norm is to have the constitution establish broad parameters such as allowing for different classes, identifying what property can be subject to the tax, and requiring some form of uniformity in assessing value of property. Only a handful of states have detailed provisions imbedded in the state constitution — and I have not found one that does so to the extent that Alabama's does.
- *Tax base*: What can be taxed is virtually always a state decision; a significant number of states do this in the constitution, but most leave at least some of the decision-making on this factor to the legislature. Moreover, with few exceptions, the property tax is limited to real property (land and improvements) and motor vehicles. All but a few states also allow for property to be divided into separate classes and for those classes to be taxed differently from one another (but those states that do also retain a requirement for uniformity within a class). In addition, every state has provision for exempting certain types of property from taxation; these typically include government property and the property of religious

Sullivan – expert witness report-amended
5/24/2009

organizations. A majority of states have some sort of “homestead” exemption which gives some amount of preferential treatment to owner-occupied residential property. States typically leave the details of this to the legislature — I have not found another state that has details of the exemption imbedded in the state constitution like Alabama has.

- *Assessment ratio(s)*: State policy on assessment ratios has a major impact on the property tax capacity of a state. It is the factor that is most important for long term decision-making (such as land use policy and location decisions for businesses, developers and the like). As such, in all states it is a statewide decision. As noted earlier, most state constitutions have some type of “uniformity” requirement. Property classification is also a statewide decision, although many states allow for local deviations for short periods of time (for economic development purposes). A few state constitutions contain specific parameters, but the norm is to leave the details to the state legislature. States that do mandate specific assessment ratios typically mandate that assessments be at full market value. No other state has provisions like Alabama’s that limit assessed values to a small fraction of market value — either imbedded in the state constitution or the result of a law enacted by the state legislature. About two-thirds of all states have some type of “current use” provision, but overwhelmingly the norm is for the constitution to enable the legislature to provide for this method of valuation for certain types of property. Typically, limits are placed on this method of valuation to ensure that it supports some stated public policy (e.g., preserving family farms). A number of states where property values are increasing rapidly also have provisions regarding how fast assessments can rise, but again these are typically legislative decisions and not provisions of the state constitution.
- *Mill rate*: In the short term, this factor tends to have the most impact on property tax capacity and yield. In virtually all states there is a significant amount of local control. Many states do have provisions that require local voter approval (rather than simply local government approval) for rates to exceed some threshold or changes in rates to exceed some magnitude. In most states, these thresholds are set by the legislature and not specifically imbedded in Alabama’s state constitution.

Comparisons with Other Southeastern States

Property tax patterns tend to be regional, and thus the other southeastern states constitute the most relevant group for detailed comparisons. While some of these states have some provisions that are similar to ones in Alabama, none of them come close to mirroring the extent to which property tax details are imbedded in the state’s constitution.

- *Authority*: All southeastern states have local property taxes, and all but Texas and Florida have a statewide property tax as well. Virtually all these states have the same types of local jurisdictions as Alabama: cities, counties and school districts.

Sullivan – expert witness report-amended
5/24/2009

In a majority of these states, the legislature establishes almost all of the rules for the local jurisdictions, with the state constitutions providing only broad guidelines. Three of the states specifically empower the legislature to establish other types of taxing jurisdictions, and in some of the others it is implicit in the general taxation powers of the legislature.

- *Tax base*: Again here Alabama looks like most other southern states. All limit local property taxes to real property (land and improvements); some do include motor vehicles in the state property tax. All states also provide for different “classes” of property — about half do so directly in the state constitution and about half grant the legislature the authority to establish different classes. All also provide for exempting certain types of property (e.g., public property and property owned by religious organizations). Only two other states (Georgia and Mississippi) provide for a homeowner’s exemption (as noted earlier, this is much more common nationally).
- *Assessment ratios*: This is one of two areas where Alabama is unique. While about half of the other southeastern states’ constitutions reference assessment ratios, they all call for assessing property at fair market value or at the full current use value. Some of the states do grant the legislature the authority to set differential assessment ratios, and the legislatures do so, but those ratios are considerably higher than the ones in the Alabama constitution. What really creates unique problems for Alabama is that it not only puts the allowable assessment ratios in the state constitution; it also has very low ratios, especially for residential, agricultural and forest property; and in the case of agricultural and forest property, it applies those low ratios to a current use valuation. All of the southeastern states provide for some sort of current use valuation. Nine of the eleven states have a general constitutional provision and empower the legislature to establish details (including to what types of property it will apply, what limits will be placed on the right to use it, and what sort of “recapture” provision, if any, there will be.) Only two of the eleven states specify details in the state constitution about categories to which it will apply; the other nine simply have a general provision giving the legislature the right to do it. All but two of the other states have some sort of recapture provision (most are longer than Alabama’s); and about half the states place limits on what property is eligible (e.g., many exclude agricultural land owned by a corporation and others limit the amount of land one can get treated favorably — reflecting the fact that the rationale for this policy was to protect the family farmers). None of these recapture provisions are imbedded in a state’s constitution, and only two states (Texas and North Carolina) have constitutional limitations on eligibility. Since all deviations from uniform, market-based valuation are designed to achieve specific public policies, giving the legislature the power to change the policy as the needs or priorities of the state changes makes good sense.
- *Millage rates*: Five of the other southeastern states have no constitutional limits on mill rates for any jurisdiction. However, in four of the five, the legislature has the

Sullivan – expert witness report-amended
5/24/2009

authority to put ceilings on local jurisdictions (none have done so). Three of the other six states have no limits on school districts and the other three do have limits, but allow local voters to override those limits. Two of the six states also require voter approval (within the jurisdiction) for all other types of taxing jurisdictions to increase taxes above a specified limit. The other four have specific limits imbedded in their state constitutions for selected jurisdictions — in two of the states it is cities and counties, and in the other two it is a limit on a state property tax. In every case, the effective limit in these constitutions is at least double the limits in the Alabama constitution.

Implications/Consequences

There are three primary implications or consequences that arise from the current structure of the property tax in Alabama.

- The combination of the constitutional limits imposed on both assessment ratios and on mill rates means that the starting point for the capacity of the property tax in Alabama to generate revenue is well below that of all other states. Some states may put limits on one or the other, but most of those do so through legislative action. No other state has the combination of limits that places such a restrictive ceiling on property tax capacity. While the national norm is for property taxes to equal about 1 percent of fair market value for residential property and 1.5 percent for commercial and industrial property, in Alabama the figures are 0.3 percent and 0.7 percent respectively.
- The decision-making process for changing almost any aspect of the property tax is very cumbersome, making efforts to change various provisions much more difficult than in other states.
- Virtually all changes sought in the property tax involve efforts to increase the amount of revenue generated by the tax, most often by increasing mill rates. The difficulty in making any changes has contributed substantially to Alabama continuing to fall further behind in the amount of revenue it generates from property taxes, and hence the amount of money it has to fund schools and other local services, compared with other states.

2. The Alabama property tax system is “unfair” in an economic sense

To talk about a “fair” tax system, one needs to consider three elements: effort, efficiency and equity.

Tax *effort* can be viewed from three perspectives: the total amount of revenue raised (usually measured in per capita terms), the amount of revenue raised relative to overall ability to pay, and the amount of revenue raised relative to perceived needs. On the first measure, Alabama is well below the national average and below all of its neighbors. Alabama’s performance on the second measure is misleading because the state has artificially reduced its measured ability to pay by artificially reducing the measured value of taxable property. From the third perspective, Alabama appears to be losing ground (i.e., unmet need is growing).

Sullivan – expert witness report-amended
5/24/2009

The *efficiency* of a tax system also has three dimensions: the stability of the tax base over time, the flexibility of the system to adapt to changing needs, and the neutrality of the system with respect to economic decisions in the private sector. Alabama's current system is highly inefficient on all three counts: it over-relies on more volatile taxes (income and sales) and under-relies on more stable taxes (property); its constitutional caps and extreme rate of earmarking make the system less flexible than that of any other state (the constant problem of proration, and the inefficiencies it leads to, are a direct result of this lack of flexibility); and the imbalance in revenue sources (especially the undervaluing of certain property) distorts land-use decisions.

The *equity* of a tax system has two dimensions: the relative effort required by different groups compared to their ability to pay and the relationship between who pays and who benefits. With regard to the first dimension, Alabama's system is regressive, putting a much higher burden on the poor than on middle and upper income citizens. This is a result of underutilizing the property tax (while there is some debate, the evidence seems clear to me that the property tax is a tax on wealth), above average reliance on sales taxes (which are highly regressive), and having an income tax that is not progressive. The second dimension is typically viewed as applying most to situations where taxes are seen as a substitute for user fees - e.g., using a tax on gasoline to pay for roads. However, it also comes into play when the state collects taxes and then distributes them to localities (e.g., local school districts). Here the two dimensions seem to compete, and having a willingness to redistribute revenues from one jurisdiction to another requires acceptance of the idea that local jurisdictions are arbitrary creations of the state.

Aside from the excessive earmarking of the state income and sales tax, the most serious problems with the current system are a result of constitutional constraints on the property tax. Any effort to create a "fair" system needs to put the focus here. The constitutional mandates impact all three elements of fairness.

The single biggest problem is with the current classification system, including the rules related to "current use," as it impacts assessed valuations. This system not only reduces overall measured capacity; it does so in a way that is unrelated to ability to pay. Moreover, it creates serious distortions in land use decisions. In addition, the problems created by this system are likely to be more significant in poorer counties and school districts and thus to disproportionately affect them.

The decision-making process also contributes to Alabama's tax system being one of the least efficient and least equitable in the nation. The system lacks flexibility to address changing needs or changing public priorities. The disparity in effective rates also tends to distort private sector land use decisions and location decisions. Local jurisdictions with relatively large amounts of property assessed at 10 percent not only have limited tax capacity; they also have a more difficult time attracting businesses, since they would have to contribute disproportionately to local services. The Alabama system also creates a disconnect between those who pay taxes and need services and

Sullivan – expert witness report-amended
5/24/2009

those who decide what tax rate to allow. And finally, the wide disparity in assessment ratios means that there is no real relationship between taxes paid and the ability to pay those taxes.

3. The Alabama property tax system seriously constrains the ability of local school systems to raise adequate revenue.

There are three mechanisms, all imbedded in the state constitution, that create a problem.

- The first mechanism is the property classification system ... Under the current system, residential rental property is taxed as commercial property (class II) – that is, at double the rate that homeowners are taxed (and with no benefit of a homeowner’s exemption). At the same time, agricultural and timber properties, which are commercial properties, are taxed at the lower rate. Since renters tend to have lower incomes than homeowners, and since the property tax is assumed to be fully shifted in rural communities, this likely has an adverse impact on the poor. In addition, these districts are likely to have little commercial property that is not farm or timber land. What this means is that most of Class II property is actually residential and most commercial property is in class III. This increases the share of the actual tax incidence falling on residents. The current classification system also can be an obstacle of gaining approval for new levies (see below).
- The second, and most significant, are the provisions for classifying and taxing property in “current use.” I began with the assumption that the current use provisions (which are fairly common) worked like they do in other states, and that their impact would be relatively small. While statewide, the impact is limited, in selected districts the impact turns out to be quite large. First, while most states use these provisions for the social purpose of encouraging landowners to keep good land in its current use, Alabama’s law actually works to encourage landowners to keep bad, as well as good, land in current use – the “current use” value is actually dependent on how productive the land is, with land deemed “non-productive” being valued at 20 percent of land deemed to be “good.” Moreover, most states use a process similar to that for other classes of property, determining what good timberland or agricultural land is selling for without any development premium. In Alabama, the actual values are determined at the state level by means of a very specific formula which tends to undervalue the land. For the 2008-09 tax year, agricultural land is to be valued at \$110 to \$532 per acre, depending on quality, and timber land is to be valued at \$284 to \$653 an acre. According to the websites of real estate agents in Alabama (confirmed by telephone conversations with two of them), good timberland is currently selling in Alabama \$2,000 to \$3,000 an acre (without any premium for potential development value). Farmland is selling for \$1500 to \$2500 an acre. If one uses \$2,500 as an average fair market value for good timberland and \$2000 for agricultural land, then the property is being valued at 4 to 25 percent of fair market value in its current use. Moreover, it is then being assessed at half the rate of other commercial property. Now the formula suggests that the statewide average for all timberland is about

Sullivan – expert witness report-amended
5/24/2009

\$500 per acre, or about 20 percent of its fair market value (using the \$2,500 figure); and since it is in class III rather than class II, and thus taxed at half the rate of other commercial property, this means its contribution to the tax base is 10 percent of what it would be if it were treated as regular commercial property and initially valued at its full fair market value (even allowing for that value to be based on current use). Now, statewide, current use property accounts of 1.77 percent of the tax base, meaning even at full commercial value it would add only about 18 percent to the tax base. However in five counties it is over 15 percent of the base, and in 7 others it is 10-15 percent. To use Sumter as an example, if the agricultural and timber property were valued based on current use, but using their true fair market value in current use (\$2,200 for timberland and \$1,500 for agricultural land), and were assessed as commercial property, Sumter's tax base would go from \$131 million to \$310 million, a 137 percent increase. That is, rather than being tied to the typical state purpose for having a current use provision (to preserve good farm and timberland), the Alabama system appears designed to have farm and timber landowners not pay any significant taxes. Moreover, what is important about this type of property is that if they did pay a fairer share, and even if the burden could be shifted, little if any would fall on the residents of the school district.

One last point on this topic: defendants argued (in their response to the plaintiff's request related to findings of fact) that a material amount of timber and agricultural land is not in current use. However, based on the data provided by them, this does not appear to be the case. In fact, in most counties, all timberland land is classified in current use.

- The third mechanism is the limits on mill rates and the process required for local districts to override those rates – this relates to tax capacity, where the first two relate to the tax base. The limits are of two forms: specified mill rate ceilings, above which additional authorization is needed, and absolute limits on the amount that any individual property owner is required to pay (these absolute limits cannot be overridden, except by Mountain Brook, Vestavia Hills, and Huntsville). The process as an obstacle to increasing authorization has two important dimensions. The first is that most changes require “double” decision-making: first a proposal must be approved by the legislature, and then it must be approved by the voters. Moreover, even decisions that apply to one local area (e.g., a single county) can require statewide approval. Other states have mill rate limits specified in their respective constitutions, but virtually all give local voters the right to override — this right is universal when it comes to funding schools. The second dimension is that a local system's authority is actually a combination of several authorities, each of which has a limit that would require a vote to override. Moreover, some of these authorities require multiple tax districts, even for a single school system. And all of these authorities are required to expire, so that systems must go back to the voters to renew previously approved taxing authority. This cumbersome system is compounded by the current property classification system; those being taxed at higher rates are less inclined to support referenda. As a result, many districts must

Sullivan – expert witness report-amended
5/24/2009

rely on other local revenue sources, such as sales and use taxes. These taxes 1) are not under the control of the local school board, and 2) tend to be more regressive (and more volatile) than the property tax. Moreover, since many are not subject to voter approval, they can easily be withdrawn.

4. The above constraints disproportionately impact African-Americans, especially those who are poor and living in districts that are rural and predominantly African-American.

- Overall, the actual percent of the tax base (valued at full fair market value, including allowing timber and agricultural lands to be valued at the fair market value for their current use) to which ad valorem taxes are applied ranges from 6 to 15 percent across the 67 counties in Alabama. For 23 counties, net assessed values total less than 10 percent ; in two-thirds of these counties, a majority of residents are non-white. One consequence of this fact is that it takes a lot of millage to raise significant amounts of revenue. To use Sumter County as an example, it has two unused authorizations for ad valorem taxes. One is the 5 mill authorization under amendment 202; and the other is the 3 mill authorization under amendment 382. Each would require separate voter approval (and the second must be voted on separately in each of Sumter’s two tax districts). Assuming these all passed, with the current taxable base this would add approximately \$340 per pupil, or about 4 percent, to Sumter’s current level of spending. Spending beyond this level would require a constitutional amendment. This amount reflects the fact that Sumter’s net tax base yields about \$45 per pupil per mil. Lawrence County, whose school system has the same unused taxing authority as Sumter county, could also increase funding by less than 5 percent if it were to get approval to use all of this unused taxing authority.
- As noted earlier, for some counties, a major contributor to the artificially low tax base is the manner in which current use properties are valued. As you can see from the list below, these are all (but one) heavily minority districts.
 - Top 5 counties (current use property = more than 15 percent of the net assessed value): Perry, Bullock, Geneva*, Sumter, Wilcox (*Geneva is the only one that is majority white).
 - Next 7 counties (current use property = 10-15 percent of net assessed value): Conecuh, Greene, Pickens Lowndes, Monroe, Hale, Marengo.
 The average share of the tax base that current use property represents in counties that are majority African American is nearly three times the share in counties that are not majority African American. As a result, for African American students, the impact on the tax base of having artificially low values for current use property is nearly double the impact for white students.
- In Alabama, there is a strong relationship between income levels and race. This is evident both in household data at the county level and student data at the school system level. Looking first at counties, 9 counties have median household incomes of less than \$25,000. These nine counties collectively have populations that are

Sullivan – expert witness report-amended
5/24/2009

98 percent nonwhite. Moreover, over 1/3 of the residents of these counties live in poverty. For the 25 percent of the counties with the lowest median household incomes, all but one (Winston) have populations that are more than 60 percent nonwhite. Overall, the correlation between percent nonwhite in a county and median household income is .84, and the correlation between percent nonwhite and the percent living in poverty is .82.

Turning to the school system level, and using percent of students receiving free lunch as a measure of poverty, 67 percent of students in districts that are majority African American qualify for a free lunch (the lowest percentage for any district where a majority of the students are African American is 48 percent). In contrast, only 40 percent of students in other districts qualify for a free lunch. And in over half these districts, fewer than 20 percent qualify.

Why this is important is a two-step explanation. First, it takes more effort on the part of low income households to raise a given amount of tax than it does households with higher incomes. In districts that are black majority, to raise an additional \$800 per student would cost the median household about 1.5 percent of its income; in districts that are not black majority, the median household would have to pay about 0.8 percent of its income. And second, the limitations placed on the property tax require poor districts to have a greater reliance on the sales tax. This tax is not only more regressive than the property tax; in rural areas it falls virtually entirely on residents, further increasing their burden. Tax policies that have an adverse impact on the poor also have an adverse impact on African Americans – and vice versa. Statewide, the share of local funding from the sales tax for African American students is nearly 50 percent higher than the share of local funding from the sales tax for white students.

5. The limitations of the property tax system have a significant impact on the funding of public elementary and secondary schools in Alabama.

- Poor districts are seriously hampered in their ability to raise adequate funds. The poorest one-fifth of districts (which are 77 percent African American) raise only \$800 per student from local taxes, while the wealthiest one-fourth of districts (which are 86 percent white) raise over \$2500 per student.
- The state government contributes a substantial amount to the funding of elementary and secondary education. However, that spending does little to reduce the substantial inequality in funding across districts. One reason is that its primary mechanism, the so-called “Foundation Program,” has only limited variability in the amount given to each district. The Program’s formula could be written as “\$6500 +/- \$1100 per pupil.” That is, no district receives less than \$5400 or more than \$7600 per pupil. The reason is that the local match is determined by the yield of 10 mils. This is not a significant amount since most districts have such small tax bases. The formula also does not take tax burden into account at all (that is, 10 mils is viewed as requiring the same effort from every district). Moreover, the target level of the funding is determined by available resources and not on some

Sullivan – expert witness report-amended
5/24/2009

educational basis. That is, it is not intended to ensure an adequate level of funding for all districts.

- The need for the state to contribute such a sizeable share of the funding for K-12 education is a product of the inadequate revenue generated by the local property tax. And this need for a large state share creates two additional problems. Both arise from the fact that K-12 education must compete with public higher education for state funds; the total amount of money available for both in any given year is fixed. At the K-12 level, this makes it less likely that the state will be able to provide adequate funding to ensure a quality education. This limitation is one that disproportionately impacts African American students. And second, it increases the likelihood that the available funds of higher education will be less than what the Alabama Commission on Higher Education has determined the “need” for those institutions is. The result is greater tuition increases than would otherwise be the case, making it more difficult for poor Alabama residents (who are disproportionately African American) to attend college. [Additionally I would note that the opinions I expressed in *Knight v. Alabama* remain valid.]
 - The unique and cumbersome process for local school boards to increase the millage rate for property taxes for schools has meant that very few school systems have been able to do so. Since 2000, according to a compilation done by the Alabama Association of School Boards, there have been at least 66 referendums on property taxes for schools (I say “at least” since there is no official record of referendums, especially those that are defeated, and there may be omissions in the AASB compilation). 40 of these referendums were defeated (including some to simply renew existing millage rates). Of the 26 that passed, 19 were to renew existing millage rates (as noted earlier, this requirement that school taxes expire is unique to Alabama and itself an obstacle to local school boards being able to raise adequate revenues). Only 7 resulted in an increase in the millage rate. One involved a city (Sheffield) increasing its indebtedness under CA8 to build a new school. Another (Mobile) required a full constitutional amendment. And the remaining five (Chambers, Escambia, Homewood, Macon and Wilcox) all required legislative acts to authorize the referendums. Moreover, in three of these cases (Chambers, Homewood and Wilcox), the increase in school taxes needed to be folded into referenda to increase other city or county taxes. The point is that this process itself represents a serious obstacle both to local school boards being able to raise adequate revenues and to these boards having control over their fiscal situation. It is instructive that there has not been a single successful effort to raise millage rates for school taxes since 2003.
6. The bottom line is that the inefficiencies, inequities and complexities of the Alabama property tax system have the effect of preserving the past and preserving any inequities that result from social values and public priorities that were in place at the time the structure was established.