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December 10, 2013

While Property Tax Reform Proposals Abound in Harrisburg, Real Reform Still Needed

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Overview

Property taxes have been a subject of much debate in Pennsylvania, and efforts to reform them have heated up in recent months. Unfortunately, the four major proposals currently before the General Assembly do not address the primary issue with property taxes in Pennsylvania — that too few state dollars are used to support public schools in the commonwealth.

Lawmakers' interest in addressing property taxes in Pennsylvania is not surprising as these taxes have long been found to be the least liked in study after study, across the United States.¹ Despite their low popularity, property taxes have long been the cornerstone of local taxation in the U.S.

In Pennsylvania, property taxes are the primary funding source for school districts, counties, and municipalities. Totaling \$16.6 billion in 2011, property taxes accounted for more than 70% of all local tax revenue in Pennsylvania.² Local school property taxes accounted for \$11.5 billion, or 69%, of all local property taxes in 2011. Four out of every five local tax dollars collected to fund Pennsylvania schools in 2011 came from property taxes.³

Property tax issues can make it difficult to provide a quality education to every child, especially in Pennsylvania, which relies more heavily than most states on using local funds to pay for schools. In 2011, Pennsylvania ranked 8th highest in the share of school funding coming from local sources.⁴

¹ For example, a 1972 Federal Advisory Commission on Intergovernmental Relations study found that property taxes were ranked by 45% of respondents as being the least fair tax, followed by the federal income tax at 19%. "Public Opinion and Taxes," Advisory Commission on Intergovernmental Relations, May 1972, <http://www.library.unt.edu/gpo/acir/Reports/survey/S-1.pdf>.

² State & Local Government Finance Data Query System, The Urban Institute-Brookings Institution Tax Policy Center, <http://slfdqs.taxpolicycenter.org/>. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (2011). Accessed November 26, 2013 at 4:38 p.m.

³ School property taxes as reported for 2011 by the Pennsylvania Department of Education, available at: http://www.portal.state.pa.us/portal/http://www.portal.state.pa.us:80/portal/server.pt/gateway/PTARGS_0_123706_1335912_0_0_18/Finances%20AFR%20Revenues%202011-2012.xlsx.

⁴ "2011 Annual Survey of School System Finances," Table 5, U.S. Census Bureau, http://www2.census.gov/govs/school/elsec11_sttables.xls.

If legislative changes are made to lessen local dependence on property taxes, new funding sources must be identified to replace the lost revenue for public schools. This amounts to a tax shift — in which some taxpayers win and others lose. The larger the scope of the reform, the larger the tax shift has to be.

In the last six months, there have been four major proposals to change school property taxes in Pennsylvania, most of them employing some type of tax shift. Despite this activity, it is unclear if any will pass both houses of the General Assembly.

Done well, property tax reform can make it easier for Pennsylvania to finance our schools more equitably for both students and property owners. Done poorly, reform efforts could create larger inequities in the system and reduce school funding.

A Closer Look at the Legislation

Below is a brief summary of the four major legislative proposals addressing property taxes in Pennsylvania.

[House Bill 76 \(Cox\) and Senate Bill 76 \(Argall\)](#)

Called the “Property Tax Elimination Act” by supporters, these identical bills would eliminate school property taxes⁵ for all taxpayers and replace them with a mix of increased state sales and personal income tax. The amount of property taxes levied by school districts in 2013-14 would be replaced dollar-for-dollar with the new state taxes. In future years, the amount distributed to schools would increase by the lower of sales tax or Consumer Price Index (CPI) growth in the previous year.

This artificial constriction of school funding is a key element to the plan. A recent study by the Pennsylvania Independent Fiscal Office (IFO) projected that schools would receive \$2.6 billion less in funding from HB76/SB76 by 2018-19 than could be expected from the current system.⁶

While schools would receive less, certain taxpayers would clearly benefit from this plan. Corporations, which currently pay roughly 30% of all property taxes in Pennsylvania, would see their school district property taxes eliminated without any increase in state corporate tax rates. This means the taxes corporations currently pay would be shifted to personal income and sales taxpayers.

These bills have received hearings in the Finance Committees of both the House and Senate, where the bills remain. On the floor of the House, supporters of the plan attempted to amend HB 1189 to replace its language with text from HB 76, but the vote failed 59-138.⁷

⁵ School districts would be able to levy property taxes to pay off existing school district debt outstanding at the time of the bill’s enactment.

⁶ “Analysis of House Bill 76 and Senate Bill 76,” Independent Fiscal Office, October 15, 2013, http://www.ifo.state.pa.us/resources/PDF/HB-SB_76_IFO_Fiscal_Analysis.pdf

⁷ Roll Call Vote, [House Bill 1189](#) PN 2355, [A3448](#) Cox, House of Representatives, Session of 2013-2014, Regular Session, October 1, 2013, 6:29 p.m., available at: http://www.legis.state.pa.us/CFDOCS/Legis/RC/Public/rc_view_action2.cfm?sess_yr=2013&sess_ind=0&rc_body=H&rc_nbr=728

The bills have received support from vocal local taxpayer groups, the Pennsylvania Association of Realtors⁸ (whose members would benefit from increased sales commissions from the change as housing prices inflate), and the Pennsylvania Farm Bureau.⁹

[House Bill 1189 \(Grove\)](#)

HB 1189 would create an “Optional Property Tax Elimination Act” allowing local school districts to enact “replacement taxes” to directly offset school property taxes. The bill would permit school boards to adopt the new taxes — earned income and gross receipts-based mercantile/business privilege taxes on certain types of businesses¹⁰ — by a majority vote. The bill requires at least 50% of the new tax revenue generated to come from earned income taxes.

While the bill gives local school districts the opportunity to diversify their tax revenues and lessen reliance on local property taxes, it has limited impact. Rather than addressing the over-reliance on local taxes to fund schools, it shifts who pays local school taxes.

Most school districts, 461 of 500,¹¹ already collect earned income taxes, so it is unclear how much districts would be able to raise local income tax rates. With the requirement that half of the new revenue come from earned income taxes, this could limit how much replacement revenue is raised in a district that already has an earned income tax rate of 1% or more.

The shift from property taxes to mercantile and business privilege taxes raises other issues regarding the nature of business support for local public education. Any reduction of school property taxes paid by businesses is essentially shifted to wage earners and a narrow band of businesses that pay mercantile and business privilege taxes. This includes all school property taxes paid by manufacturers, beer distributors, banks, farmers, and food processors, as these businesses are exempt from mercantile and business privilege taxes. If property taxes in a district were completely eliminated, many of these exempt businesses would be paying nothing toward supporting local schools. The impact of this shift would vary from district to district due to the mix of business types operating in each.

Mercantile and business privilege taxes are unpopular with the business community for several reasons. One complaint is that businesses subject to these taxes must pay them whether their business is profitable or not. Another is that if businesses operate in more than one locality, it can be difficult to determine what share of receipts are taxed in a particular jurisdiction. Finally, since this would be a new tax for most communities, it adds to the complexity of local taxes across the state. The taxes were seen as being so problematic that Act 145 of 1988 banned local governments from enacting new mercantile or business privilege taxes.¹² HB 1189 would reverse this for school districts.

⁸ “Property Tax Reform,” Pennsylvania Association of Realtors, <http://www.parealtor.org/property-tax-reform/>

⁹ “Update of State House Bills of Interest, 2013-2014 Legislative Term,” Pennsylvania Farm Bureau, November 2013, <http://www.pfb.com/images/issues/current-House-report-2013.pdf>

¹⁰ These taxes are levied on wholesalers, retailers, and service providers.

¹¹ “Summaries of Annual Financial Data Reports, Local Revenue, 2011-12,” Pennsylvania Department of Education, http://www.portal.state.pa.us/portal/http://www.portal.state.pa.us:80/portal/server.pt/gateway/PTARGS_0_123706_1336397_0_0_18/Finances%20AFR%20LocalRev%200304-1112.xlsx

¹² Local Tax Reform Act, Act of Dec. 13, 1988, P.L. 1121, No. 145, available at: <http://www.legis.state.pa.us/cfdocs/legis/Li/uconsCheck.cfm?txtType=HTM&yr=1988&sessInd=0&act=145>

HB 1189 passed the House on October 2, 2013.¹³ It is unclear if the Senate will act on this bill.

The Pennsylvania Farm Bureau has publicly supported¹⁴ this bill, and the Pennsylvania School Boards Association supports portions of the bill.¹⁵

[House Bill 1685 \(Benninghoff\)](#)

Much like HB 1189, HB 1685 is focused solely on optional local tax changes, shifting taxes among local taxpayers. HB 1189 is focused on wage earners and homeowners. The bill permits school boards to enact an earned income tax by a majority vote of the board. Current law requires a voter referendum to approve the new tax. Any revenue raised from the earned income tax is used to increase the homestead property tax exclusion in a district. Essentially, the bill shifts taxes from owners of primary residences (homesteads) to wage earners.

The bill preserves local control over local taxation, but does not address the issue of overreliance on local taxation to fund schools or the inequity of resources available between districts.

HB 1685 is currently listed on the House of Representatives voting calendar for second consideration.

[Senate Bill 299 \(Pileggi\)](#)

SB 299 redirects gaming revenue from casinos currently used to pay for general property tax relief to all homesteads to finance a school property tax freeze beginning in 2013 for eligible senior homeowners. To be eligible, seniors must have lived in their homestead for the previous five years and be up-to-date in their school property tax payments. Once eligible, a senior's school property taxes are frozen at the current level, with any increase being paid by the state from the Property Tax Relief Fund.

According to the bill co-sponsorship memo, seniors would have to choose whether they wanted the school property tax freeze or benefits under the state's Property Tax/Rent Rebate Program.¹⁶ It is unclear if the current bill contains this limitation.

Any gaming funds that are used to finance the tax freezes for seniors would reduce the amount of funding available for general homestead property tax relief. At this time, it is not clear how large of a reduction this would be. With less general homestead tax relief coming from gaming funds, homeowners would see their property tax bills increase with the passage of this bill, even if the local school district does not raise property tax rates.

¹³ House Bill 1189, House of Representatives, Session of 2013-2014, Regular Session, available at: http://www.legis.state.pa.us/cfdocs/billInfo/bill_history.cfm?year=2013&sind=0&body=H&type=B&bn=1189

¹⁴ "Update of State House Bills of Interest 2013-2013 Legislative Term," Pennsylvania Farm Bureau, November 2013, <http://www.pfb.com/images/issues/current-House-report-2013.pdf>

¹⁵ "House Bill 1189: Optional Property Tax Elimination Act," Pennsylvania School Boards Association, <http://www.psba.org/issues-advocacy/issues-research/property-tax-reform/hb1189.asp>

¹⁶ Co-Sponsorship Memorandum: Legislation Implementing a School Property Tax Freeze for Residents 65 and Older, Senator Dominic Pileggi, Session of 2013-2014, Regular Session, December 5, 2012, 3:53 p.m., available at: <http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=S&SPick=20130&cosponId=9812>

The freeze benefits are not targeted to those most in need, and in fact could be largely used to subsidize wealthy taxpayers' property tax bills. If more expensive homes appreciate more quickly than moderate priced homes, more of the state gaming funds would be directed to the faster-increasing gap between frozen property tax values and the current market.

It is also unclear what occurs if revenue in the Property Tax Relief Fund are insufficient to repay local school districts for the cost of the frozen taxes for seniors. While this is unlikely to be an issue initially, it becomes an issue the longer taxes are frozen and the gap between the frozen rate and the rate being charged to other homeowners grows.

SB 299 is currently in the Senate Finance Committee awaiting consideration.

Conclusion

While the General Assembly has spent a considerable amount of time discussing property tax issues in the past year, the four proposals discussed in this paper fail to address the primary issue at the root of these problems – too few state dollars are used to support our public schools.

HB 76 and SB 76 replace most local funding with state dollars, but this “solution” is worse than the problem. The plans would constrict school funding, damaging the quality of education for future students.

HB 1189 and HB 1685 give local schools a more diverse revenue base, but do nothing to lessen Pennsylvania's heavy dependence on local sources to fund schools.

SB 299 redirects gaming revenue to seniors, but without regard to their income or wealth.

Property tax relief should be targeted to those most in need. All property owners can be helped with increasing state dollars to fund local schools. Increasing state funds also helps ensure students receive a high quality education no matter where they live or the value of the local tax base.

Property tax relief should be directed to people who pay an excessively large share of their income in property taxes. Expanding and reforming the state's existing Property Tax/Rent Rebate Program would be a more effective way to target relief to specific taxpayers in need. The program could be expanded to include non-seniors.

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