



# Throwing the Baby Out with the Bathwater:

Pennsylvania Budget and Policy Center Testimony on HB 1776  
Pennsylvania House of Representatives Finance Committee Hearing  
June 4, 2012

Good morning Representative Benninghoff and Representative Mundy and fellow members of the Finance Committee. Thank you for the opportunity to comment on House Bill 1776. I am Michael Wood, Research Director of the Pennsylvania Budget and Policy Center. Founded in 2005, the Pennsylvania Budget and Policy Center (PBPC) is a nonpartisan, statewide policy research project that provides independent, credible analysis on state tax, budget, and related policy matters, with attention to the impact of current or proposed policies on working families.

## Overview

HB 1776 attempts to “solve” the property tax problem in Pennsylvania by eliminating school property taxes, typically the largest portion of a taxpayer’s property tax bill. While property taxes are a problem for people in specific situations and over-reliance on a single source of tax income is a problem for public institutions, eliminating school property taxes in Pennsylvania - and the strict limits placed on schools – in this bill would have dire unintended consequences for our state, our residents, and our children.

Rather than taking the radical steps encompassed in HB 1776 and the uncertainty they would foster, we think the General Assembly could consider a number of more targeted and proven policy prescriptions that would better address property tax issues in Pennsylvania.

Pennsylvania has over 5 million owner-occupied residences, according to the U.S. Census.<sup>1</sup> Proponents argue that 10,000 Pennsylvanians lose their homes each year, which equates to less than 0.2% of the total homes in the state. Dismantling the school funding system for a problem that doesn’t affect 99.8% of the homeowners is “throwing the baby out with the bathwater” as HB 1776 suggests.

Other states that have tried similar measures and the results are not promising for success in Pennsylvania.

HB 1776 includes a number of features that could be part of an effective solution, but as currently written goes too far.

As you consider this bill, and other proposals to reform property taxes, a number of things should be kept in perspective.

### **1. While people do not like paying property taxes, they benefit our communities and our wallets.**

Our local communities invest our property tax payments in education for our children. As funding has increased, so have the offerings schools can provide. These have tangible benefits we see through increased test scores, increased graduation and college entrance rates, and improved job readiness/competitiveness. Good schools in our communities make our houses worth more and expand opportunities for us all. Over the years, property taxes have helped make this possible.

These investments show dividends. Pennsylvania was the only state of the 25 measured in a Center on Education Policy study with rising test scores in all three grades (4, 8, and 11) measured and all three achievement levels in both reading and math.<sup>ii</sup> Pennsylvania students are also increasingly entering college immediately after high school, growing from 53.8% of students in 1992 to 63.9% in 2008.<sup>iii</sup> This is helping to make Pennsylvania a more educated and job-ready workforce.

Studies have shown that increasing skills in local areas is a key driver of growth – and good schools are significant part of this. A 2003 paper published by the Harvard Institute on Economic Research concluded “city growth can be promoted with strategies that increase the level of local human capital. At the regional or metropolitan level, attracting high human capital workers may require provision of basic services, amenities and quality public schools that will lure the most skilled.”<sup>iv</sup>

**2. Generally speaking, property taxes are not high in Pennsylvania – but they are not uniform across the state. Eliminating school property taxes to fix a localized issue is bad tax policy.**

According to the most recent data compiled by the U.S. Census, local property taxes (from all levels of government - including schools, and from all payers –businesses and individuals) in Pennsylvania are slightly lower than the national average. At 3% of personal income, Pennsylvania local property taxes ranked 26<sup>th</sup> highest in 2008-09 – and slightly below the U.S. average of 3.3% of personal income. The same is true in terms of our neighbors. New Jersey, New York, and Ohio have higher local property taxes (as a share of personal income), while West Virginia, Maryland, and Delaware have lower levels of local property taxes than Pennsylvania.

<b>Pennsylvania Local Property Taxes in the Middle of the Pack (2008-09)</b>		
	Local Property Taxes as a Share of Personal Income	Rank (1=highest)
<b>New Jersey</b>	5.2%	1
<b>New York</b>	4.4%	6
<b>Ohio</b>	3.1%	23
<b>Pennsylvania</b>	<b>3.0%</b>	<b>26</b>
<b>West Virginia</b>	2.3%	40
<b>Maryland</b>	2.3%	41
<b>Delaware</b>	1.8%	45
<b>U.S. Average</b>	3.3%	

Source. PBPC calculations using U.S. Census data.

So, if we are seeking to eliminate property taxes because they are high – compared to other states – that can’t be supported in the data.

However, in 2008-09, Pennsylvania state taxes and income taxes both ranked 30<sup>th</sup> highest as a share of personal income. This means that there is some capacity to equalize our tax effort by replacing a portion of property tax revenue with increased state income tax dollars.

The central issue for HB 1776 seems to be the burden of property taxes on residential properties. As a share of personal income, residential school property taxes do vary by district, but not by as much as generally assumed.

**In 2009-10, 26 districts (only 5.2% of the total) had property tax levels that exceed 150% of the state-wide average of 3.0% of personal income.<sup>v</sup>** A list of these districts can be found at the end our written comments. These are clustered in Northeastern and Southeastern Pennsylvania. A number of cases in the Northeast are affected by a large presence of vacation homes. For these areas, the tax on vacation homes is exported to other areas – much like sales tax in Florida or severance taxes from Texas. Generally speaking, this is thought to be beneficial to local taxpayers.

In other areas, like inner-ring suburbs in the Southeast, declining wealth and increasing poverty have led to high taxing effort. Hampered by the wage tax system in Philadelphia, these suburbs are heavily reliant on property taxes to operate their schools.

Eliminating school property taxes statewide to address localized issues is not good policy – particularly when other remedies exist.

Pennsylvania has the 8<sup>th</sup> highest reliance on local dollars to funds schools, which in most cases means property taxes. At the same time, our percentage of school funding coming from the state ranks 42<sup>nd</sup>. This is evidence of too much reliance on local sources, but there are ways to address this in a more targeted, less volatile manner.

**3. HB 1776 would do irreparable harm to Pennsylvania’s ability to adequately fund public education. It replaces local control over school financing with a one-size-fits-all approach that would fail our children and our communities. It trades certainty for variability.**

The bill takes a locally-controlled revenue stream (school property taxes) and replaces them with an artificially limited state revenue stream. HB 1776 assumes local finances are what they were in 2010-11 and limits growth to the lower of consumer price index (CPI) or sales tax growth. In recessions, when consumption decreases, sales tax growth can be negative –which would translate into cuts to schools.

Had this formula been in place during the last recession, schools would have endured three straight years of “property tax replacement” cuts, as sales tax receipts dropped 1%, 4%, and 1%, respectively from 2007-08 through 2009-10. Over the three years, this would equate with a loss of over \$1.3 billion in school funding. Had there been no federal stimulus, the state, too would have likely cut funding for schools. This would have resulted in massive layoffs and fewer dollars being driven back into local communities.

We would be trading the countercyclical benefits that schools provide our economy for a system directly related to consumption. Children need the same access to education in good times and bad.

With the expansion of the sales tax base, growth - and responses to the general economy – will be different than what we have experienced historically. We don’t know what this would be. Linking school funding to this unknown factor is risky.

That the new funding mechanism even equals the school property taxes it would replace is uncertain, particularly with the significant expansion of the sales tax base.

The rigid funding formula in the bill is too restrictive and will significantly reduce funding for classroom instruction. The bill initially replaces property tax revenues that existed in 2010-11. In future years, this amount would grow by the lesser of the growth rate of sales tax collections or the consumer price index.

This does not account for known and likely cost increases. Both the state and school districts will have to contribute significant new dollars in the coming years to correct unfunded pension liabilities. Health care costs in every sector are increasing at a rate much faster than inflation. Fuel prices spike. Mandates increase. More kids are found to have special needs that have to be addressed. All of these things cost more money – more than the lesser of CPI or sales tax growth could be expected to meet. This means the funds have to come from somewhere else – classrooms.

**4. HB 1776 would be a huge tax windfall for one group of taxpayers – corporations. Paid for by a shift of taxes to individuals.**

HB 1776 is being described as a great deal for seniors, but they would see increases in their sales tax bills for staples like food, non-prescription drugs, and many other supplies. Seniors who rent would see little benefit from the elimination of school property taxes, as it is unlikely that their rent would be reduced when property taxes were eliminated.

Corporations, on the other hand, would see their school taxes eliminated with little to no increase in other taxes, as many business-to-business transactions would be exempted from sales tax and most manufacturing inputs are already exempt. The bill includes no increase in the corporate income tax rate.

Non-residential property accounts for 28% of the assessed value of property in Pennsylvania, according to 2009 data from the State Tax Equalization Board (STEB). Tax dollars that were previously generated from these properties would be shifted to individuals through higher personal income and sales taxes.

No longer would corporations be partners with others in the community to help pay for an educated workforce and customer base. The financial benefits corporations receive would be distributed nationally and internationally – not locally.

For typical Pennsylvania families, property taxes are less regressive than the existing sales tax. The Institute on Taxation and Economic Policy estimates that families in the lowest income fifth spend over five times as much of their income on sales taxes as the top 1% of Pennsylvania families. For property taxes, the difference is 2.7 times.<sup>vi</sup> Adding many new goods and services to the sales tax base could make this disparity much worse.

Pennsylvania: State & Local Taxes in 2007							
Shares of family income for non-elderly taxpayers							
Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	Top 1%
<b>Income Range</b>	Less than \$19,000	\$19,000 - \$35,000	\$35,000 - \$56,000	\$56,000 - \$89,000	\$89,000 - \$175,000	\$175,000 - \$428,000	\$428,000 or more
<b>Average Income in Group</b>	\$10,500	\$26,500	\$45,200	\$70,900	\$119,300	\$257,100	\$1,369,600
<b>General Sales - Individuals</b>	2.1%	2.0%	1.8%	1.5%	1.2%	0.8%	0.4%
<b>Property Taxes</b>	3.8%	2.6%	2.9%	2.8%	3.0%	2.6%	1.4%

Source: Institute on Taxation and Economic Policy, *Who Pays?*, 2009.

Most egregious of these proposed changes is the taxation of many groceries. Items that qualify for the federal Women’s, Infants, and Children program would be exempt from sales tax, but families would soon find out how limited that list actually is. A small sampling of items that would be taxable include: fresh, frozen or sliced meat, butter or margarine, green peas, organic or reduced fat peanut butter, pasta sauce, salsa, white potatoes, fruit cocktail, baked goods, individually wrapped cheese, ice cream, most non-whole grain or sweetened cereals, and white bread or rice.<sup>vii</sup>

Most states do not tax groceries (food consumed at home). Only two states, Mississippi and Alabama, tax groceries at the full sales tax rate. Seven states tax groceries at reduced rates. And five states offer credits to offset the sales tax costs.<sup>viii</sup>

This type of trading of tax of bills will make the poor, including many elderly, even poorer.

#### 5. Many unanswered questions remain

How are funds distributed? Are property taxes replaced locally, dollar-for-dollar, or are they replaced based on a per student basis and enrollment?

What happens to growing or shrinking schools?

Many schools already are funded through earned income taxes; wouldn’t they receive less benefit than schools completely dependent on local property taxes?

How does the bill address differences in local school spending preferences?

What role would local officials have in school spending decisions?

What happens if the new state revenue sources do not generate sufficient revenue to replace school property taxes?

## 6. Similar “reforms” tried in other states, with poor results

California - One of the first property tax revolts occurred in California with the passage of Proposition 13 in 1978. This law rolled back property tax assessments to 1975-1976 levels, limited taxes to 1% of assessed values, and limited annual assessment increases.

Education funding was shifted largely to the volatile state income tax. Following the recession of 2001, California General Fund revenue declined by 17%, due in large part to falling income tax receipts.<sup>ix</sup> This continues today with California facing a budget shortfall of \$16 billion, forcing cuts to schools and other critical services – at a time when the rest of the nation is slowly recovering.<sup>x</sup>

The impact on schools was more equal spending, largely due to reduced spending by previously higher spending districts.

Michigan – In 1993, Michigan temporarily banned schools from using property taxes and gave voters a choice – increasing sales taxes or income taxes. The voters chose to increase reliance on the state sales tax. The plan included a new state-wide property tax for schools, lower and restricted local property taxes, and increased state revenue from sales tax.<sup>xi</sup>

Much like HB 1776, the Michigan changes shifted much of the responsibility for funding schools to state sales taxes. As the Michigan economy collapsed in the early 2000s, state revenues plummeted, resulting in squeezing of school funding.

A decade after implementation, a reviewer concluded, “Proposal A, as it was created originally, could have worked if the economy were strong indefinitely. However, due to the way the public school funds are collected and distributed, it is not a system based on equality or equity, and it shows all children are not given the same value, nor are they receiving the same service.”<sup>xii</sup>

One of the factors cited for the problems with state school funding in Michigan was the whittling away at the sales tax base almost immediately after the passage of Proposal A. Small cuts add up quickly, reducing revenue for schools.

How would Pennsylvania be different? A look in the expenditure section of the Pennsylvania budget shows that our sales tax base has been riddled with exemptions. Just a few weeks ago, the House of Representatives approved the exemption of corporate jets and their repair from sales tax.

How long would a sales tax base expansion last?

North Dakota – while not enacted, the North Dakota proposal that is model of HB 1776 is opposed by a number of groups – including many in the business community.<sup>xiii</sup> The North Dakota plan uses severance tax revenue from their oil boom to eliminate property taxes. While businesses would seem to benefit from the plan, the uncertainty the plan creates makes the state a riskier place to do business.

## 7. Better, more targeted options exist

It is unclear what the main issue HB 1776 is intended to fix. Even so, many of the issues identified can be addressed with smaller, more measured changes. There are two approaches: target tax relief to individuals based

on ability to pay. Since the central complaint cited for the need for HB 1776 is that taxes are not directly based on the ability to pay, this will directly address that problem.

The second approach, which Pennsylvania has used before, is to target relief by school district. This approach can be beneficial to communities with relatively high property taxes that are a drag on economic growth.

Expand the Property Tax /Rent Rebate program for seniors – Bill proponents claim seniors are being driven from their homes due to property taxes. Pennsylvania already has a program, the property tax/rent rebate (PTRR) program, to address this need for the poorest of elderly Pennsylvanians. Currently, the program provides a modest state subsidy (\$250 to \$650, based on income up to \$35,000 per year) for homeowners.<sup>xiv</sup>

This program could be expanded to offset property taxes for seniors with limited incomes and for properties up to the median value in a school district – or the payments could be sent directly to the district to offset any tax an eligible senior would otherwise owe. The program expansion could be funded with more modest increases in the state’s personal income tax rate, or a higher tax rate on unearned income.

Enact a “circuit breaker” to target property tax relief to needy taxpayers, regardless of age – these programs compare property tax payments to a family’s income and like an electrical circuit breaker, the program benefits activate once property taxes exceed a set threshold.<sup>xv</sup> This would be means tested and accountable – no matter what school district you live in. In 2008, 18 states had some form of a circuit breaker program – whether targeted to seniors or all homeowners.

Create a property tax deferral program – like a reverse mortgage, property tax deferral plans allow specific groups of homeowners (typically, the elderly), to tap into the unrealized equity of their homes to pay their property taxes. The taxes would be paid when the house is sold. Oregon and Washington currently offer such programs.<sup>xvi</sup>

Increasing state funding for schools - and sticking with it – Pennsylvania’s larger than average dependence on local funds for schools could be addressed by increasing state funding for all districts. This cannot be a promise of convenience for the state, as has been the case in past years.

Develop a new school funding formula that incorporates tax effort as a critical variable. Pennsylvania has a funding formula adopted in statute in 2009. That formula should be modified to include a variable that better measures local tax effort, and distributes a higher share of state dollars to districts with high tax effort.

Thank you for this opportunity and I am happy to answer questions.

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<sup>i</sup> [http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=DEC\\_10\\_DP\\_DPDP1&prodType=table](http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=DEC_10_DP_DPDP1&prodType=table).

<sup>ii</sup> [http://www.cep-dc.org/cfcontent\\_file.cfm?Attachment=PressRelease%5FSTST07%2D08%2DPart1%5F061709%2Epdf](http://www.cep-dc.org/cfcontent_file.cfm?Attachment=PressRelease%5FSTST07%2D08%2DPart1%5F061709%2Epdf)

<sup>iii</sup> <http://www.higheredinfo.org/dbrowser/?year=2008&level=nation&mode=data&state=0&submeasure=63>

<sup>iv</sup> <http://time.dufe.edu.cn/spti/article/harvard/2025.pdf>

<sup>v</sup> Pennsylvania School Employees Association analysis of State Tax Assessment Bureau and Pennsylvania Department of Education data.

<sup>vi</sup> [http://www.itepnet.org/wp2009/pa\\_whopays\\_factsheet.pdf](http://www.itepnet.org/wp2009/pa_whopays_factsheet.pdf)

<sup>vii</sup> <http://www.pawic.com/foodlist-en.pdf>

<sup>viii</sup> <http://www.cbpp.org/cms/?fa=view&id=1230>

<sup>ix</sup> [https://www.lincolinst.edu/pubs/dl/1308\\_Kenyon%20PFR%20Final.pdf](https://www.lincolinst.edu/pubs/dl/1308_Kenyon%20PFR%20Final.pdf)

<sup>x</sup> [http://www.mercurynews.com/breaking-news/ci\\_20611259/californias-budget-deficit-has-ballooned-16-billion-gov](http://www.mercurynews.com/breaking-news/ci_20611259/californias-budget-deficit-has-ballooned-16-billion-gov)

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<sup>xi</sup> [https://www.lincolnst.edu/pubs/dl/1308\\_Kenyon%20PFR%20Final.pdf](https://www.lincolnst.edu/pubs/dl/1308_Kenyon%20PFR%20Final.pdf)

<sup>xii</sup> [http://scholarworks.gvsu.edu/cgi/viewcontent.cgi?article=1014&context=spnareview&sei-redir=1&referer=http%3A%2F%2Fwww.google.com%2Furl%3Fsa%3Dt%26rct%3Dj%26q%3Dmichigan%2520school%2520funding%2520proposal%2520a%26source%3Dweb%26cd%3D10%26ved%3D0CH4QFjAJ%26url%3Dhttp%253A%252F%252Fscholarworks.gvsu.edu%252Fcgi%252Fviewcontent.cgi%253Farticle%253D1014%2526context%253Dspnareview%26ei%3DIS\\_IT90tJ8jn0QH96piiAQ%26usg%3DAFQjCNEJIHbiF008sFkle-AGsV8pzOtZJQ#search=%22michigan%20school%20funding%20proposal%22](http://scholarworks.gvsu.edu/cgi/viewcontent.cgi?article=1014&context=spnareview&sei-redir=1&referer=http%3A%2F%2Fwww.google.com%2Furl%3Fsa%3Dt%26rct%3Dj%26q%3Dmichigan%2520school%2520funding%2520proposal%2520a%26source%3Dweb%26cd%3D10%26ved%3D0CH4QFjAJ%26url%3Dhttp%253A%252F%252Fscholarworks.gvsu.edu%252Fcgi%252Fviewcontent.cgi%253Farticle%253D1014%2526context%253Dspnareview%26ei%3DIS_IT90tJ8jn0QH96piiAQ%26usg%3DAFQjCNEJIHbiF008sFkle-AGsV8pzOtZJQ#search=%22michigan%20school%20funding%20proposal%22)

<sup>xiii</sup> <http://keepitlocalnd.com/>

<sup>xiv</sup> [http://www.portal.state.pa.us/portal/server.pt/community/property\\_tax\\_\\_\\_rent\\_rebate\\_program/11410](http://www.portal.state.pa.us/portal/server.pt/community/property_tax___rent_rebate_program/11410)

<sup>xv</sup> <http://www.cbpp.org/files/policybasics-taxcaps.pdf>

<sup>xvi</sup> [http://dor.wa.gov/docs/pubs/prop\\_tax/seniordefs.pdf](http://dor.wa.gov/docs/pubs/prop_tax/seniordefs.pdf)

## Appendix 1

<b>School District</b>	<b>County</b>	<b>Household Property Taxes % Personal Income 2009-10</b>
Antietam SD	Berks	4.8%
Muhlenberg SD	Berks	4.8%
Bristol Township SD	Bucks	5.2%
Morrisville Borough SD	Bucks	4.6%
Jim Thorpe Area SD	Carbon	8.3%
Octorara Area SD	Chester	5.1%
Oxford Area SD	Chester	4.5%
Chichester SD	Delaware	5.7%
Garnet Valley SD	Delaware	4.7%
Ridley SD	Delaware	5.2%
Southeast Delco SD	Delaware	5.3%
Wallingford-Swarthmore SD	Delaware	5.0%
William Penn SD	Delaware	5.7%
Northern Lehigh SD	Lehigh	4.5%
East Stroudsburg Area SD	Monroe	9.7%
Pleasant Valley SD	Monroe	6.0%
Pocono Mountain SD	Monroe	10.4%
Stroudsburg Area SD	Monroe	6.1%
Cheltenham Township SD	Montgomery	5.0%
Pottsgrove SD	Montgomery	5.3%
Pottstown SD	Montgomery	5.0%
Easton Area SD	Northampton	4.8%
Saucon Valley SD	Northampton	4.5%
Delaware Valley SD	Pike	6.3%
Wallenpaupack Area SD	Pike	8.7%
Western Wayne SD	Wayne	6.2%
<b>Statewide Average (2009-10):</b>		<b>3.0%</b>

Source. Pennsylvania School Employees Association analysis of State Tax Assessment Bureau and Pennsylvania Department of Education data. "High tax" calculation made by the Pennsylvania Budget and Policy Center (set at 150% of the statewide average).

