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## FLAWED BY DESIGN: A REVIEW OF THE PROPOSED TAX AND EXPENDITURE LIMITATION AMENDMENT

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## EXECUTIVE SUMMARY

Citizens for Tax Reform, a group chaired by Ohio Secretary of State Ken Blackwell, is gathering signatures to place a proposed amendment to the state constitution on the November ballot. The amendment is a version of a tax and expenditure limitation, or “TEL,” that is similar to an initiative adopted by Colorado voters in 1992. Spending limits apply to the state and political subdivisions (a term that includes local governments as well as school districts and other local taxing districts). Political subdivisions are subject to additional restrictions on their ability to levy new taxes or raise existing taxes. Because of the sweeping nature of the amendment, the analysis that follows is not comprehensive. Instead, based on an initial review of the amendment, this analysis will point out how it would create radical changes in the way government operates, and how some provisions may prove to be unworkable from a practical standpoint. The key findings discussed in this *Report* are:

- The TEL contains a supremacy clause that ensures that it will prevail in case of conflict with any other constitutional section. The TEL’s mandatory year-end collection of unencumbered funds poses potential conflicts with constitutional sections that restrict the use of fuel taxes and workers’ compensation funds.
- The TEL imposes an overall cap on state spending and a separate spending cap for each local government. The spending cap applies not just to the expenditure of tax revenue, but also to revenues raised from certain voluntary transactions, such as lottery ticket sales.
- Significant portions of state four-year university spending may be subject to the aggregate state spending cap, including tuition, fees, and sales of tickets to sports and entertainment events.
- The TEL’s requirement that the state pay for mandates on political subdivisions fails to define the term “mandate.” This oversight creates an open invitation to litigation. If given an expansive interpretation by the courts, this provision will overturn the established relationship between the state and its political subdivisions. Political subdivisions may be able to object to state laws passed in order to comply with federal mandates.
- The tax refund mechanism in the proposed amendment would pool revenue from many different taxes and fees and will give it to individuals who paid the income tax. Individuals or businesses that paid a fee for a specific program or license may see little of this refund.
- By using a *pro rata* method for tax refunds, the TEL would direct the bulk of the tax relief to the wealthy. Many low income individuals pay more in sales and excise taxes each year than income taxes. Their fractional shares of a mandatory BRF refund would not reflect this reality, however.
- The TEL does not specify how to implement the spending cap formula in school districts and other taxing districts that cross political boundaries.

- The TEL makes no exception for the municipal home rule sections of the Ohio Constitution. Requiring voter approval before levying any tax conflicts with the authority of a charter municipality to levy a property tax for outside millage without voter approval.
- Both the state and local spending limits cover capital expenditures, even though voters have already authorized general obligation bonds through state constitutional amendments or local levies, and state law contains strict limits on debt service.
- The emergency clause exception to the spending limit is predicated upon a formal declaration of an emergency by the governor. There is no way for the General Assembly or a political subdivision to use the emergency spending safety valve if the governor refuses to act.
- When it is necessary to exceed the state spending cap, the imposition of a mandatory referendum delays the effective date of the state budget by at least three months, giving a new legislature just three months to produce a budget. This allows less time for public concerns to be raised in the legislative process, and makes it more likely that the legislature will not be able to pass a budget before the end of a fiscal year.
- Many important concepts and procedures in the amendment are unclear, and will generate many rounds of litigation before they are sorted out.

## INTRODUCTION

Since November 2004, Citizens for Tax Reform, a private organization chaired by Ohio Secretary of State J. Kenneth Blackwell, has put forward three public versions of a proposed amendment to the Ohio Constitution. These amendments are modifications of a “tax and expenditure limitation,” or TEL, that was adopted by Colorado voters in 1992. Critics of this approach have pointed out the devastating effects the TEL has had in Colorado and the likelihood that similar problems would occur in Ohio. Based on Colorado’s experience, it is likely that Ohio would see state support for critical programs such as higher education and health care decline dramatically.<sup>1</sup> If Ohio had adopted a spending cap based on population and inflation like that in the proposed amendment in 1994, Ohio’s spending on K-12 education in FY 2003 would have been \$900 million lower than the actual level.<sup>2</sup> Over time, most of the state’s discretionary spending might be devoted to providing a match for federal programs, rather than responding to the priorities of Ohio’s residents.<sup>3</sup>

This *Report* discusses the third, most recent version of the Citizens for Tax Reform amendment, which is currently being circulated for voter signatures in order to be placed on the statewide ballot for the November 8, 2005, election. This version would add Section 14 to Article XII of the Ohio Constitution. It supersedes an earlier initiative petition (the first public version of the amendment) that was submitted to the Ohio Attorney General in November 2004. The second version, which was introduced in the Ohio legislature in January 2005, does not have sufficient support to move forward.<sup>4</sup> It is worth noting that each version of the amendment contains new provisions and substantial modifications to fundamental elements of the proposal. These changes give the appearance of a proposal that has not been fully developed, even as its proponents advocate that it be placed in the state constitution.

Given the amendment’s far-reaching nature, it is not possible to understand all of its implications without undertaking a detailed review of how it would affect each program area and unit of government. Over the coming months, these analyses should be undertaken by all concerned citizens and units of government so that Ohio voters can fully understand the potential effects of the proposal. The analysis contained in this document is not comprehensive. Instead, based on an initial review of the amendment, it will point out how the amendment would create radical changes in the way government operates, and may prove to be unworkable from a practical standpoint.

In many instances, the consequences of the proposed amendment are unclear because the language is poorly drafted and omits key points. The General Assembly will have the opportunity to fill in some of these gaps with implementing legislation. Unfortunately, the amendment’s lack of clarity extends to many of its fundamental provisions. So, in these situations, the proposed amendment’s immediate consequence would be to give rise to litigation.

## SUMMARY OF THE PROPOSED TEL

The proposed TEL imposes a limit on annual spending growth of the state and its political subdivisions. The amendment does not restrict the state's ability to levy taxes. It does prohibit political subdivisions from levying new taxes or increasing the rate of an existing tax without voter approval, however. The state-level spending cap formula permits expenditures to grow at the greater of either (1) 3½ percent or (2) the sum of the annual rate of consumer inflation and the rate of annual state population growth. The formula for a political subdivision's budget is the same, except that it substitutes local population growth for that of the state. Inflation in recent years has been in the range of two or three percent, so the formula leaves little room for real, inflation-adjusted growth in state spending.

Except in an emergency, the state spending limit may not be exceeded without the approval of a simple majority of the voters in a mandatory statewide referendum on a bill that identifies the amount and purpose of all expenditures above the cap. Voter approval is also required for a political subdivision to exceed its spending limit. Other provisions establish a formula for the distribution of state revenues to localities (local government fund) and a budget reserve fund. In addition to resources provided through the local government fund, the amendment requires the state to reimburse local governments for the full cost of state-mandated activities.

## KEY TERMS AND CONCEPTS IN THE PROPOSED AMENDMENT

- **Aggregate expenditures** – The spending limits apply to “aggregate state expenditures” and “aggregate political subdivision expenditures.” Typically, the government budgeting process makes a distinction between programs supported by general tax revenues and programs that are supported by special purpose revenue, such as fees or bond proceeds. Most of the revenue from major taxes such as the sales tax and individual income tax are deposited into the General Revenue Fund (GRF), which is the main operating fund of the state. The GRF is the major source of funding for basic state services, such as education (both K-12 and higher education), criminal justice, and the state share of Medicaid. Under the constitution, the state must balance its budget on an annual basis.

The Ohio General Assembly passes separate bills for the state's operating budget and capital budget. The state's capital budget includes spending for buildings, roads, and other public infrastructure that will endure for decades. Traditionally, the capital budget is looked upon as an investment, and hence it is financed by long-term debt. The Ohio Constitution places strict limitations on the ability of the state to issue “general obligation” debt that is financed by the general taxing power of the state. The state may issue general obligation bonds only when authorized by a specific constitutional provision. Constitutional provisions often state the amount of debt that may be issued or the amounts that may be outstanding at one time. Debt service on general obligation bonds (the amounts paid to bond holders) may not exceed 5 percent of the combined total of the GRF and net lottery profits.<sup>5</sup>

Political debates about state spending typically revolve around growth in the GRF because it is supported by general taxation. Fees, on the other hand, are a legally distinct form of government revenue that is charged in return for a specific service or to support a particular regulatory

activity. Consequently, fees are often used as “special purpose” revenue in state accounting. Legal case law draws a distinction between fees and taxes. Fees that are greater than amounts necessary for administration and provision of specific services may become subject to judicial scrutiny as taxes.<sup>6</sup>

The proposed amendment erases the typical distinction between the state’s operating budget and capital budget by applying the spending limitation to nearly all state spending that is derived from the state’s own resources. The spending limitation applies to “aggregate” expenditures, which means “the sum of all expenditures” with only a few exceptions. One exception at both the state and local level is for “refunds of any kind.” Another exception is for revenue sharing from a higher level of government. This exception applies to federal resources at the state and local levels, and state funds spent by local governments.

The definitions of “aggregate **political subdivision** expenditures” and “aggregate **state** expenditures” differ in one important respect, however. The definition of aggregate **state** expenditures excludes revenues from sources **other than** “taxes, licenses, permits, fees, or sales.” This exclusion means that income from legal settlements (e.g., Ohio’s share of the nationwide suit against tobacco companies) and unclaimed financial deposits are not subject to the spending cap. Coverage of investment income is less clear, and depends on whether a court makes a legal distinction between such income and the revenue source used to make the investment (e.g., is investment income derived from a fund created to hold reserves of tax revenue considered “taxes”?). “Sales” could include items such as lottery proceeds (because they are derived from the sale of lottery tickets) and bond proceeds (both general obligation and revenue bonds, because they are derived from the sale of financial instruments.) Debt service for general obligation bonds would also be subject to the cap.<sup>7</sup> State GRF spending would clearly be covered under the spending limit. Fee income would be included as well, although the coverage of independent boards that are entirely supported by fees would have to be litigated.

The definition of aggregate **political subdivision** expenditures contains an exception for “gifts, grants, donations, or bequests which are to be expended for purposes specified by the donor.” It is likely that revenue from legal settlements would be covered under the local spending cap.

The implications of aggregating almost all sources of funds in this manner are profound. Most state spending would be subject to a one-size-fits-all straightjacket. Revenues that result from voluntary transactions, such as the purchase of lottery tickets, are treated the same as revenue raised through the compulsory taxing authority of the public sector. Likewise, the spending cap makes no distinction between spending on long-term investments for public infrastructure and spending on current operating expenses. Treating capital expenditures in this manner seems unnecessary given that voters must authorize the issuance of debt through constitutional amendment, as noted above. Nonetheless, the TEL seeks to limit the spending of the proceeds of bond issuances that the public has previously authorized.

- **Emergency** -- Spending by the state or a political subdivision to combat an emergency condition is not subject to the spending cap if the authorizing legislation follows specific procedures outlined in the amendment. These conditions include a three-fifths vote of the general assembly or the legislative authority of the political subdivision.<sup>8</sup> Under the amendment,

an emergency situation exists only if formally declared by the governor due to attack or natural disaster. The amendment specifically states that a “budget shortfall” is not an emergency. The TEL does not permit the state legislature to pass an emergency appropriation in the absence of the governor’s declaration of emergency. Currently, the legislature has the final word in a dispute with the governor. The legislature may override the governor’s veto of any appropriation item. For provisions of law that are not appropriations, legislature can declare an emergency if the bill receives a veto-proof two-thirds majority.<sup>9</sup>

•***The State and state universities*** – The proposed amendment defines the term “state” to mean any division or unit of state government that is “directly supported with tax funds.”<sup>10</sup> The amendment does not define the phrase “directly supported with tax funds,” however, so it will have to be defined through judicial interpretation. It appears to exclude certain organizations that exercise a function of state government but are funded with fees or other types of revenues that are not taxes.<sup>11</sup> This phrase is difficult to reconcile with the TEL’s definition of aggregate state expenditures, which includes other revenue sources besides taxes. The same type of problem is found in the definition of a political subdivision, which lists certain kinds of political subdivisions and then adds the phrase “any other taxing district of the state which is directly supported by tax funds.” Nonetheless, in the absence of a definitive conclusion, it seems reasonable to conclude that state universities are units of state government that fit under the TEL’s definition. They are “directly supported with tax funds” because they receive appropriations of state general revenue funds for operating expenses, and appropriations of the proceeds of general obligation bonds for capital projects.

Currently, state universities are independent organizations with budgets that are approved by each institution’s board of trustees. The consequence of including state universities under the spending limit is that certain portions of their spending would be included in the aggregate state spending limit. In this line of reasoning, there would not be an individual limit for each university’s main campus budget. On the other hand, branch campuses of universities that are established as “university branch districts” would become subject to TEL provisions that apply to political subdivisions to the extent that they are directly supported by taxes.<sup>12</sup>

As noted above, the state-level spending cap applies to “taxes, licenses, permits, fees, or sales.” Therefore, university spending derived from the following sources probably would come under the state spending cap: tuition and other fees charged to students and faculty; ticket sales to university sports and entertainment events; licensing revenue from items bearing university logos and from university-owned intellectual property; proceeds from bond sales, sales of property, and contracts for the sale of university services.<sup>13</sup> Alumni gifts and bequests, income derived from federal sources, grants, and (perhaps) investment income are major sources of university revenues that could support expenditures that would not fall under the state spending cap.<sup>14</sup>

Again, the lack of any distinction between revenues from voluntary transactions and those from tax revenue is plainly evident. Tuition from out-of-state students is treated the same as that from in-state students, even though the tuition payments of out-of-state students are not economic

burdens for Ohioans. The TEL will even limit spending of the proceeds of tickets to Ohio State Buckeye football games. On a more serious note, the thrust of state policy in recent decades has been to induce more university interaction with the local economy through contracts for private research and development projects that are relevant to business' needs. These contracts will now come under the cap. Moreover, the state has encouraged university researchers to become more entrepreneurial by developing intellectual property that can be licensed by the university. These revenues will become subject to the cap as well.

### THE TEL SUPREMACY CLAUSE AND THE OHIO CONSTITUTION

The TEL provides that “In any case of conflict between any provision of this section and any other provision contained in this constitution, the provisions of this section shall control.”<sup>15</sup> It also instructs judges that its provisions “shall be liberally construed for effectuating the purposes thereof.”<sup>16</sup> The supremacy clause was not present in the two earlier versions of the amendment. The full implications of this sweeping provision cannot be known in advance. Potential conflicts exist with constitutional sections that limit the uses of workers' compensation funds and motor fuel taxes, and with the home rule power of charter municipalities. These potential conflicts are discussed below in the sections on the state budget reserve fund and limitations on political subdivisions.

The most obvious change in constitutional law is the requirement that the state hold a mandatory voter referendum to authorize spending above the cap. Under a current constitutional provision, laws providing for tax levies or appropriations for the current expenses of state government go into immediate effect and are not subject to the referendum.<sup>17</sup> An exception to this rule occurred in 1997, when the legislature placed an issue on the ballot to increase the sales tax by one percent in order to raise revenue for schools.<sup>18</sup> The legislature interpreted another constitutional provision (Sec. 26 of Article II), which permits general laws pertaining to schools to take effect without legislative enactment, to permit the 1997 referendum.<sup>19</sup>

## PROHIBITION ON STATE MANDATES

The TEL provides that political subdivisions are not required to fulfill a state-imposed mandate unless the state provides sufficient funds:

A political subdivision may not be required to fulfill any mandate imposed by the state unless and until, and may be required to fulfill that mandate only to the extent that, moneys are provided to the political subdivision by the state for that purpose. The general assembly is not required to appropriate moneys for mandates if more than two years have passed since the effective date of the mandate and no claim for funding has been made by the political subdivision.<sup>20</sup>

This provision turns existing state-local relations upside down. The amendment borrows the concept of a “mandate” from federal-state relations in which states are semi-sovereign entities. State-local relations are an entirely different matter, however. Except for municipalities, which have “home rule” powers under the Ohio Constitution, and the ability of a county to become a “charter” county (Summit County is the only example of the latter), political subdivisions are arms of the state. They have only those powers conferred by state statute, and must perform duties that are required by statute.

Unfortunately, the proposed amendment does not define what is meant by a “mandate,” so how the courts would construe this provision is anyone’s guess. Under an expansive interpretation, substantive requirements imposed on a local government above and beyond the basic administrative duties of a public office might be construed as a mandate. The principle of shared state and local responsibility would be eviscerated, and the state would either have to pay in full for a mandate or remove it. The phrase “**any** mandate imposed by the state” [emphasis added] appears to include state efforts to comply with federal mandates as well.

The second (i.e., legislative) version of the TEL required the State Auditor to identify the costs of all state programs.<sup>21</sup> As impractical as this gargantuan task may have been, it did establish an administrative calculation of the costs that could serve as a baseline in discussion between the state and localities. The current version of the amendment removes the State Auditor’s role. If the state and political subdivisions cannot agree on the costs of a program, then the dispute will become yet another source of litigation. The right of a political subdivision to refuse to comply with a mandate will take on added importance if the state is in a fiscal crisis. As noted above, the “emergency” spending exception to the spending cap does not include a budget shortfall.

Unlike the second version of the amendment, the current version makes no distinction between existing requirements and new requirements that may be added after its adoption. This leaves open the question of whether the provision applies to mandates that were adopted before the effective date of the amendment. At first glance, the second sentence of the quotation above appears to apply the provision only to new mandates and those with effective dates less than two years before the adoption of the amendment.

On the other hand, the amendment contemplates its application to existing laws in its requirement that “The general assembly shall repeal or amend all laws that are not consistent with the provisions of this section...”<sup>22</sup> Moreover, the TEL’s requirement that its provisions be

“liberally construed” may be at odds with an interpretation that puts many existing mandates forever out of reach, particularly in light of the fact that the General Assembly constantly modifies procedures and standards used in existing law. An existing section of law may be amended multiple times over the course of just a few years. Courts may decide that substantial modifications to an existing mandate have changed it significantly enough to give it a new effective date, or may decide that elements that have been added to an existing law are subject to the TEL while older provisions of the law are not. Either way, legions of Ohio attorneys will be employed litigating these points.

### IMPACT OF THE TEL ON THE BUDGET TIME-FRAME

***The imposition of a mandatory referendum delays the effective date of the state budget by at least three months if the legislature decides that the budget must exceed the TEL.*** The mandatory referendum must take place more than 60 days after the bill is filed with the Secretary of State. Then, if approved by the voters, the proposal would not take effect until 30 days after the date of the election. These two requirements establish a minimum period of 90 days between approval by the governor and the effective date of a spending bill. In order to have the bill take effect at the end of the current fiscal year, legislative deliberation would have to be concluded by the end of March. This would severely compress the normal time for budget hearings, and make it more difficult for legislators and the public to fully explore all of the difficult choices that must be made.

A statewide campaign, with no opportunity for compromise or changes in the proposal, would take the place of the normal legislative process.

### BUDGET RESERVE FUND

The proposed amendment would create a Budget Reserve Fund (BRF) “in the state treasury for the purpose of receiving and holding budgetary reserves for the state...” These reserves could be spent for “for any lawful purpose.”<sup>23</sup> The expenditure of BRF resources would still be subject to the spending cap unless used for refunds or an emergency. The TEL establishes a mandatory fiscal year-end transfer of money to the BRF. The transfer consists of “**all** of the unencumbered moneys in the general revenue fund, and ten percent of the unencumbered moneys in **all** non-general revenue funds.”<sup>24</sup> (Emphasis added.) In state budget terminology, funds become encumbered if they are necessary to meet a contractual obligation, even if they are not actually spent until the next fiscal year.<sup>25</sup> Under the amendment, half of these accumulated funds are to be used for tax refunds, and half of the funds are to be placed in the BRF. If *at any time* the budget reserve fund exceeds fifteen per cent of aggregate state expenditures for the preceding fiscal year, the excess money must be refunded on a *pro rata* basis to all individuals who paid Ohio income tax in the preceding calendar year.

• ***The mandatory return of unencumbered funds means that income taxpayers may receive a refund from taxes they have not paid.*** The tax refund mechanism in the proposed amendment would pool revenue from many different taxes and fees and give it to individuals who paid the income tax. Individuals or businesses that paid a fee for a specific program or license may see little of this refund. This is an unfair and cumbersome way to distribute a surplus

• ***Returning the BRF surplus on a pro rata basis (i.e., according to each individual's contribution to total income tax receipts) would produce a windfall for wealthy individuals.***

Because Ohio's income tax is structured with graduated rates, wealthy taxpayers pay a proportionately higher share of their income to that tax. Ohio's overall tax system is not so progressive, however. By tying tax refunds to the income tax, the TEL would direct tax relief to the wealthy. Many low income individuals pay more in sales and excise taxes each year than income taxes. Their fractional shares of a mandatory BRF refund would not reflect this reality, however.

• ***The year-end transfer of resources to the BRF sets up possible conflicts with other constitutional provisions that protect special purpose funds.*** The state treasury contains many special purpose funds in addition to the GRF. Some of these funds are considered "custodial" or "trust" funds that are held by the state treasurer for administrative purposes, but are not considered "state funds" like the GRF and most of the other funds subject to legislative appropriation authority.<sup>26</sup> The Treasurer of State's web site contains a list of these funds that includes, for example, various funds for the retirement of bonds or the holding of bond proceeds, funds for the investments of public employee retirement systems, a fund to receive Ohio's share of payments derived from the legal settlement with cigarette companies, and a fund to hold reserves for the Ohio Tuition Trust Authority (OTTA).<sup>27</sup> Some of these custodial funds, like the OTTA, may be excluded from the year-end transfer because they do not contain tax revenue and so are excluded from the TEL's definition of the term "state," but this is not clear (see the heading "Key terms and concepts in the proposed amendment," above). Other custodial funds contain tax revenue but are dedicated to a specific use by existing constitutional sections.

Would the TEL's requirement for a year-end transfer of resources to the BRF cover funds that are protected by existing sections of the constitution? When the phrase "**all** of the unencumbered moneys in the general revenue fund, and ten percent of the unencumbered moneys in **all** non-general revenue funds" is viewed in light of the TEL's supremacy clause, this outcome is very likely.

For example, a potential conflict could arise between the TEL and the constitutional requirement that all motor vehicle fuel taxes and license fees must be devoted to highway construction, repair, and related traffic safety issues.<sup>28</sup> The drafters of the TEL make no specific exception for this constitutional section in the BRF provisions. In the absence of a specific exclusion for fuel taxes, the phrase "expended by the general assembly for any lawful purpose" could be interpreted to allow unencumbered funds from motor-vehicle operation to be placed in the BRF and then redirected to other spending purposes or refunds.<sup>29</sup>

Likewise, the Ohio Bureau of Workers' Compensation (BWC) collects premiums from employers under the authority of a specific constitutional provision that permits the state to establish a fund to compensate workers and their dependents for death, injuries, or occupational disease.<sup>30</sup> No specific exclusion is made by the drafters of the TEL for this existing constitutional section, either. Under current law, the State Insurance Fund and other BWC funds are custodial funds in the state treasury that cannot be used except for purposes defined in the constitution.<sup>31</sup> The TEL may force the year-end transfer of unencumbered amounts from BWC

funds to the BRF, where they could then be appropriated for other purposes or used for tax refunds.<sup>32</sup>

Clearly, not all of the BWC funds are “encumbered” in the sense that they are needed to meet existing obligations. In recent years, the BWC has accumulated a surplus from which it has derived investment earnings. Although some of the investment decisions and the size of the investment earnings have come under scrutiny lately, the investment earnings have been used to give employers a discount on their premium payments. Regardless of whether these discounts continue, the TEL poses a real threat to the principle that the finances of the workers’ compensation system are ultimately to benefit injured workers and their dependents.

Even for special revenue accounts that are established without specific constitutional authority, an indiscriminate transfer of resources to the BRF violates the expectation that special fees for licensure or regulation are used for a specific purpose, not to prop up general state spending or to provide for general tax relief. Special revenue funds are created for many different purposes, and taking funds away from them should be accomplished through the deliberation of the legislative process, not through an indiscriminate sweep of 10 percent of their fund balances.

### LIMITATIONS ON LOCAL PROPERTY TAXES

State law already contains many restrictions on local taxation. It is unclear why the framers of the TEL felt it necessary to add even more restrictions. The most notable existing restriction on local taxation is that voters must approve all property tax levies that would cause the aggregate amount of taxes on property to rise above the “ten mill limitation” (i.e., above one percent, also known as “outside millage”).<sup>33</sup> Voters may decrease the rate of continuing levies for outside millage.<sup>34</sup> Levies for outside millage also are subject to a constitutionally-required property tax rollback unless they are for a specified amount of money or to pay debt charges.<sup>35</sup> The rollback ensures that the total amount of revenue collected does not increase due to appreciation in property values. Under the TEL, all political subdivision property tax levies for inside millage would need voter approval as well, although as a practical matter, most political subdivisions have used their full allotments of inside millage.<sup>36</sup>

The Ohio Constitution permits a municipality to adopt a charter under which it may establish its own procedures for the exercise of matters of local self-government that are at variance with state law.<sup>37</sup> According to the Ohio Municipal League, 242 Ohio municipalities have adopted a charter.<sup>38</sup> The constitutional provisions requiring voter approval of outside millage and the property tax rollback have specific exceptions for levies that are imposed according to the procedures of a municipal charter. These exceptions express the principle that voters in municipalities should be given the option of modifying provisions in state law, even those that are intended to control taxation.<sup>39</sup>

Unlike these existing constitutional provisions, the TEL makes no exceptions for charter municipalities. The supremacy clause makes it clear that the TEL prevails in a conflict with the home rule sections of the Ohio Constitution. Therefore, under the TEL, a charter municipality could not levy any property taxes without voter approval, regardless of charter provisions to the contrary. Municipalities also would no longer be able to levy an income tax up to one percent without voter approval.<sup>40</sup>

## APPLICATION TO LOCAL GOVERNMENT DEBT SERVICE

The application of the TEL's spending limit provision may produce a strange situation for taxes levied to pay debt service on bonds. Even after voters have approved property tax levies for debt service, the proposed TEL could limit the expenditure of these amounts. Current statutory law provides that voter authorization of a bond levy "shall be deemed to be an appropriation of the proceeds of the bond issue" although the taxing authority must authorize their expenditure.<sup>41</sup> The proposed amendment could lead to a situation in which voters refuse to authorize spending some, or all, of the revenues in subsequent years if the political subdivision proposed to exceed its spending limit. In the meantime, taxes must continue to be collected for debt service.

## ISSUES FOR SCHOOL DISTRICTS

Some of the problematic situations that could occur on the local level can be illustrated through the following situations that could confront school districts:

- The limit for "aggregate expenditures" may pose a major problem for districts whose budgets have a high proportion of capital spending for buildings and other infrastructure. A district that begins a major capital project using its own funds may find that its proposed budget exceeds the annual cap, even if student enrollment is flat or declining.
- Many school districts cross municipal, township, or even county lines. The amendment gives no guidance as to how the spending cap should be determined when a district crosses multiple jurisdictions. If the population estimates for a political subdivision are "not available," then the TEL requires the use of population estimates for the county. What happens if they are available but do not correspond to the school district's boundaries? Litigation will be need to answer this question.

## CONCLUSION

The proposed TEL contains numerous flaws, not the least of which is that many of its provisions are ambiguous and will require a substantial amount of litigation to sort out. What state “mandates” on local governments must the state pay for? What population estimates are used when a school district crosses multiple political jurisdictions? Is investment income subject to the state spending cap? How does the amendment treat workers’ compensation premiums and motor fuel taxes? Three versions of the amendment have been put forward since November 2004. The proponents of the amendment have had ample time to remedy these ambiguities, but they have chosen not to. Instead, they inserted a supremacy clause into its provisions. Ohio’s voters will not know exactly what they are getting if they approve this amendment, but they can be assured that the amendment will override any other section of the constitution in case of conflicts.

In the instances when the meaning of the amendment is clear, it will produce significant changes in the way government operates. The requirement that the state hold a referendum in order to exceed spending limits gives less time for public input into the legislative process. The mandatory tax refund provisions create a windfall by refunding taxes to individuals who may have never paid a particular kind of tax or fee. A large portion of state university spending will become subject to an overall state spending cap even though universities have their own budgets. The amendment is poorly conceived and would not serve the interests of Ohioans. It deserves to be rejected.

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<sup>1</sup> “TABOR: A Taxpayer Bill of Goods?,” John R. Corlett, The Center for Community Solutions (Cleveland), January 14, 2005.

<sup>2</sup> This figure is based on an across-the-board cut to the GRF. David Bradley and Iris J. Lav, “A State of Decline: What a TABOR would mean for Ohio,” Washington, D.C.: Center on Budget and Policy Priorities, April 19, 2005.

<sup>3</sup> “TEL Increases Federal Government’s Influence over Ohio’s Spending Priorities,” David A. Ellis, Ph.D., The Center for Community Solutions (Cleveland), January 27, 2005.

<sup>4</sup> Senate Joint Resolution No. 4 and H.J.R. 4 of the 126<sup>th</sup> General Assembly.

<sup>5</sup> Sec. 17, Art. 8, Oh. Const.

<sup>6</sup> 86 *Ohio Jurisprudence 3d* Taxation § 6.

<sup>7</sup> Debt service for revenue bonds at the local level would be subject to the cap, unless financed by grants or gifts. Coverage of debt service for revenue bonds at the state level would depend on the nature of the revenue used for repayment.

<sup>8</sup> Other requirements for emergency spending legislation include (1) the identification by appropriation item of the amount and purpose of each temporary expenditure and the means by which revenue will be generated to fund it; (2) limitation of the expenditure to the amount and purpose outlined in the bill; and, (3) the expenditure of all federal or other funds earmarked for emergency purposes and then for the entire amount of the budget reserve fund before spending any additional funds. Sec. 14(F)(1) and (2) of the proposed amendment.

<sup>9</sup> There must be a separate vote on the emergency clause of a bill. Section 1d, Article 2, Oh. Const.

<sup>10</sup> The definition contains a long list of examples of types of state organizations, including “branch, state office, authority, agency, board, commission, institution, instrumentality...” Sec. 14 (F)(8) of the proposed amendment.

<sup>11</sup> In contrast, Revised Code section 1.60, which defines the term “state agency” for the purposes of Title 1 of the Code, makes no reference to the manner of funding but provides that the term “means every organized body, office, or agency established by the laws of the state for the exercise of any function of state government.”

<sup>12</sup> Ohio law defines a university branch district as “a political subdivision of the state and a body corporate with all the powers of a corporation...” (RC 3355.01(A). *See also* R.C. 3355.03) A university branch district may issue bonds supported by a local property tax levy for its capital construction needs. (R.C. 3355.08 et seq.)

<sup>13</sup> The reference to “sales” as a covered revenue source must be interpreted in conjunction with the exclusion for federal revenue. It is unclear whether university service contracts with the federal government would be covered.

<sup>14</sup> A recent Ohio Attorney General opinion states that “...the awarding of a grant generally connotes an element of gift, rather than an equal exchange resulting in a standard business contract.” Oh. Att. Gen. Op. No. 2004-014, p. 21.

<sup>15</sup> Sec. 14(G)(4) of the proposed amendment.

<sup>16</sup> Section 14(G)(1) of the proposed amendment.

<sup>17</sup> Sec. 1d, Art. 2, Oh. Const.

<sup>18</sup> Richard G. Sheridan, *Follow the Money: Ohio State Budgeting*, Cleveland: Federation for Community Planning (2000), pp. 15 and 36.

<sup>19</sup> This interpretation was never tested in the Ohio Supreme Court. *Id.*, p. 15.

<sup>20</sup> Sec. 14(C) of proposed amendment. The provision goes on to state that funds provided for mandates are subject to the state spending limitation, and are in addition to state funds required under the amendment’s local government fund provision.

<sup>21</sup> Sec. 14(C) of Senate Joint Resolution No. 4, 126<sup>th</sup> G.A.

<sup>22</sup> Sec. 14(G)(4) of the proposed amendment.

<sup>23</sup> Sec. 14(B)(3) of the proposed amendment.

<sup>24</sup> Sec. 14(B)(2) of proposed amendment.

<sup>25</sup> R.C. 131.01(M) defines an “encumbering document” as “a document reserving all or part of an appropriation.” An encumbrance represents “commitments against appropriations for unperformed (executory) contracts for goods and services.” Sheridan, *op. cit.*, Appendix A, p. 207.

<sup>26</sup> See the discussion in Ohio Attorney General Opinion No. 2004-014.

<sup>27</sup> Available at the Treasurer’s website, <http://www.ohiotreasurer.org/f-cust.htm>.

<sup>28</sup> Sec. 5a, Art. 12, Oh. Const.

<sup>29</sup> It would be possible for the General Assembly to avoid a conflict by segregating fuel taxes within the BRF and devoting them entirely to highway spending in future budgets rather than tax refunds or other government programs. This would be possible only if fuel taxes in any fiscal year were less than one half of the revenues accumulated by the year-end transfer to the BRF. In that way, other taxes could be used to satisfy the requirement that one half of the year-end surplus be used for tax refunds.

<sup>30</sup> Sec. 35, Art. 2, Oh. Const.

<sup>31</sup> In a 1960 decision, the Supreme Court refused to allow the General Assembly to transfer amounts from the State Insurance Fund to the GRF (*Corrugated Container v. Dickerson* (1960), 171 Ohio St. 289). Likewise, a 1999 Attorney General's opinion stated that resources in the State Insurance Fund are "not moneys belonging to the state" for purposes of Section 4, Article 8 of the Ohio Constitution, which prohibits state aid to private industry (Ohio Attorney General Opinion No. 99-002). In recent years, the Supreme Court has given the BWC more leeway to use resources from the state insurance fund as long as they are for integral components of the state's workers' compensation scheme. (see *Northwestern Ohio Bldg. and Constr. Trades Council v. Conrad* (2001), 92 Ohio St.3d 282).

<sup>32</sup> Even if the definition of the term state and the phrase "directly supported with tax funds" is construed to limit the scope of the year-end transfer of funds, workers' compensation premiums may be subject to the transfer if a court finds that they are taxes rather than fees. The Ohio Supreme Court has not been faced with a decision as to whether workers' compensation premiums are taxes. The court has warned that "Determining whether an assessment is a fee or a tax must be done on a case-by-case basis dependent upon the facts and circumstances surrounding each assessment." (*State, ex rel. Petroleum Underground Storage Tank Release Compensation Board v. Withrow* (1991), 579 N.E.2d 705, p. 708; 62 Ohio St.3d 111). Nonetheless, it seems likely that a court would view the premiums as taxes. In a case involving unemployment compensation, which is also a social insurance program, the Ohio Supreme Court ruled that contributions paid by employers are excise taxes. (*State, ex rel. Youngstown Sheet & Tube Co. v. Leach* (1962), 173 Ohio St. 397, 183 N.E.2d 369, paragraph one of the syllabus. Followed in *State, ex rel. Shkurti v. Withrow* (1987), 513 N.E.2d 1332, 32 Ohio St.3d 424). Moreover, federal bankruptcy law treats Ohio workers' compensation premiums as excise taxes. (*Ohio Bureau of Workers' Compensation v. Mullins* (2000), 747 N.E.2d 856, 140 Ohio App.3d 375; Follows the U.S. Court of Appeals for the Sixth Circuit decision *In re Suburban Motor Freight* (C.A. 1993), 998 F.2d 338)

<sup>33</sup> Sec. 2, Art. 12, Oh. Const.

<sup>34</sup> An initiative petition calling for a decrease in the rate of a continuing levy may be submitted to the voters once every five years (R.C. 5705.261).

<sup>35</sup> Sec. 2a, Art. 12, Oh. Const.

<sup>36</sup> Inside millage levies may be for current operating expenses or for certain types of permanent improvements (see R.C. 5705.04 and 5705.05).

<sup>37</sup> Sec. 7, Art. 18, Oh. Const.

<sup>38</sup> "Appendix A: Ohio Municipalities with Charters," document available at the Ohio Municipal League website, [http://www.omunileague.org/Charters\\_web.PDF](http://www.omunileague.org/Charters_web.PDF), accessed July 14, 2005.

<sup>39</sup> The General Assembly recognized these exceptions when enacting implementing legislation for these two constitutional provisions. A municipal council can vote to levy or increase property taxes above the ten mill limit without a vote of people if the charter provides for a specific limitation on the total tax rate (R.C. 5705.18). The rollback does not apply to taxes provided for by the charter of a municipal corporation (R.C. 319.301).

<sup>40</sup> R.C. 718.01(C).

<sup>41</sup> R.C. 5705.41(A).



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