COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES

JOINT HEARING
OF THE
HOUSE FINANCE COMMITTEE,
HOUSE SELECT COMMITTEE ON
PROPERTY TAX REFORM,
AND
SENATE FINANCE COMMITTEE

STATE CAPITOL
HARRISBURG, PA

MAIN CAPITOL BUILDING
ROOM 140

MONDAY, OCTOBER 1, 2012
10:03 A.M.

PRESENTATION ON
INDEPENDENT FISCAL OFFICE REPORT
ON HB 1776 AND SB 1400
AND
PA ASSOCIATION OF REALTORS REPORT
ON HB 1776 AND SB 1400

BEFORE:
HONORABLE KERRY A. BENNINGHOFF, HOUSE MAJORITY CHAIRMAN OF THE FINANCE COMMITTEE
HONORABLE THOMAS J. QUIGLEY, HOUSE MAJORITY CHAIRMAN OF THE SELECT COMMITTEE ON PROPERTY TAX
HONORABLE RYAN P. AUMENT
HONORABLE JOHN C. BEAR
HONORABLE SCOTT W. BOYD
HONORABLE ROSEMARY M. BROWN
HONORABLE JIM COX
HONORABLE GORDON DENLINGER
HONORABLE GEORGE DUNBAR

* * * * *

BEFORE (cont.'d):

HONORABLE ELI EVANKOVICH
HONORABLE MATT GABLER
HONORABLE C. ADAM HARRIS
HONORABLE FRED KELLER
HONORABLE DUANE MILNE
HONORABLE MICHAEL PEIFER
HONORABLE KATHY L. RAPP
HONORABLE MARIO M. SCAVELLO
HONORABLE JUSTIN J. SIMMONS
HONORABLE ROSEMARIE SWANGER
HONORABLE WILL TALLMAN
HONORABLE PHYLLIS MUNDY, HOUSE DEMOCRATIC CHAIRMAN OF THE FINANCE COMMITTEE
HONORABLE TIM BRIGGS, HOUSE DEMOCRATIC VICE CHAIRMAN OF THE SELECT COMMITTEE ON PROPERTY TAX
HONORABLE MATTHEW D. BRADFORD
HONORABLE MARGO L. DAVIDSON
HONORABLE MADELEINE DEAN
HONORABLE FLORINDO J. FABRIZIO
HONORABLE SID MICHAELS KAVULICH
HONORABLE WILLIAM C. KORTZ II
HONORABLE RICK MIRABITO
HONORABLE W. CURTIS THOMAS

HONORABLE MIKE BRUBAKER, SENATE MAJORITY CHAIRMAN OF THE FINANCE COMMITTEE
HONORABLE DAVID G. ARGALL
HONORABLE MIKE FOLMER

COMMITTEE STAFF PRESENT:

TAMARA LYNN FOX
MAJORITY EXECUTIVE DIRECTOR,
HOUSE FINANCE COMMITTEE

JERI G. DAVIS
MAJORITY LEGISLATIVE ADMINISTRATIVE ASSISTANT,
HOUSE FINANCE COMMITTEE

CHARLES W. QUINNAN
DEMOCRATIC EXECUTIVE DIRECTOR,
HOUSE FINANCE COMMITTEE

KRISTEN M. BERNARD
DEMOCRATIC COMMITTEE LEGISLATIVE ASSISTANT,
HOUSE FINANCE COMMITTEE

KATHRYN L. ZERFUSS
DEMOCRATIC RESEARCH ANALYST,
HOUSE FINANCE COMMITTEE

ANNA J. MALCEIN, ESQ.
MAJORITY LEGAL COUNSEL,
HOUSE SELECT COMMITTEE ON PROPERTY TAX

EILEEN R. KRICK
MAJORITY LEGISLATIVE ADMINISTRATIVE ASSISTANT,
HOUSE SELECT COMMITTEE ON PROPERTY TAX

I N D E X

TESTIFIERS

* * *

P R O C E E D I N G S

* * *

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: The hour of 10 has come. If we can get people in their seats, I'd like to get things started, please.

Good morning, everyone. Welcome to the Members and attendees and everyone else, and our testifiers. This officially opens up the House Joint Hearing between the House Finance Committee, the Senate Finance Committee, and the House Select Committee on Property Tax.

I want to thank Representative Tom Quigley, who actually had reserved this room ahead of time, for acquiescing and allowing us to do it in this order. Representative Quigley, thank you very much for doing that, and Senator Brubaker for joining us.

For the sake of brevity and hopefully clarity, I'm going to go around the room and let the Members introduce themselves and where they are from. It will probably save me from putting my foot in my mouth. So we will start to my right with Senator Brubaker.

SENATE MAJORITY CHAIRMAN BRUBAKER: Good morning.

I'm Mike Brubaker, the 36th Senatorial District, the Chairman of the Senate Finance Committee, and I'm from Lancaster County.

HOUSE MINORITY CHAIRMAN MUNDY: Good morning.

My name is Phyllis Mundy. I represent the 120th District in Luzerne County, and I serve as Democratic Chairman of the Finance Committee in the House.

REPRESENTATIVE DEAN: Good morning.

I'm Madeleine Dean from Montgomery County, the 153rd District.

REPRESENTATIVE KORTZ: Good morning, everyone.

My name is Bill Kortz. I'm from the 38th District, Allegheny County.

REPRESENTATIVE KAVULICH: Sid Michaels Kavulich, 114th District, largely Lackawanna County.

REPRESENTATIVE KELLER: Fred Keller, 85th House District, Union and Snyder Counties.

REPRESENTATIVE BOYD: Scott Boyd, 43rd District, Lancaster County.

REPRESENTATIVE EVANKOVICH: Eli Evankovich, Westmoreland and Armstrong Counties.

REPRESENTATIVE FABRIZIO: Flo Fabrizio, 2nd Legislative District, Erie County.

REPRESENTATIVE MIRABITO: Rick Mirabito, 83rd Legislative District, Lycoming County.

REPRESENTATIVE DAVIDSON: Margo Davidson, 164th District, Delaware County.

REPRESENTATIVE DENLINGER: Gordon Denlinger, 99th District, Lancaster County.

REPRESENTATIVE COX: Jim Cox, 129th District, Berks County.

REPRESENTATIVE SCAVELLO: Mario Scavello, 176th District, Monroe County.

REPRESENTATIVE AUMENT: Ryan Aument, 41st District, Lancaster County.

REPRESENTATIVE PEIFER: Good morning.

Mike Peifer, 139th District, Pike County.

REPRESENTATIVE THOMAS: Curt Thomas, Philadelphia County, Democratic Chair of the Urban Affairs Committee in the House.

SENATOR ARGALL: Dave Argall, 29th State Senate District.

REPRESENTATIVE BROWN: Rosemary Brown, 189th District, Pike and Monroe Counties, and a Member of the Select Property Tax Committee.

REPRESENTATIVE DUNBAR: George Dunbar, 56th District, Westmoreland County.

SENATOR FOLMER: Senator Mike Folmer, 48th Senatorial District.

REPRESENTATIVE BEAR: John Bear, 97th District, Lancaster County.

REPRESENTATIVE RAPP: Kathy Rapp, 65th District, Warren, Forest, and McKean Counties.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Tom Quigley, the 146th District in Montgomery County.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: This is our Executive Director, Tammy Fox. I also want to acknowledge Will Tallman. And what district are you out of?

REPRESENTATIVE TALLMAN: 193, Adams and York Counties.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you -- one of our shyer members. And also Representative RoseMarie Swanger, who has also joined us.

We apologize there aren't any more seats here at the dais, but we understand their interest.

This hearing is on two property tax proposals, commonly known as HB 1776 and SB 1400, authored by Senator Argall and Representative Jim Cox out of Berks County. We know they and many of the Members on this group are very interested in the issue of property taxes. This has been something that has been a struggle for the Legislature and the Commonwealth as a whole as we continue to address the skyrocketing costs of funding our schools and trying to find a way to keep that in balance with skyrocketing property taxes. These bills are specific to school property taxes and not eliminating all property taxes.

We are joined by several presenters today from the IFO office here in the State -- the Independent Fiscal

Office. We have Matt Knittel, the Director, and Mark Ryan, the Deputy Director, of the Independent Fiscal Office. We will also be joined by Jason Horwitz, a Consultant with the Anderson Economic Group. And we have asked the Members, if you would, let both presenters present and then we will take questions subsequently.

Matt, you're on, and I appreciate you joining us. Are you going to be joined by Mark at all?

MR. KNITTEL: Mark will be joining us for the question and answer after the presentation.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Okay. Very good. Feel free to begin when you're comfortable.

As an editorial note, those of you who have cell phones, please make sure they're off.

And I also want to acknowledge that Representative Gabler is here. And we will be joined with, Representative Adam Harris called me. Being a newlywed, he's on his way, so we all wish him and his family best blessings.

Matt, thank you for joining us this morning.

MR. KNITTEL: Well, Mr. Chairman and Members of the committee, thank you very much for the opportunity to testify before you this morning.

Let me note that we have some additional copies of the slide presentation up here at the table if you do not have one. They arrived a bit late.

For this morning, I'd like to present our analysis of HB 1776 and SB 1400 of 2012. Before I begin that analysis, I would like to start with a little background and note three points.

I'd like to note that the analysis is consistent with the mission of the Independent Fiscal Office, or the IFO. We view the mission of the office to assist taxpayers and the General Assembly in their evaluation of policy proposals, and the office attempts to present data in a neutral and accessible manner.

Also consistent with the mission of the office, I'd like to note that the IFO cannot comment on whether a policy is good or bad or better or worse than current law.

And finally, I'd like to note that the report I'll present to you today does provide a general framework for the analysis of the proposal, and the IFO would defer to the committees of the General Assembly for further analysis of the fiscal and policy implications of any amendments. However, we would be happy to work with the committees in that regard where appropriate.

Moving forward for today's presentation, what I'd like to do is provide a very brief overview of HB 1776 and SB 1400 of 2012, and I will refer to that generally as "the proposal." I would then like to touch on the analysis objectives, and then I'd like to move forward to the analysis results, focusing on the surplus or the shortfall to the newly created Education Stabilization Fund and the distributions to school districts. I'll then provide some detail by revenue source. I'll then provide some additional detail on the property tax forecast, as that forecast is integral to the analysis. And finally, we'll close up with some general economic analysis across homeowners, renters, business and nonbusiness entities.

Moving forward to the proposal, as I'm sure you're all well aware, the proposal eliminates local school property taxes. However, it does allow for levies, for debt in existence as of December 31, 2011. Those would be retained but phased out over time.

In place of those levies, we would have State funding based on FY '12-13 district collections, and those funds would generally come from three sources. The first would be an increase in the State sales tax rate from 6 to 7 percent and then expansion of the sales tax base; an increase in the personal income tax rate, or PIT, from 3.07 to 4.01; and finally, certain transfers from the Property Tax Relief Fund.

I should also note that in this analysis, we have assumed that the General Fund is held harmless and that the Department of Revenue would be able to separate new revenues under the proposal from existing revenues and put the new revenues into the Education Stabilization Fund.

Regarding the analysis objectives, we do have three objectives that we'll attempt to cover. First are the dedicated revenues sufficient to fund the proposed distributions to the school districts; second, how do those distributions compare to a "current law" property tax baseline for schools; and third, what are the potential economic effects of the proposal for businesses and nonbusinesses, homeowners and renters, home prices and rental payments, and general business competitiveness.

But before I move on to the results of the analysis, I'd like to note what it does and does not do.

The analysis does capture the response of consumers and businesses to higher tax rates. If you look at the economic research, it does show that consumers will buy less when sales taxes go up, that workers will work less when income taxes go up. We do include those effects in our analyses. The research also shows that noncompliance will also generally go up with higher tax rates, and we have included those in our revenue estimates.

The analysis does capture what we call "secondary" economic effects, and this would be the interaction among tax cuts. For example, if we cut property taxes, we expect that sales tax collections would go up, as people have more disposable income and spend a greater share of it, and so we capture those secondary effects.

However, the analysis does not capture what we call macroeconomic “feedback” effects, and moreover I would say that the impact on that is unclear. So we assume that the underlying growth rate of the Pennsylvania economy is not affected by the proposal. We assume that the employment levels are also not affected by the proposal.

Moving forward to the results. In Table 1, and let me note that the numbering convention in the slides corresponds to that of the report -- they’re the same -- and we have a broad-brush view of the proposal. At the top we have our dedicated revenues across our three sources, and we have shown the effects over 5 years. We allow it to phase in. We would consider the outyear in 2017-18 to be somewhat of a steady State impact. But I will focus on the 2013-14 effects in the first year.

In the first year for the sales tax, for the rate increase and base expansion, $5.2 billion; for the PIT rate increase, $3.4 billion; and for transfers from the Property Tax Relief Fund, $526 million, for a total of $9.1 billion of dedicated tax revenues.

On the bottom half of this slide, we have the property tax replacement. First we have our property tax forecast at $12.68 billion. That is what we call our current law baseline projection of property tax revenues. We will touch more on that later in the presentation. We deduct from that the existing debt service that is allowed to be continued to be levied by the school districts at $2.1 billion, for a property tax replacement of $10.61 billion.

And let me note the terminology here, the "PROPERTY TAX REPLACEMENT." What we're assuming in the analysis is that school districts are held harmless, so that is the amount that would have to be distributed to the schools for that result.

The bottom-line impact: In '13-14 is a shortfall of $1.51 billion, growing out to $2.02 billion by 2017-18.

In your next slide, we have disaggregated that result into its two component parts. At the top half of the slide, we have the impact on the Education Stabilization Fund. This asks the question, are the dedicated revenues sufficient to fund the proposed distributions to school districts? Again, we have our dedicated revenue sources of $9.1 billion in '13-14 and we have our computed distributions to schools at $10.45 billion, for a difference of $1.4 billion in '13-14. And as you can see, over time, that shortfall declines. And the general reason for that is that the distributions to school districts are growing at a CPI rate, whereas the dedicated revenues, mainly coming from sales tax and personal income tax, are growing quicker than the CPI rate, so we get a shrinking difference.

On the bottom half of the slide, we have the impact to school districts. Are the distributions sufficient to hold them harmless? And the distributions to schools, again at $10.45 billion, what we call the replacement baseline or the amount that would have to be distributed to hold them harmless at $10.61 billion, for a differential of $154 million in 2013-14, growing over the window to $1.15 billion in 2017-18.

The reason for that trend, again, is similar to what we saw in the top half of the slide. The distributions to school districts are growing roughly at a CPI rate, whereas the replacement baseline is growing by something somewhat quicker, by the adjusted Act 1 Index, and for exceptions such as pension and special education, and I'll touch more on that in a later slide.

So moving to the revenue source detail, let me start with the sales tax base expansion. The proposal does newly tax a number of goods. I have some of the larger ones up here on your slide.

Pulled in under the sales tax base expansion are many food items. However, there is a carveout for WIC purchases -- Women, Infants, and Children. Those would be items such as certain cereals, bread, milk, eggs. And also SNAP or food-stamp purchases. Those are exempt. We have clothing and apparel that exceeds $50. We have items such as nonprescription drugs, pain relievers, vitamins. And finally, personal hygiene products such as toiletries and diapers.

We also have many newly taxed services. Some of the larger ones, again up on the slide: certain health-care services such as for-profit nursing homes and day-care centers; recreational services such as movies, bowling, amusement parks; basic cable services; personal services such as barber shops and beauty salons; and the intrastate transport of persons such as taxis, bus, and rail service.

There also are some items that are a little different. The proposal exempts all telecommunications services. It also provides for a vendor discount, per vendor, of $300 per year instead of the 1 percent. It expands the exemption, the sales tax exemption, to certain entities supplying educational services.

And I would note that the technical appendix in our report, Technical Appendix A, does provide a complete itemization of the different goods and services that are pulled in under the base expansion and the ones that we have left out. The report also provides a discussion of certain assumptions that we needed to make in order to complete the analysis.

So the numbers for the sales tax base expansion and rate increase on the next slide. At the top we have the impact of the rate increase from 6 to 7 percent against the current base, generating $1.5 billion. We then move to the base expansion: the food items with the WIC and SNAP carveout, $1.1 billion; clothing above $50 at $418 million. And then moving to our services: recreational services at $570 million; certain health services at $612 million; professional services at $378 million.

And I'll call your attention to the bottom part of the slide. Under "Secondary Effects" at $181 million, that is the effect basically of the property tax cut increasing disposable income, of which we assume most of it is spent, and roughly 70 percent would be spent on taxable items, thereby increasing sales and use tax collections, for a bottom-line impact of $5.2 billion in '13-14, growing to $6.3 billion in '17-18.

Moving to the personal income tax rate increase. It was a fairly straightforward analysis. We have our baseline projection, and then we allow a rate increase from 3.07 to 4.01, and in '13-14 we project that generates $3.5 billion. The proposal, because it increases the rate, would also increase refunds that are reported on the balance sheet, and we have included those amounts in our analysis. Refunds would go up by $142 million. And finally we have various miscellaneous secondary effects at $20 million, for a net impact of $3.4 billion in ’13-14, growing out to $4.1 billion in ’17-18.

I will note that anybody who currently gets tax forgiveness under the current system and has complete income tax elimination, there would be the same result under the proposal. They would not have a tax increase.

Moving to the property tax forecast. I’m going to spend a bit more time on this, because it was a little more complex and it’s such an integral part of the proposal.

On this first slide we have some historical growth rates in property tax collections by school districts. As you can see, prior to the recession and prior to Act 1, we had fairly significant growth, 5.9 and 4.6, and then moving into the recession and once Act 1 became effective, it does appear that the growth in the property tax levies has been reduced.

Let me also note that in our technical appendix, in Technical Appendix B of the report, we do have lots of property tax tabulations by county, historical levies, and for these amounts we do have a 30-year history.

So for the purposes of the school property tax forecast, rather than rely on historical growth rates, we thought it best to use the structure of the Act 1 Index for that purpose, and if you look at the Act 1 Index, you will see that there are two major components to that index. There is what we call the adjusted index, which places a cap on the potential increase in millage rates each year, and then there are the exceptions to that index, which allow school districts to exceed the index for certain types of expenditures, mainly for pensions and for special education.

And here on this next slide we have the index projections. First we have the base index, which is simply a weighted average growth rate between the statewide average weekly wage, which we received from the Department of Labor and Industry. It also looks at the employer cost index for elementary and secondary schools, and the base index is simply an average of those two growth rates over time.

We received our projection of the ECI, the employment cost index, from Global Insight. To that amount, certain adjustments must be made for market value to personal income aid ratios. Schools with an aid ratio above .4 can adjust their index, and so the final column in the table shows you the net effect. It’s a statewide average. Allowing for the market value to personal income adjustments generally raises the base index by .2 to .3 percent per year.

One of the main exceptions to the Act 1 Index is for pension obligations. On this slide, we have the projections from the PSERS report for employer contributions, and these amounts are built in to our projections. We do have the pension exceptions increasing over time until the employer contributions reach a steady State level, which appears to be achieved in roughly 2016-17, and then the exceptions for pensions start to trail off from that point, and that detail is included in Table 6 of our analysis.

So when we combine the effect of the Act 1 Index and the adjustments to that index and we allow for pension exceptions and special education exceptions, we have here on the next slide our net effect, how we think the current law property tax baseline will grow over the next 5 years. Again, we have a bit of a ramp-up. We're starting from an actual of 2.3 percent in FY 2011-12, ramping up to four points, 4 percent, and then back down to 2.9. That is driven by the assumptions in the ECI, the employer cost index, the statewide average weekly wage, as well as our exceptions for pensions and special education.

What I'd like to do now is to shift gears. Oh, excuse me; before I do that, I need to cover this table,

Table 6. Again, this is the table from our report, and it has the same numbering convention. We’ve just collapsed it a bit for purposes of the slide, and let me walk you through the 2013-14 computation.

At the top line, we have the prior year adjusted amount of $12.34 billion, and that is simply the amount collected in the prior year, allowing for any assessment growth, and based on some analysis of historical trends, we assume that assessment growth would have increased those amounts by roughly 0.6 percent per annum, and we hold that constant over the window. To that amount, we allow for growth in the Act 1 adjusted index, and we have $164 million in ’13-14. We allow for exceptions such as pension and special education of $174 million, for a total Act 1 increase of $338 million. We add that to the prior year adjusted amount to get what we call our current law property tax baseline of $12.678 billion. We deduct from that the debt service allowed under the proposal of $2.1 billion, to get our net amount subject to replacement of $10.61 billion. Again, that is the amount based on our projections of current law property taxes that the schools would need to receive to be held harmless under the proposal.

Moving forward now to the next part of the analysis, the economic analysis. When we performed the analysis, it was requested that we look at the impact on business and nonbusiness entities and to separate the impact into those two categories. And for those purposes, what we looked at was the “statutory tax incidence,” or the party that has the legal obligation to remit payments. For example, if a consumer had to pay 7 percent on sales taxes, they would have the legal obligation to remit the payment. The vendor would just be collecting it and forwarding it to the State.

Before I present the results from that analysis, I would like to note three cautionary notes. First of all, the statutory tax incidence need not be representative of the true economic burden. It may be the case that the consumer appears to pay 7 percent more at the cash register; however, certainly the business could bear some of that tax burden as well. It could have reduced their profits.

Also, the business versus nonbusiness distinction is somewhat artificial and not meaningful in many cases. As you know, business entities cannot bear the burden of a tax cut or tax increase. It must be the owners or the shareholders of the firm.

And finally, for the results that I'm going to show you, we do not include any impacts on Federal income taxes. I'll cover that in a later slide. But the numbers you'll see on the next slide do not capture that effect.

So on Table 7 we've broken down the three tax changes between business and nonbusiness entities, and the analysis finds that for sales taxes, that nonbusiness entities would bear $4.62 billion of the statutory tax incidence; for personal income taxes, they would bear $3.04 billion; and for property taxes, our data show that individuals would receive roughly 70 percent of the tax cut at $7.4 billion. The bottom-line numbers for nonbusiness entities, the statutory tax incidence goes up very slightly, to about $240 million, and we have what appears to be a tax cut for business entities of $2.27 billion for FY 2013-14.

And again, this analysis does have many assumptions built in to it, some of which I have noted at the bottom of the slide. There are many more in the report. We tried to be as explicit as possible so that readers would know all of the assumptions built in.

Moving forward, we wanted then to look at how the proposal impacts residents of the State, and for that we focused on the two characteristics that would drive tax changes under the proposal, and that would be housing tenure and age. Age will drive changes in taxes under the proposal, because older residents generally have tax-exempt income from pension or Social Security and so would not be adversely affected by the PIT rate increase. Moreover, the data show that older and younger residents have different spending patterns, and therefore, they might be differently affected by the sales tax base expansion.

So what we did is we looked at four groups, four representative groups: homeowners, both working age and retired, and renters, both working age and retired, and for those groups we tried to construct a median representative individual. We looked at Census income to get our median income levels for those four groups, and for spending patterns, we used the data from the U.S. Department of Labor. They have spending patterns by age cohort and income cohort. And basically what we did is we compared taxes under current law and the proposal for those four groups.

And on the next slide, we have the results of that analysis. What we did is we looked at two scenarios. One we call the fully phased-in scenario. Under that scenario, you might consider that the long-term. It does allow a 73-percent cut in property taxes, so that would be the operating portion and the debt portion that is phased out over time. It also assumes that some rental relief will be pushed forward to renters.

Under that scenario, we find that the median homeowner who is working would have a 7-percent tax cut, the median homeowner who is retired would have roughly a 38-percent tax cut; the median renter who is working, roughly an 11-percent tax increase, and the median renter who is retired roughly an 8-percent tax increase.

We also looked at what we call the first year effect, and in the first year, property taxes would only be reduced by 63 percent because districts can still levy the debt portion, and that’s phased out over time. Moreover, in the first year it is likely that no rental relief will get pushed forward to renters, and so we have assumed that in fact none does. And the results are slightly different, but very broadly the same: for the median homeowner who’s working, about a 5-percent tax cut, the median homeowner who’s retired, about a 31-percent tax decrease; the median renter, about a 22-percent tax increase, and the median renter who’s retired, about a 25-percent tax increase.

Again, I’d like to note that we were very explicit about all of the assumptions that were built in to this analysis. They’re laid out either in the main text of the report or in the technical appendix. One thing that there’s very little data on, quite frankly, is the amount of rental relief that would eventually get pushed forward under the proposal. We have assumed it was roughly one-third that would eventually get pushed forward to renters, and they would get some rental relief as a result of the proposal.

Shifting gears to homeowners and house prices. Looking at the economic research and capitalization rates, we think the capitalization rates in the literature suggest roughly a 20- to 50-percent capitalization rate, and for purposes of the analysis, we have assumed one-third. By "capitalization rate," we mean how much of future property taxes are embedded in the home price. Therefore, if we were to eliminate property taxes, how much could we expect home prices to appreciate over time?

So for this analysis, we are projecting that the median home price in 2014 would be roughly $180,000 and that the median school property tax cut would be about $2,200. If we assume a discount factor of 4 percent, the discount factor being the factor one uses to convert future payments into present values, and if we had full capitalization at 100 percent, that would imply a home price appreciation of $55,000. However, the research suggests that if we do not have full capitalization, that something reasonable might be 33 percent, and if it is indeed one-third, that does suggest a potential long-term gain to homeowners, the median homeowner, of about $18,000.

Again, I would like to note that the analysis is sensitive to the assumptions we use; in particular, the discount factor. The research generally uses a discount factor of 3 to 5 percent, and we elected to use a value in the midpoint of that range.

I should also note that the capitalization rates, while we have assumed that statewide it would be roughly one-third, we would find that the rates would vary substantially throughout the Commonwealth. And what we should find is that in more developed areas, there would be higher capitalization rates, and therefore, current homeowners would capture more of the property tax cut. Less of it would spill out to prospective homebuyers, and that is simply because the supply of housing cannot increase. So when something cannot increase, the current owner of the asset gets more of the benefit or the impact of the tax cut or tax increase.

Also, I would note two assumptions, two key assumptions, regarding the analysis of housing gains. It does assume implicitly that the level of services provided to homeowners does not change. It also assumes that prospective homebuyers are convinced that property taxes will not be levied again in the future. If they remain unconvinced, then any price appreciation would generally be lower.

Moving on to renters. For renters, quite frankly, when you look at the existing research, we find even a less clearer picture than for homeowners, and there are mixed results. But I would say that the weight of the evidence does suggest that property taxes are fully pushed forward to renters, and if that is indeed the case, what we'd expect under the proposal is that renters should receive some property tax relief in their rental payments. Again, for the purposes of the analysis, we have assumed that one-third of the property taxes that are eventually pushed forward to them are reduced, which amounts to about a 4-percent reduction in their monthly rental payment.

We have the same result for renters as we do for homeowners. In more developed areas, they'll probably get less relief, because the supply of rental units cannot be expanded. As a group, we would expect that renters are generally worse off under the proposal compared to homeowners.

I would also note that any rental relief that is eventually passed forward would likely take many years to show up. That's due to the lock-in effect of lease agreements and the lead time that's necessary to construct new rental units.

Shifting gears, finally, to businesses. The question we wanted to ask for business entities is how important property taxes are to them, and an analysis of the data suggests that property taxes comprise about .4 to .9 percent of business receipts. However, property taxes appear to comprise roughly one-third of the total tax payments that businesses will make to State and local governments. Therefore, for many businesses, there is the potential for a significant reduction in tax payments.

In particular, firms that are likely to gain from the proposal are firms that have significant real property such as large manufacturers or firms engaged in the rental of real estate, and certain telecommunication firms specifically appear to benefit from the proposal as they have much real property.

Balancing that out are business entities who are likely or might be worse off from the proposal, and there are four types of entities that might be worse off. We might have small pass-through entities such as partnerships or sole proprietors who have very little real property and the owners actually supply much of the labor to that entity, and in fact they would be hit by the almost 1-percentage-point increase in the PIT rate.

We have firms pulled in under the base expansion such as clothing retailers, food retailers, pharmaceutical retailers, and certain service providers. Of course, they will need to push that 7-percent increase in the price forward to consumers or else bear the brunt of it in their profits.

We have firms that are in competition, are in close proximity to the State border, who might have to compete with out-of-State providers. And as well, we have firms that must compete against Internet sales. Under the proposal, if a Pennsylvania resident were to buy clothing over $50 from an out-of-State provider, in theory, they would need to remit use tax on that purchase. However, the data show that the use tax compliance is very low.

On the next slide, in Table 9, we looked at the tax rates in surrounding States, competitor States, for property, income, and sales taxes. And for property tax rates, these are the effective tax rates, and they represent the rate in the largest city in the State. For property taxes, the effective tax rate for Philadelphia, in Pennsylvania, 4.12 percent. Comparing it to surrounding States, that does appear to be somewhat higher. However, that's somewhat offset by the fact that Pennsylvania does not levy taxes on personal property.

Moving to the income tax rates. For corporate income taxes, Pennsylvania generally has a higher statutory rate than other States. However, that rate is not affected by the proposal. What is affected is the rate in the other column. That would be the rate on wage income or other business income, income that is passed through to owners and shareholders, and these rates that you see on the slide are the statutory maximums. The rate in Pennsylvania is much lower and would continue to be lower under the proposal. However, I would note that many other States have a graduated rate structure whereas Pennsylvania does not, and so some of the difference between the rates here would be offset by that effect.

In the final column, we have the sales tax rate levied by the State. It excludes local levies: Pennsylvania at 6 percent, roughly in the middle, comparable to the other States. At 7 percent would be on the high end of the scale but still comparable to a number of the surrounding States.

Moving to the next effect, the impact of the proposal. One of the things we did is we looked at how the proposal would interact with Federal income taxes, and we do think there would be a significant interaction with the Federal income taxes, in particular for Pennsylvania itemizers. On the Schedule A, their deduction for property taxes will fall, their deduction for State and local income taxes will rise, but it will be a net reduction in Schedule A deductions. So we project that for tax year 2014, Pennsylvania itemizers might realize roughly a $550 million Federal tax increase.

A similar result for businesses. They would not capture all of the gains from the property tax cut because they can claim those as a deduction. If one assumes that the effective tax rate on business entities is roughly 25 percent, it suggests that they would capture perhaps three-quarters of the property tax cut that goes to them.

Very broadly speaking, what the proposal is doing is it's exchanging a tax that's deductible for Federal tax purposes -- that is, property taxes both for businesses and homeowners -- for a tax that is not deductible, mainly sales taxes on consumers. The personal income tax would remain deductible.

But offsetting that effect, however, are some positive effects on the General Fund and to local units. In the analysis, it talks about the gains to realty transfer taxes from the appreciation of home prices, and the analysis projects that the General Fund will pick up roughly $30 to $40 million per year once housing prices respond. There would also be gains to local units from realty transfer tax revenues, as well as property taxes that remain under the proposal.

There would be gains to local units that levy a sales tax, Allegheny County and Philadelphia from the base expansion, the sales tax. We project that at roughly $100 to $200 million per year.

And finally, there would be gains to the General Fund from increases in corporate net income taxes due to the elimination of the deduction for property taxes, or most of it, roughly $30 to $40 million per year.

I would note that both the Federal effects and the local and General Fund effects are not included in our analyses, the numbers that we present to determine whether it's revenue neutral, because they do not affect the revenue neutrality of the proposal. They are outside of it. They're either affecting local units or they're affecting General Fund revenues or they're affecting individuals through their Federal income tax.

So in summary, the analysis suggests that the proposal as it is currently constructed has a shortfall, and one could disaggregate that into two pieces.

The analysis finds that the revenues for the distributions are about $1 billion short, the dedicated revenue sources for the distributions from the Education Stabilization Fund. If one assumes that school districts would be held harmless, those distributions also fall short of about $1 to $1 1/2 billion of the school property tax baseline that we project through 2017-18.

The analysis finds that current homeowners are likely the clear winners under the proposal, and many would realize large windfall gains due to capitalization of property taxes. It's likely that most renters will be worse off under the proposal.

I would say that the outcome is somewhat unclear for prospective homebuyers. It will depend on their individual circumstances. In particular, if they're in a less developed area, some of the property tax cut will likely leak out to them and they might benefit as well.

And also, I think there's a mixed picture for businesses. Clearly, some businesses will benefit, businesses with large amounts of real property. However, we have certain other businesses that might fare worse under the proposal such as small pass-through entities and firms pulled in under the sales tax base expansion.

And that concludes my presentation for today. We will have the presentation up on our Website. Hopefully it's going up right now as we speak. As well, the full report is available at the Website.

Thank you very much.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Mr. Knittel, I think you and Mr. Ryan have done a sensational job. We appreciate the hard work, the time, and the energy and the detail of your report.

Senator Brubaker, do you have any comments or questions, just to Matt specifically.

SENATE MAJORITY CHAIRMAN BRUBAKER: Well, thank you, Mr. Chairman. I do have a few very brief questions, if I may.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: I

apologize; we're going to hold the questions. I just didn't know if you had a comment in reference to that. I apologize. I do want to hold off on the questions, if we could, until the other expert testifies, if that's all right.

SENATE MAJORITY CHAIRMAN BRUBAKER: Of course, Mr. Chairman.

Then I would like to offer also my congratulations to you and to your entire IFO team. It's an 80-page report. It's extremely comprehensive, extremely well done, and I do look forward to the question-and-answer period. Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: And I will give that same luxury to Representative Mundy, and to Representative Tom Quigley in a moment here.

Representative Mundy, if you just want to make comment regarding the report itself?

HOUSE MINORITY CHAIRMAN MUNDY: Just that I agree the report is very comprehensive and very well presented in a very clear fashion, so I appreciate your hard work.

MR. KNITTEL: Our pleasure.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Chairman Quigley.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Thank you, Mr. Chairman.

Again, I echo the comments here -- a very comprehensive report. And I think what the significant thing is is that finally we do have a baseline of what we can look at as we continue to deliberate the effects of a total property tax elimination for school districts. And I think this is what has been missing in the debate for some time now, so I'm very appreciative of the work that the IFO has done.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Matt. We are going to call you and Mr. Ryan back up after Mr. Horwitz's presentation, and we'll take the group's questions at that point.

Also, I want to let us know that we've been joined by Representative Milne of the southeast area.

Jason Horwitz, a Consultant with the Anderson Economic Group, has presented an independent report that was sanctioned and commissioned by the Pennsylvania Realtors Association, who has also joined us here. But we appreciate their support in looking out in the interests of not only their consumers but all Pennsylvanians. Thank you to the Realtors.

Jason, welcome to Pennsylvania.

MR. HORWITZ: Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: I believe you're from Michigan?

MR. HORWITZ: I’m actually in the Chicago office.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Well, that’s close.

MR. HORWITZ: Close enough.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: I’ll blame it on the new glasses. But thanks for joining us anyhow.

When you’re comfortable, go ahead and begin.

MR. HORWITZ: Okay.

Good morning. I’d like to thank the House and Senate Finance Committees and Members of the House Select Committee on Property Tax Reform for having me here this morning.

My name is Jason Horwitz, and I’m a Consultant for Anderson Economic Group. Anderson Economic Group is a consulting and economic analysis firm based out of East Lansing, Michigan. We also have an office in Chicago, and that’s where I work.

We provide market and industry analysis, economic and fiscal impact analyses, and other studies on the consequences of public policies. Our clients range from private companies to trade organizations, unions, nonprofits. We also work extensively with governments.

Some recent relevant work that we’ve performed at AEG. The last time I was in front of a legislative committee like yourselves was in late July. We presented the results of the study on the impact of incentives for economic development in the State of Kentucky. Also, at the beginning of this year we worked extensively with the Michigan Manufacturers Association and the Lieutenant Governor in Michigan on the fiscal and economic impact of reforms to the personal property tax there, and those reforms are still pending, as far as I know.

So Keystone Analytics, on behalf of the Pennsylvania Association of Realtors, has asked Anderson Economic Group to provide an independent assessment of the fiscal impact of the reforms in HB 1776. We have produced a memorandum presenting the results of that fiscal impact analysis. I hope you have a copy with you.

What this report does is basically look at the effects of HB 1776 on the State budget overall, not just the Education Stabilization Fund but the overall State budget, as well as the effects on school district revenues statewide. So for this presentation, first I'm going to discuss some important details about what we did and did not review in this analysis, then I'm going to go through a brief description of HB 1776 and the reforms contained therein, and then I'll move on to our fiscal impact study and sort of go line by line and talk about each of the different components of the bill and their impact on schools and the State budget.

So some important details about our analysis. First, we analyzed only the version of HB 1776 as it was reported to the Committee on Finance in April of 2012. We have not reviewed any amendments since then. So you'll find, for example, that we have an estimate of the fiscal impact of the reforms to rental and property tax reimbursements for the elderly and permanently disabled which are no longer part of the bill, or at least there have been recent amendments regarding those.

This was a static analysis. So as the IFO claimed, they did secondary effects, which means that when you lower the property tax, there might be a certain result in the price of homes. When you increase sales taxes or personal income taxes, that might decrease the total amount of sales or income statewide. We haven't accounted for any of those effects. This is just if the current trends were to continue in home prices and sales and income, this is what the impact will be.

Our fiscal impact is actually annualized for fiscal year 2013. So essentially we've asked the question, if these reforms were in effect for the entirety of the current fiscal year, what would be the impact on the State budget and school district budgets statewide?

One important part of this bill is that it gives school districts the right to implement a personal income tax or an earned income tax at the school district level. We haven't assumed that that will occur in any situation, although in some school districts, it almost certainly will to an extent.

Also, we've assumed that the transfer of property tax relief funds would not continue due to the wording of the bill. So the impact of them continuing, it's relatively straightforward; it would just result in fewer funds at the State level and more funds at the school district level. But we've essentially assumed that school districts would no longer receive about $500 million in slot machine revenues that they're currently receiving in order to cover exemptions from the property tax.

So I'll briefly summarize the contents of HB 1776. This is on page 3 of our memo, if you'd like to follow along.

Starting at the beginning of the 2013 calendar year, school districts will no longer have the ability to implement local property taxes to support operating costs. They will be able to continue millages in order to cover current outstanding debts, but that will be phased out because they will not be able to issue new debts and pay for them with local property taxes.

The State personal income tax will be increased by .94 percent, from 3.07 to 4.01 percent.

The State sales and use tax will increase from 6 percent to 7 percent.

The tax base for the sales and use tax will be expanded to include additional goods and services. A list of those goods and services is in Exhibit 1, which is at the very back of our report. Some of the more notable additions are newspapers and magazines, nonprescription drugs, clothing and footwear that costs $50 or more, personal hygiene products, personal legal and financial services, dry cleaning and laundry services, and tickets to sporting events and concerts.

Property tax rebates -- so this is, again, we haven't considered any amendments, but this is a provision in the version of the bill that we analyzed. Property tax rebates for the elderly and permanently disabled will be discontinued starting in the year 2013. Rent rebates will continue and will be available at a lower rate to households with incomes up to $25,000.

In fiscal year 2013, the State would allocate funds from the Education Stabilization Fund to school districts. That amount allocated would be equal to the operating revenues that the district received from property tax in the previous fiscal year times the change in the Consumer Price Index for the State of Pennsylvania. The allocation of funds for subsequent years was not defined in the current version of the bill.

School districts will have the ability to implement a personal income tax or an earned income tax within their districts, with no limit on rate, subject to a no-exception public referendum.

So that's our understanding of the bill in the version that we analyzed.

To move on to our fiscal impact. That's on page 4 in the memo that you have. So briefly to overview, we found that the total net impact on school district revenue would be a decrease in revenues of approximately $760 million statewide. The fiscal impact on Pennsylvania State Government was a net impact of approximately $1.8 billion less in fiscal year 2013, annualized. Again, this is based on fiscal year 2013 data.

So for starters, at the top there we have the fiscal impact on school districts. We estimate the real estate taxes that would be collected by schools for operating costs only at $10.9 billion. So that's not including any taxes collected for debts. We calculated that for the year 2013 by looking at recent property tax collections and projecting property tax collections for this year based on those trends. The trend that we used was slightly higher than that used by the IFO. Our trend was just under 4 percent increase by year, at 3.9 percent to be exact.

The State payment to schools under HB 1776 would be $10.7 billion. That's based on the operating collections for operating costs from property taxes for the previous year and then increasing that by the projected change in the cost of living, or CPI, from 2012 to 2013.

Finally, again we assumed that the property tax reduction allocations from gaming revenue would discontinue under this bill, and that would result in $510 million less being distributed to schools from the State Government. And that's captured in that third line there under "Fiscal Impact on School Districts," and the result is a loss of $760 million in revenue.

Now, the main reason behind the gap between real estate taxes that would be collected and State payments to schools is that the State payment to schools is tied to a CPI increase, whereas the real estate taxes that would be collected tend to increase somewhat faster than inflation over time.

Moving on to the fiscal impact on Pennsylvania State Government. That first line is the State payment to schools under HB 1776. It's about $10.7 billion.

The personal income tax increase. We calculated that in a relatively straightforward fashion. We just looked at how much the collections would be in the current year based on recent trends and then inflated that based on the increase in percentage from 3.07 to 4.01 percent. That would result in an additional approximately $3.25 billion in fiscal year 2013.

The sales tax increase on the current base. So this doesn't consider the expansion; this is only looking at goods and services that are currently subject to sales tax. That increase from 6 percent to 7 percent would result in a revenue increase of $1.5 billion to the State.

The expanded sales tax base would result in a $3.5 billion increase for the State. Now, the way that we calculated the expanded sales tax base, essentially we looked at personal consumer expenditure data. So that's available from the Bureau of Labor Statistics. They have a survey, and you can purchase microdata from the Bureau of Labor Statistics where it goes through, by location, the amount of money spent on a very detailed list of items. So we essentially went through that list of items, picked out which goods and services we thought were newly taxable under this law, and determined that about 17 percent of all personal consumer expenditures would be newly taxed under this law, and the result would be an increase of about $3.5 billion in State revenue.

The State property tax reduction allocations, again, is about $510 million. If those were discontinued, the State would realize a savings of about $510 million.

And those last two, again, appear to have recently been amended out of the bill. But if property tax rebates were eliminated, the State would realize a savings of about $180 million. And the expansion of rent rebates, we estimated a cost of approximately $70 million to the State for that expansion.

Once you add all those numbers up, you get a total net impact of $1.8 billion.

So again, just to summarize, we estimate that the fiscal impact on school districts would be a shortfall of approximately $750 million from previous revenue collections, and the fiscal impact on Pennsylvania State Government, in part due to additional expenses, in part due to additional revenues, would be a total net impact of negative $1.8 billion.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you very much, Jason.

If you will remain there, I'm going to ask Mark and Matt to join us, and then we'll have the Members proceed with questions.

I would ask the Members to ask one question, and if you have additional questions, we will circle back around. But because we have the Joint Hearing between the House and Senate and Tom Quigley's committee, I would like to give everyone the courtesy to get the first questions around.

We'll start with Chairwoman Mundy, to my right.

HOUSE MINORITY CHAIRMAN MUNDY: Thank you, Mr. Chairman, and thank you both for your very good and thorough presentations.

Mr. Knittel -- am I pronouncing your name correctly?

MR. KNITTEL: Yes.

HOUSE MINORITY CHAIRMAN MUNDY: Knittel?

MR. KNITTEL: Yes.

HOUSE MINORITY CHAIRMAN MUNDY: Could you tell me, did you consult at all with the Department of Revenue? Because originally we were told through our Appropriations Committee, Democratic Appropriations Committee, that the funding gap was $3 1/2 billion, and now we're learning that, according to your analysis, it's quite a bit less, and I'm trying to figure out what the discrepancy might be or whether there's a different methodology being used by one group or the other.

MR. KNITTEL: Yes. I can say that we did sit down and talk with them. Mainly it was regarding the sales tax base expansion and what should be included and what should not be. I can say that comparing our estimates to theirs for both the sales tax and personal income tax, they're pretty similar. I think we pick up a bit less because we have behavior built in to our estimates, whereas their numbers are what we call tax expenditure numbers. They're right out of the budget; they don't have any behavior built in. So I think if they were to go back and revisit theirs and do a formal analysis, it would be somewhat less.

Now, regarding the differentials -- and Mark, maybe you can speak to this -- I can't exactly recall why they had a larger shortfall. I don't know if you can.

MR. RYAN: I don't believe the Department of Revenue made a forecast of property tax revenues for the baseline, at least in terms of the materials that we have seen, so I can't really account for the difference. I think that's probably part of it.

It's also a question of whether or not the number that you quoted included the property tax that would be retained to service-existing debt, which is about $2.1 billion. So that's certainly a part of it, and that might be the biggest part of the difference between the number you quoted and the number we came out with.

HOUSE MINORITY CHAIRMAN MUNDY: Just to follow up briefly on that question. So, Mr. Knittel, the behavior that might change as a result of this bill might account for at least part of the difference in the funding gap?

MR. KNITTEL: Correct. We have behavior in our numbers and they would not, so that could explain some of it. But I think, as Mark noted, I believe in their analysis they did not do a projection of the current law property tax baseline.

HOUSE MINORITY CHAIRMAN MUNDY: Okay.

MR. KNITTEL: So that element is missing.

HOUSE MINORITY CHAIRMAN MUNDY: Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Madam Chairwoman.

We are also joined by Representative Simmons. Thank you for joining us today.

Did I see Representative Dean had a question?

REPRESENTATIVE DEAN: I, too, thank you for your great testimony and very clear presentation of something quite complex. And it helps us clarify some things that we were looking at in the Finance Committee when we analyzed or were taking a look at 1776.

One of the questions that came up there, and I know Mr. Horwitz in particular, you did a static report, but any one of you maybe could give us some indication of what happens over time and in particular with a changing economy. With an economy that's growing, I assume good things, and so the revenue streams continue. But if we shift the revenue source to schools in particular away from property tax, in a down economy, what happens under this new scheme?

MR. HORWITZ: Well, to a certain extent, it’s hard to say exactly how it would differentiate between a good economy and a bad economy. I guess one thing that I could say to speak to that is something that this bill does do, assuming that it would lock in a funding mechanism for future years for schools, is it somewhat protects schools from a certain amount of volatility in property tax collections and makes their revenues a little bit more predictable. But at the same time, it would be subjecting the State Government at the State level to a bit more volatility.

For example, our experience in Michigan with the School Aid Fund was about 6 or 7 years after that School Aid Fund was established -- and in Michigan what we did was something very similar, but it was only part of local school revenues were replaced by State and personal income tax revenues. About 6 or 7 years after this new system was implemented, they had the recession of 2001, after which Michigan never really recovered until basically a couple of years ago. So this School Aid Fund got the brunt of that when sales and personal income tax revenues dropped. So the State saw a lot of volatility. They had a lot of trouble balancing their budget at that level, although at the same time, schools were, to a certain extent, protected from that.

MR. KNITTEL: I guess I'd take a slightly different slant on that. I do think the base expansion generally would be, in terms of revenue volatility, would be good for the Commonwealth. It would even out the revenue volatility in the sales and use taxes.

However, I do believe the proposal reads that the distributions would be based on the lesser of sales tax, the growth rate in sales tax collections, or the CPI. So if sales tax collections decline, it is possible that distributions to schools could decline as well.

REPRESENTATIVE DEAN: Thank you very much.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Senator Brubaker.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you, Mr. Chairman.

I have many questions, but the rule is one, so of course I will abide by the one question. May I submit additional questions in writing, Mr. Chairman?

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: We're going to circle back around, too. We just, as a courtesy, are trying to give every member a question---

SENATE MAJORITY CHAIRMAN BRUBAKER: I understand and I support it, but may I---

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Because you're a Senator, we'll give you two then.

SENATE MAJORITY CHAIRMAN BRUBAKER: Oh, no, no; I'll follow one.

Slides 8 and 9 in the IFO report, and you may have addressed it but I just want to make sure that for the record we're perfectly clear, Slide 8 says basic cable will be added to the base taxation?

MR. KNITTEL: That is correct.

SENATE MAJORITY CHAIRMAN BRUBAKER: Okay. And this is all one question: Slide 9, it says all telecommunications are exempt. Now, is that exemption in error?

MR. KNITTEL: I don't believe it's an error. Whether or not it was intended, I can't say. But it's written into the bill, so we scored it out. And as you'll see, the exemption appears to be about, we have it scored out about $340 million.

SENATE MAJORITY CHAIRMAN BRUBAKER: Mr. Chairman, are we able to determine whether that "All telecommunications services exempted" on Slide 9 is indeed in error?

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: We have the author here, if he would like to address it. Mr. Cox, do you---

REPRESENTATIVE COX: Senator Brubaker, that was in fact a drafting error that was actually brought to my attention by the IFO. They didn't know it was a drafting error, so they had to treat the language as it was. But my intent was not to eliminate the current exemption but rather to reach out and tax residential telecommunications, which are not currently taxed. And because of the structure of the tax code -- it's fairly complicated -- I made a drafting error, so I apologize for the confusion.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you. That helps me very much. Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Senator Brubaker.

Next we have Chairman Quigley.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Thank you, Mr. Chairman.

I just wanted to go over, on the IFO report, Slide 12 and then 16. Just looking at, just for my clarification to make sure this is correct, on Slide 12 where we're talking about the school property tax forecast, and we take a look at from '06-07 up to '10-11, so what we've seen is a decrease in those property tax increases.

MR. KNITTEL: Right.

HOUSE MAJORITY CHAIRMAN QUIGLEY: And I guess that's twofold, because I guess some of what we've heard recently is that as the State has pulled back on money or as the stimulus money has gone away, that the local school districts have actually increased their taxes to offset those with lack of stimulus and perhaps State cuts. But this would show that not to be the case, at least from those periods of time.

MR. KNITTEL: That's correct.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Okay. And then the bad news, I think, is, though, on Slide 16 as we look into the future with the impact of the pension looming out there, that we're actually, we probably could see increases in the local property taxes.

MR. KNITTEL: That's correct. I mean, if you look in the report on Table 6, it will show you that the pensions are driving a lot of that increase that you see there into 2014 and '15. We get a little run up in the growth rate and then it comes back down when the contributions level off at about 23 or 24 percent.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Okay. All right. I just wanted to make sure that's clear and make sure that I understood what that was meaning.

Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Chairman Quigley.

Representative Cox.

REPRESENTATIVE COX: Thank you, Mr. Chairman.

If I could add one addition to the question that Senator Brubaker asked. The dollar amount there, the error of pulling out the commercial telecommunications is about $340 million, and the amount that residential would bring in is about $98 million. So that error that I made cost us roughly $438 million, on paper at least.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Your question?

REPRESENTATIVE COX: Thank you, Mr. Chairman.

I'd like to ask a question regarding Slide 6, if I could, and I'd like to focus, if I could, on the second part of the slide where it talks about property tax replacement. I wanted some clarification, if I could, for the Members here and for the public as well.

The property tax forecast, that growth that we see from 2013 on through 2018, that forecast is based on no change in the law and how things would grow based on past behavior combined with the indexes and other things, which you touched on in your testimony. Is that correct?

MR. KNITTEL: That's correct.

REPRESENTATIVE COX: Okay. And then the property tax replacement, that line is a growth that is based on the CPI, because that ended up being the lower of the two, because in the bill we have a choice between CPI versus the growth in the sales and income tax rates. Your projections were that the growth in CPI was smaller. Is that correct?

MR. KNITTEL: Smaller than?

REPRESENTATIVE COX: Smaller than---

MR. KNITTEL: The current law?

REPRESENTATIVE COX: Well, the growth in the CPI, what number did you use there, I guess is my question. Is that the growth in CPI? Across those 5 years.

MR. RYAN: In this particular chart, the property tax replacement is determined by taking the property tax forecast, the current law, and subtracting the forecast for debt service. So the CPI does not factor into this chart. The CPI would factor into the distributions from the Education Stabilization Fund to the school districts.

So in terms of establishing the baseline, it's strictly the forecast for property taxes minus the forecast for the debt service to service the debt that was in existence on 12/31/2011.

REPRESENTATIVE COX: Okay. So on Slide 7, the "Distributions to Schools," that line grows the CPI -- grows according to CPI rather than a sales and income tax.

MR. RYAN: Yeah. The baseline overall forecast grows by CPI and then less the debt service.

REPRESENTATIVE COX: Okay. And so that difference, that net impact difference on the bottom of

Slide 7, that is the difference between what taxpayers would be paying under existing law versus what taxpayers would be paying under HB 1776 as amended.

MR. RYAN: Well, it represents the total of the impacts to the Education Stabilization Fund and the school district impact. So the Education Stabilization Fund piece is the State revenue side of it, and the school district impact is the school district side. Combined, they add up to the total amount.

And the difference on the school district impact represents the difference between what the school districts would be able to levy under current law versus the distributions they would receive from the ESF, or Education Stabilization Fund.

REPRESENTATIVE COX: Okay. So rephrasing my question, because I'm trying to drill down to see if I'm understanding this correctly, the roughly $2 billion shown at the bottom as part of the net impact in 2018, beginning at $1 1/2 billion and going up to $2 billion roughly across those 5 years, is it fair to say that is a difference in what is coming out of the pockets of taxpayers, that they are paying $1 1/2 billion less in 2013 and roughly $2 billion less in 2018? Is that the net savings to the taxpayers?

MR. RYAN: I don't know that I would characterize it quite that way, because the Education Stabilization Fund would be short about $1.4 billion for that level of distribution. So I don't know if I would characterize it as a savings to taxpayers, because at some point I guess it -- if the moneys are not there to distribute to the schools, I guess if one reduced the distributions to the level in the ESF, one could say that that's the amount that would be provided to school districts that's less than the amount in current law. And depending how you want to characterize that, some would see it as a savings to taxpayers, some would see it as a shortfall to districts.

REPRESENTATIVE COX: Okay. Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Representative Davidson.

REPRESENTATIVE DAVIDSON: Thank you, Mr. Chairman.

I just want to be clear regarding the report's findings. I think it was a little muddied in the last exchange.

Your report is showing -- and this was a part of a lot of our debate in the Finance Committee. Your report is showing that there will be a $1.5 billion shortfall to school districts under this current proposal. That's the gap.

MR. KNITTEL: Correct. Yes.

REPRESENTATIVE DAVIDSON: Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: I actually have a question, since we have three experts here from varying parts of the country, and I'm curious, Mr. Knittel -- now I'm probably saying it properly -- you had commented about the sales and use tax compliance being very low. You know, I have a special interest and concern. Is there any reflection in either of your reports for trends in continual Internet purchasing? Because I think that, you know, if you look at this overall property tax replacement, the lion's share of the money comes from the sales and use, whether it's an increased rate or expansion, that I'm concerned about the volatility it puts us at as a Commonwealth.

MR. KNITTEL: Right.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Because I don't think trends are going to reverse themselves; I think people are going to continue, and we see the younger generations doing a large percentage of their purchasing by Internet sales, that I don't want to be 5 years out and have a significant drop-off depending, based on those. Is there a way that you are able to or is there a way that we need to look at that so that we are not held in a tough position later on down the road? I'm interested in all three of your opinions on that.

MR. KNITTEL: Well--

MR. HORWITZ: Well, I guess -- Oh, I'm sorry; go ahead.

MR. KNITTEL: Okay.

Well, I agree with you, the proposal would place more pressure on the distinction between Main Street sales and Internet sales due to the sales tax. We have not explicitly built in a base-erosion factor into our projection of current law collections under the sales tax. I would say that that element is built in to our projection, and since we are doing a statistical analysis, we get some regression parameters, we project out the baseline, and what we find is that every year when we reestimate our equations, the factors that we put in to it, such as the income, have less an effect, and some of that is due to the fact of this erosion issue through the Internet sales. So every year, once we update our parameters and make a new projection, that effect is getting built in. But we haven't, we do not have an explicit sales tax base erosion for increasing Internet sales.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Jason, I may be going out on a limb, but you've had the experience seeing Michigan, so we've got a little bit of historical perspective there. Is there anything there that we can draw on as a Commonwealth? Obviously the Internet utilization has increased since they implemented theirs years before.

MR. HORWITZ: Sure.

Well, I guess to answer your first question, we also didn't account for that here, which is to say we sort of made the implicit assumption that the extent to which that is occurring now will not change when the base is expanded.

And it's sort of difficult to say whether that will be the case under this base expansion. You certainly have some things in here, like clothing over $50 and certain types of nonprescription drugs, that may be prone to being purchased online whereas, you know, some services are less prone to being purchased online. So it's hard to say exactly what the effect would be.

That being said, I do know that there is an effort in Michigan, like in many other States, to try to get a handle on compliance to the sales and use tax for purchases of goods and services online. I'm afraid I don't know what the recent data is or what the experience is in that State for that particular issue, though.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Do you know if that effort is due to the implementation of expanding their sales and use tax or just as an opportunity to try to balance their budget in tough economic times?

MR. HORWITZ: They actually have not significantly expanded the sales and use tax. For example, many services are still exempt from sales and use taxes in the State. It was mainly an increase in sales and use taxes as well as an increase on tobacco taxes that funded their School Aid reforms.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you.

Mr. Ryan, do you have anything else to add to that?

MR. RYAN: No.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Okay. Thank you both.

We are at round two -- I apologize; the last two Members of round one, Representative Gabler and Representative Briggs, in that order, please.

REPRESENTATIVE GABLER: Thank you very much, Mr. Chairman, and thank you all for your very fascinating analysis.

I want to refer, Mr. Knittel, to Slide 28. I’m interested in the Federal income tax impact. I know we’re jumping all over the place here. I’m interested in this analysis because everything else we’re discussing is basically how money is moved around within the State boundaries. But when it comes to the Federal income tax impact, this could represent a net change in how much money is essentially in our State.

And so first I wanted to ask, does this account for, you talk about in your first line that the replacement of the property tax with a sales tax will cause a net decrease in Federal tax deductions. The fact that there is an increase in the State income tax, that's a deduction, too. Is that accounted for in this computation?

MR. KNITTEL: Yes, it is. The net effect is the differential between the two.

REPRESENTATIVE GABLER: Okay. So the $550 million, that is a -- but when you say "federal income tax increase," that's the amount paid.

MR. KNITTEL: Correct.

REPRESENTATIVE GABLER: So would it be a fair way to say it that this is the one part of the analysis that shows that essentially money in our State, with the bill versus without the bill, would be a net change of $550 million just in Federal tax liability?

MR. KNITTEL: I would agree with that. And basically the Federal Government is subsidizing the property tax through the deduction, but they are not doing it for the sales tax.

REPRESENTATIVE GABLER: Thank you very much.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Representative Gabler.

Representative Briggs, please.

HOUSE MINORITY VICE CHAIRMAN BRIGGS: I think this is going to be to the IFO. If you could just talk about Slide 19 related to the nonbusiness versus business. I know you had some cautionary notes. But when I just look at it, it looks like the nonbusiness, which I'm assuming is individuals, tax liability would go up $237 million?

MR. KNITTEL: Correct.

HOUSE MINORITY VICE CHAIRMAN BRIGGS: And the business would be reduced to $2.2 billion?

MR. KNITTEL: Correct.

HOUSE MINORITY VICE CHAIRMAN BRIGGS: Could you just explain a little bit of that and the cautionary, by just looking at that. I mean, I thought the point of removing the property tax was to lower individuals' tax burden to the State. So I would just like to hear about that.

MR. KNITTEL: Correct. And as I noted in the cautionary notes, some of the division here is artificial. For example, on the nonbusiness side, we're assuming, and you can see in the footnote, that the entire amount -- and we discuss it in the paper -- the entire amount of the base expansion is paid by consumers, and that need not be the case. I mean, there's no guarantee that firms will push that whole 7-percent increase forward to consumers in the final sales price. It's very possible that they can only push forward a portion of it and have to internalize some of it, perhaps through lower profits or some other mechanism. So that number, the $4.62 billion, implicitly assumes that the entire amount of that 7 percent is pushed forward into the final sales price, so therefore, consumers bear it, but that need not occur.

And we have similar effects with the personal income tax. For example, on capital gains, interest, and dividends, the tax rate on that would go up. Do you put that in a business basket or a nonbusiness? Well, we put that in the nonbusiness basket. So there were a number of calls such as that that we had to make to put them in a nonbusiness or a business basket, which may or may not hold up.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Representative Briggs.

Representative Denlinger is going to start.

REPRESENTATIVE DENLINGER: Thank you, Mr. Chairman, and thanks to each of you for your very interesting testimony.

I'm wondering, as you were working through your analysis, the degree to which you used demographic content, and let me unpack that a little bit.

In the income study, the question I think at the root for a lot of us is, who's really carrying the burden of funding education in the State? When we look at income taxation, Pennsylvania is fairly generous to our senior population. We do not tax retirement income. So income taxation tends to rest more heavily on those of working years, we'll say 22 to age roughly 60 to 65. Sales taxation is generally thought of in terms of its regressivity, the burden falling more heavily on those of lower income than on the wealthy. Can you share with us -- and I guess I'm asking this to both groups here for the report purposes -- how much of that analysis you wove into your report to us today.

MR. KNITTEL: I can say in our distributional analysis, where we tried to look at those four representative groups, we tried to build that in explicitly. So we did have data from the Census Bureau for the income level of your median homeowner who is either retired or is working age, and we even had a very good idea regarding the composition of that income: Is it taxable? Is it pension? Is it wage income? So we were able to establish that.

And we also had the data from BLS, the Bureau of Labor Statistics, again, on their spending patterns. So we had, I think, a pretty good idea of what they would spend their money on and whether it would or would not be taxed under the base expansion. So I think we had a good idea, and the distributional analysis probably gets to that best.

Regarding the regressivity, we did not explicitly look at that. We did not try to address that component. As you note, on its face, one would think a sales tax generally would be somewhat regressive, particularly when you're bringing in food items. However, the proposal does attempt to lessen the regressivity through the exclusion for SNAP, food stamps, WIC. The WIC carveout actually takes a lot of the food purchases out, we think about 20 to 25 percent of the base, and the clothing sales under $50. We haven't looked at that explicitly, but I suspect that maybe lower income individuals might benefit from that a bit more.

MR. HORWITZ: We actually did not look into the distributional impacts. We only looked at the fiscal impact statewide for school districts and for the State Government. So I cannot speak specifically to what the change in taxes is falling on, who exactly it's falling on.

REPRESENTATIVE DENLINGER: I appreciate that.

And then just the back part of the question: Is Pennsylvania a unique case from a tax policy standpoint? Because I guess we are the second highest retirement destination State for people nationally -- Florida being number one, Pennsylvania being number two -- largely because of our favorable tax policies for seniors. Are we going to have a harder time, this Joint Committee, solving this issue because we are becoming an aging State in essence?

MR. HORWITZ: Well, I would say that the issues with property taxes in Pennsylvania are somewhat unique, at least in my experience in terms of the extent to which assessments are sort of inconsistent and outdated, even among like neighborhoods that are relatively close to each other. And that's, as I'm sure you know, a fairly difficult problem to solve, because it mainly results in someone having to pay more and the other person having to pay less, and it's sort of a negotiation at that point. So yes, I do think that at least the property tax situation is relatively unique in Pennsylvania.

MR. KNITTEL: I would only add to that, I think your note is right regarding the income tax in Pennsylvania. I think only a handful of other States exempt all of the retirement income such as Pennsylvania does. Is that right? Maybe four or five other States do as well.

Moving forward on the property tax side, again, I don't think it changes the incentives for prospective homebuyers or an individual who might move into this State.

Again, what should happen in theory is that we're eliminating the property taxes, but that should be offset by the higher home prices. So moving forward, I don't think it changes, in theory, the incentives moving forward.

REPRESENTATIVE DENLINGER: Okay. Thank you.

Thank you, Mr. Chairman.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you.

Senator Brubaker will lead off on round two.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you, Mr. Chairman.

I'd like to take this brief time that we have and title it "clarification," if I may. Just a very few clarification points. I'd like to do it inside of a very, very confined timeline.

Number one, KOZs. Any change to the KOZs inside of your bill analysis? Keystone opportunity zones.

MR. KNITTEL: Correct. No, we didn't build that in.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you.

Number two, you said numerous times that schools will be held harmless. Did you mean by that collectively our 500 schools, or individually each of our 500 schools?

MR. KNITTEL: I think it's correct -- let me defer to Mark -- all of them. Is that---

MR. RYAN: I mean, collectively. We didn't look at our forecast results for specific districts, so in the aggregate, the baseline. And when we talk about holding harmless, that really means the current law baseline; what would happen, with no change in the current law, under current trends. So that's the baseline against which we measured this piece of legislation.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you.

And you talked about our sales tax going from 6 to 7 percent in the proposal. We currently have 6, 7, and 8 percent sales tax across the Commonwealth of Pennsylvania. What happens to the 7- and 8-percent jurisdictions?

MR. KNITTEL: Correct. So they go up as well. They take it by percentage point, and on a later slide, we think the locals, Allegheny and Philadelphia, will pick up between $100 and $200 million per year.

SENATE MAJORITY CHAIRMAN BRUBAKER: And the final clarification question is, clothing has been referenced several times. Fifty dollars was what has been explained. Is that an individual item, or is that a collective purchase of clothing, $50 or more?

MR. KNITTEL: Our understanding is it's an individual item, and that's how we scored it.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you.

Thank you, Mr. Chairman. That's all.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Very well done there, Senator.

Representative Dean.

REPRESENTATIVE DEAN: I'm just curious; I think with both of these reports and both of your analyses of the fiscal impact of this shift, what do you think, sitting side by side, are the key parallel takeaways of your reports, of your studies, or the key distinctions that you see as a result of the two studies you each did?

MR. HORWITZ: Well, that's a great question. I would say that, when I first saw the IFO report, I was surprised, actually, by the relative amount of consensus, just because of the number of moving parts here. So I would suggest that you could take away from these reports that there is in fact going to be a shortfall here, at least at the State Government level and probably amongst school districts statewide under the current plan.

I would also say -- so their report does take certain things into account, including the effect, the secondary effects, and they look at it over time, which is something that we didn't do, and I think that those things are important. So to the extent that they account for those, that's something that you should consider when you're looking at our report versus their report.

REPRESENTATIVE DEAN: Okay. Great.

MR. KNITTEL: Yeah; I would second that, that I think looking broadly, both at the sales tax base expansion and the PIT rate increase, if you compare our analysis with Jason's analysis, and moreover with the Department of Revenue's analysis, you get very similar answers. I think the difference probably between our two reports is maybe what we assumed about property taxes, the property tax baseline.

REPRESENTATIVE DEAN: I'm sorry; I didn't hear that. Could you say that again?

MR. KNITTEL: The current law property tax baseline, where we're basing ours kind of on an Act 1 Index and the pension exceptions.

REPRESENTATIVE DEAN: Oh. Thank you. Great. Thanks very much.

MR. KNITTEL: Sure.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Representative Dean. That was a good question.

Representative Quigley, followed by Chairwoman Mundy.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Thank you, Mr. Chairman.

I wanted to take a look, again, at the IFO report, looking at Slide 19 and then Slide 21, because I know we were looking, again, about the distinction between the impact and the savings to nonbusiness versus business, and then -- because that has been part of the debate here. You know, should the elimination of the property tax apply to residential property only or should it be across the board? And, you know, some of the critics would say that according to Slide 19, it appears that we're giving businesses a break from their overall tax burden if we eliminate the property tax.

And then when we go to Slide 21, though, I think it breaks it down a little more as it relates to homeowners, and looking at an individual who was a homeowner and retired, they're looking at a tremendous break from taxes and their net tax liability drops dramatically, and even if they're working, their tax liability drops dramatically.

So when we look at the nonbusiness entity of a total increase there on Slide 19, is that increase because it includes all nonbusinesses? But when we drill down a little bit more, we see that a person who's a homeowner comes away a winner under this proposal.

MR. KNITTEL: Correct. I would say that's relatively accurate the way you're characterizing it. There are many other different groups out there who have different effects, and we only considered four of them in that distributional analysis.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Okay. And then obviously some of the proposals that have been talked about, not this specifically, but in the past there have been ideas of, you know, making a constitutional change so that in fact businesses could still be taxed where residential property would be exempt, and obviously under that proposal, it would be an even more dramatic savings for individuals, perhaps.

MR. KNITTEL: Relative to business---

HOUSE MAJORITY CHAIRMAN QUIGLEY: Right.

MR. KNITTEL: Correct.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Right. Okay. All right. Thank you, Mr. Chairman.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Representative Quigley.

Chairwoman Mundy.

HOUSE MINORITY CHAIRMAN MUNDY: Thank you, Mr. Chairman.

We already talked about the variation in the sales tax from municipality to municipality statewide, where Philadelphia, for example, has a higher sales tax. But how about the higher tax rates in the PIT or the EIT? For example, my hometown of Kingston is a home-rule community, and we have a higher personal income tax to start with. And then Scranton, for example, I believe the

EIT is 3.4 percent already. So when you look at these, you know, you were looking at the macro statewide and using averages, I'm wondering the impact on places like that.

MR. KNITTEL: Absolutely. I think that is a good question, and there's a lot of variation across the State. And I have to say that in our analysis, we did not focus specifically on that local option to raise a PIT or an EIT and how it might affect the incentives moving forward.

I mean, I think your point is correct, and that's also the case with the change in the property taxes. Different parts of the State, homeowners will get different benefits. So it will really vary depending on the local unit.

HOUSE MINORITY CHAIRMAN MUNDY: And then I wonder, you know, you talked about sales of property, because who's going to want to buy a home in Kingston, for example, when you're raising the PIT and the sales tax or the, you know, real estate transfer tax?

MR. KNITTEL: Correct.

HOUSE MINORITY CHAIRMAN MUNDY: It makes you wonder.

And then the city of Scranton is a distressed community, and they're being told they need to raise their taxes even before this to fill their funding gaps. So I guess for individual municipalities, this would create some challenges.

MR. KNITTEL: Correct.

HOUSE MINORITY CHAIRMAN MUNDY: Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Any other Members?

Representative Quigley.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Thank you, Mr. Chairman.

Again, for the IFO, I was looking at the detailed report that you have out on the Website, and this gets to an issue that we had talked with some of our previous testifiers in the House Select Committee where we were looking at it based on counties, broken down by counties. And the number of, I think it was some statistic like the top 10 counties as far as property tax collections account for, you know, I forget if it was 60, 70 percent of the total of the property tax pot.

So a number of these charts that you have in the full report seem to bear that out, that if we look at the growth year, you break down here a 5-year average, 10-year annual average, and 15-year annual average of growth rates by county ending in those respective fiscal periods, it looks like the amount that's collected by the counties and the growth rate that those counties have, obviously there's a correlation there.

MR. KNITTEL: Yes.

HOUSE MAJORITY CHAIRMAN QUIGLEY: So, you know, as it relates to a statewide solution as proposed by HB 1776 versus other proposals that would look to break it down by counties, perhaps, or even what they're calling a local option, it seems that the data you've collected and presented here may lend some credence or some, you know, opportunity to look at it as a local option rather than a statewide solution.

Because as you said, when you look at the individual's overall tax liability, if you're currently in a county or a school district that has a very low property tax, this new proposal of an increased sales and increased income, you individually could wind up paying more at the end of the day than you are right now.

MR. KNITTEL: Yeah. I would agree with that, yes.

Mark, do you want to---

MR. RYAN: Yeah; I think so.

MR. KNITTEL: I think that's accurate.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Okay.

And then for Mr. Horwitz. In your analysis, was there any looking at that breakdown by county or by localities, or were you just looking strictly at the---

MR. HORWITZ: We only looked statewide.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Statewide at the totality. Okay.

And then in the Michigan example, you were talking about with the sales tax there. Is Pennsylvania so unique with all these 500 school districts and the way we have things broken down for school funding that is there an accurate comparison out there of another State that you're aware of that may have broken it down as a local option and looking at property tax rather than a statewide solution?

MR. HORWITZ: There are plenty of States that have looked at these particular types of reforms. I guess, so what do you mean when you say "broken it down as a local option"?

HOUSE MAJORITY CHAIRMAN QUIGLEY: In other words, instead of having the State fund the school districts or take over the property tax issue, have other States enabled localities to make differentiations as to how they would fund public education?

MR. HORWITZ: You know, that's actually rare. I would say the trend over the past probably 50 years or so has been towards more centralization of school funding. And I'm not sure how much that's playing here, but in the past, at least, that is largely driven by a desire to equalize funding throughout the State. And so, for example, that has happened in Texas, California, and

Michigan, and they have sort of reformed and revisited those systems over time.

HOUSE MAJORITY CHAIRMAN QUIGLEY: So in those examples, it looks as though that, in your opinion, the trend has been for the various States to take a more active role as---

MR. HORWITZ: Right.

HOUSE MAJORITY CHAIRMAN QUIGLEY: ---reforming the system but also providing more funding in the effort to try to provide equalization.

MR. HORWITZ: That’s right. So there is a tendency to want to equalize funding and centralize funding at the State level. That doesn’t always result in more funding, though. It often results in less. It depends on which State you’re referring to.

And then in a State like Texas, for example, there’s a very complicated funding formula where it is, to a certain extent, very localized, where they take into account a lot of different things that are happening at the local level: How rural is it? How much bilingual education do they need? You know, how big is their special education system, all that stuff, and they take all that into account when they’re determining how they allocate those funds.

HOUSE MAJORITY CHAIRMAN QUIGLEY: All right. And it was just mentioned, I guess, last week by our Budget Secretary in PA about looking at re-weighting the formula, if you will, to include such factors that you just outlined.

So again, Texas took that approach of trying to have a formula that takes into consideration, I guess, the differences in localities or in regions of that State.

MR. HORWITZ: That's right.

HOUSE MAJORITY CHAIRMAN QUIGLEY: Okay.

All right. Thank you, Mr. Chairman.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Senator Brubaker.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you, Mr. Chairman.

I believe one of the Members asked about the Department of Revenue and whether they were engaged. I think the answer was that they were at least consulted and/or there was a conversation. Do you have a way to communicate to us, should this bill become law, either of these bills become law, just how cumbersome will this be for the Department of Revenue? Will they need to staff up? What kind of timeline would they need in order to fully implement?

MR. KNITTEL: Yeah; correct. And we did ask the department to give us an estimate of how much additional staff they would need under the proposal, and in footnote 2 of the report they give us an analysis here. I'll just read it out: "...the Department of Revenue estimates that 117,000 new sales tax licensees will need to register with the department. For the sales tax base expansion, the department projects that it will require an additional 31 staff." And the projected cost for mailings, labor, and computer programs is approximately $4 million.

I do think moving forward, the greatest difficulty they would have would be compliance under some of the expansion to the service and administering it. And also, in separating the new revenues from the proposal from the old revenues, I think that would be fairly difficult.

SENATE MAJORITY CHAIRMAN BRUBAKER: And it's potentially that their computer systems may need to be modified accordingly---

MR. KNITTEL: Correct.

SENATE MAJORITY CHAIRMAN BRUBAKER: ---and who only knows what kind of complexity that might yield. So therefore, it's a red flag. It's an area of concern that would need to be more focused on.

MR. KNITTEL: Correct. I think they could have some difficulties with the base expansion.

SENATE MAJORITY CHAIRMAN BRUBAKER: There are an awful lot of questions regarding impact on jobs. There are many great associations in the Commonwealth focusing on jobs, two of which -- and forgive my absence for the others -- are the Pennsylvania Chamber and the NFIB, but no doubt there are many others. Have you reached out to the Pennsylvania Chamber and the NFIB and any other reputable business organizations to better understand the impact on this to Pennsylvania business?

MR. KNITTEL: No. For this analysis, we did not. We did touch base with two organizations for our revenue estimates. One was the Pennsylvania Retailers' Association, and also the Food Merchants Association. So we touched based with them regarding the clothing sales and the carveout for WIC items to make sure our estimates were as accurate as possible, but we did not talk to organizations such as NFIB.

SENATE MAJORITY CHAIRMAN BRUBAKER: Thank you.

And the AEG group, I believe that you had disclosed early on that your report was paid for by the Pennsylvania Realtors. Is that correct?

MR. HORWITZ: It was paid for by Keystone Analytics on behalf of the Pennsylvania Association of Realtors. That's correct.

SENATE MAJORITY CHAIRMAN BRUBAKER: Okay.

And for anyone that might believe there's a conflict, can you tell us, we all support a robust housing industry here in the Commonwealth of Pennsylvania, but can you assure us that that report was done in an independent manner?

MR. HORWITZ: Yes. Our intention is always to make an honest and open assessment of any policy that comes our way. So you will see all of the assumptions we've made in the methodology in the back of our memorandum. So if you object to any single one of them, then I suppose that's okay. But yes, we tried to be open and fair and transparent about what we did here.

SENATE MAJORITY CHAIRMAN BRUBAKER: Well, and I believe that's the case. I just wanted to put that on the record. Thank you so much.

MR. HORWITZ: Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Senator.

I have two quick questions. I also want to make kind of an editorial note, too.

For those that don't understand, the Independent Fiscal Office, they do not necessarily answer to a Republican or a Democrat or the Senate or the House, and I think both the objectivity of their office and Mr. Horwitz's organization on behalf of the Realtors is really very, very helpful for us. I've been involved with multiple attempts at this issue throughout my tenure, and I think this is probably the most comprehensive on that.

So I'm going to throw two quick questions out there, kind of coat-tailing on what Senator Brubaker was starting to touch on. Is it going to be any more cumbersome on a business who's now all of a sudden going to start reporting this information, maybe they hadn't in the past just by the nature of what it is that they do or produce, and where do we see the relationship to any tax savings they might see versus the cost of having to implement or report this?

I mean, one of the things a lot of our local small businesses will say to us is, our current sales and tax code is very cumbersome: Do I tax a bag of beans; don't I tax cooked beans? If I have a chicken rolling around on a rotisserie and you purchase it, it's taxed; if it's frozen in the freezer, on and on and on. I mean, a simple thing as a ball of yarn; they have to actually ask the person purchasing it, what are you going to make with this yarn? If you're going to knit a sweater, then it's not taxed; if you're going to make an afghan, then it's taxed.

My major objective is not making something that's already cumbersome more cumbersome and then try and tell somebody it's good for them: "But you're going to have a savings." Well, sometimes the savings is far outweighed by the difficulty. And more importantly, the penalty that they can receive if they're not in compliance or not reporting accurately. I find that very discouraging and do not want to make that any worse. Any anticipation of whether we're enhancing that or making that more difficult under this proposal, by either organization.

MR. HORWITZ: Well, yes, so that's something you always want to consider. And it does seem like, for example, the provision that exempts WIC foods and doesn't exempt non-WIC foods might result in some confusion. The same thing with clothing $50 or greater. I feel like you might suddenly have a lot of clothes that are worth $49 in the State after putting in place a provision like that.

But in general, as a principle, a broader sales tax base tends to be a good idea, just because you can have lower rates when the base is broader and it's less volatile, as Mr. Knittel expressed earlier.

But yeah, I imagine that at least in a few ways, things will be more complex. And also, with a lot of these services, there might be some industries that, you know, aren't familiar with how to deal with the new tax and there will be a certain transition period where there might be a certain amount of noncompliance in those new areas.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Which then will probably make things more cumbersome for the

Department of Revenue.

MR. HORWITZ: Yes.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Okay.

Mr. Knittel.

MR. KNITTEL: I would generally agree with that observation. There are elements of the proposal which would make it simpler. For example, you know, sales at pharmaceutical firms, the various different types of items that are taxed or not taxed -- you know, razors versus other items. So those would all be -- there is going to be some clarification there. However, as Jason noted, there would be, on the WIC items especially, when we ran into that and we were costing that out, we ran into a bit of difficulty about what would be included and what would not be included, you know, lunch meats or deli meats or things such as that.

So I think there are both sides to it. As you had noted, there's also the element that there's a cost to comply with the law, and that could be burdensome for the smaller mom-and-pop service providers who are providing all of the labor to the small firm, much more so than the larger firm who's already reporting these amounts.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you.

Mr. Ryan, anything to add to that?

MR. RYAN: No; he said it all.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Well, you gentlemen have said a lot. We are very grateful. We are thankful, again, to the Realtors for allowing you to present to us as well. I know you're going to be presenting to their great organization.

Mr. Cox, you slipped in under the wire, young man. Mr. Cox has the closing question. I apologize.

REPRESENTATIVE COX: I apologize; I had to step out and leave a proxy for another meeting that's going on right now. And I'm not sure if the question has been asked; if so, then we can talk afterwards.

But the concept of regressivity and how this is regressive has been addressed or it has been a concern that has been ongoing from various versions of this plan. And regressivity is often seen in terms of what's being taxed and things like that. Two recurring subjects are food and clothing, and we tried, in the drafting of the legislation, we tried to carve out commonsense exemptions that would prevent, that would keep regressivity at a minimum, if you will, or that would lower the level of regressivity. Do you think we've done a fair job there in the food and the clothing exemptions in the way we've carved them out with dollar amounts for the clothing and with certain types of food?

MR. KNITTEL: Yeah; regarding the clothing, I think that's the more difficult of the two, but we don't have data regarding whether low-income purchasers tend to buy more clothing items under $50. I suspect it's the case, but we didn't have data to support it.

Regarding the WIC carveout, we found in our analysis that the WIC carveout is reducing the food tax base by about 20 to 25 percent, and it does appear that lower income consumers do spend a disproportionate amount on WIC-type items such as milk, bread, cheese, eggs. So I do think it's addressing some of the regressivity there.

REPRESENTATIVE COX: And I've been informed by the Chairman that as the last person asking questions, I can actually ask more than one at this point, and as the prime sponsor of HB 1776, I'm going to take that, take the Chairman up on that latitude.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Ask the question.

REPRESENTATIVE COX: The report shows that renters, by and large, are hit more directly and there's more of an impact on renters than there is on homeowners. Does any of your report take into account that there will probably be some renters who will now purchase homes because there's not that barrier of property taxes? Does your report take that into account, or is this a static snapshot saying renters as they are right now?

MR. KNITTEL: We discuss it; we don't take it into the analysis per se. And I think on prospective homebuyers, as you note, some could be worse off, some could be better off. It depends on how much of the property tax cut leaks out from the current owners.

Clearly, I think it is the case that the property tax cut would increase the supply of housing and provide some jobs there as well, and some of the prospective homebuyers may be able to capture some of the property tax cut when they go to purchase a home.

REPRESENTATIVE COX: And do you think, you talked about the capitalization being about 33 percent, one-third. Do you feel that that change in capitalization resulting in a higher home price, will that prevent renters from becoming homeowners, or do you think the offset of the disappearing property taxes will---

MR. KNITTEL: Correct. In theory, they should balance out. You know, in the normal case, moving forward, the housing price goes up but the present value of the future property taxes goes down to exactly offset it. So in theory, in most cases, one would assume it has a plus or minus. But, of course, in individual cases it will vary, and it will also vary based on the location in the State and how developed an area is.

REPRESENTATIVE COX: So to try to get a summary out of it, do you anticipate homeownership across the Commonwealth, whether it be through housing being built? I'm assuming the growth has to come from housing being built. Some home sales will occur and be filled, but once those current homes are filled, we'll have to build more homes. Do you see more people owning homes 5 years down the road under this or the same or fewer?

MR. KNITTEL: I think it's unclear, because you have the same incentives with the renters. If the renters are paying all of the property tax in their rental payments, then we reduce that, in theory, the rental payments should go down as well and more rental housing should be built. So how it trades out, I think it will be mixed across the Commonwealth. Some areas will get more housing, others less so. And I don't know if Jason had a chance to look at that.

MR. HORWITZ: No, we didn't specifically look at the impact on renters versus homeowners. We did look at the affect on home prices, and we got a similar result as the IFO.

And yeah, insofar as the future reduction in property taxes, it's just captured in a current increase in the home prices; it's not really clear whether that will actually result in more homeownership or not. Because people will like that property taxes are lower in the future, but they will also see higher prices in homes now, and those would offset each other.

REPRESENTATIVE COX: Okay.

I do want to commend all of you for the tremendous work that you've done. This study is probably the most comprehensive work we've seen on this subject since back in, I think, 2004-2005. We had some reports at that point, but this collection of research will really help us analyze how and the best way to move forward on this.

So I want to thank all of you for your work and your support staffs behind you, because I know it can't always be done alone. So thank you.

MR. KNITTEL: My pleasure.

MR. HORWITZ: Thank you.

HOUSE MAJORITY CHAIRMAN BENNINGHOFF: Thank you, Representative Cox. We know this issue is near and dear to you and you've put a lot of work into it.

I want to thank the Members for staying here for the hearing throughout. And to the three testifiers, thank you very much. You've done a great job, and we will be back in touch.

This meeting is adjourned.

(The hearing concluded at 11:54 a.m.)

I hereby certify that the foregoing proceedings are a true and accurate transcription produced from audio on the said proceedings and that this is a correct transcript of the same.

Debra B. Miller

Committee Hearing Coordinator/

Legislative Reporter

Notary Public

Kristin O'Brassill-Kulfan

Transcriptionist