

THE JONATHON B. CHASE PAPER

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RAISING REVENUE FOR AN ADEQUATE EDUCATION IN NEW HAMPSHIRE

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*Every child in America needs an excellent education—because global competition demands a highly skilled and knowledgeable work force, because democracy in the modern era depends on a thoughtful and well-educated citizenry, and because knowledge and a love of learning are among the most precious gifts society can give to children*¹

Knowledge and learning, generally diffused through a community, being essential to the preservation of a free government; and spreading the opportunities and advantages of education through the various parts of the country, being highly conducive to promote this end; it shall be the duty of the legislators and magistrates, in all future periods of this government, to cherish the interest of literature and the sciences, and all seminaries and public schools, to encourage private and public institutions, rewards, and immunities for the promotion of agriculture, arts, sciences, commerce, trades, manufactures, and natural history of the country; to countenance and inculcate the principles of humanity and general benevolence, public and private charity, industry and economy, honesty and punctuality, sincerity, sobriety, and all social affections, and generous sentiments, among the people: Provided, nevertheless, that no money raised by taxation shall ever be granted or

[†] See *Dedication*, 13 VT. L. REV. 1 (1988) for a biographical sketch of Dean Chase.

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1. David Dormont, *Separate and Unequal: School District Financing*, 11 LAW AND INEQ. J. 261, 261 (1992) (citing NATIONAL COMMISSION ON CHILDREN, BEYOND RHETORIC: A NEW AMERICAN AGENDA FOR CHILDREN AND FAMILIES 177-78 (1991)).

applied for the use of the schools or institutions of any religious sect or denomination.²

And further, full power and authority are hereby given and granted to the said general court, from time to time, . . . to impose and levy proportional and reasonable assessments, rates, and taxes, upon all the inhabitants of, and residents within, the said state.³

INTRODUCTION

While it is almost universally accepted that education is an essential element of a well-informed citizenry and healthy democracy, the United States Supreme Court in *San Antonio Independent School District v. Rodriguez* held that under the United States Constitution there is no fundamental right to education.⁴ In contrast, many state courts have found such a right exists under their state constitutions.⁵ "All state constitutions, except that of Mississippi, contain some type of education clause mandating that the state maintain a system of free public education."⁶ For example, in *McDuffy v. Secretary of Executive Office of Education*, the Massachusetts Supreme Judicial Court held that the Commonwealth had a constitutional duty to "provide an education for *all* its children, rich and poor, in every city and town . . . at the public school level."⁷

In *Claremont School District v. Governor*, the New Hampshire Supreme Court cited the *McDuffy* decision in order to settle part of the long fought battle over providing public education in New Hampshire.⁸

2. N.H. CONST. pt. 2, art. 83.

3. N.H. CONST. pt. 2, art. 5.

4. *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 35 (1973).

5. See *Shofstall v. Hollins*, 515 P.2d 590, 592 (Ariz. 1973) (en banc); *Dupree v. Alma Sch. Dist. No. 30*, 651 S.W.2d 90, 93 (Ark. 1983); *Serrano v. Priest*, 557 P.2d 929, 951 (Cal. 1976) (in banc), cert. denied sub nom. *Clowes v. Serrano*, 432 U.S. 907 (1977); *Horton v. Meskill*, 376 A.2d 359, 373 (Conn. 1977); *Skeen v. State*, 505 N.W.2d 299, 313 (Minn. 1993); *Robinson v. Cahill*, 303 A.2d 273, 291 (N.J. 1973), cert. denied sub nom. *Dickey v. Robinson*, 414 U.S. 976 (1973); *Seattle Sch. Dist. No. 1 v. State*, 585 P.2d 71, 92 (Wash. 1978) (en banc); *Pauley v. Kelly*, 255 S.E.2d 859, 878 (W. Va. 1979); *Buse v. Smith*, 247 N.W.2d 141, 149 (Wis. 1976); *Washakie County Sch. Dist. No. One v. Herschler*, 606 P.2d 310, 333 (Wyo. 1980), cert. denied sub nom. *Hot Springs County Sch. Dist. No. One v. Washakie County Sch. Dist. No. One*, 449 U.S. 824 (1980).

6. William E. Thro, Note, *To Render Them Safe: The Analysis of State Constitutional Provisions in Public School Finance Reform Litigation*, 75 VA. L. REV. 1639, 1661 (1989).

7. *McDuffy v. Secretary of Executive Office of Educ.*, 615 N.E.2d 516, 548 (Mass. 1993).

8. *Claremont Sch. Dist. v. Governor*, 635 A.2d 1375, 1378 (N.H. 1993). "Given that New Hampshire shares its early history with Massachusetts, that we modeled much of our constitution on one adopted by Massachusetts four years earlier, and that the Massachusetts Constitution contains a nearly identical provision regarding education, we give weight to the interpretation given that provision by the Supreme Judicial Court in *McDuffy* . . ." *Id.*

Specifically, the court found that a fundamental right to a free and adequate public education existed under the New Hampshire Constitution.⁹ The court held that education was an "important substantive right" and found that the State Constitution's Education Clause imposed a "duty on the State to provide universal education and to support the schools."¹⁰ The court, however, determined neither the adequacy of the quality of education provided by individual school districts nor the adequacy of the State's present education funding scheme.¹¹ Leaving the task of defining the specific parameters of an adequate public education to the Legislature and Governor, the court remanded the issue of funding to the district court.¹² The court offered the lower court some guidance by stating that New Hampshire's "constitutional duty extends beyond mere reading, writing and arithmetic" and includes an education that prepares its "citizens for their role as participants and as potential competitors in today's marketplace of ideas."¹³

The New Hampshire Supreme Court's disposition of the *Claremont School District* case has re-ignited the political debate concerning how public education is funded in New Hampshire.¹⁴ The ruling clearly established that the State Government has a constitutional duty to financially support public education, and that the education must be adequate.¹⁵ Applying equal protection guarantees to this duty, it follows that an adequate education must be equally available across the State.¹⁶

9. *Id.* at 1376. The New Hampshire Constitution provides that: "[I]t shall be the duty of the legislators . . . to cherish the interest of literature and the sciences, and . . . to encourage private and public institutions, rewards, and immunities for the promotion of agriculture, arts, sciences, commerce, trades, manufactures, and natural history of the country." N.H. CONST. pt. 2, art. 83.

10. *Claremont Sch. Dist.*, 635 A.2d at 1381. The New Hampshire Supreme Court, in reaching this conclusion, construed the words "to cherish" as not purely hortatory, but as imposing a duty upon the State. *Id.* at 1378.

11. *Id.*

12. *Id.*

13. *Id.*

14. Following the *Claremont School District* decision in December 1993, legislation concerning education funding was introduced in the 1994 legislative session. See, e.g., 1994 N.H. Laws 349 (establishing a public education funding issues task force).

15. *Claremont Sch. Dist.*, 635 A.2d at 1376.

16. *Id.* The New Hampshire Supreme Court has identified Part I, Articles 1, 2, and 12 of the New Hampshire Constitution as sources of State equal protection guarantees. Opinion of the Justices, 337 A.2d 354, 356 (N.H. 1975) (Article 1); *Le Clair v. Le Clair*, 624 A.2d 1350, 1355 (N.H. 1993) (Article 2); *State v. Cooper*, 498 A.2d 1209, 1212 (N.H. 1985) (Article 12). "Although equal protection of the laws does not require complete equality in the face of factual differences, it does mandate that those who are similarly situated be similarly treated." *Belkner v. Preston*, 332 A.2d 168, 170 (N.H. 1975) (citations omitted).

Numerous studies have found a correlation between the economic resources of schools and the average academic performance of the students.¹⁷ Like other New England states, New Hampshire relies heavily on the local property tax to fund its public education. Because the property tax is based upon a taxing district's assessed taxable wealth, funding for public education varies among districts as the taxable wealth of the districts vary.¹⁸ This funding disparity may result in inequalities in the education that children receive.¹⁹ New Hampshire's existing tax structure may be insufficient to provide an adequate education equally across the State. If New Hampshire attempts to provide the necessary funds to rectify the inequalities, its existing tax structure will be severely strained.

In addition, variations in taxable wealth can also lead to taxpayer inequities. For example, existing property wealth variations among school districts cause similarly situated taxpayers to bear dramatically different tax burdens in order to fund comparable education.²⁰ Paying disproportionate amounts of taxes for the same education also violates basic notions of taxpayer fairness. New Hampshire has attempted to alleviate these inequities, as well as the resulting inability of property-poor school districts to raise sufficient funds for public education, by distributing State aid to these districts under its Foundation Aid Program.²¹ Despite the Foundation Aid Program's efforts, New Hampshire's tax structure is unable to fully support public education, and local property taxes continue to bear the bulk of the cost. If no change is made in the method of public education funding, disparities in the taxpayer burdens will persist.

Other states facing similar challenges in trying to raise additional funds for education have also reevaluated their tax structure. These states have successfully solved not only the inequities caused by their former reliance on the property tax, but also the financial difficulties of raising revenue for education. Applying some of the same solutions may help New Hampshire resolve its current education and taxpayer equity issues.

While the New Hampshire Legislature has made numerous attempts to alter New Hampshire's tax structure, none of the suggested changes have been successful.²² This Paper will explore possible solutions to achieving taxpayer equity while raising the necessary revenue for adequate

17. *See infra* Part I.

18. *See infra* Part II.C.

19. *Id.*

20. *See infra* Part II.D.1.

21. *See infra* Part II.C.

22. *Id.*

public education in New Hampshire. Only through a reassessment and restructuring of New Hampshire's present tax system will taxpayer inequities be minimized. First, this Paper will explore what is necessary to achieve an adequate education. Next, the Paper discusses New Hampshire's history of taxation and the failure to solve the problem of taxpayer inequities. Third, options for addressing the inadequacy in education funding and the continuing problem of taxpayer inequities will be detailed. Finally, the Paper concludes with the determination that New Hampshire's tax structure needs reformation. The best way to achieve this is to reduce reliance on the local property tax system as the primary means to fund public education.

I. ADEQUATE EDUCATION AND THE MONEY FACTOR

The relationship of money to education, although not linear, is undeniable. Although in *Claremont School District v. Governor* the New Hampshire Supreme Court did not define "adequate education," it did find that an adequate education is a constitutional right.²³ This Part explores the link between money and an adequate education.

New Hampshire does not have a formal definition of what constitutes an education adequate to prepare its citizens to compete in today's marketplace of ideas.²⁴ Regardless of how an adequate education is defined, achieving it inevitably involves money. Non-monetary means of improving the level of education, such as school choice programs and charter schools, have not achieved the goal of providing adequate education in all school districts.²⁵ In 1975, New Hampshire authorized a

23. *Claremont Sch. Dist. v. Governor*, 635 A.2d 1375, 1376 (N.H. 1993).

24. Donn Tibbetts, *Merrill Seeks School Aid Revisions, \$17.5 Million for NH Kindergartens*, THE UNION LEADER, July 16, 1994, at 1, 10 (noting that the Merrimack County Superior Court has given Governor Merrill until October 1995 to define what it would take to achieve an adequate education). Trial is now set for May 6, 1996. Order on Pet'r's Mot. to Continue, *Claremont Sch. Dist. v. Merrill*, 635 A.2d 1375 (N.H. 1993) (No. 91-E-306).

25. New Hampshire and other states have attempted to alleviate education financing pressures by using school choice and charter school programs. The Charter Schools and Open Enrollment Act allows the creation of non-profit charter schools. Charter Schools and Open Enrollment Act, N.H. REV. STAT. ANN. § 194-B (Supp. 1995). Charter schools are operated under contract and governed by a board of trustees. *Id.* School choice "is designed to make schools compete for pupils, thereby spurring innovation and better teaching." *Bill Offers Charter Schools, School Choice*, THE UNION LEADER, Jan. 5, 1995, at C5. This is reminiscent of the 1960s' efficiency theory, which espoused the view that schools would be more efficient if school boards were not pressured by the dictates of locally collected taxes. See Richard W. Lindholm, *Introduction to PROPERTY TAXATION AND THE FINANCE OF EDUCATION* xvi (Richard W. Lindholm ed., 1974) (noting that James Conant argued in 1968 that local school boards could make better decisions if the pressures of deriving financing from locally collected taxes were eliminated). Theoretically, the resulting competition improves school

school choice program, but it was discontinued in 1988.²⁶ School choice and charter schools were again introduced in New Hampshire in 1995, but no school districts have implemented these options.²⁷ It does not appear that these non-monetary methods will be a solution to achieving adequate education.

Beyond the non-monetary means, evidence supports a connection between funding levels and adequacy in education. Education experts have long observed that school districts' inability to comply with required minimum state education standards usually stems from inadequate funding.²⁸ A recent Brookings Institution study found that differences in the economic resources of schools may relate to academic performance.²⁹ For example, when a state eliminates mandatory educational programs, richer districts can afford to maintain them while poorer districts are more

performance. See also HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, UNITED STATES GENERAL ACCOUNTING OFFICE, CHARTER SCHOOLS: NEW MODEL FOR PUBLIC SCHOOLS PROVIDES OPPORTUNITIES AND CHALLENGES 1 (1995) [hereinafter CHARTER SCHOOLS] (noting that charter schools are being used to address the lack of public school accountability for student performance).

"Unlike traditional public schools, charter schools operate under charters or contracts with [local] school districts, state education agencies, or other public institutions." *Id.* As a solution to ensuring that an adequate public education is provided in all school districts, school choice has shortcomings. Schools are simply not run with the same efficiency as businesses. Evidence shows that the pressures of local financing have not resulted in efficiency, but instead have caused taxpayers to control spending allocations. Lindholm, *supra*, at xvi. Those schools which have difficulty financing education would likely be the ones to lose students and, more importantly, also lose the corresponding amount of State aid. Dan Billin, *Education Tops Agenda In District 5*, VALLEY NEWS, Nov. 4, 1994, at A1, A8.

26. Education Voucher Programs, N.H. REV. STAT. ANN. § 194-A (repealed 1986).

27. Charter Schools and Open Enrollment Act, N.H. REV. STAT. ANN. § 194-B. See also Telephone Interview with Pat Busselle, Administrator, Office of the Commissioner of Education (Feb. 23, 1996) (discussing the handful of school districts which have placed adoption of § 194-B on their 1996 town meeting warrants, since adoption by the town is a precondition to creating charter schools). In comparison, Massachusetts has experienced only limited success with employing non-monetary means to achieve adequate education. Billin, *supra* note 25, at A1, A8. "One year after Massachusetts enacted limited school choice, a *Boston Globe* review found that improvements occurred only in districts where voters were already so disposed and also had sufficient economic resources." *Id.*

28. Telephone Interview with Gerald Bourgeois, Acting Deputy Commissioner of Education, New Hampshire Department of Education (Jan. 16, 1995); N.H. CODE ADMIN. R. DEP'T OF EDUC. 306.01 (1995). Standards set maximum class size, ratio of guidance counselors to students, the size of school libraries, and whether art, music, physical education, and other non-academic classes are offered. *Id.* at 306.01-306.40. Although these standards have not been used in the past to determine school funding, they soon may be. 53 *Struggling School Districts Face Fund Loss*, THE UNION LEADER, Feb. 5, 1996, at A1.

29. JOHN E. CHUBB & TERRY M. MOE, POLITICS, MARKETS, AND AMERICA'S SCHOOLS 102-04 (1990).

likely to discontinue them.³⁰ Another study found a meaningful relationship between local property wealth and higher student achievement as measured by the Scholastic Aptitude Test (SAT).³¹ This study also reported the level of per pupil spending as a factor in student success on the SAT.³²

The link between income and quality of education was also intimated by the fact that all five plaintiff school districts in the *Claremont School District* lawsuit scored below the average on a statewide achievement test for third graders.³³ Three of the five school districts had per pupil spending below the State average in 1995.³⁴ This link between per pupil expenditures and quality of education was also noted by the California Supreme Court in *Serrano v. Priest (Serrano I)*.³⁵ *Serrano I* found that differences in education result when "as a practical matter districts with small tax bases simply cannot levy taxes at a rate sufficient to produce the revenue that more affluent districts reap with minimal tax efforts."³⁶

Even though the relationship between adequate education and per pupil spending is widely acknowledged, other factors influence the degree of correlation. Funding education at similar levels in all school districts does not always translate into equal educational opportunities for the

30. William Celis, *Furor in New Hampshire on Vote to Cut Standards*, N.Y. TIMES, Aug. 26, 1992, at B7.

31. DOUGLAS E. HALL, ANALYSIS OF EDUCATIONAL ACHIEVEMENT IN NEW HAMPSHIRE'S PUBLIC SCHOOLS 35-36 (1995). The effect, however, was small when compared to the effect of home factors, which are factors over which schools have no control. *Id.* at 27. The SAT is often used to measure educational adequacy, however, its utility is diminished because the SAT is a college entrance exam and thus only measures the scholastic aptitude of students who plan to attend college. Misuse can lead to the erroneous conclusion that all New Hampshire's students receive an adequate education. See Kent Fischer, *State's high SAT scores called inflated*, THE CONCORD MONITOR, Aug 24, 1995, at A1 ("State officials often point to New Hampshire's high score as evidence that the education system doesn't need fixing . . .").

32. HALL, *supra* note 31, at 33-35. This report also cited the education level of the student's parents and the parents' economic well-being as factors affecting SAT scores. *Id.*

33. In 1995, New Hampshire administered a statewide achievement test to its third graders. *School Test Results, Financing Debated*, THE UNION LEADER, Nov. 3, 1995, at A1. See also Ralph Jimenez, *After the School Tests, A Test of Interpretation*, THE BOSTON SUNDAY GLOBE, Nov. 27, 1994, at NH1 (reporting 1994 test results).

34. *School Test Results, Financing Debated*, *supra* note 33, at A16.

35. *Serrano v. Priest*, 487 P.2d 1241, 1252-53 (Cal. 1971) (in bank) [hereinafter *Serrano I*]. The issue was one the court accepted as true because the defendant offered a general demurrer to the plaintiffs' allegations. *Id.* The court in *Serrano I* discussed other opinions which found equal per pupil expenditure levels would result in equal education between school districts. *Id.* at 1253 n.16.

36. *Id.* at 1250, 1252-53.

children in each district.³⁷ For instance, school districts may expend funds for education at different rates of efficiency.³⁸ Purchasing power may also vary by district. Purchasing power problems may be corrected, however, by "modify[ing] all [per pupil] dollar allocations by some regional price index that adjusts for the varying purchasing power of the educational dollar."³⁹ Another factor concerns disadvantaged districts. Some school districts may actually need more funding than other districts in order to raise education to an adequate level.⁴⁰ For instance, a large percentage of high-cost students requiring special education may be clustered in a single school district.

While local spending for education has increased 31% since 1983, a report prepared by Augenblick, Van de Water, and Associates for the Education Commission of the States shows that the increased funds were primarily used to raise teacher salaries.⁴¹ Unless a direct correlation exists between teacher salaries and teacher effectiveness, providing additional funds for teacher salaries does not necessarily lead to educational improvement.⁴²

Colin D. Campbell, Professor of Economics at Dartmouth College, and Rosemary G. Campbell, an economist, have also reviewed the correlation between money and education.⁴³ They maintain that it is incorrect to conclude that the quality of education varies in proportion to

37. JAMES S. COLEMAN, EQUALITY AND ACHIEVEMENT IN EDUCATION 139-40 (1990). The Pennsylvania Supreme Court, in *Danson v. Casey*, also recognized the limitations of similar funding to achieve equality. *Danson v. Casey*, 399 A.2d 360, 366 (Pa. 1979). The *Danson* court reasoned that:

[E]xpenditures are not the exclusive yardstick of educational quality, or even of educational quantity. . . . [T]he same total educational and administrative expenditures by two school districts do not necessarily produce identical educational services. The educational product is dependent upon many factors, including the wisdom of the expenditures as well as the efficiency and economy with which available resources are utilized.

Id.

38. COLEMAN, *supra* note 37, at 138.

39. Allan Odden, *Including School Finance In Systemic Reform Strategies: A Commentary*, CPRE FINANCE BRIEFS, May 1994, at 7.

40. See Kimberly J. McLarin, *At Issue: What Is Adequate for the Poor?*, N.Y. TIMES, July 13, 1994, at B6.

41. Chris Pipho, *School Finance: Moving From Equity to Productivity*, 74 PHI DELTA KAPPAN 590, 590 (1993) [hereinafter *Moving From Equity to Productivity*].

42. See Richard J. Murnane, *Interpreting the Evidence on "Does Money Matter?"*, 28 HARV. J. ON LEGIS. 457, 462 (1991) (noting that "[u]nless additional funding results in a change in someone's behavior, no real change in outcomes will occur").

43. COLIN D. CAMPBELL & ROSEMARY G. CAMPBELL, PROPERTY TAXES IN NEW HAMPSHIRE 21 (1978).

the differences in per pupil expenditures.⁴⁴ While there may not be a direct relationship between money and educational quality, Campbell and Campbell's conclusion must be qualified. They base their conclusion on expenditures by New Hampshire's ten largest school districts.⁴⁵ In 1992, however, the majority of those ten districts had below-average school tax rates per \$1000 of equalized valuation.⁴⁶ These ten school districts are also some of the wealthiest school districts in the State.⁴⁷ To substantiate Campbell and Campbell's broad conclusions, data should be compared from both property-poor and property-wealthy school districts.⁴⁸

Admittedly, some limitations exist on the ability of increased funding to achieve equal and adequate education among school districts. Despite these limitations, increased funding can play an important role in ensuring that all children in New Hampshire receive an adequate education.

II. ACHIEVING ADEQUATE EDUCATION NECESSARILY INVOLVES TAXPAYER EQUITY

A financial solution to achieving adequacy in education among New Hampshire's school districts is likely to strain New Hampshire's present tax structure.⁴⁹ Additional funds will have to come from the State

44. *Id.*

45. *Id.*

46. New Hampshire School Boards Association, *NEW HAMPSHIRE SCHOOL DISTRICTS AND MUNICIPALITIES, DATA BOOKLET 13 (1993)* [hereinafter *DATA BOOKLET*] (analyzing New Hampshire Department of Education statistics); *COMPUTER AND STATISTICAL SERVICES, NEW HAMPSHIRE STATE DEPARTMENT OF EDUCATION, VALUATIONS, PROPERTY TAX ASSESSMENTS, AND SCHOOL TAX RATES OF SCHOOL DISTRICTS (1993)* [hereinafter *VALUATIONS*].

47. Compare *DATA BOOKLET*, *supra* note 46, at 13 (comparing property-poor districts with property-wealthy districts) with *VALUATIONS*, *supra* note 46 (analyzing each town's wealth and school tax rate).

48. Additionally, Campbell and Campbell compared Concord, the school district with the highest per pupil expenditures, with Rochester, the school district with the lowest per pupil expenditures, concluding that the quality of education does not vary in proportion with per pupil expenditures. See *CAMPBELL & CAMPBELL*, *supra* note 43, at 21. The school year of comparison was 1975 to 1976, a time when this author experienced first-hand the effects of inadequate funding for education. Because Rochester was unable to fund construction of a new high school, classes in the junior high and high school were overcrowded. As a result, double sessions were instituted. Half of the high school attended school from 7 a.m. to 12 p.m., others attended school from 12:30 p.m. to 5:30 p.m. Shortages of teaching supplies compounded the problem already caused by overcrowding. This author believes, based upon the aforementioned personal experience, that the quality of education does depend, at least in part, upon per pupil expenditures.

49. See *infra* Part II.C.

government.⁵⁰ Although potential sources of federal funding exist, these are not viable sources of revenue due to political considerations and other funding issues.⁵¹ The present federal legislative agenda has been characterized as the pursuit of fend-for-yourself federalism.⁵² The United States Congress has contemplated abolishing the Federal Education Department and eliminating the National Education Standards and Improvement Council.⁵³ Cuts of this nature mean New Hampshire must look to its own revenue sources to ensure that all school districts provide students with an adequate education.

This Part will review New Hampshire's past and present revenue sources. It will then explore New Hampshire's funding sources and how

50. See *United States v. Lopez*, 115 S. Ct. 1624, 1640 (1995). "[I]t is well established that education is a traditional concern of the states." *Id.* (construing *Milliken v. Bradley*, 418 U.S. 717, 741-42 (1974)). A statement issued by President Bush and the nation's governors at a September 1989 education summit stated that "[e]ducation has historically been, and should remain, a state responsibility and a local function." *The Statements by the President and Governors*, N.Y. TIMES, Oct. 1, 1989, § 4, at 22.

51. For example, the 1972 Advisory Commission on Intergovernmental Relations considered "whether revenues from a federal value-added tax should be substituted for residential property taxes as the means of financing education." HENRY J. AARON, WHO PAYS THE PROPERTY TAX? A NEW VIEW 4 (1975) [hereinafter WHO PAYS THE PROPERTY TAX?]. "[T]he Commission voted not to support the substitution." *Id.* Funding through the Federal Goals 2000 Educate America Act could provide New Hampshire with \$400,000 in the first year, up to \$2 million in the second year, and up to \$10 million distributed over the next five years. See also Telephone Interview with State Senator Deborah Pignatelli (D-Nashua) (June 8, 1995); John DiStaso, *NH Promised Local Control Of Goals 2000 Plans, Funds*, THE UNION LEADER, June 14, 1995, at A1. In the past, New Hampshire has not applied for Goals 2000 funds because of political disagreement over whether unwanted conditions might attach to the funds. *Id.* at A1. See also *Ex-Officials Offer Views on Why NH Won't Go for School Grants*, THE UNION LEADER, May 16, 1995, at A4 (quoting Charles Marston, former State education commissioner as stating decision not to apply was due to requirement that the State set standards and strategies to "ensure all students receive a fair [educational] opportunity"). A 1996 New Hampshire House Bill mandating the State apply for Goals 2000 funds, however, has won preliminary passage in the New Hampshire legislature. Donn Tibbetts, *Goals 2000 Mandate Wins Key House Vote*, THE UNION LEADER, Feb. 14, 1996, at A1. Even if New Hampshire received federal support, such as through Goals 2000, it would not come close to the \$57 million needed to fully fund Foundation Aid. See N.H. REV. STAT. ANN. § 198:27 (1989 & Supp. 1995).

In addition, significant federal matching aid is available through school building construction aid programs. See N.H. REV. STAT. ANN. § 198:15-g (1989). These federal funds, however, are dependent on yearly appropriations. Telephone Interview with William Porter, Administrator, Office of School Building Aid, New Hampshire Department of Education (Sept. 22, 1995). The significance of this aid depends on how much the school district contributes. In this regard, the school building aid is not equalizing aid. If property-poor school districts are unable to raise revenue to build a new school, they are unable to reap the maximum benefit from the federal matching school building aid. *Id.*

52. See Steven D. Gold & Sarah Ritchie, *State Governments and Local Fiscal Trends*, ROCKEFELLER INST. BULL., 1993, at 60 (discussing recent intergovernmental developments of fend-for-yourself federalism and de facto federalism).

53. Sandra Sobieraj, *House Begins Reform, Axes Commission*, THE UNION LEADER, May 16, 1995, at A4.

the State chooses to fund education with these revenues. Finally, it assesses taxpayer inequities created by New Hampshire's heavy reliance on the property tax.

A. *History of Property Taxation in New Hampshire*

To assess the proper role of the property tax in funding adequate education in New Hampshire, a historical overview of New Hampshire's tax policy is necessary. When this tax was first enacted, it proportionally measured a taxpayer's ability to pay.⁵⁴ The property tax was a good measure of both annual income and long-term wealth as both were directly tied to land ownership.⁵⁵ The property owner of valuable farmland had greater income to pay more taxes than did the owner of lesser-valued land.⁵⁶ Additionally, in the colonial agrarian society, real estate was put to a fairly homogeneous use,⁵⁷ and thus taxpayers derived similar rates of income.⁵⁸ Consequently, the property tax was equitable because the tax was responsive to the varying abilities of property owners to pay taxes. Property tax directly related to income and long-term wealth, because the most valuable farmland or wharf was likely to yield the most income.⁵⁹ The property tax was thus proportional to wealth and complied with the New Hampshire constitutional mandate that assessments be "proportional

54. When the property tax was first implemented in New Hampshire, it was assessed against a person's wealth as measured by both real and personal property. PETER LOUGHLIN, *NEW HAMPSHIRE PRACTICE—MUNICIPAL LAW AND TAXATION* § 6.03 (1993). A tax was assessed on the general inventory of polls (typically adult males 16 years or older) and ratable estate (real and personal property). "[T]he inventory consisted of polls, specified articles of general property and 'faculty.'" *Id.* The Act of 1680 taxed "[p]olls 16 years and upwards, . . . all land within fence, meadow or marsh, mowable . . . all oxen . . . steer, cows . . . heifers . . . yearlings . . . horses . . . mares . . . sheep . . . swine of specified ages." *Id.* (citing ROBINSON, *A HISTORY OF TAXATION IN NEW HAMPSHIRE* 25 (1902)).

55. *History of School Finance and the Property Tax in New Hampshire*, in *PUBLIC SCHOOLS, TAXES, AND YOU* 4-5 (Roland Kimball ed., 1979) [hereinafter *History of School Finance*].

56. *Id.*

57. See RONALD JAGER & GRACE JAGER, *NEW HAMPSHIRE: AN ILLUSTRATED HISTORY OF THE GRANITE STATE* 83 (1983) (discussing use of the land for timber and for agriculture). Governor Benjamin Pierce characterized the pre-1800 lifestyle as "self-sustaining husbandry." *Id.* at 31. The key to colonial development was the farm and the barter system. *Id.* Most members of the society drew much if not all of their subsistence from their land, livestock and farming tools, or from ships, warehouses, wharfs, and stock in trade in Portsmouth's commercial port. Charles E. Clark, *The History of Taxation in New Hampshire*, in *THE FUTURE OF TAX POLICY IN NEW HAMPSHIRE* 1-2 (on file with author).

58. *History of School Finance*, *supra* note 55, at 5.

59. See *id.* at 4-5.

and reasonable."⁶⁰ Administration of this early property tax was simple because property "was easily accounted for, almost impossible to conceal, and readily assessable."⁶¹

Over the years, the homogeneity of our early agricultural economy declined as the Industrial Revolution modernized New Hampshire's economy.⁶² Personal property wealth grew to include intangible property such as stock in modern business corporations.⁶³ The early personal property categories, such as livestock, were also eliminated from the determination of taxable wealth.⁶⁴ As a result of these developments, "the fit between wealth and income and tax liability began to slip."⁶⁵

In 1874, the legislature appointed a commission to establish an equal system of taxation.⁶⁶ In an effort to encourage the continued development of manufacturing, the commission recommended that a tax be assessed only on real property and not on machinery, materials, or capital invested in personal property.⁶⁷ The commission also recommended that the State enact other taxes to raise revenue. These included a business profits tax, a rooms and meals tax, and social taxes on alehouses and pool parlors.⁶⁸ Some of these taxes are still present in New Hampshire's current tax structure.

B. Current Revenue Sources in New Hampshire

New Hampshire derives its revenue from an assortment of taxes. Some taxes, such as the property tax, the rooms and meals tax, and interest and dividend taxes, are intended solely to raise revenue. Other taxes, such as those on liquor, beer, tobacco, and dog racing, are of the type commonly referred to as "sin taxes." Over the years, sin taxes have

60. N.H. CONST. pt. 2, art. 5. See also *American Auto. Ass'n v. State*, 618 A.2d 844, 845 (N.H. 1992) (finding a tax is an enforced contribution to raise revenue and not to reimburse the State for special services; under the State Constitution, it must be proportional and reasonable, that is, equal in valuation and uniform in rate, and just).

61. Clark, *supra* note 57, at 2.

62. JAGER & JAGER, *supra* note 57, at 83-84.

63. The Business Corporation Act was not enacted until 1981; however, historical footnotes to the statutes cite cases recognizing corporations in the early 1800s. See, e.g., *Lumbard v. Aldrich*, 8 N.H. 31 (1835) (recognizing foreign corporation in New Hampshire); N.H. REV. STAT. ANN. § 293-A (1987 & Supp. 1995) (Business Corporations Act).

64. Compare LOUGHLIN, *supra* note 54, at § 6.03 (reporting that early taxable property included livestock) with N.H. REV. STAT. ANN. § 72:6 (1991) (taxing only real property).

65. *History of School Finance*, *supra* note 55, at 5.

66. Clark, *supra* note 57, at 6.

67. *Id.*

68. *Id.*

evolved to become a relatively large source of revenue for New Hampshire. In 1994, New Hampshire generated revenue at the State and local level from the following sources:

Local Property Taxes (56.2%)	Board & Care/Medicaid (12.6%)
Rooms & Meals (8.8%)	Business Profits (4.4%)
Gas Tax (4.02%)	Liquor (2.5%)
Insurance (1.7%)	Tobacco (1.7%)
Other (1.6%)	Uncompensated Pool (1.6%)
Interest & Dividends (1.4%)	Estate & Legacy (1.3%)
Telecommunication (1.2%)	Real Estate Transfer (1.1%)
Business Enterprise (0.9%)	Court Fines & Fees (0.8%)
Utilities (0.8%)	Securities Revenue (0.5%)
Beer (0.4%)	Parks Income (0.2%)
Dog Racing (0.1%)	Horse Racing (0.1%). ⁶⁹

Numerous lessons may be extracted from this data. New Hampshire's revenue statistics visibly illustrate the prominent role the property tax plays in the State's revenue-raising landscape. The property tax is four and one half times larger than the next largest reported revenue source—Medicaid. Medicaid, however, has been the target of federal budget cuts and is an unreliable revenue source.⁷⁰ Removing Medicaid revenues from the analysis reveals that the second largest revenue source is really the rooms and meals tax. Revenues generated by the local property tax, the largest source, are roughly six times larger than revenues generated by the State rooms and meals tax.

Aside from demonstrating the largest revenue sources, this data illustrates that the remaining revenue sources individually generate relatively insignificant revenues. Aside from the property tax, Medicaid, and the rooms and meals tax, all other revenue sources provide between .1% and 4.4% of New Hampshire's total revenues. According to the fiscal year 1994 Annual Report, New Hampshire received \$1.12 billion from all taxes.⁷¹ These taxes partially support education since revenues

69. NEW HAMPSHIRE DEPARTMENT OF ADMINISTRATIVE SERVICES, COMPREHENSIVE ANNUAL FINANCIAL REPORT 97 (1994) [hereinafter ANNUAL FINANCIAL REPORT].

70. See Dan Morgan, *Medicaid Windfall Cut N.H. Deficit*, WASH. POST, Feb. 28, 1993, at A1, A6; see also Neal Kurk, *Weare In The House*, MTN. VALLEY ECHO, June 1995, at 26 (noting that reduction in federal "Mediscam" money will result in budget cuts at the State level which could, in turn, place the burden of funding human services on local property taxes). New Hampshire attempted to recoup this loss in Medicaid revenue by enacting a special tax on the gross patient services revenue of every hospital. N.H. REV. STAT. ANN. § 84-A:2 (Supp. 1995).

71. See ANNUAL FINANCIAL REPORT, *supra* note 69, at 97.

from the general fund, in addition to the sweepstakes revenue, contribute to the State's supplemental education fund, Foundation Aid.⁷² Despite yearly increases in sweepstakes gross revenue,⁷³ the current revenue structure has been unable to fully fund Foundation Aid.⁷⁴

The contribution to education from New Hampshire's state revenue sources must be placed in perspective. In the 1990-91 school year, the national median state contribution to public education was 47.4% of the total cost of education.⁷⁵ Hawaii contributed an exceptional 90% toward public education.⁷⁶ New Hampshire was the lowest contributing state, providing approximately 8% of the total funding for public education.⁷⁷ The second lowest state contributor, South Dakota, paid 26%.⁷⁸ The remainder of the cost of public education in New Hampshire was borne by local property taxes and federal funds, approximately 89% and 3% respectively.⁷⁹ At the local level, the cost of education comprised, on average, 64.1% of a town's total property tax assessment.⁸⁰ These statistics illustrate the fact that New Hampshire's largest revenue source is the local property tax. This heavy reliance on local property taxes bears the dubious distinction of being the highest in the country.⁸¹ Property tax

72. See *infra* Part II.C. for a discussion of Foundation Aid.

73. NEW HAMPSHIRE SWEEPSTAKES COMMISSION, SIGNS OF SUCCESS: 1995 ANNUAL REPORT (1995). Adjusted gross revenues for the past five years were: 1991, \$99,724,543; 1992, \$106,530,552; 1993, \$106,587,945; 1994, \$112,118,195; and 1995, \$143,474,699. *Id.*

74. *Id.* In Fiscal Year 1995, the Sweepstakes Commission transferred \$43,642,614 to the education fund. *Id.* See also N.H. REV. STAT. ANN. § 198:30 (1989) (adjusting the formula when the amount of the computed distribution is less than the amount of funds actually appropriated for distribution under the formula).

75. Terry Whitney, *School Funding Alternatives*, NCSL LEGISBRIEF, June 1994, at 1.

76. *Id.*

77. *Id.* Also, in 1992-93, the state aid portion was funded from the following sources: Foundation Aid (48%), business profits tax (22%), School Building Aid (15%), Catastrophic Aid (8%), Area Vocational Aid (5%), and other (2%). See INFORMATION SERVICES, NEW HAMPSHIRE DEPARTMENT OF EDUCATION, SCHOOL DISTRICT REVENUE FROM STATE SOURCES 1992-93 (Sept. 13, 1994). It should be noted that through the distribution of State funds through the Foundation Aid and Special Education Programs, some school districts may receive more aid than 8%.

78. Whitney, *supra* note 75, at 1.

79. *Id.*

80. School costs comprised as little as 29.57% of a town's total assessment (Waterville Valley) and as high as 102.32% (Roxbury). See VALUATIONS, *supra* note 46, at 5.7; DATA BOOKLET, *supra* note 46, at 21, 23-34.

81. Doug Hall et al., *The School Finance/Property Tax Problem*: HB 1260 (Jan. 3, 1994) (document supporting bill in legislature) (on file with author); Steven D. Gold, *School Property Taxes Under Fire*, STATE FISCAL BRIEF, Apr. 1994, at 3. In 1991, New Hampshire had the highest overall property tax burden in the nation. *Property Taxes*, Daily Rep. for Executives, BNA, May 20, 1994, available in LEXIS, BNA Library, DER File (1994 DER 96 d78).

reliance does not create a fair and equitable system to fund an adequate education.

C. Local Property Taxes and Funding for Education

New Hampshire relies heavily on local property taxes to fund public education.⁸² This tax policy presents problems for public schools: In New Hampshire, a taxing district's boundaries are usually coterminous with the school district's boundaries.⁸³ A school district's taxable property wealth is measured by totaling the assessed value of all the real property within the taxing district.⁸⁴ School funding commentators have found that funding for education varies among school districts, because local taxing districts vary in their taxable wealth.⁸⁵ This conclusion is true in New Hampshire. Statistics from the New Hampshire Department of Education comparing school districts by taxable wealth illustrate that school funding varies with property wealth. The property-poor school districts expended, on average, \$1,831.44 less per pupil than the property-wealthy school districts.⁸⁶ At the same time, taxpayers in property-poor districts, on average, paid a higher school tax rate than taxpayers in property-wealthy districts.⁸⁷ The Brookings Institution reports that this phenomenon is not new.⁸⁸ A 1979

82. See *supra* Part II.B.

83. N.H. REV. STAT. ANN. § 194:1 (1989); N.H. REV. STAT. ANN. § 74:1 (1991); N.H. REV. STAT. ANN. § 73:1 (1991).

84. N.H. REV. STAT. ANN. § 74:1.

85. See JONATHAN KOZOL, *SAVAGE INEQUALITIES: CHILDREN IN AMERICA'S SCHOOLS* 55 (1991) (comparing the ability of poor and affluent communities to raise money for education). Even if poor districts tax themselves at rates several times higher than the tax rate in affluent districts, "they are likely to end up with far less money for each child in their schools." *Id.*

86. DATA BOOKLET, *supra* note 46, at 13. The New Hampshire School Boards Association divided school districts into three groups, ranked low to high according to equalized valuation per pupil. In 1992, Pupil Group 1 had less than half the property wealth of Pupil Group 3. *Id.* at 13-14.

	1992 EQUALIZED PROPERTY VALUATION PER PUPIL	1992 SCHOOL TAX PER PUPIL	1992 SCHOOL LOCAL REVENUE PER PUPIL
GROUP 1 (PROPERTY-POOR)	\$227,849.00	\$18.77	\$4277.00
GROUP 2	\$305,528.00	\$17.00	\$5195.00
GROUP 3 (PROPERTY-WEALTHY)	\$587,576.00	\$10.40	\$6108.68

Id.

87. *Id.*

88. See *supra* note 29 and accompanying text.

study conducted by the New Hampshire Center for Educational Field Services concluded that educational opportunities available to New Hampshire students depends on the property wealth of each school district.⁸⁹

If, as these studies suggest, a strong correlation exists between the level of funding and the level of education, then the level of education children receive depends on the funding available in these three school district groups. Property-poor school districts may not be able to raise the funds necessary to provide an adequate education from local property taxes. This may be due to the fact that a smaller tax base with already high tax rates may make taxpayers less tolerant of additional school expenditures. Thus, the property-poor school districts risk failing to provide their children with the adequate public education that the New Hampshire Constitution mandates.

If New Hampshire's present tax and education funding systems remain the same, and if all school districts are required by the New Hampshire Supreme Court to provide their children with an adequate education, similarly situated taxpayers across New Hampshire will bear dramatically different property tax burdens in their effort to provide that education.⁹⁰ Even though taxes within local taxing districts are proportional, the fact that taxpayers across the State may pay disproportionate amounts of taxes for the same education violates a basic notion of tax fairness. This effect would be the same regardless of whether New Hampshire chose to achieve educational adequacy by either increasing funding for Foundation Aid or by granting the money specifically to school districts with low per-pupil expenditures. If left unchanged, inequities within New Hampshire's current tax scheme will only be exacerbated.

New Hampshire has attempted to alleviate the pressure on property taxes to fund education. Since 1985, New Hampshire has provided education funding to property-poor school districts under the Foundation Aid Program.⁹¹ New Hampshire distributes its Foundation Aid funds

89. CENTER FOR EDUCATIONAL FIELD SERVICES, *IS IT FAIR TO YOU? HOW SCHOOLS AND TAXES RELATE TO EDUCATIONAL OPPORTUNITIES IN NEW HAMPSHIRE 2* (1979).

90. See Christopher J. Stracco, *Time To Change School-Funding Source*, 141 N.J. L.J. 1310, 1310 (1995). The New Jersey Supreme Court made the same observation in *Abbott v. Burke*, 575 A.2d 359, 383 (N.J. 1990): "the poorer the district—measured by equalized valuation per pupil, or by other indicators of poverty—the less per pupil expenditure; the poorer and more urban the district, the heavier its municipal property tax, the greater the school tax burden" The New Jersey Supreme Court eventually struck down that State's school funding formula, because it relied too heavily on a tax district's property tax. Stracco, *supra*, at 1310.

91. N.H. REV. STAT. ANN. § 198:27 (1989 & Supp. 1995).

according to a formula known as the Augenblick Formula.⁹² Since it was adopted in 1985, the Formula, which receives its revenues from the sweepstakes and general funds, has not been fully funded.⁹³ The policy of New Hampshire Statute Section 198:27 is to assist the needier school districts in providing an adequate education program.⁹⁴ The Formula distributes aid according to an elaborate calculation which measures the property and income wealth of the tax district in which the school district is located and the amount of funds that the district expects to spend per weighted pupil.⁹⁵ Foundation Aid distribution for fiscal year 1996 totaled \$48,347,869.⁹⁶ For comparison, local property taxes across the State raised \$1.56 billion for public education in 1995.⁹⁷ In the Final Report of the Foundation Aid Formula Study Committee issued December 30, 1992, Foundation Aid was found to be struggling to meet the policy of Section 198:27 to assist poor school districts in educating their children.⁹⁸ The Committee found the Formula was insufficiently funded and as a result only offered financial assistance to the most severely needy districts.⁹⁹ The Committee recommended that the Formula be adequately funded.¹⁰⁰

Recently, New Hampshire sought to increase the amount of revenue distributed through the Foundation Aid Program by instituting a new

92. Jordan Rau, *For Augenblick, Years Pass But The Debate Stays Same*, VALLEY NEWS, Oct. 5, 1994, at A1.

93. *Id.* John Augenblick testified before the Public Education Funding Task Force that his school funding equalization formula was not designed to be partially funded. John Augenblick, Testimony before the Public Education Funding Task Force of the New Hampshire Legislature (Oct. 4, 1994) (notes of testimony on file with author). See also N.H. REV. STAT. ANN. 6:12(a) (1988) (crediting sweepstakes to the sweepstakes special fund); N.H. REV. STAT. ANN. § 284:21-j (1987 & Supp. 1995) (requiring the balance after expenses to be continually appropriated to the Department of Education and distributed according to N.H. REV. STAT. ANN. § 198:27-33 (1989)); N.H. REV. STAT. ANN. § 198:31(II) (1989) (basing portion of payments on sweepstakes revenues).

94. N.H. REV. STAT. ANN. § 198:27(1) (1989 & Supp. 1995).

95. *Id.* § 198:28(IX). A weighted pupil is defined as "a resident pupil who has been assigned to one of the following classifications, based on the [cost of the] type of education the pupil received." *Id.*

96. BUREAU OF INFORMATION SERVICES, NEW HAMPSHIRE DEPARTMENT OF EDUCATION, FOUNDATION AID FY96 AND FULL FUNDING (1995) [hereinafter FOUNDATION AID FY96].

97. DEPARTMENT OF REVENUE ADMINISTRATION, PROPERTY TAX TABLES BY COUNTY: VALUATIONS, TAXES AND TAX RATES, 6, 9, 12, 15, 18, 21, 24, 27 (Feb. 8, 1996) [hereinafter PROPERTY TAX TABLES BY COUNTY].

98. FOUNDATION AID FORMULA STUDY COMMITTEE, FINAL REPORT, at 1 (1992) (Foundation Aid Formula Study Committee established by 1991 N.H. Laws 321).

99. *Id.*

100. *Id.* Whether this Formula will be the solution to providing an adequate public education to all New Hampshire children is still being debated in the New Hampshire Legislature and by parties to the Claremont School District litigation, and is not the subject of this Paper.

sweepstakes source, Powerball.¹⁰¹ When Powerball was first introduced as a potential revenue source, much debate occurred as to whether increased gambling would increase crime in New Hampshire, and, if this risk existed, whether the benefit of funding education in such a manner outweighed the burden of increased crime.¹⁰² In addition to the issue of a possible increase in crime, the Powerball revenue solution had another flaw. The legislation authorizing Powerball estimated revenue of \$4 million after fiscal year 1997,¹⁰³ \$56 million short of the total amount necessary to fully fund Foundation Aid.¹⁰⁴ Powerball is not a complete solution. A development which may further frustrate Powerball revenues from funding public education is that Powerball may be a possible funding source for a new statewide kindergarten program.¹⁰⁵ For this reason, increasing revenues from sweepstakes, such as Powerball, may work as part of a network of revenue raising tools, but sweepstake revenues alone will not relieve the pressure now placed on local property taxes.

The Foundation Aid Program attempts to make adequate education equally available among wealthy and poor school districts by equalizing funding. It does not, however, resolve issues of taxpayer equity caused by the heavy reliance on the local property tax. Despite the existence of this equalizing program, the State's current tax structure still forces some tax districts to choose between: funding adequate education and having higher than average property tax burdens; or having low tax burdens and inadequate education.¹⁰⁶ To date, New Hampshire school districts have been unable to provide equal access to an adequate public education among school districts with an equal tax burden among taxpayers.¹⁰⁷ While this is partially due to the heavy reliance on local property taxes to fund education, it may also be due to the fact that Foundation Aid has not been

101. See *Governor Won't Veto Powerball*, THE UNION LEADER, May 17, 1995, at A1. Governor Steve Merrill states he does not believe in expanded gambling but is willing to expand it because revenues will fund education. *Id.*

102. See *Police Vs. Powerball: NH Police Chiefs Should Be More Selective*, THE UNION LEADER, May 23, 1995, at C1 (editorial disagreeing with New Hampshire Police Chiefs Association's position that increasing gambling will increase crime).

103. N.H. H. 211, 1995 Sess.

104. Rau, *supra* note 92, at A3.

105. M.L. Elrick, *Lawmakers Again Tackle Kindergarten*, CONCORD MONITOR, Dec. 26, 1995, at A1 (noting that the State is looking into possible funding sources in hopes of creating a public kindergarten program).

106. See generally STUDY COMMITTEE, REPORT ON THE FEASIBILITY OF A STATEWIDE PROPERTY TAX TO FUND EDUCATION IN NEW HAMPSHIRE 1-5 (1993) (Study Committee established by 1993 N.H. LAWS 277) [hereinafter STATEWIDE PROPERTY TAX STUDY].

107. See *supra* Part I.

fully funded since its inception.¹⁰⁸ Inability to fund the Program may be a conscious decision or, more probably, may arise from New Hampshire's inability to raise the necessary revenue under its present tax scheme.

Because of the correlation between local property wealth and a school district's ability to raise revenue, the quality of education children receive in that school district can be greatly impacted by the district's property wealth. If a school district can raise large amounts of revenue, then per pupil expenditures are higher and more education can be purchased. If a school district is unable to raise funds for the level of education minimally required by State standards, children in that district will likely receive a lesser education than children from a wealthier district.

In addition to the adverse effect upon schoolchildren, the disparity also raises issues of taxpayer equity. Because of property wealth differences, property owners in wealthy districts often pay lower tax rates than taxpayers in poorer districts, even though the wealthy districts often raise more money per pupil.¹⁰⁹ This compounds the taxpayer inequities among taxing districts because similarly situated taxpayers across New Hampshire will have varying property tax rates in order to fund the minimum threshold of education. Therefore, providing an adequate public education in all school districts necessarily involves addressing property tax equity issues.

D. Inequities Within the Current Property Tax System

The New Hampshire Constitution requires that assessments, rates, and taxes levied upon citizens of the State be "proportional and reasonable."¹¹⁰ This embodies the general philosophy of fairness which underpins the tax system—that taxes should be based on a taxpayer's ability to pay. Wealth is often used as a measure of one's ability to pay. The recognition in New Hampshire that the local property tax no longer accurately reflects a taxpayer's wealth and ability to pay is not new. This issue fueled Governor John G. Winant's hiring of the Brookings Institution to survey New Hampshire's tax structure in 1932;¹¹¹ Governor Hugh Gregg's study

108. See *infra* note 93 and accompanying text.

109. See, e.g., *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 12-13 (1973).

110. N.H. CONST. pt. 2, art. 5.

111. See Clark, *supra* note 57, at 8 (citing THE BROOKINGS INSTITUTION, REPORT ON A SURVEY OF THE ORGANIZATION AND ADMINISTRATION OF THE STATE, COUNTY, AND TOWN GOVERNMENTS OF NEW HAMPSHIRE (1932)). The Institution recommended that New Hampshire adopt a general income tax, finding that an income tax would result in a more equitable tax burden than New Hampshire's excessive reliance on property taxes. It also recommended that New Hampshire adopt a value added tax but not a general sales tax. *Id.*

of New Hampshire's tax structure in 1955; and Governor Walter Peterson's Citizens' Task Force in 1969.¹¹² In 1989, the legislature established the Committee to Study the Revenue Structure in New Hampshire.¹¹³ In December 1990, the Committee reported that public hearing testimony "made it clear that no consensus exist[ed] on either retaining [New Hampshire's] present tax structure, or replacing it with a different structure."¹¹⁴ The Committee concluded that, because the "divergence of opinion [was] so deep," the only credible study of New Hampshire's tax structure would be one performed by an independent organization.¹¹⁵ In 1993, New Hampshire again assessed its tax structure when it contemplated a statewide property tax to fund education.¹¹⁶ The Committee found that a statewide property tax would have a "significant impact on equalizing the tax burden for education throughout New Hampshire."¹¹⁷ In 1996, the legislature introduced two bills to "bring about property tax relief"¹¹⁸ and to establish "a committee to study school property tax elimination."¹¹⁹

Assessing a taxpayer's ability to pay according to ownership of real property continues to draw criticism as an inaccurate measure of wealth. Candidates in the 1994 New Hampshire gubernatorial race offered tax proposals to replace the State's current tax system.¹²⁰ Despite these efforts to seek tax reform, no substantive change in New Hampshire's tax structure has occurred. The importance of education, the increased pressure on New Hampshire's current tax structure to provide funding for

112. *See id.* at 9.

113. 1989 N.H. Laws 199.

114. COMMITTEE TO STUDY THE REVENUE STRUCTURE IN NEW HAMPSHIRE, FINAL REPORT 1 (1990) (Committee established by 1989 N.H. Laws 199).

115. *Id.* at 2.

116. 1993 N.H. Laws 277 (establishing a committee to study the effects and feasibility of a statewide property tax to fund education).

117. STATEWIDE PROPERTY TAX STUDY, *supra* note 106, at 3.

118. N.H. H. Con. Res. 23, 1996 Sess. ("urging the governor and general court to take action to bring about property tax relief").

119. N.H. H. 1387, 1996 Sess. ("establishing a committee to study school property tax elimination").

120. *See, e.g.*, Wayne King, Property Tax Relief & Educational Excellence—The King Plan (1994) (campaign flier) (on file with author) [hereinafter The King Plan]; Fred Bramante, Cut Warren's Property Taxes! (1994) (campaign flier) (on file with author). The King Plan was offered by Democratic gubernatorial candidate Wayne King. Republican gubernatorial candidate Fred Bramante also offered a property tax reform plan. Neither candidate won the gubernatorial race. According to the New Hampshire Secretary of State's Office, Bramante garnered 6623 votes to incumbent Governor Merrill's 68,340 votes in the Republican primary. Wayne King received 79,686 votes to Merrill's 218,134 votes in 1994. DEPARTMENT OF STATE, NEW HAMPSHIRE MANUAL FOR THE GENERAL COURT, No. 54, at 126, 264 (1995).

education, and the fact that revenues are not meeting current projections demonstrate the need to change New Hampshire's tax structure.

I. Horizontal Inequities in New Hampshire's Property Tax System

The history of the local property tax in New Hampshire demonstrates that the State's ability to fully measure the wealth of a taxpayer has diminished.¹²¹ The property tax currently measures only a portion of an individual's wealth—real property.¹²² Because New Hampshire is no longer dominated by a land-based economy, the property tax is an inadequate measure of one's ability to pay.¹²³ Because the property tax is the largest revenue source for New Hampshire's tax districts, only a portion of the taxpayers bear the total tax burden. This tax structure therefore produces horizontal inequities.

The principle of horizontal equity demands that similarly situated taxpayers pay similar amounts of taxes.¹²⁴ In 1994, property taxes generated 56.2%, or \$1.56 billion in revenues, while the interest and dividend tax comprised only 1.4% of revenues, generating \$35.77 million.¹²⁵ The property-owning taxpayer bears a larger share of State and local taxes than the taxpayer with similar wealth in securities. This disparity violates the principle of horizontal equity. The result of this

121. See *supra* Part II.A.

122. N.H. REV. STAT. ANN. § 72:6 (1991); *King Ridge, Inc. v. Town of Sutton*, 340 A.2d 106, 110 (1975). "[T]he apparent legislative policy behind RSA 72:6 [is] to provide local governmental units with broad power to tax real property within their boundaries." *Id.*

123. See *supra* Part II.A.; see also CENSUS BUREAU, U.S. DEPARTMENT OF COMMERCE, PUB. NO. CPH-3-31, 1990 CENSUS OF POPULATION AND HOUSING, OUTSIDE METROPOLITAN AREAS: NEW HAMPSHIRE 36 (1990) (28.2% of the housing units in New Hampshire were not owner-occupied).

124. Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 580 (1986). In New Hampshire, for instance, if one taxpayer owns \$100,000 worth of real property and another taxpayer in the same tax district owns \$100,000 worth of securities, these individuals will not bear similar tax burdens. Only the taxpayer owning the real property will bear the property tax burden despite the fact that both taxpayers have equal wealth and thus ability to pay. Under this example, the holder of securities will be taxed under New Hampshire's interest and dividends tax. N.H. REV. STAT. ANN. § 77:3 (1991). This statute, however, is the subject of a constitutional challenge. Plaintiffs in the New Hampshire case of *Smith v. Dep't of Revenue Admin.*, No. 95-852, argue that Section 77 violates the Commerce Clause or Equal Protection Clause of the United States Constitution because it exempts interest earned in banks in New Hampshire and Vermont and certain dividends paid by New Hampshire banks. *New Hampshire Supreme Court, Cases Accepted, December 1995*, NEW HAMPSHIRE BAR NEWS, Jan. 17, 1996, at 25. Because this tax is collected at the State level and deposited into the general fund, which only partially supports the Augenblick Formula, it does not directly support local expenditures such as public education. See generally ANNUAL FINANCIAL REPORT, *supra* note 69, at 97.

125. ANNUAL FINANCIAL REPORT, *supra* note 69, at 97; PROPERTY TAX TABLES BY COUNTY, *supra* note 98, at 6, 9, 12, 15, 18, 21, 24, 27.

disparity is that the taxpayer owning no real property almost entirely escapes paying for public education. The system's inherent inequities are magnified because the local property tax does not measure a taxpayer's current ability to pay. In today's economy, the original equitable nature of the property tax system is lost. Additionally, not all land is put to similar use; thus real estate does not generate uniform income.¹²⁶

Horizontal inequities also exist between taxing districts. When properties of similar value are compared throughout New Hampshire, some taxpayers pay considerably more property taxes than taxpayers in neighboring districts.¹²⁷ This occurs despite the fact that the taxpayers have the same equalized property value.¹²⁸ An example of this inequity can be seen by comparing homes in the resort town of Alton with similar homes in Farmington, twenty miles away. The Alton homeowner pays property taxes at a rate of \$8 per \$1000.¹²⁹ Although their homes are given the same property values, the Farmington homeowner pays three times the Alton assessment because of the local tax structure.¹³⁰

A comparison made in a political pamphlet distributed during the 1994 New Hampshire gubernatorial campaign illustrates the wide gulf between wealthy and poor taxing districts.¹³¹ The pamphlet compared property tax paid in two different tax districts.¹³² One home had an assessed value of \$84,700 and the other home was valued at \$368,600, yet

126. This recognition that not all land produces the same amount of current income fueled development of alternative taxing categories. New Hampshire, like many states, has enacted a Current Use Program which exempts low income producing farmlands and undeveloped lands from being taxed at their highest and best use and taxes them according to the income they generate. N.H. REV. STAT. ANN. § 79-A (Supp. 1995). New Hampshire law states that "[i]t is further declared to be in the public interest to prevent the loss of open space due to property taxation of values incompatible with open space usage." *Id.* § 79-A:1 (1994) (Declaration of Public Interest). Vermont has also recognized that not all property generates the same current income. See VERMONT DEPARTMENT OF TAXES, DIVISION OF PROPERTY VALUATION AND REVIEW: ANNUAL REPORT 40 (1995) [hereinafter VT. TAX REPORT]. Vermont's Current Use Program goal includes "achiev[ing] greater equity in property taxation on undeveloped land." *Id.*

127. Frances A. Burns, UPI, June 8, 1995, available in LEXIS, Nexis Library, UPI File.

128. Except for property assessed at current-use value, real property in New Hampshire must be assessed at full and true value. Full value assessment makes property taxes uniform within a taxing district for property of equal value. CAMPBELL & CAMPBELL, *supra* note 43, at 10.

129. Burns, *supra* note 127.

130. *Id.*

131. THE KING PROPERTY TAX RELIEF PLAN, KING FOR GOVERNOR (1994) (campaign flier) (on file with author) [hereinafter THE KING PROPERTY TAX RELIEF PLAN]; see also The King Plan, *supra* note 120, at 10.

132. THE KING PROPERTY TAX RELIEF PLAN, *supra* note 131.

both homeowners paid similar amounts in property taxes.¹³³ Regardless of whether these examples violate New Hampshire's constitutional mandate that taxes, rates, and assessments be "proportional and reasonable,"¹³⁴ they confirm the conclusion that New Hampshire's present property tax scheme is inequitable.

Varying local school tax rates between districts also result in inequities among similarly situated taxpayers.¹³⁵ The total cost of education to the school district divided by the sum of the taxing district's taxable property comprises the school tax rate.¹³⁶ Property-wealthy school districts usually have lower tax rates, but are still likely to collect more revenue simply because they have a larger property base and spend more per capita for public education than less wealthy districts.¹³⁷ A decade ago, analyses of property tax rates and revenues raised for education found that tax rates were twice as high in property-poor districts than in property-wealthy districts.¹³⁸ Yet these poor districts raised one-third less revenue per pupil than their property-wealthy neighbors.¹³⁹ This is still true today.¹⁴⁰ This variation in school tax rates among similarly situated taxpayers may result in significantly fewer educational opportunities in property-poor school districts.

133. *Id.* Proponents of New Hampshire's current property tax system claim that applying lower property tax rates to the higher priced home is justified and equitable because the homeowner already paid his or her fair share of municipal services by paying more for the property initially. See generally State's Mem. of Law in Objection to Pet'r's Mot. for Partial Summ. J., at 6, 17, *Claremont Sch. Dist. v. Governor*, 635 A.2d 1375 (N.H. 1993) (No. 91-E-00306-B). Under this analysis, the tax burden includes not only the property tax rate currently being paid, but also the initial cost of the higher priced home. It appears that proponents view paying more for property and enjoying the subsequent lower tax rates as equivalent to paying less for property initially and paying higher property tax rates later.

134. N.H. CONST. pt. 2, art. 5. This issue is the subject of the *Claremont School District* litigation which has yet to be resolved. See *Claremont Sch. Dist.*, 635 A.2d 1375 (N.H. 1993) (remanded for further proceedings).

135. Gary Rayno, *When True Comparisons Are Made Rochester Taxes Among Highest*, FOSTER'S DAILY DEMOCRAT, June 13, 1995, at A1, A12 (illustrating Town of Newington's estimated full value tax rate to be \$4.13 per \$1000 property value while City of Rochester's rate is estimated at \$34.14 per \$1000 property value).

136. N.H. REV. STAT. ANN. § 198:1-2 (1989 & Supp. 1995); N.H. REV. STAT. ANN. § 21-I:15 (III) (1988 & Supp. 1995). Municipal Services adjusts a town's actual school appropriations to take into consideration funding from other sources, such as other school districts, the School Building Aid Program, and Foundation Aid. Telephone Interview with Donald Borrer, Auditor with Municipal Services, New Hampshire Department of Revenue Administration, Apr. 3, 1996. This amount is divided by the taxable valuations and then multiplied by 1000 to get the tax rate. *Id.*

137. *History of School Finance*, *supra* note 55, at 7.

138. *Id.* at 9.

139. *Id.*

140. Hall et al., *supra* note 81, at 3.

The impacts stemming from variations in local property tax rates become exacerbated when property-wealthy districts attract valuable commercial, industrial, and residential properties through appealingly low tax rates.¹⁴¹ This can cause some communities to suffer a competitive disadvantage in attracting investment capital.¹⁴² Low tax rates may not be the sole factor attracting increased development in property-wealthy districts. However, to the extent that low tax rates have such an effect, it is a quality that adds strength to the argument that taxes or tax rates should not play a significant role in business decisions.¹⁴³ As a result of the disparities in local property tax rates, wealthy districts also get wealthier while poor districts get poorer.¹⁴⁴ If low property tax rates act as an incentive for businesses to cluster in those areas, tax rate imbalances among districts will be further exacerbated.¹⁴⁵ Towns with low tax rates will spread the tax burden among even more taxpayers while towns with high tax rates will be required to spread the tax burden among fewer taxpayers.¹⁴⁶

If New Hampshire's property-poor school districts raise school tax rates to increase revenues for adequate education, tax rate imbalances will be compounded. Taxpayers owning similar property in different school districts in New Hampshire will thus pay different tax amounts for the same adequate education. This inequity demands property tax reform.

141. Based on calculations from New Hampshire Department of Revenue Administration Equalization Surveys, from 1984 to 1989 the property-rich town of Amherst and the property-poor town of Claremont both enjoyed growth in taxable property wealth and corresponding lower tax rates. APPRAISAL DIVISION, NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION, 1984 EQUALIZATION SURVEYS 8, 12 (1985) (individual documents for each year) [hereinafter EQ. SURV.]; 1985 EQ. SURV. 8, 12; 1986 EQ. SURV. 8, 12; 1987 EQ. SURV. 8, 12; 1988 EQ. SURV. 11, 17; 1989 EQ. SURV. 14, 20. During the recession, 1990 to 1994, however, property wealth declined more rapidly in Claremont than in Amherst and property tax rates increased at a faster rate in Claremont than in Amherst. 1990 EQ. SURV. 14, 20; 1991 EQ. SURV.; 1992 EQ. SURV.; 1993 EQ. SURV.; 1994 EQ. SURV. At the same time, per pupil expenditures increased at a faster rate in Amherst than in Claremont. *Id.* In 1984, both districts paid approximately \$2,270 per pupil and in 1993, that figure was \$5,419 in Claremont and \$5,834 in Amherst. 1984 EQ. SURV. 8, 12; 1993 EQ. SURV.

142. HENRY J. AARON, TAX CHANGE IN NEW HAMPSHIRE: THE PROPERTY TAX VERSUS ALTERNATIVES 7 [HEREINAFTER TAX CHANGE IN NEW HAMPSHIRE] (on file with author).

143. *Treasury Tax Reform Study*, TAX NOTES TODAY (Dec. 24, 1984) (economic neutrality is generally viewed as a desirable objective of tax policy).

144. *History of School Finance*, *supra* note 55, at 11; *see also* TAX CHANGE IN NEW HAMPSHIRE, *supra* note 142, at 7.

145. *See* Paul D. Ballew et al., *School Reform and Tax Reform: A Successful Marriage?*, GOV. FIN. REV., Aug. 1994, at 32, 34 (noting that Michigan's economic decline was caused by the high cost of doing business in the State, which was driven, at least in part, by high property taxes).

146. *Id.* at 34.

2. Vertical Inequities in New Hampshire's Property Tax System

The current local property tax system in New Hampshire also contributes to vertical inequities. The principle of vertical equity refers to the distribution of costs and benefits across different income groups.¹⁴⁷ When comparing the total tax burden of low-income and high-income taxpayers, as measured by percent of personal income, low-income taxpayers bear a larger proportion of the total tax burden than high-income taxpayers.¹⁴⁸ The tax burden is not proportional to their ability to pay.

The property tax burdens lower income households disproportionately.¹⁴⁹ Property and state income taxes comprise 9.3% of income for the poorest 20% of New Hampshire households, while property and state income taxes comprise only 2.9% of income for the wealthiest 1% of New Hampshire households.¹⁵⁰ The average property and state income tax burden in the United States is 3.5% of income.¹⁵¹ As income decreases, the percentage of income devoted to property taxes increases. Some commentators view a property tax scheme as defective if its burden falls more heavily on households with below-average income.¹⁵² New Hampshire's tax scheme would be considered defective under this standard. Although homeowners are allowed to deduct local property taxes paid during a taxable year from gross income for federal income tax purposes, this only partially alleviates the inequity in tax burdens.¹⁵³

147. Kaplow, *supra* note 124, at 580.

148. Hall et al., *supra* note 81, at 6. A tax burden can be measured in several ways: amount per capita, percentage of personal income paid in property taxes, or ratio of property taxes to the market value of property. CAMPBELL & CAMPBELL, *supra* note 43, at 7. Some economists note, however, that difficulties exist with such comparisons.

The principal difficulty in using the ratio of property taxes to personal income to compare the burden of the property tax in different states is that while the data for personal income are for the residents of the State, a portion of the property taxes may be paid by nonresidents who have vacation homes in the State. Also, the impact of current use is not known.

Id.

149. Josephine M. LaPlante, *Capping Maine's income tax: Neglected issues and dimensions*, ME. POL'Y REV., Oct. 1995, at 65.

150. Hall et al., *supra* note 81, at 6. The income tax referred to here is the interest and dividends tax.

151. LaPlante, *supra* note 149, at 65. "In 1992, Maine raised 4.5% of personal income as property tax, while the U.S. average was only 3.5%." *Id.*

152. STEVEN D. GOLD, PROPERTY TAX RELIEF 16 (1979) [hereinafter PROPERTY TAX RELIEF].

153. 26 U.S.C. § 164(a)(1) (1986) (allowing a deduction from a taxpayer's gross income of taxes paid on real estate). This only partially alleviates the inequity in tax burden because poor and wealthy taxpayers can both deduct property taxes from their gross income.

Proponents of the property tax counter that because "[annual] income fluctuates for many people, the relationship between property tax and average income measured over several years is a better indicator of the distribution of property tax burdens than is the ratio of property taxes to annual income."¹⁵⁴ If assessments are measured over several years, relative to annual income, the property tax on homeowners "ceases to appear to be regressive."¹⁵⁵ In fact, proponents claim, the impact of the "property tax seems to be roughly proportional to income."¹⁵⁶ Regardless of the validity of this argument, the annual income comparison still justifies property tax reform on public policy grounds. It is not good policy to tell a family with a temporarily depressed income that their inordinately high property tax burdens may decrease over the next few years.¹⁵⁷

Proponents of the property tax also counter that while New Hampshire's property tax burden is the highest in the country, the amount of other taxes collected by New Hampshire is relatively low.¹⁵⁸ Thus, the combined tax burden is less than in other states, producing a favorable economic climate.¹⁵⁹ For example, in 1980 the total combined State and local taxes paid by New Hampshire residents amounted to \$740 per capita, while the national average was \$987 per capita.¹⁶⁰ The assertion, however, that New Hampshire taxpayers pay less in taxes than taxpayers in other states is based on the State's average tax burden, and conceals the vertical inequities demonstrated above.¹⁶¹ While residents of other states may have higher total tax burdens, the inequities may actually be less dramatic because of diversification. States such as Michigan and Connecticut have attempted to minimize the inequities of their tax system by relying on more than one tax as a source of revenue.¹⁶²

154. TAX CHANGE IN NEW HAMPSHIRE, *supra* note 141, at 6.

155. *Id.*

156. *Id.*

157. ALLAN ODDEN & PHILLIP E. VINCENT, THE REGRESSIVITY OF THE PROPERTY TAX: THE INCIDENCE OF THE PROPERTY TAX UNDER ALTERNATIVE ASSUMPTIONS OF INCIDENCE IN FOUR STATES: CONNECTICUT, MINNESOTA, MISSOURI AND SOUTH DAKOTA 7 (1976).

158. Ralph Jimenez, *Economy is top issue in governor's campaign: Optimism vs. pessimism*, BOSTON GLOBE, Oct. 30, 1994, at NH1.

159. MICHAEL A. CONTE, AN ECONOMIST LOOKS AT NEW HAMPSHIRE'S TAXES 4 (1982).

160. *Id.* at 8.

161. Hall et al., *supra* note 81, at 5.

162. James A. Papke, *A Reexamination of the Indiana Tax Structure: Introduction and Overview*, 93 TAX NOTES TODAY 36-38 (Feb. 24, 1993). "By distributing reliance among multiple tax sources, it is argued, the potentially adverse equity, efficiency, and uncertainty effects of excessive dependence on any particular tax are minimized." *Id.*

The argument that New Hampshire's total tax burden is the lowest in the country does not bode well for public education in the State. As previously discussed, the property tax comprises the bulk of New Hampshire's taxes, and education expenses comprise the majority of the local property tax.¹⁶³ Statistics showing that New Hampshire collects fewer taxes than other states illustrate that New Hampshire is either very efficient in using its money or that New Hampshire does not spend much on education. In order to achieve adequate and equal education throughout New Hampshire, State decision-makers must reevaluate the tax policy and redistribute the tax burden in order to achieve greater taxpayer equity.

III. REMEDYING TAXPAYER INEQUITIES THROUGH ALTERNATIVE REVENUE SOURCES

A. The Need to Upgrade an Outmoded Tax System

A reassessment of New Hampshire's revenue sources must be made in order to fully evaluate the future direction of New Hampshire's tax policy. New Hampshire's traditional policy of "no broad-based taxes" entrenches the State's existing tax structure. The phrase should mean no net increase in tax burden and should not foreclose the possibility of equitable redistribution of New Hampshire's tax burden. To achieve taxpayer equity regarding the property tax, reductions in property tax revenues must occur. Any reduction in New Hampshire's heavy dependence on the local property tax will translate into increases in other State revenue sources to make up the difference. In order for New Hampshire to accommodate the additional pressure from an increase in funding for adequate education, the present tax system should be restructured to equalize the tax burden, while taking into consideration an individual's ability to pay. In reassessing how it apportions the tax burden, New Hampshire will need to modernize its tax structure.

State tax systems in this country were established in a vastly different age.¹⁶⁴ In the 1930s, states across the country attempted to modernize their property tax systems by adopting broad-based sales and income taxes.¹⁶⁵ This change arose from the recognition that the United States had become a nation of factory and office workers instead of land-owning

163. See *supra* Parts II.B-II.C.

164. Ronald K. Snell, *Our Outmoded Tax Systems*, STATE LEGISLATURES, Aug. 1994, at 17, 19.

165. *Id.* at 19.

farmers.¹⁶⁶ In 1929, for example, non-farm personal income was ten times greater than farm income.¹⁶⁷ The need to reform New Hampshire's tax structure was studied extensively at that time, though no substantial changes were ever made. New Hampshire's tax scheme has remained dominated by the local property tax while other states have shown a trend of declining reliance on the local property tax.¹⁶⁸ In the absence of leadership at the State level to alleviate taxpayer inequities, some towns are considering innovative ways to address problems associated with high property taxes.¹⁶⁹ The community of Rollinsford recently considered allowing taxpayers to work off their property tax bill through community service.¹⁷⁰

The need to modernize state tax structures is becoming increasingly necessary. Americans generate wealth and spend their income in a dramatically different manner than when the property tax was first introduced.¹⁷¹ Manufacturing is in decline relative to other areas of the economy.¹⁷² In 1975, service industries were a larger share of the gross national product than manufactured goods, and the service sector has continued to grow.¹⁷³ In 1990, as compared to 1960, expenditures on services grew from 25% to 42% of consumer expenditures.¹⁷⁴ This trend is likely to continue.¹⁷⁵ Commentators caution that if states fail to modernize their taxes to take consumer spending into account, tax bases will become even more inequitable and, as tax bases become narrower, taxes will not grow in proportion to economic growth without repeated rate increases.¹⁷⁶ As illustrated previously, significant taxpayer inequities are already occurring under New Hampshire's tax system.¹⁷⁷

166. *Id.*

167. *Id.*

168. TAX CHANGE IN NEW HAMPSHIRE, *supra* note 142, at 4.

169. *Rollinsford May Allow Townspeople To Work Off Property Taxes*, THE UNION LEADER, Dec. 28, 1995, at A1.

170. *Id.*

171. Snell, *supra* note 164, at 17.

172. *Id.* at 19.

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.* at 21.

177. See *supra* Part II.D.

Evidence also suggests New Hampshire's tax structure is not providing the necessary revenues.¹⁷⁸ New Hampshire faced \$20 million in State budget cuts due to the fact that it received \$20 million less in federal Medicaid funds.¹⁷⁹ New Hampshire also faced a \$16 million shortfall in revenues during the first half of fiscal year 1996, mainly because the federal government failed to make Medicare payments to the State.¹⁸⁰ Revenues from New Hampshire's other State taxes were also down: rooms and meals tax, down \$3.5 million; business enterprise tax, down \$2.8 million; miscellaneous taxes and fees, down \$2.4 million; tobacco tax, down \$1.6 million; and liquor revenues, down \$229,000.¹⁸¹ The business profits tax, insurance tax, and utility tax, however, were all up from State estimates.¹⁸²

Other states have addressed taxpayer equity and education funding issues by implementing traditional broad-based income or sales taxes.¹⁸³ In this day and age of dwindling resources, however, it seems more appropriate to reform a tax structure by adopting consumption taxes which can help curb wasteful uses of resources rather than adopting income taxes which tend to discourage savings and investment.

There are several general guidelines to tax reform. First, states should review how changing economic conditions affect state tax structure.¹⁸⁴ Second, states should consider their tax policy systemically rather than as sets of unrelated components,¹⁸⁵ due predominantly to the fact that no single revenue type can provide adequate revenue at all times.¹⁸⁶ Finally, states must evaluate the impact of economic development

178. Garry Rayno, *September Revenues Down for State*, FOSTERS DAILY DEMOCRAT, Oct. 3, 1995, at A1; see also Donn Tibbetts, *State Revenue Dips During October*, THE UNION LEADER, Nov. 2, 1995, at A4.

179. M.L. Elrick, *Lawmakers face red ink reckoning*, CONCORD MONITOR, Jan. 10, 1996, at A1.

180. *Id.* House Finance Committee Chairman Channing Brown stated New Hampshire is still waiting for \$20 million in Medicaid money it had expected from the federal government for last year. *Id.*

181. Donn Tibbetts, *State Revenue Estimates Off \$16.1M After 6 Months*, THE UNION LEADER, Jan. 3, 1996, A9; Charlotte Thibault, *State revenue worries*, CONCORD MONITOR, Jan. 10, 1996, at A6.

182. Tibbetts, *supra* note 181, at A9.

183. See *infra* Parts III.E-III.F.

184. Snell, *supra* note 164, at 22.

185. *Id.*

186. LaPlante, *supra* note 149, at 65. All revenue types vary in their degree of elasticity, that is, their ability to grow with the economy and decline with a downturn. *Id.* A property tax is an example of an inelastic tax, and an income tax would exemplify an elastic tax. Elasticity and fiscal soundness thus require the entire tax structure to be considered holistically.

incentives on the state's tax policies.¹⁸⁷ Ultimately, the Legislature will choose which revenues will best help New Hampshire raise revenue for adequate education. New Hampshire will need to tailor any alternative tax structure to its own needs and tax philosophy. An evaluation of changes to New Hampshire's existing revenue sources is the subject of the remainder of this Paper.¹⁸⁸

Changes in New Hampshire's tax structure may not require across-the-board increases in the tax burden in order to alleviate taxpayer inequities. Any increases in the tax burden will undoubtedly encounter some degree of opposition. The National Conference of State Legislatures recently reported that voters are becoming more selective in the types of tax increases they will support.¹⁸⁹

This conference report also provides some encouragement for New Hampshire. It found that tax initiatives had the most success in passing "when they were part of a package of education reforms and when public explanations were focused on what the public was getting for its money."¹⁹⁰ A 1994 University of New Hampshire poll reached a similar conclusion.¹⁹¹ The poll found that 71% of New Hampshire residents supported increased State spending for education.¹⁹² The poll did not indicate from what source residents believed the added State funding should come.¹⁹³ New Hampshire's 1996 legislation also suggests New Hampshire is ready to address tax reform.¹⁹⁴ One piece of legislation calls

187. See Snell, *supra* note 164, at 22.

188. The constitutionality or adequacy of school equalization formulas distributing the revenues generated under alternative taxing schemes is beyond the scope of this paper.

189. *Moving from Equity to Productivity*, *supra* note 41, at 591.

190. *Id.*

191. See *UNH Poll Finds Unexpected Support For Increase in State Aid to Schools*, THE UNION LEADER, July 16, 1994, at 10.

192. *Id.*

193. See *id.* The support for increased spending on education varied by age group. Although 77% of residents between the ages of 18 and 30 supported higher education expenditures, only 64% of residents 60 or older supported increased funding. *Id.*

194. During the 1996 legislative session, legislation concerning both education and tax reform were introduced. N.H. H. 1387, 1996 Sess. (establishing a committee to study school property tax elimination); N.H. H. 1617, 1996 Sess. (imposing a flat income tax and repealing the commuter tax, business enterprise tax, rooms and meals tax, real estate transfer tax, communication services tax and local property taxes used to fund education); N.H. H. 1216, 1996 Sess. (allowing municipalities to adopt an exemption from property taxes for low income homeowners and repealing the authority to use local property tax revenue to fund education); N.H. H. 1272, 1996 Sess. (changing the basis on which single family homeowners pay property taxes from property value to income); N.H. H. 1191, 1996 Sess. (assessing taxes on earnings from gambling to fund State aid to education); N.H. H. 1452, 1996 Sess. (eliminating the net operating loss deduction from gross business profits); N.H. S. 543, 1996 Sess. (appropriating 7% of the business profits tax revenues to cities and towns). At the same time, another proposed bill would require a vote of 60% of the House and Senate to pass any new tax

for the Governor and General Court to take action to bring about property tax relief.¹⁹⁵ Both the poll results and the proposed legislation suggest that the political climate in New Hampshire is becoming more receptive to tax reform.

The following Parts will detail the characteristics which make taxes equitable. Then, the Paper will explore possible modifications to the property tax and whether these modifications can address taxpayer inequities which are currently a part of the property tax. The Paper will then consider the relationship between local taxing and local control. Finally, this Paper will critique the aspects of broad-based sales and income taxes and assess the appropriateness of such taxes in New Hampshire.

B. Elements of an Equitable Tax System

To alleviate inequities experienced by New Hampshire taxpayers under the current tax system, the State must diversify its tax structure and reduce its heavy reliance on local property taxes. Numerous views exist on what comprises a good tax system,¹⁹⁶ but in general a good tax system is marked by the following characteristics. First, the tax system should be characterized by vertical and horizontal equity.¹⁹⁷ Second, the tax system should promote economic efficiency and should do so neutrally, having as little impact on economic decision-making as possible.¹⁹⁸ Third, the tax structure should be broad-based, reducing individual tax rates by distributing the tax burden over the entire taxpayer population.¹⁹⁹ Finally, the tax system should strive to be productive, providing stable, predictable revenues which grow naturally with expenditures without the need for artificial rate increases.²⁰⁰

or fee. N.H. H. 1245, 1996 Sess. (requiring a 60% vote of each house to pass any new tax or fee, but not for increasing existing ones).

195. N.H. H. Con. Res. 23, 1996 Sess.

196. Tracey A. Kaye, *Sheltering Social Policy In the Tax Code: The Low-Income Housing Credit*, 38 VILL. L. REV. 871, 929-30 (1993). The view that the tax system is a poor vehicle for social policy is probably the dominant opinion among Treasury officials, academic tax lawyers, and tax economists; however, Congress and the Administration use the tax system to encourage economic or social activities. *Id.*

197. Snell, *supra* note 164, at 20.

198. *Id.*

199. *Id.*

200. *Id.* These elements are similar to a list, prepared by John Myers of Augenblick, Van de Water & Myers, of attributes of an equitable school finance system. These attributes include:

3) The allocation of state aid is sensitive to the tax rates of school districts.

To effectively relieve the inequities experienced by New Hampshire taxpayers under the current property tax system, each tax alternative considered should reflect the above criteria. In addition, each alternative should be administratively cost-effective and relatively easy to implement. Otherwise, a large portion of the tax revenues raised will be spent on administration rather than on achieving adequate education.

Progressivity, a form of vertical equity, is generally a desirable quality of a tax structure.²⁰¹ In progressive tax systems, wealthier taxpayers bear more of an individual tax burden than poorer taxpayers.²⁰² The tax rate increases as income rises.²⁰³ Viewing a tax system as a whole, progressivity of one tax can be used to offset the regressivity of another tax.²⁰⁴ New Hampshire's Constitution, however, prohibits achieving this characteristic within any one tax. All taxes levied must be proportional.²⁰⁵ Thus, a progressive tax is unavailable as an alternative in New Hampshire because it would likely be found unconstitutional. Despite this, New Hampshire can still make its tax structure more equitable by achieving the other characteristics of a good tax system.

Because different philosophies exist concerning the purpose of tax structures, taxation is often more than a means of raising revenue.²⁰⁶

- 9) Taxpayers are treated equitably.
 -Property is assessed uniformly.
 -Low income taxpayers are relieved of some of the obligation to pay property taxes.
 -The burden of paying for schools is shared equitably among homeowners and businesses.

- 10) The state has some procedure to define and measure equity and periodically assesses how equitable the school finance system is.

John L. Myers, Outline of Remarks to Vermont Republican Legislators 4-5 (May 17, 1995) (outline on file with author). The last attribute is particularly relevant to New Hampshire's current property tax debate. If New Hampshire had adopted a similar periodic assessment of tax equity, New Hampshire might have updated its tax structure earlier. See *supra* notes 111-17 and accompanying text.

201. See *supra* Part II.D.2.

202. An example of progressivity can be seen in the United States Income Tax section 1 of the Federal Income Tax Code which lists the respective tax rates for varying income brackets. 26 U.S.C. § 1 (1988).

203. *Id.*

204. Snell, *supra* note 164, at 22.

205. N.H. CONST. pt. 2, art. 5. See also *Boston, C. & M. R.R. v. State*, 60 N.H. 87, 95 (1880). "Taxation requires a uniform valuation and a uniform rate But the rule of uniformity is coextensive with the territory to which a tax applies, and prevents unjust discrimination. A state tax must be uniform throughout the state, a county tax throughout the county, a town tax throughout a town." *Id.*

206. Ronald M. Green, *Ethical Issues In Taxation*, in THE FUTURE OF TAX POLICY IN NEW HAMPSHIRE 17 (on file with author).

Taxation can also involve moral issues concerning social values, fairness, and justice.²⁰⁷ As a result of the social nature of taxes, competing moral issues must be balanced. Many people believe that "society has a responsibility for promoting social justice and for reducing undesirable economic inequalities among its citizens."²⁰⁸ This social attitude is often referred to as distributive justice.²⁰⁹ Far from being economically neutral, taxation is often invoked as a convenient means of promoting this end.²¹⁰ Because the legislature represents the people and prevailing public sentiment, such a balancing of social agendas is best made by the legislature rather than the executive branch or the courts.

C. Modifications to the Property Tax

New Hampshire's history illustrates that numerous efforts have been made to reform its heavy reliance on the local property tax.²¹¹

Every public opinion poll which compares the property tax with other state and local taxes consistently indicates that the property tax is the most disliked, considered least fair, and dubbed most onerous. As one economist put it, "if any tax could have been eliminated by adverse criticism, the general property tax should have been eliminated long ago. One searches in vain for one of its friends to defend it intelligently."²¹²

Despite public criticism, proponents of the property tax contend that inequities between property-poor and property-wealthy school districts are caused by reliance on local taxes, not dependence on the local property tax per se.²¹³ These proponents further argue that, "[i]f local income or sales

207. *Id.* For example, New Hampshire is contemplating raising its tobacco tax to discourage smoking. N.H. H. 1517, 1996 Sess.

208. Green, *supra* note 206, at 17.

209. *Id.*

210. *Id.*

211. See *supra* notes 111-19 and accompanying text.

212. *History of School Finance*, *supra* note 55, at 6. This comment was made "in 1931 when the property tax burden was but a fraction of what it is today." *Id.* A 1976 study conducted by the Education Finance Center showed that the property tax produces marked regressivity for incomes below \$15,000. ODDEN & VINCENT, *supra* note 157, at 25. The study also concluded that the property tax is probably regressive at median income levels as well. *Id.* The authors of the study urged states to continue enacting property tax relief programs aimed at reducing the regressivity which persists at low-income households: *Id.* at 25-26.

213. PROPERTY TAX RELIEF, *supra* note 152, at 1.

taxes were substituted for property taxes, inequalities in local tax bases would be even greater."²¹⁴

Consistent with this viewpoint, the property tax has at least two favorable attributes. First, the property tax grows with the state's population and inflation.²¹⁵ Natural growth is desirable because, without it, tax rates must continually increase even when real per capita expenditures do not.²¹⁶ Second, property taxes are said to be the most stable of all revenue sources.²¹⁷ Stability is one of the elements which characterizes a good tax structure,²¹⁸ and "as a steady stream of revenues, and as a basis for sound county and municipal bond ratings, nothing has adequately replaced [the property tax]."²¹⁹ Unfortunately, although this stability is beneficial to the state, taxpayer liability does not change if a taxpayer loses his or her job. In this regard, stability is achieved without measuring a taxpayer's current ability to pay. Although the property tax has defects, proponents argue that it should be repaired rather than replaced.²²⁰ This would not only retain the economic advantage of having no broad-based sales or income taxes, but would also alleviate taxpayer inequities while raising revenue for public education.

1. Expanding the Scope of the Current Property Tax

a. Inclusion of Personal and Real Property

Because New Hampshire's property tax rates are already high, increasing the property tax to generate the revenue necessary for public education is politically unlikely. Broadening the scope of the property tax would alleviate current inequities among taxpayers and any future inequities caused by increased funding for education. Currently, New

214. *Id.*

215. CONTE, *supra* note 159, at 9.

216. *Id.*

217. Scott Mackey, *The Property Tax Predicament*, STATE LEGISLATURES, Aug. 1994, at 24. See also Donn Tibbetts, *Governor Challenges 'Myths' About NH Education Funding*, THE UNION LEADER, July 16, 1994, at 10 (noting that the property tax is more resistant to recession than other taxes).

218. CONTE, *supra* note 159, at 4.

219. Carl Horowitz, *Property Tax In Full Retreat?*, INVESTOR'S BUSINESS DAILY, Apr. 7, 1994, at 1 (quoting Philip Dearborn, Director of Government Finance Research for the U.S. Advisory Commission on Intergovernmental Relations).

220. PROPERTY TAX RELIEF, *supra* note 152, at 17.

Hampshire taxes all real property unless exempted by statute.²²¹ As an alternative, the property tax could be extended to include personal property. If the property tax is intended to fairly measure a taxpayer's ability to pay, arbitrary exclusion of certain property, such as specific real property, business inventories, and personal property, should be avoided since landholdings alone do not represent taxpayer wealth completely. Basing a tax on a taxpayer's total property, real and personal, provides a more accurate measure of wealth and ability to pay.

Expanding the definition of taxable property to include personal property creates enforcement difficulties. By requiring registration of real property in the land records, recording acts simplify the determination of real property wealth.²²² Although all states require registration of large items of personal property, such as automobiles,²²³ identifying other personal property wealth is difficult and can lead to greater administrative costs than other revenue alternatives.

If New Hampshire modified the property tax to include all property it would also overlook certain public policies advanced by the property tax. For example, current use programs attempt to preserve open space and provide taxpayer relief.²²⁴ The New Hampshire Supreme Court has permitted the exemptions of certain types of property, holding that the inequality caused by taxing some property and not taxing other property is permitted.²²⁵ This position represents an application of public policy but is adverse to the notion that every taxpayer should be taxed in proportion to wealth and ability to pay. If the property tax applied to all property, the current use exemption for open space, and the policy behind it, would be lost and may be impossible to replicate through other revenue alternatives.

Expansion of the property tax to include those categories of real property previously exempted from full taxation also raises issues of fairness to the owners of exempted property. Individuals often buy

221. N.H. REV. STAT. ANN. § 72:6 (1991). An effort was made in 1957 to increase taxable property. 1957 N.H. Laws 202:1. The property tax is assessed against buildings, mills, wharves, ferries, toll bridges, locks, canals, and aqueducts owned by private entities. N.H. REV. STAT. ANN. § 72:7 (1989).

222. N.H. REV. STAT. ANN. § 477:3-a (requiring every deed or other conveyance of real estate be recorded at length in the county registry).

223. N.H. REV. STAT. ANN. § 261:40 (1993) (requiring registration of motor vehicles).

224. N.H. REV. STAT. ANN. § 79-A:1 (Supp. 1994).

225. *In re* Opinion of the Justices, 138 A. 284, 289 (N.H. 1927).

property because it is eligible for exempt status.²²⁶ Exemptions are both general; for property devoted to the same general purpose as public property, and special, for property used for religious purposes.²²⁷ Expansion of the property tax to include previously exempted property could be disruptive to owners of these properties who may not have a current ability to pay. If New Hampshire finds it necessary to expand the property tax to all real property, it would need to minimize the adverse effects on previously exempted taxpayers. To this end, any inclusion of previously exempted property should be made gradually.

b. Net Wealth Approach

A more subjective tax reform alternative to alleviating property tax inequities is to tax according to the taxpayer's net property wealth. The property tax has been criticized because it falls predominantly on gross holdings of real property and fails to consider encumbrances which reduce that wealth.²²⁸ For this reason, a taxpayer's net wealth may be a better measure of the ability to pay.²²⁹ Because the current property tax system measures gross wealth and not net holdings, taxpayers with equal net worth may face vastly different property tax liabilities. For example, an owner of real property unencumbered by a mortgage has more equity, and thus more wealth, than the owner of identical, encumbered real property. Both owners, however, will incur the same property tax liability. A property tax on net, rather than gross, property value will alleviate some of the horizontal inequities illustrated.²³⁰

Before enacting a net wealth tax, difficult issues must be addressed. A tax on net wealth might encourage taxpayers to increase personal expenditures to avoid the tax. This avoidance would result in less State revenue. This difficulty could be alleviated by supplementing the net wealth tax with a sales or consumption tax. If net assets are defined to include personal property, administrative and enforcement difficulties are

226. WHO PAYS THE PROPERTY TAX?, *supra* note 51, at 81 (citing ALFRED BALK, THE FREE LIST: PROPERTY WITHOUT TAXES 10-19 (1971)). In 1994, 2.8 million acres in New Hampshire were exempted under current use. Telephone Interview with Linda Kennedy, Equalization Supervisor, New Hampshire Department of Revenue Administration (Apr. 15, 1996). This represents about 49% of the total acres in the State, but the percentage would be much higher if compared only to the taxable acres in the State. *Id.*

227. LOUGHLIN, *supra* note 54, at § 6.07. In provincial days, the church was regarded as a public institution. *Id.*

228. See WHO PAYS THE PROPERTY TAX?, *supra* note 51, at 90.

229. *Id.*

230. See *supra* Part II.D.1.

likely to arise. Because personal property, unlike real property, is not generally recorded in state or local records, identification of personal assets is infeasible and enforcement of the tax would be very difficult. The utility of a net wealth tax as an alternative to New Hampshire's heavy reliance on local property taxes will depend, in large part, upon resolution of these difficult issues.

c. Increasing Frequency of Assessments

Another potential reform to the property tax which may alleviate taxpayer inequity is increasing the frequency with which property is assessed at fair market value. If the property tax is to fall equally on all property, accurate appraisals of property values are essential.²³¹ Currently, property assessments change slowly, which results in inaccurate valuations. This inaccuracy results from the length of time it takes for the appreciation and depreciation of property values to work through the complicated assessment system.²³² Dissimilar valuations can result when one home is assessed at fair market value during a town's assessment and a second home, built a few years later, is assessed at a value comparable to the first. Although the two homes have the same assessed value, the possible increase or decrease in value of the first home is not recognized. Much of the property tax inequity between similarly situated taxpayers in the same tax district is caused by inaccurate assessments.²³³ According to a 1976 U.S. Census Bureau survey, assessment ratios differed by as much as 20% from the median assessment ratio.²³⁴ Increasing the frequency of property assessments would eliminate some of the inequities caused by unequally assessed property within a tax district.

New Hampshire's neighbor, Vermont, has successfully implemented a program to encourage frequent assessments. Vermont law requires property to be listed at 100% of fair market value.²³⁵ Tax districts listing

231. WHO PAYS THE PROPERTY TAX?, *supra* note 51, at 7-8.

232. Mackey, *supra* note 217, at 24. Despite the fact that New Hampshire law requires that real property be assessed at full value, property values usually are not adjusted between town-wide assessments which would ensure that like properties within a taxing district continue to be valued similarly. See N.H. REV. STAT. ANN. § 75:1 (1991) (requiring "full and true" appraisal of all taxable property). The opportunity to file for tax abatements offers some relief. N.H. REV. STAT. ANN. § 76:16 to 20 (1991 & Supp. 1995). The taxpayer must prove the tax assessment "is disproportionately higher in relation to its true value than is the case as to other property in general in the taxing district." Bemis Bros. Co. v. Claremont, 102 A.2d 512 (N.H. 1954). This is not enough to ensure like properties are always valued similarly.

233. PROPERTY TAX RELIEF, *supra* note 152, at 211.

234. *Id.* at 211-12.

235. VT. STAT. ANN. tit. 16, § 3475 (1982).

property below full fair market value risk losing a portion of general school aid.²³⁶ Vermont's listing penalty became effective in 1982,²³⁷ and a decade later may be deemed a success. In 1980, Vermont's average assessment ratio was 58% of fair market value; in 1993, the average assessment ratio had risen to 85.3% of fair market value.²³⁸ Vermont also found that the listing penalty decreased the coefficient of dispersion statewide.²³⁹ This coefficient measures horizontal inequity between taxpayers in the same tax district.²⁴⁰ Before enactment of the listing penalty legislation, Vermont's coefficient was 26.5%.²⁴¹ By 1993 it had dropped to 14.9%.²⁴² If New Hampshire enacted a similar law, it would likely encounter the same success as Vermont since education is a contentious issue in both states.

Alleviating inequities between similarly situated taxpayers within the same district by increasing the frequency of assessments could result in increased administrative costs. In New Hampshire, the cost of property appraisals is borne by the towns.²⁴³ Increasing the frequency of assessments necessarily increases the number of times the town must pay for these assessments. Although the listing penalty for not assessing at full market value may result in a reduction of school funds, a listing penalty modeled after Vermont's would be effective only if school districts received substantial State aid to public education. Thus, the listing penalty provides no incentive to towns receiving little or no State aid to education.

Assessing property more frequently may alleviate disparities within taxing districts; however, this approach alone will not alleviate the inequities between taxpayers from property-poor and property-wealthy school districts. Moreover, increasing the frequency of assessment fails to resolve the broader issue of the property tax inaccurately measuring a taxpayer's ability to pay. This approach is limited to those taxpayers affected by the property tax. It does not distribute the tax burden among all potential taxpayers. For example, wealthy taxpayers not owning real property may actually have a greater ability to pay. For this reason, more frequent assessments should be coupled with other changes to New

236. *Id.*

237. *Id.*

238. VT. TAX REPORT, *supra* note 126, at 1.

239. *Id.*

240. *Id.*

241. *Id.*

242. *Id.* at 2.

243. N.H. REV. STAT. ANN. § 41:2-g (1991); N.H. REV. STAT. ANN. § 48:13 (1991) (outlining duties of tax assessors in appraising property); N.H. REV. STAT. ANN. § 75:1 (1991) (explaining that selectmen shall appraise property at its full and true value).

Hampshire's tax scheme in order to achieve the goals of alleviating taxpayer inequity and ensuring that revenue is raised for public education.

2. The Statewide Property Tax as an Alternative Revenue Source

A statewide property tax system is a frequently suggested proposal for preserving New Hampshire's heavy reliance on the property tax while providing funding for adequate education. In 1994, two gubernatorial candidates proposed statewide property tax plans for New Hampshire.²⁴⁴ The statewide property tax has also been considered by the New Hampshire Legislature.²⁴⁵ Whether a statewide property tax would allow New Hampshire to achieve the dual goals of funding adequate education and alleviating current taxpayer inequities depends on how the tax is implemented and how well it works within New Hampshire's total taxing scheme.

The findings of a 1993 Legislative Study Committee report on the feasibility of a statewide property tax support the determination that such a tax would allow New Hampshire to achieve its goal of providing adequate education.²⁴⁶ However, a statewide property tax is precluded

244. See, e.g., Bramante, *supra* note 120; The King Plan, *supra* note 120, at 10. See also Donn Tibbets, *Bramante Calls Tax Plan GOP Threat*, THE UNION LEADER, Aug. 24, 1994, at 5. Bramante's plan would establish a uniform tax rate with money evenly distributed to school districts to cover basic education costs. *Id.*

245. STATEWIDE PROPERTY TAX STUDY, *supra* note 106, at 2.

246. *Id.* The following findings supported the Study Committee's recommendation that New Hampshire adopt some form of statewide property tax:

3. The impact of a statewide property tax on equalizing individual city/town tax rates for education is limited with the existing foundation aid distribution (Augenblick formula), even though the amount of revenue distributed by a statewide property tax is an order of magnitude higher than the amount of foundation aid. These two types of state education support compete with each other, but the statewide property tax approach would have a greater impact for more communities.

4. Theoretically, eliminating the foundation aid allows distribution of statewide property tax revenues based on the minimum cost per student of fully approved schools at the elementary, middle/junior and high school levels.

5. [W]ith foundation aid in place, [using] a statewide property tax [in] 1992, . . . 124 cities and towns would have realized a lower tax rate for education. These cities and towns represent about 65% of the NH population.

6. Without foundation aid in place, funding of the minimum cost of fully approved schools at each school level . . . 134 cities and towns would have realized a lower total tax rate for education. These cities and towns represent 73% of the New Hampshire population.

7. Without raising additional revenues on a statewide basis, a statewide property tax has a significant impact on equalizing the tax burden for education throughout New Hampshire.

Id. at 1-2.

under current law.²⁴⁷ Should the Legislature lift the ban on a statewide property tax, districts would receive equal funds for education regardless of property wealth, because funding would come from the State and not solely from locally raised revenues. Creating one taxing district may avoid the constitutional claim that transferring tax revenues from wealthy districts to poor districts is not proportional taxation.²⁴⁸ Freeing education funding from the limitations associated with local property wealth would allow school districts to obtain funding on a more equitable basis.

This "Robin Hood" approach, transferring revenues from property-wealthy school districts to fund education in property-poor districts, has been held unconstitutional in at least one state.²⁴⁹ A statewide property tax was upheld in Kansas, however, where the State created one statewide taxing district.²⁵⁰ In an unpublished but heavily discussed decision, Judge Terry Bullock opined "local districts are an extension of the state, and local money is still state money, though it hasn't been thought of that way."²⁵¹ This decision was upheld by the Kansas Supreme Court.²⁵² The one district concept defeats the problem that revenues cannot be removed from one tax district to fund education in other districts. This statewide approach represents a growing trend toward recognizing that the welfare of a state's children is the responsibility of the entire state.²⁵³

The elimination of tax boundaries by implementing a statewide property tax district may still cause resentment from wealthy towns that would subsidize the education of children in neighboring property-poor towns.²⁵⁴ Recently, the Kearsarge Regional School district proposed a new school funding formula in which school tax rates in the district's two

247. N.H. REV. STAT. ANN. § 78:20 (1991) (stating that while tobacco tax remains in effect, no direct State tax shall be levied on cities and towns). This tax was enacted in 1939. *Id.* See also N.H. REV. STAT. ANN. § 76:3 (1991 & Supp. 1995) (regarding assessment of State taxes).

248. See *supra* note 205 and accompanying text. Raising more money from one tax district to pay for another district's services may not meet the test of uniformity.

249. *Buse v. Smith*, 247 N.W.2d 141, 143 (Wis. 1976) (striking down redistribution of local property tax revenues from rich districts to poor districts based on the Wisconsin Constitution).

250. Ralph Jimenez, *The Fallout From Claremont: Local tax? State tax? Argument is joined*, BOSTON SUNDAY GLOBE, Jan. 23, 1994, at NH1, NH5.

251. *Id.* at NH5 (quoting Judge Terry Bullock's advisory opinion).

252. *State v. Kansas Dept. of Revenue*, 856 P.2d 151 (Kan. 1993).

253. See, e.g., Kirk Johnson, *Take Our Poor, Angry Hartford Tells Suburbs*, N.Y. TIMES, Feb. 12, 1991, at A1, B5.

254. See THE MERRILL PLAN FOR EDUCATION 5 (July 15, 1994) (stating that people are less likely to tax themselves if the money for education has to be shared or is controlled by distant authorities).

wealthiest towns would be higher than in its property-poor towns.²⁵⁵ The results of this proposal may offer insight into how wealthy towns will cope with subsidizing their property-poor neighbors.

If New Hampshire implements a statewide property tax, it will have the benefit of the experiences of other states. For instance, Michigan developed a statewide property tax.²⁵⁶ The Michigan proposal capped the taxable portion of annual assessments at the rate of inflation.²⁵⁷ A statewide property tax was also implemented in California in 1978 as part of Proposition 13.²⁵⁸ Revenues collected from local property taxes were shifted to the state level in each of these proposals.²⁵⁹

According to Allan Odden, a school finance expert, although school district spending under the new tax scheme was equalized in California, overall funding was still inadequate.²⁶⁰ California's lower overall spending was probably not caused by the statewide property tax per se, but rather by the Proposition 13 cap on property taxes. Proposition 13 limited property taxes to 1% of the full cash value of property, substantially restricting the ability of local governments to access revenues.²⁶¹ This restriction would present problems if education were funded largely by local revenues while the cost of education increased faster than the rise in revenues from the tax. Under such circumstances, the property tax would not have a natural growth rate—an essential characteristic of sound tax policy.²⁶² Absent a cap similar to that of Proposition 13, a statewide property tax would provide adequate revenues to fund education.

Creating a statewide taxing district has the benefit of making local school funding wealth-neutral because the funding comes from state and not local revenues. By equalizing tax rates, the statewide property tax solution also addresses the criticism that the tax is regressive—imposing a greater tax burden on low-income taxpayers than on high-income taxpayers. The tax districts which have above-average tax rates would be

255. Jo Becker, *School Formula Would Boost Taxes In New London*, *Newbury*, VALLEY NEWS, Jan. 18, 1995, at A1.

256. MICH. CONST. art. X, § 3.

257. See Peter Luke, *Tax Season Summer for Most Under Proposal A*, THE GRAND RAPIDS PRESS, April 2, 1995, at C3.

258. Frederick D. Stocker, *Introduction to PROPOSITION 13: A TEN YEAR RETROSPECTIVE 3* (Frederick D. Stocker ed., 1991).

259. *Id.*

260. Chris Pipho, *Property Tax Bans Catch On*, 75 PHI DELTA KAPPAN 742, 743 (1994) [hereinafter *Property Tax Bans Catch On*]. Odden does not define "inadequate." *Id.*

261. Stocker, *supra* note 258, at 3.

262. See, e.g., CONTE, *supra* note 159, at 9.

brought in line with other tax districts. However, this equity may result in a loss of local control.

D. *Special Considerations of Local Control in New Hampshire*

Local control is presumed necessary to provide a good educational program.²⁶³ Proponents of New Hampshire's current tax system argue that breaking the connection between local property wealth and local school district funding threatens the local control of schools.²⁶⁴ The term local control, however, can have two different meanings. First, local control can refer to local fiscal control. "The theory behind local fiscal control is that communities will be most responsive to educational needs if given the means to express their support of local schools through locally assessed property taxes."²⁶⁵ An advantage of this type of local control is that "[w]hen parents and local residents know that their tax dollars are going to help educate their own or local children, they are more likely to be willing to pay more in taxes."²⁶⁶ It is further argued that local fiscal control also promotes closer scrutiny of expenditures resulting in greater efficiency in the use of the funds.²⁶⁷

Second, local control can also refer to the school district's ability to make "decisions about 'selection of teachers, the nature of the curriculum, the length of school year, and the tax rate to be levied.'"²⁶⁸ A concern is that "an increased state presence in school financing will create greater state (and hence less local) regulation of school policies and administration."²⁶⁹ In *Milliken v. Bradley*, Chief Justice Burger observed that "[n]o single tradition in public education is more deeply rooted than

263. Lindholm, *supra* note 25, at xvi.

264. THE MERRILL PLAN FOR EDUCATION, *supra* note 254, at 35. New Hampshire should not make the mistake of adopting a statewide property tax. *Id.* Bureaucracy and administration at the State level will obstruct local control. *Id.* See also Donn Tibbets, *Merrill Seeks School Aid Revisions*, THE UNION LEADER, July 16, 1994, at A1.

265. Kirk J. Stark, *Rethinking Statewide Taxation of Nonresidential Property for Public Schools*, 102 YALE L.J. 805, 815 (1992).

266. *America's Schools: Meeting the Challenge: Hearings Before the Senate Comm. on the Budget*, 103d Cong., 2d Sess. 458 (1994) (statement of Robert S. McIntyre, Director, Citizens for Tax Justice) [hereinafter *America's Schools*].

267. Lindholm, *supra* note 25, at xvi.

268. Christopher P. Lu, Note, *Liberator or Captor: Defining the Role of the Federal Government in School Finance Reform*, 28 HARV. J. ON LEGIS. 543, 549 (1991) (quoting Alexander, *Equitable Financing, Local Control, and Self-Interest*, in THE IMPACTS OF LITIGATION AND LEGISLATION ON PUBLIC SCHOOL FINANCE: ADEQUACY, EQUITY, AND EXCELLENCE 307 (J. Underwood & D. Versteegen eds., 1990)).

269. Stark, *supra* note 265, at 814 (footnote omitted).

local control over the operation of schools; local autonomy has long been thought essential both to the maintenance of community concern and support for public schools and to quality of the educational process."²⁷⁰ The depth of commitment to local autonomy and local fiscal control in New Hampshire may be best characterized by the state's motto: "Live Free or Die."²⁷¹

The inequity inherent in this argument is that, given school districts' varying abilities to raise and spend revenues, all districts do not benefit equally from local control. For this reason, local control has been called a "cruel illusion."²⁷² A community may only exercise local control when financial alternatives are available.²⁷³ Implicit in the argument against enactment of tax alternatives, such as the statewide property tax, is the right of wealthy districts to spend as much as desired on education, despite the inability of poorer districts to do the same. Proponents of local financing believe that disparities in education spending between rich and poor districts are not inherently bad.²⁷⁴ "There's nothing wrong with well-off parents choosing to devote lavish resources to educating their children."²⁷⁵ These proponents concede, however, that absent corrective measures, poorer school districts may lack sufficient funds to finance the minimum adequate public education the New Hampshire Constitution guarantees.²⁷⁶

The argument that a statewide property tax will reduce local control is also flawed because equalizing funding for education may actually give some districts more flexibility in determining how to run their schools. Although a statewide property tax may reduce funds that would otherwise be retained by property-rich districts, this solution will provide property-poor districts with economic alternatives that are not now available to them.

One final argument for retaining local control under the present property tax scheme is based on the notion that local schools are an extension of the family. State intrusion into school operations through a statewide property tax and revenue distribution scheme strikes close to the hearts of parents.²⁷⁷ This argument, however, draws no distinction

270. *Milliken v. Bradley*, 418 U.S. 717, 741-42 (1974).

271. N.H. REV. STAT. ANN. § 3:8 (1988).

272. *Serrano II*, 557 P.2d at 948.

273. *Edgewood Indep. Sch. Dist. v. Kirby*, 777 S.W.2d 391, 398 (Tex. 1989).

274. *America's Schools*, *supra* note 266, at 459.

275. *Id.*

276. *Id.*

277. See Richard Briffault, *Our Localism: Part II--Localism and Legal Theory*, 90 COLUM. L.

between local control over the type of education provided and local fiscal control. Local control over the content of school curricula is retained even when local fiscal control is lost, because New Hampshire's minimum educational standards allow school districts to achieve minimum standards by any alternative means.²⁷⁸ By allowing this flexibility, New Hampshire encourages districts to achieve the standards through methods which are cost-effective. If funding is disassociated from the district, the incentive to save will be lost.

New Hampshire must weigh the burden of losing local control against the benefits of reducing the inequities experienced by taxpayers in property-poor school districts. The outcome of this balancing will affect how New Hampshire evaluates alternative revenue sources as solutions to the education and taxpayer equity issues.

E. The Income Tax as an Alternative Revenue Source

If New Hampshire wishes to achieve the dual goals of providing an adequate education to all students while minimizing taxpayer inequities, it must reduce the strong connection between local property wealth of a school district and that district's ability to fund public education. Adopting new or expanded current income taxes as alternative revenue sources to the local property tax could help break such a connection. New Hampshire does not have a broad-based income tax, but it does have selective statewide income taxes on interest, dividends, trusts, and partnerships.²⁷⁹ In 1970, it added a tax on business profits.²⁸⁰ Despite past opposition to a broad-based income tax,²⁸¹ a general income tax has been recently contemplated.²⁸² During the 1996 New Hampshire legislative session, a

REV. 346, 386 (1990) (noting that "schools are the public service most bound up with the idea of family").

278. Interview with Gerald Bourgeois, *supra* note 28. The New Hampshire Administrative Rules establish procedures for approval of alternative means to comply with State education standards. N.H. CODE ADMIN. R. ED. 306.38 (1995 & Supp. 1996).

279. N.H. REV. STAT. ANN. § 77:3(I) (1991 & Supp. 1995) (taxing gross interest and dividend income exceeding \$2,400 during a taxable year); N.H. REV. STAT. ANN. § 77:10 (1991 & Supp. 1995) (taxing income from trusts); N.H. REV. STAT. ANN. § 77:14 (1991 & Supp. 1995) (taxing income from partnerships).

280. N.H. REV. STAT. ANN. § 77-A (1991 & Supp. 1995) (taxing business profits).

281. Michael Rezendes, *In N.H., "the pledge" seen losing bite*, BOSTON GLOBE, Mar. 26, 1995, at NH8. "The no-new-taxes promise has been a deciding factor in politics here for more than 20 years and is largely responsible for New Hampshire's refusal to approve a broad-based sales or income tax." *Id.*

282. N.H. H. 1617, 1996 Sess.

flat tax on income was proposed.²⁸³ If New Hampshire expands the existing taxes or imposes a broad-based income tax such as the flat tax, resulting revenues could be used to reduce inequities caused by New Hampshire's heavy reliance on the local property tax to fund education.

Other states addressing related issues of taxpayer inequity and education funding have successfully implemented income taxes to reduce property taxes. In New Jersey, the legislature enacted the Gross Income Tax Act after concluding the income tax was the only feasible source from which it might constitutionally raise the large amount of revenue necessary to fully fund New Jersey's school aid program.²⁸⁴ New Hampshire could face a similar need for revenue. If an adequate education requires the full funding of its school aid Formula, approximately \$57 million in additional revenue would be required in fiscal year 1996.²⁸⁵ This amount is comparable to the total revenues reported from the 1994 Interest and Dividends tax and the Business Enterprise tax combined.²⁸⁶ Expanding existing, or creating new, income taxes as an alternative to local property taxes is worth contemplating. New Hampshire needs to raise large amounts of revenue, and there are indications that public attitudes are more receptive to tax reform when tied to education funding.²⁸⁷

One valid concern with increasing or enacting any new tax is whether the taxes actually satisfy the goal of replacing the inequitable tax—in this case, the local property tax. Other states offer encouragement that this goal can be achieved. In Connecticut, the additional revenues generated by the adoption of income taxes reduced the property tax burden.²⁸⁸ In Michigan, an increase in the sales tax supported a reduction in property tax.²⁸⁹ Since New Hampshire is known for its frugality,²⁹⁰ and its

283. *Id.*

284. Stracco, *supra* note 90, at 1310. The Gross Income Act, along with the Public School Education Act of 1975 and the Quality of Education Act, were intended to work together to equalize spending on public education on a per-district basis by providing State aid. *Id.* This system is similar to New Hampshire's Foundation Aid Program. The Public School Education Act and Quality of Education Act were, however, declared unconstitutional because school aid still relied too heavily on local property taxes. *Id.*

285. FOUNDATION AID FY96, *supra* note 96, at 6. Full funding of the Augenblick Formula during fiscal year 1996 would require \$106,282,324. For comparison, the \$57 million shortfall represents 5.2% of the total revenues collected at the State level in 1994. ANNUAL FINANCIAL REPORT, *supra* note 69, at 97.

286. ANNUAL FINANCIAL REPORT, *supra* note 69, at 97.

287. UNH Poll Finds Unexpected Support For Increase in State Aid to Schools, THE UNION LEADER July 16, 1994, at 10.

288. Odden, *supra* note 39, at 3.

289. Penelope Lemov, *Taxes—The Struggle for Balance*, GOVERNING, Aug. 1994, at 31.

290. Donald Hall, *We are Stingy on a Soul-Level Far Deeper Than the Tax-Level*, YANKEE

animosity toward increasing the tax burden,²⁹¹ it too would probably realize a reduction in local property taxes instead of increased spending.

The flat tax proposed during New Hampshire's 1996 legislative session could provide a solution to taxpayer inequities. According to budget estimates for the proposed State flat tax, the tax could raise up to \$1.7 billion in fiscal year 1997.²⁹² Revenues generated by the local property tax for school year 1993-94 were reported as \$932 million.²⁹³ Even with the 80% distribution formula, the flat tax scheme would give \$1.4 billion back to local towns and cities to help fund schools and other municipal needs.²⁹⁴ In this manner, it could easily replace the local property tax and alleviate the associated taxpayer inequities.

The flat income tax possesses many of the qualities of a good tax structure. The flat tax would be relatively easy to implement since taxpayers are already familiar with filing federal income tax returns, and there would be less need for an education campaign by the New Hampshire Department of Revenue on how to file. Under the flat tax, businesses would be required to withhold deductions from employee paychecks. Since businesses already have to do this under the federal income tax,²⁹⁵ administration of the tax would be relatively easy. Administration of the tax would be further eased because the infrastructure to process the tax forms already exists at the Department of Revenue Administration.²⁹⁶ This infrastructure would still need to be expanded. Budget estimates are that the flat tax would require \$6.4 million in start-up costs in the first year²⁹⁷ in addition to the estimated annual administration costs of \$6.8 million.²⁹⁸ Considering flat tax revenues are estimated at \$1.7 billion annually, however, since the administrative costs are relatively small in proportion to the potential revenue of a flat tax²⁹⁹ this would satisfy the efficiency element of a good tax structure.

The proposed flat tax would also satisfy the good tax characteristic of being broad-based, since it covers all individuals. Broad-based taxes help achieve horizontal equity among taxpayers by applying the same tax on

MAGAZINE, Sept. 1991, at 58, 60.

291. Rezendes, *supra* note 287, at 10.

292. Department of Revenue Administration Fiscal Impact Statement for N.H. H. 1617 (Dec. 15, 1995) [hereinafter Fiscal Impact Statement].

293. *Id.*

294. N.H. H. 1617, 1996 Sess. (containing 80% distribution formula in proposed § 31-A:1).

295. 26 U.S.C. §§ 3401-3406 (1995).

296. N.H. REV. STAT. ANN. § 21-J:1 (1988).

297. Fiscal Impact Statement, *supra* note 292.

298. *Id.*

299. *Id.*

similarly situated individuals. Horizontal equity is what is most lacking under the current local property tax scheme.³⁰⁰ Replacing the local property tax with a flat tax would help achieve this tax reform goal. If, however, New Hampshire wants to create a tax structure that places more of the tax burden on the wealthy than on the poor, the proposed flat tax will not be a vehicle to that end.

New Hampshire's proposed flat tax abolishes the commuters income tax,³⁰¹ business enterprise tax, rooms and meals tax, real estate transfer tax, and the communications services tax, but it does not abolish other selective income taxes.³⁰² As a result, if the flat tax were instituted in addition to the existing selective income taxes, some income could be taxed twice. Taxing the same income twice could be viewed as an additional inequitable tax burden. To avoid double taxation, credits for State income tax liability should be considered if New Hampshire adopts the proposed flat tax or any other individual income tax to avoid double taxation.

New Hampshire should be aware of the social implications of imposing a broad-based flat tax. Tax exemptions are often created to effectuate social policy. Current federal income tax models exclude from taxable income: money received from health insurance policies, pre-tax contributions to pension plans, and various forms of deferred compensation for retirement savings.³⁰³ These exclusions reflect a public policy of promoting retirement savings and reducing reliance on Social Security. These exclusions, however, reduce the proportion of income tax paid by some taxpayers. Additionally, under the federal income tax, individuals on fixed incomes, such as the elderly, are given special treatment.³⁰⁴ Enactment of an income tax in New Hampshire could threaten this preferential treatment by imposing State taxes on federally exempted

300. See *supra* Part II.D.1.

301. N.H. H. 1617.

302. N.H. REV. STAT. ANN. § 77-E (1991 & Supp. 1995) (Business Enterprise Tax); N.H. REV. STAT. ANN. § 77-A (1991 & Supp. 1995) (Business Profits Tax); N.H. REV. STAT. ANN. § 77 (1991 & Supp. 1995) (Interest and Dividends Tax); N.H. REV. STAT. ANN. § 84-A (1991 & Supp. 1995) (Medicaid Enhancement Tax).

303. 26 U.S.C. § 22 (1991) (crediting the elderly and the permanently and totally disabled); 26 U.S.C. § 63(f) (1986) (defining taxable income and aged or blind additional amounts); 26 U.S.C. § 219(a) (1991) (deducting payments to individual retirement accounts).

304. There is a tax credit against the federal income tax for those 65 and older. 26 U.S.C. § 22 (1994). There is also an additional deduction from gross income. 26 U.S.C. § 63(f). Additionally, only about half of social security benefits are recognized as gross income. 26 U.S.C. § 86 (1994).

income.³⁰⁵ In its reform efforts, New Hampshire will need to balance these benefits and trade-offs against inequities in the current tax structure.

The flat tax, or any income tax for that matter, does not adequately satisfy the good tax characteristic of stability because of its high elasticity in relation to the economy. An income tax is based on a taxpayer's current income and thus may accurately measure a taxpayer's current ability to pay. This would be equitable for a taxpayer, for instance, who recently became unemployed. The taxpayer would not have income and no income tax would accrue. Such a responsiveness to downturns in the economy would cause revenues to fluctuate. This attribute would be deemed unstable and undesirable from a treasury standpoint, although the federal system does employ this technique. New Hampshire can minimize the effects of this unfavorable attribute by diversifying its tax structure and not relying solely on income taxes for the bulk of its revenue.

Another caution against relying heavily on the income tax for revenue is that an income tax only measures one aspect of wealth and thus only one aspect of one's ability to pay. Income taxes are imposed only when a taxpayer has current income or if a taxpayer's wealth has recognized gain during the tax year. Thus, a wealthy person without a job, living off tax-exempt income, pays no income tax under the current system. New Hampshire should, therefore, strive to diversify its tax structure to achieve accurate assessments of an individual's ability to pay and equitably apportion the tax burden.

If New Hampshire implemented any income tax, it would have to satisfy the proportionality requirement of the New Hampshire Constitution.³⁰⁶ In practice, this means New Hampshire cannot simply model its State income tax after the federal income tax. Nor could it adopt a flat percentage of the federal income tax, because the federal income tax is graduated,³⁰⁷ and thus not proportional.³⁰⁸ To satisfy the proportionality requirement, any State income tax would be limited to one with a single tax rate. The flat tax appears to satisfy this requirement. Despite the proportionality requirement, the income tax, as a component of a comprehensive tax reform, could nevertheless be progressive. Since both property and sales taxes disproportionately burden the lowest income

305. See Snell, *supra* note 164, at 22 (expanding personal income taxes and giving tax breaks to the elderly may result in lost revenue as the number of elderly increases if income levels are not reconsidered when giving the elderly tax breaks).

306. N.H. CONST. pt. 2, art. 5.

307. 26 U.S.C. § 1 (1995).

308. *History of School Finance*, *supra* note 55, at 6.

households, an increased reliance on income tax would shift the tax burden to those with higher incomes.³⁰⁹

Despite New Hampshire's aversion to implementing a broad-based tax, it has been the subject of debate in the State. New Hampshire's Legislature has proposed a flat tax.³¹⁰ Additionally, Republicans campaigning in New Hampshire for the presidential nomination have been proposing flat tax plans.³¹¹ Representative Dick Arney (R-Texas) arrived in New Hampshire to defend his flat tax plan proposed in Congress.³¹² This activity indicates that the political climate against an income tax in New Hampshire may be changing and that taxpayers may consider an income tax as part of a tax reform package. New Hampshire could capitalize on the wealth of literature and studies that Republican presidential candidates have generated in support of their respective flat tax plans to determine the right tax for the State. Adopting new, or expanding current, income taxes as alternative revenue sources to the local property tax could help reduce the inequities caused by New Hampshire's heavy reliance on the local property tax to fund education. In this regard, a flat tax would help New Hampshire achieve the goals of providing an adequate education for all students while minimizing taxpayer inequities.

F. The Sales Tax as an Additional Revenue Source

In addition to including income taxes as part of a tax reform package, New Hampshire should consider raising additional revenue from either a general sales tax or expanding selective sales taxes. Like the broad-based income tax, a broad-based sales tax has historically been disfavored in New Hampshire.³¹³ New Hampshire currently has selective sales taxes on beer, tobacco, telecommunications, real estate transfer, and rooms and meals.³¹⁴ In 1994, these taxes provided \$339 million in revenue.³¹⁵

309. See LaPlante, *supra* note 149, at 65.

310. N.H. H. 1617.

311. Michael Cousineau, "Whistleblower" Arney Comes to Granite State to Defend Flat-Tax Idea, THE UNION LEADER, Feb. 9, 1996, at A1.

312. *Id.*

313. Rezendes, *supra* note 281. The Governor has repeatedly stated his opposition to a statewide sales tax. See, e.g., THE MERRILL PLAN FOR EDUCATION, *supra* note 254, at 3 (claiming it is a myth that a broad-based tax is needed to supply additional education funding).

314. N.H. REV. STAT. ANN. § 178:28 (1994 & Supp. 1995); N.H. REV. STAT. ANN. § 78 (1991 & Supp. 1995); N.H. REV. STAT. ANN. § 82-A (1991 & Supp. 1995); N.H. REV. STAT. ANN. § 78-B (1991 & Supp. 1995); N.H. REV. STAT. ANN. § 78-A (1991 & Supp. 1995).

315. ANNUAL FINANCIAL REPORT, *supra* note 69, at 97. Individually the revenues consisted of beer: \$11,199,000; tobacco: \$43,712,000; telecommunication: \$30,512,000; real estate transfer: \$29,221,000; and rooms and meals: \$224,946,000. *Id.*

Because these taxes individually only comprise between .1% and 8.8% of total State and local revenues,³¹⁶ they could be expanded to take the burden off the local property tax. Since New Hampshire already has an infrastructure to collect existing selective taxes, expanding these taxes would probably not increase administrative costs.

A general or selective sales tax may be easier to adopt than other taxes³¹⁷ and would allow New Hampshire to achieve the goals of funding adequate education and reducing taxpayer inequities. Taxpayers are generally less hostile toward sales taxes than toward property and income taxes.³¹⁸ This attitude may exist because property taxes are paid in one painfully visible lump sum, whereas the sales tax is paid piecemeal when purchases are made. Additionally, compared to the income tax, the sales tax is more discretionary. Although taxpayers may, to a degree, choose not to purchase goods, few taxpayers can afford not to work. A sales tax may also positively affect savings, in contrast to an income tax.³¹⁹

New Hampshire is in a fortunate position as far as tax reform is concerned because it collects fewer taxes than its neighboring states.³²⁰ To remain competitive, states do not generally want their revenue systems to fall out of line with those of the nation and neighboring states.³²¹ All states bordering New Hampshire already have broad-based sales taxes.³²² For this reason, New Hampshire could adopt a sales tax and not be out of line with neighboring states. Once adopted, New Hampshire will need to monitor its sales tax rates to guard against losses in revenue.³²³ New Hampshire should be mindful of its neighbor Massachusetts if it

316. See *supra* note 69 and accompanying text.

317. Robert W. McGee, *Principles of Taxation for Emerging Economies: Lessons from the U.S. Experience*, 12 DICK. J. INT'L L. 29, 75 (1993).

318. See *id.* at 74-76.

319. *Id.* at 76.

320. CONTE, *supra* note 159, at 4. Total state tax collections in the average state reached \$607 per person in fiscal year 1980. *Id.* New Hampshire collected \$291 per person which is less than half the national average and placed the State last in the nation. *Id.*

321. Ballew et al., *supra* note 145, at 34. A study in Vermont found that the State's sales tax was not in line with its neighboring states. *Id.* The economic study found that in 1992, Vermont lost \$191 million in retail sales to New Hampshire. *Economist: Vi. Taxes Drive Business to NH*, THE UNION LEADER, Dec. 7, 1995, at A9.

322. VT. STAT. ANN. tit. 32, §§ 9771-9818 (1994 & Supp. 1995) (sales and use tax); VT. STAT. ANN. tit. 32, §§ 5811-5954 (1991 & Supp. 1995) (income tax); MASS. GEN. L. ch. 64H, § 1-33 (1991) (sales tax); MASS. GEN. L. ch. 62, §§ 1-64 (1991) (income tax); ME. REV. STAT. ANN. tit. 36, §§ 1751-1765 (West 1964 & Supp. 1995) (sales and use tax); ME. REV. STAT. ANN. tit. 36, §§ 5101-5102. (West 1964 & Supp. 1995) (income tax).

323. New Hampshire could keep its tax rates in line with its neighbors by referring annually to the index of tax effort compiled by the Advisory Commission on Intergovernmental Relations. WHO PAYS THE PROPERTY TAX?, *supra* note 51, at 9.

contemplates raising its sales tax on beer and liquor. Massachusetts is considering deregulating its liquor industry to better compete against New Hampshire in that market.³²⁴

While contemplating raising existing sales taxes, New Hampshire should remember that these taxes have a certain degree of exportability to them.³²⁵ For example, a rooms and meals tax is generally borne by travelers and vacationers, persons generally not living within the State.³²⁶ Although exportability may be desirable to New Hampshire taxpayers because it reduces their tax burden, it also tends to be unneighborly.³²⁷ A tax is viewed as unneighborly when it places the tax burden on out-of-state taxpayers who do not benefit from the services the tax revenues support. Neighboring states may then retaliate and enact their own exportable tax.

A basic notion of taxation fairness is that those who receive the benefit of tax revenues should pay the tax. Taxes on beer, tobacco, and rooms and meals are generally viewed as having a certain degree of exportability.³²⁸ Because these taxes are imposed on vacationers and out-of-state purchasers, any increase in these taxes would increase the tax burden borne by nonresidents.³²⁹ If the sales tax revenues were used to fund public education, out-of-state taxpayers would not reap the benefit of increased taxes to pay for education. Since out-of-staters do not receive the benefit from the taxes, New Hampshire should be wary of imposing a greater share of the tax burden on them. For this reason, it may be preferable for New Hampshire to adopt a broad-based sales tax which taxes both resident and out-of-state consumers, rather than expand its current selective sales taxes.

324. *Mass.-N.H. Liquor War Is Possible*, THE UNION LEADER, Jan. 22, 1996, at A1, A8. New Hampshire lures about half of its \$208 million in annual liquor sales from out-of-staters. An estimated \$50 million in sales comes from Massachusetts alone. *Id.* These revenues could be adversely impacted if New Hampshire were to raise its beer and liquor taxes at the same time Massachusetts' liquor industry became more competitive. For this reason, New Hampshire should be mindful of its neighboring state's liquor tax rates when it evaluates the possibility of raising this selective sales tax.

325. CONTE, *supra* note 159, at 8.

326. *Id.*

327. Papke, *supra* note 162, at 36-38. Elements of a high quality revenue system include minimizing interstate tax competition. *Id.*

328. CONTE, *supra* note 162, at 8.

329. *Id.* at 7-8. New Hampshire's neighbor, Vermont, recently attempted to increase some of its exportable sales taxes. Vt. H. 541, 1994 Adj. Sess. In an effort to equalize school tax rates among Vermont towns, the rooms and meals tax would have been increased to 9% and liquors would have been removed from the sales tax exemption. *Id.* The bill passed the House on January 14, 1994 but was sent to conference committee and has not been enacted. Telephone Interview with Catherine M. Benham, Associate Fiscal Officer, Vermont Legislature (June 22, 1995). Had Vermont increased its exportable taxes, the unneighborly aspect of New Hampshire possibly increasing these taxes to Vermont's rates would be diminished.

If New Hampshire adopts a broad-based sales tax, it will need to address social policy issues reflected in common exemptions to the tax. Groceries, for instance, are usually exempt from sales tax based on the theory that food is a necessity of life, and, therefore, levying a tax on food would penalize the poor.³³⁰ Poorer taxpayers generally spend a larger portion of their income on necessities than wealthier taxpayers.³³¹ Acknowledging this fact, 1996 Republican Presidential candidate Senator Richard Lugar proposed that his 17% national sales tax include exemptions for food and medicine.³³² New Hampshire should consider exemptions such as these to reduce the burden any general sales tax would impose.

The sales tax is also not generally imposed on the sale of services. Therefore, if New Hampshire taxed services, it could place New Hampshire businesses in a competitive disadvantage if neighboring states excluded services from their sales tax. New Hampshire will have to balance these exemptions from the sales tax against any tendency the exemptions have to reduce distributive equity.³³³ Exemptions can make a tax economically non-neutral and reduce the effectiveness of the tax as a revenue source.³³⁴ Additionally, if too many exemptions are adopted, the tax could be deemed progressive.³³⁵ A progressive tax would violate New Hampshire's constitutional requirement that taxes be levied proportionately.³³⁶

One sales tax New Hampshire could utilize to raise revenue for public education is the tobacco tax, which could also address the social policy against the use of tobacco.³³⁷ The 1996 Legislature has proposed to

330. PROPERTY TAX RELIEF, *supra* note 152, at 211.

331. *Id.* at 208-09.

332. *Lugar Wants a Sales Tax to Replace Income Tax*, WALL. ST. J., Apr. 6, 1995, at A10. Critics of the national sales tax warn that to be effective, the tax rate would have to be around 20% which would push much of the economy underground. Jonathan Marshall, *Ins, Outs of Many Tax Plans*, SAN FRANCISCO CHRONICLE, Jan. 29, 1996, at E2. If New Hampshire adopts a sales tax as part of a comprehensive tax strategy, the diversity of the revenue sources could free New Hampshire from imposing a high sales tax rate and still remain competitive with neighboring states.

333. Distributive equity refers to a tax's ability to distribute equally the tax burden among taxpayers. If services supported by tax proceeds are used by everyone, tax exemptions which cause the tax to fall upon only a few taxpayers are unfair.

334. See *supra* notes 208-10 and accompanying text.

335. *History of School Finance*, *supra* note 55, at 6.

336. N.H. CONST. pt. 2, art. 5.

337. *A State of Good Health*, BOSTON GLOBE, Dec. 20, 1995, at 14. A \$.25 per pack tobacco tax increase combined with an anti-tobacco campaign showed a cigarette consumption decline of 15.6%. *Id.* A \$2 per pack tax increase would reduce the number of people who smoke by about 7.6 million. COALITION ON SMOKING OR HEALTH, AMERICAN LUNG ASSOCIATION, SAVING LIVES AND RAISING REVENUE 12 (1995). Although poll results do not identify whether respondents were nonsmokers, or whether the question referenced funding popular issues such as health care, polls

increase New Hampshire's existing tobacco tax.³³⁸ The tax increase would place New Hampshire's tobacco tax more in line with taxes in other neighboring states.³³⁹ The proposed \$.11 cent per pack tax increase is projected to generate \$17,856,000 in additional revenue, for a total of \$45,000,000 in 1996.³⁴⁰ This revenue could replace a portion of the \$1.54 billion in revenues generated by the local property tax.³⁴¹ The only drawback in utilizing the tobacco tax as part of a tax reform package is that the current tobacco tax cannot coexist with a direct State tax levied on cities and towns unless New Hampshire Statute Section 78:20 is repealed.³⁴²

Both sales and income taxes have been included in tax reforms aimed at reducing heavy property tax burdens.³⁴³ Vermont's 1994 property tax reform package, for example, introduced a 5% sales tax as well as increasing rooms and meals tax, liquor sales tax, corporate profits tax, telephone property tax, and auto rental tax.³⁴⁴ The intent of these changes is to reduce Vermont's reliance on local property taxes for education and to minimize funding disparities between school districts.³⁴⁵

Michigan has also taken steps to narrow the gap between wealthy and poor school districts by abolishing the use of local property taxes as a primary funding mechanism for elementary and secondary education.³⁴⁶ Michigan replaced this revenue source with a statewide property tax, creating various tax rates for different classes of property.³⁴⁷ In addition, the sales tax was increased from 4% to 6%, the cigarette tax was increased from \$.25 to \$.75 per pack, and new taxes on real estate transfers and out-of-state phone calls were instituted.³⁴⁸

consistently report public support over 60%. *Id.* If New Hampshire combines the tobacco tax with a successful anti-smoking education campaign, reductions in smoking consumption will likely occur.

338. N.H. H. 1517, 1996 Sess.

339. Memorandum from G. Philip Blatsos, Revenue Analyst for the New Hampshire Department of Revenue Administration, to Stanley Arnold, New Hampshire Commissioner of Revenue 3 (Feb. 1, 1996) (stating that current New England tobacco taxes range from the following: New Hampshire \$0.25; Maine \$0.37; Vermont \$0.44; Connecticut \$0.50; Massachusetts \$0.51; Rhode Island \$0.61).

340. *Id.* at 1.

341. PROPERTY TAX TABLES BY COUNTY, *supra* note 97, at 6, 9, 12, 15, 18, 21, 24, 27.

342. N.H. REV. STAT. ANN. § 78:20 (1991 & Supp. 1995).

343. Lemov, *supra* note 289, at 31.

344. H.R. OVERVIEW H. 541 EDUCATION IMPROVEMENT ACT, 1994 Sess., at 2, 4 (1994).

345. Telephone Interview with Catherine M. Benham, *supra* note 329.

346. Ballew et al., *supra* note 145, at 32.

347. *Id.* at 33.

348. *Id.*

Although sales taxes are commonly perceived as fluctuating with the economy, Michigan's Treasurer provided data showing that the State sales tax revenues had increased in all but one of the last twenty years.³⁴⁹ Based upon this information Michigan then chose to increase the sales tax because of its stability. In addition to increasing stable taxes, Michigan also diversified its revenue sources. Diversification of tax resources is sound tax policy, because over-reliance on one revenue source would magnify potentially adverse equity issues and this would tend to distort economic choices of businesses and consumers.³⁵⁰ By diversifying its tax structure, Michigan's taxes tend to be economically neutral.³⁵¹

Many similarities exist between Michigan and New Hampshire. As discussed previously, states do not want their revenue system to be out of step with neighboring states.³⁵² Because Michigan's neighbors had sales taxes, increasing Michigan's sales tax placed it in symmetry with neighboring states.³⁵³ New Hampshire is in a similar position in that it has no sales tax while neighboring states do.³⁵⁴ It appears, however, New Hampshire could still adopt a broad-based sales tax and retain a competitive advantage over neighboring states.

Michigan, like New Hampshire, also faced pressures from litigation over public education funding.³⁵⁵ In 1991, before tax reform was enacted, Michigan had the third highest school property tax rate in the country and New Hampshire had the fifth highest tax rate.³⁵⁶ Similarities alone will not ensure that, if New Hampshire adopts a sales tax, it too will successfully reduce taxpayer inequities and raise sufficient revenue for adequate education. Michigan's success, however, offers an illustrative model for the New Hampshire Legislature.

349. *Property Tax Bans Catch On*, *supra* note 260, at 742.

350. Papke, *supra* note 162, at 36-38.

351. Critics of eliminating local property taxes as a funding source for education may cite the early closing of the Kalkaska school district in 1993 as evidence of this solution's failure. The Kalkaska situation, however, is not that simple. Kalkaska residents voted down a property tax increase three times over seven months. *Blame school cuts on state inequities*, DETROIT FREE PRESS, Mar. 18, 1993, at 14A. The increase was needed to close the \$1.5 million budget gap. *Id.* The complexity of the situation is evident from the fact that observers also cite the closure as evidence of the State's ineffective funding system, while others cite the Kalkaska closing as evidence of teacher greed. *Id.*

352. Ballew et al., *supra* note 145, at 35.

353. *Id.*

354. See *supra* notes 322-31 and accompanying text.

355. Lemov, *supra* note 289, at 33.

356. PROPERTY TAX RELIEF, *supra* note 153, at 2.

CONCLUSION

According to the New Hampshire Supreme Court's decision in *Claremont School District v. Governor*, New Hampshire must provide an adequate education to all its children.³⁵⁷ New Hampshire currently does not have a definition of adequate education. However, evidence strongly suggests money plays a factor in defining adequacy in education. New Hampshire has attempted to remedy the disparity between wealthy and poor districts through the Foundation Aid Program which gives money to the poorer school districts in the State. Foundation Aid, however, has never been fully funded because revenue sources have not raised the funds necessary to fully support the Augenblick Formula. The disparity between the amount of education poor and wealthy school districts provide remains. Because nonmonetary means have not provided students equal access to an adequate education across the State, New Hampshire will need to consider additional funding sources to achieve this goal. Due to New Hampshire's heavy reliance on the local property tax, obtaining funding for public education by increasing tax rates under New Hampshire's existing tax structure will exacerbate taxpayer inequities.

Taxpayer inequities can only be remedied by reducing heavy reliance on the local property taxes to fund local public education. Pressures caused by increasing taxes to fund an adequate education could be reduced by restructuring New Hampshire's tax system to redistribute the tax burden among taxpayers who have the ability to pay. Ideally, any change in New Hampshire's tax structure should spread the tax burden more evenly, not result in an increase in the total tax burden. Judging from the State's current revenue shortfalls, however, the goal of no net increase in taxes may not be realistic.

New Hampshire can benefit from the experiences of other states which have attempted to alleviate taxpayer and educational inequities by modifying the State's current tax structure. States facing similar financial difficulties raising education funding have modified their property tax and increased income and sales taxes. If a statewide property tax option were pursued in New Hampshire, it would require repeal of Section 78:20 or repeal of the entire tobacco tax because the statute bans direct State taxes as long as a tobacco tax exists in New Hampshire.³⁵⁸ Other states have addressed inequities in their property tax systems simultaneously by changing their tax structures. Some of these alternatives may be appropriate remedies to New Hampshire's current education and tax

357. *Claremont Sch. Dist.*, 635 A.2d at 1381.

358. See *supra* note 247.

inequities. If a broad-based tax is needed, a sales tax may be more appropriate than an income tax because sales taxes tend to discourage the wasteful use of resources. In contrast, income taxes are direct taxes and may discourage savings and investment. Additionally, public opinion polls suggest the public is more willing to accept a sales tax, especially if it is slated to fund education.

New Hampshire is in an enviable position. Numerous tax reform options exist which would allow the State to meet the goals of adequately funding education and addressing taxpayer equity while retaining its economic edge. Now is the time for New Hampshire to reassess both its tax structure and how it funds public education.