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# Staff Analysis and Economic Impact Statement

| | | REFERENCE: | ACTION: |
|---|---|---|---|
| Measure: | CS/CS/CP 45 | | |
| Sponsor: | Finance and Tax Committee | 1. FTC<br>2. PBPC | Fav/CS<br>Fav/CS for CS |
| Subject: | State and Local Revenue Limitations | 3. TBRC | Pre-meeting |
| Date: | March 19, 2008 | | |

## I. Summary:

The Committee Substitute for Committee Substitute for Constitutional Proposal 45 proposes an amendment to the State Constitution to limit revenue increases by the state, and other units of government. The proposal provides for the disposition of excess revenues beyond the limitation levels. Voter approval of the respective government is required for the imposition of a new tax or fee. Increases in revenue limitations can be authorized by supermajority vote of the legislature and local governing boards. A temporary exemption is provided for newly established municipalities or independent special districts. Provisions are included to adjust revenue limitations for the fiscal impact of intergovernmental transfers of funding responsibilities and exclusion of higher education tuition and fees from the revenue limitations.

## II. Present Situation:

Article VII, s. 1(d), Fla. Const., requires the Legislature to provide by law for "raising sufficient revenue to defray the expenses of the state for each fiscal period." However, the Constitution also places several limits on the power of the state to raise revenue. These limitations address: ad valorem taxes, personal income tax, estate tax, corporate income tax, state bonds, and state revenue. Section 1 of Article VII limits state revenue collections to the revenue collected in fiscal year 1994-1995 plus an adjustment for growth based on the growth rate of state personal income over the preceding five years. Excess collections must be deposited in the budget stabilization fund until it is fully funded. Excess revenues at this point are then refunded to taxpayers. The Legislature is allowed to increase the revenue limit by a vote of two-thirds of the membership of each house. According to Article VII, section 1(e) of the Florida Constitution:

> State revenues means taxes, fees, licenses, and charges for services imposed by the legislature on individuals, businesses, or agencies outside state government. However, "state revenues" does not include: revenues

> that are necessary to meet the requirements set forth in documents authorizing the issuance of bonds by the state; revenues that are used to provide matching funds for the federal Medicaid program with the exception of the revenues used to support the Public Medical Assistance Trust Fund or its successor program and with the exception of state matching funds used to fund elective expansions made after July 1, 1994; proceeds from the state lottery returned as prizes; receipts of the Florida Hurricane Catastrophe Fund; balances carried forward from prior fiscal years; taxes, licenses, fees, and charges for services imposed by local, regional, or school district governing bodies; or revenue from taxes, licenses, fees, and charges for services required to be imposed by any amendment or revision to this constitution after July 1, 1994.[1]

***State Revenue Flexibility***

Appellate court opinions have not examined the scope of the Legislature's authority under Art. II, s. 6, Fla. Const. However, arguably, the provision may permit the Legislature to raise revenue from restricted sources during an emergency resulting from an enemy attack. Article II, s. 6, Fla. Const., states:

> Enemy attack.—In periods of emergency resulting from enemy attack the legislature shall have power to provide for prompt and temporary succession to the powers and duties of all public offices the incumbents of which may become unavailable to execute the functions of their offices, and to *adopt such other measures as may be necessary and appropriate to insure the continuity of governmental operations during the emergency. In exercising these powers, the legislature may depart from other requirements of this constitution, but only to the extent necessary to meet the emergency.*[2]

Article IV, s. 13, Fla. Const., gives the state some procedural flexibility to address revenue shortfalls. The constitutional provision states:

> Revenue Shortfalls.—In the event of revenue shortfalls, as defined by general law, the governor and cabinet may establish all necessary reductions in the state budget in order to comply with the provisions of Article VII, Section 1(d). The governor and cabinet shall implement all necessary reductions for the executive budget, the chief justice of the supreme court shall implement all necessary reductions for the judicial budget, and the speaker of the house of representatives and the president of the senate shall implement all necessary reductions for the legislative

[1] Article VII, Section 1, Fla. Const.
[2] Article II, Section 6, Fla. Const.

> budget. Budget reductions pursuant to this section shall be consistent with The provisions of Article III, Section 19(h).[3]

Article IV, s. 13, Fla. Const., was proposed by the 1990 Taxation and Budget Reform Commission in response to an opinion of the Florida Supreme Court requiring all revenue reductions to be made by the Legislature.

***Traditional Tax and Expenditure Limitations***

At least 30 states, including Ohio, Maine, Colorado, and Massachusetts, currently operate under a tax or expenditure limitation. Twenty three states have spending limits, four have tax limits, and three have both.[4]

Traditional tax and expenditure limitations include revenue, expenditure, or appropriation limits such as:

- Revenue limits. Revenue limits tie allowable yearly increases to personal income or an index which may include inflation or population, and allow for the refund of excess revenues to taxpayers.
- Expenditure limits. Expenditure limits are also tied to personal income or a growth index. In many states, the limit is tied to a growth index related to the expansion of the economy.
- Appropriations limited to a percentage of revenue estimates. This variation of a spending limit simply ties appropriations to the revenue forecast. Delaware, Iowa, Mississippi, Oklahoma, and Rhode Island have this type of appropriation limit in place.
- Hybrids. States also have combined components of various limits. For example, Oregon has a state spending limit tied to personal income growth, and a provision requiring refunds if revenues are more than 2 percent above the revenue forecast. This law limits spending and, in a sense, limits revenues by tying them to the forecasted amount. Colorado, under the Taxpayer's Bill of Rights (TABOR), is another hybrid state.[5]

The most restrictive type of limit includes voter approval requirements. All taxes or increases over a specified amount must receive voter approval to implement this type of limit. Missouri and Washington require voter approval for tax increases over a specified amount. Sixteen states require legislative supermajority votes to increase some or all of the taxes. Of the 30 states with tax and spending limitations, seventeen have constitutional provisions and thirteen have statutory provisions for revenue limits.

***Tax and Expenditure Limitations Pros and Cons***

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[3] Article IV, Section 13, Fla. Const.

[4] National Conference of State Legislatures, *State Tax and Expenditure Limits –2007*: http://www.ncsl.org/ (Last visited January 30, 2008).

[5] National Conference of State Legislatures, http://www.ncsl.org/ (Last visited January 30, 2008).

There are arguments for and against, tax and expenditure limitation issues. Proponents indicate that limits will:

- Make government more accountable and control the growth of government;
- Make government more efficient;
- Provide a means for citizens to become more involved in the process and vote on tax increases;
- Help diffuse the power of special interests; and
- Force government to evaluate programs and prioritize services.

Opponents of limits indicate that they will:

- Shift the decision process from the representatives elected to serve the citizens;
- Fail to provide sufficient funds for growth in social services and education;
- Cause a "ratchet-down" effect decreasing the spending base without the ability of growth to bring the base to its original level;
- Fail to provide funding for "shortfall years" and respond to quick changes in the economy;
- Make it harder for states to raise new revenue; and
- Result in declining government service levels over time.

The details of the design of a tax and expenditure limitation will impact the effectiveness of the limitation and its influence on government spending. In a research report from the New England Public Policy Center,[6] the growth index and base are highlighted as powerful determinants of the limitation's impact. The growth index is the annual rate at which a tax and expenditure limitation allows the state or local government expenditures, appropriations, or revenues to grow and the base is the amount of money expended, collected, or appropriated.

***TABOR (Taxpayer's Bill of Rights)***

The most well-known tax and expenditure limitation is the Colorado initiative known as "TABOR." In 1992, the TABOR constitutional amendment, a citizen initiative, was adopted by Colorado voters. TABOR limits the growth of Colorado's state revenues to inflation plus population. The limits do not apply to federal funds, private gifts, and a few other specified revenue sources. The TABOR amendment also requires voter approval for any tax increase proposed by the state, counties, cities, towns, school districts, or special districts. Revenues in excess of the revenue limit must be returned to the voters; however, the voters may vote to allow the state to retain the excess funds. TABOR limits the revenue that the state government can retain in a year to the previous year's allowed collection. In 2005, the voters passed Referendum C which suspends the revenue and spending limits for four years to address the critical fiscal status of the state.

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[6] New England Public Policy Center, Research Report 06-3, Reading the Fine Print: How Details Matter in Tax and Expenditure Limitations, http://www.bos.frb.org/economic/neppc/researchreports/2006/rr0603.html.

Dr. Barry Poulson, Professor of Economics at the University of Colorado, proposed a framework for the development of a Taxpayer Protection Amendment for Florida, and reasons why an amendment is necessary, in "Taxes in Florida Are At An All Time High: Time for a Taxpayer Protection Amendment."[7] The reasons presented indicating why an amendment is necessary are:

- To limit the growth in revenue and spending to the growth of population plus inflation;
- To stabilize the budget over the business cycle;
- To ensure that some surplus revenue is invested in an emergency and budget stabilization fund;
- To ensure that additional surplus revenue is rebated to taxpayers;
- To require voter approval for increased taxes, debt, or expenditure of surplus revenue;
- To establish a hard budget constraint that would create incentives for tax reform;
- To provide much-needed property tax relief, and reduce property tax rates;
- To create opportunities for home ownership for all Florida citizens;
- To create a more favorable tax climate that Florida needs to attract business investment and create jobs; and
- To improve incomes and standards of living for Florida citizens.

The framework provided for the development of an amendment included that:

- It is a constitutional, rather than a statutory, provision;
- It would impose a stringent limit on the growth in spending equal to inflation and population growth;
- This limit would be applied to a broad measure of state revenue and spending, with few exceptions;
- Some surplus revenue would be allocated to a budget stabilization and emergency fund;
- Some surplus revenue would be allocated to tax relief, including property tax relief;
- Voter approval would be required for any increase in taxes, debt, or expenditure of surplus revenue; and
- This limit would be applied at the local, as well as the state, level.

## III. Effect of Proposed Changes:

Voters of the respective government must approve the imposition of a new tax or fee. State revenues collected by the state and local government revenues collected by each local government for any fiscal year are limited to revenues for the prior fiscal year plus an adjustment for growth. For the 2009-2010 fiscal year, revenues allowed for the prior

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[7] Barry Poulson, "Taxes in Florida Are at an All Time High: Time for a Taxpayer Protection Amendment", Presentation to the Taxation and Budget Reform Commission, September, 2007.

fiscal year shall equal each government's revenues collected in the 2007–2008 fiscal year plus the adjustment for growth for the 2008-2009 fiscal year.

***Definitions***
The Committee Substitute for Committee Substitute for Constitutional Proposal 45 provides definitions for the following:

- Local government;
- State revenues;
- Local government revenues;
- Growth;
- Rate of inflation;
- Rate of population change;
- Rate of enrollment change; and
- Fiscal year.

Local government is defined as a county, municipality, school district, or special district. Any municipal service taxing or benefit unit of a county and any special district dependent to a county is to be included in that county government. Any special district dependent to a municipality is to be included in that municipality.

State revenues are defined as taxes, fees, licenses, fines, and charges for services imposed by the legislature on individuals, businesses, or agencies outside state government. The following are excluded from "state revenues":

1. Revenues necessary to meet the requirements set forth in documents authorizing the issuance of bonds by the state prior to July 1, 2008;
2. Proceeds from the state lottery returned as prizes;
3. Receipts of the Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation or their successor entities;
4. Balances carried forward from prior fiscal years;
5. Taxes, licenses, fees, and charges for services imposed by local, regional, or school district governing bodies;
6. Revenues of a government-owned enterprise that receives less than ten percent of its revenues from the state or a local government; or
7. Revenues from taxes, licenses, fees, and charges for services required to be imposed by any amendment or revision to the state constitution after July 1, 2008.

Local government revenues are taxes, fees, assessments, licenses, fines, and charges for services imposed by a local government on individuals, businesses, or another local government. However, the following are excluded from "local government revenues:"

1. Revenues necessary to meet the requirements set forth in documents authorizing the issuance of bonds issued by each local government prior to July 1, 2008;

2. Ad valorem taxes approved for periods not longer than 2 years by vote of the electors pursuant to Section 9(b) of Article VII or ad valorem taxes levied for purposes provided in Section 12 of Article VII;
3. Non-ad valorem taxes levied pursuant to voter approval required by the state constitution or by general law;
4. Revenues that are used to pay for the direct cost of providing electric, water, wastewater, gas, or other utility services;
5. Revenues of any other government-owned enterprise that receives less than ten percent of its revenues from the state or a local government;
6. Balances carried forward from prior fiscal years;
7. Revenues from taxes imposed by a county on the lease or rental, living quarters or accommodations for tourism promotion and related activities; or
8. Revenue from taxes, licenses, fees, and charges for services required to be imposed by any amendment or revision to the state constitution after July 1, 2008.

"Growth" is defined as an amount equal to a government's revenues for the prior fiscal year multiplied by the sum of one percentage point plus the combined rate of inflation and rate of population change. For school districts, enrollment is to be used in lieu of population.

"Rate of inflation" is defined as the percentage change in the Consumer Price Index for all urban consumers, U.S. City Average, all items 1982-1984=100, or successor reports for the preceding calendar year as initially reported by the United States Department of Labor, Bureau of Labor Statistics. The Legislature will determine the percentage change from information available from the United States Department of Labor based on a comparison of the average of the Consumer Price Index during the most recent two consecutive twelve-month periods.

“Rate of population change" is defined as the percentage change in population within the respective government's boundaries. The Legislature will determine the percentage change from information available on the first day of February prior to the beginning of the fiscal year and will compare estimates of population as of April 1 of the most recent two consecutive years.

"Rate of enrollment change" is defined as the percentage change in each school district's student enrollment. The Legislature will determine the percentage change from information available on the first day of February prior to the beginning of the fiscal year and compare the enrollment of the most recent two consecutive years.

"Fiscal year" is defined as the applicable fiscal year for the respective government.

***Revenues***
State revenues collected in excess of the revenue limit for any fiscal year must be returned to taxpayers, as provided by general law, or transferred to the budget

stabilization fund until the fund reaches the maximum balance specified in Section 19(g) of Article III.

Local government revenues collected in excess of the revenue in any fiscal year must be transferred to a budget reserve fund or returned to taxpayers as provided by general law. The Legislature is required to provide by general law for the establishment of local government reserve funds and for the uses of revenues deposited in the funds.

Government revenue limitations may be increased for up to ten years upon approval of a three-fourth vote of the membership of the governing board or three-fourth vote of the Legislature. Governments may also increase a fee upon approval of a three-fourth vote of the membership of the governing board or three-fourth vote of the Legislature.

Revenues collected by a municipality or independent special district in existence for less than five fiscal years are not subject to the revenue limitations provisions.

Revenues collected prior to the fifth year after an independent special district's governing board is elected for an independent special district initially to provide for the delivery of urban community services are not subject to the revenue limitations provisions.

An adjustment to the revenue limit must be made to reflect the fiscal impact of transfers of responsibility for the funding of governmental functions among local governments or between local governments and the state. An adjustment to a local government's revenue limit must be made to reflect the revenues from the first full fiscal year of implementation of a new tax or fee adopted by the local government prior to March 1, 2008.

Revenues collected from tuition and fees charged to students by public universities and community colleges are excluded from the revenue limitations provisions.

## IV. Constitutional Issues:

### A. Constitutional or Statutory Issue:

None.

### B. Other Constitutional Issues:

None.

## V. Economic Impact and Fiscal Note:

### A. Tax/Fee Issues:

CS/CS/CP 45 limits revenues for state and local government. It does not explicitly increase any taxes or fees.

### B. Private Sector Impact:

None.

### C. Government Sector Impact:

CS/CS/CP 45 will limit the fiscal growth of the state and local governments, including school districts. These limitations will impact services provided at all government levels, if passed by the electors. At the state level, services impacted may include education and social service programs.

**REVENUE CAP SCENARIO (in millions)**
**REVENUE DEFINITION: EXCLUDE DEBT SERVICE AS OF 7/1/2008 AND LOTTERY PRIZE PAYOUTS.**
***NOVEMBER 2007 REVENUE FORECAST ADJUSTED FOR EXPECTED OR ACTUAL 2008 REVISIONS***

| Pop and CPI Inflat Growth Factor +x% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% |
|---|---|---|---|---|---|---|---|---|---|---|
| | Base Year 2007-08 | | | | | | | | | |
| | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 |
| Estimate of State Revenues | 35,454 | 36,475 | 39,058 | 41,866 | 44,394 | 46,527 | 48,696 | 51,095 | 53,699 | 56,239 |
| Limitation Factor | | 1.0571 | 1.0445 | 1.0374 | 1.0421 | 1.0455 | 1.0471 | 1.0468 | 1.0477 | 1.0479 |
| Revenue Limit | 35,454 | 37,478 | 39,148 | 40,614 | 42,324 | 44,250 | 46,332 | 48,498 | 50,812 | 53,245 |
| Revenues (Over) or Under the Limit | - | 1,003 | 90 | (1,252) | (2,070) | (2,278) | (2,364) | (2,597) | (2,887) | (2,993) |

Source: Florida House of Representatives, Policy and Budget Council

CS/CS/CP 45 does not exclude the state's Public Medical Assistance Trust Fund (PMATF) from the revenue limit. Failure to exclude the PMATF may cause the state to have to shift funds from other sources to cover matching fund requirements for federal Medicaid programs, or reduce services provided to Florida citizens.

Under Art. XI, s. 5(d), Fla. Const., the Secretary of State must publish in newspapers throughout the state proposed constitutional amendments and notice of the date of the election at which it will be submitted to the electors. According to the Department of State, the average publishing costs for citizen initiative amendments is $60,000. However, the cost to publish lengthy amendments will exceed that amount.

## VI. Technical Deficiencies:

None.

## VII. Related Issues:

To the extent that the rate of growth of the economy exceeds the rate of inflation, this measure will shrink the size of state and local governments relative to the economy. As a result, voters likely will have to make many decisions on taxes which are currently made by elected officials.