

Questions about Property Tax Reform Bill H.B. 1776

In November 2011 we wrote a *Policy Brief* about a proposal to end school property taxes in Pennsylvania (*Volume 11, Number 61*). The proposal came from the House Majority Policy Committee with the promise that a bill would be forthcoming. That bill, H.B. 1776, is being considered by the House Committee on Finance.

The basic premise of the proposal was that residential school property taxes would be eliminated and lost revenues replaced by an increase to the income tax and an expanded state sales tax with a much broader base. So what has changed from the Policy Committee's proposal to the actual bill?

The original proposal called for the elimination of residential property taxes by school districts. Back then the Committee estimated that \$9.1 billion in revenues would have to be replaced. We questioned the strategy of leaving commercial property subject to the school district taxation as it would create an unfair advantage for districts with large fractions of their tax base made up of commercial properties. But more important, as we noted, it would send a negative message to the business community and there would be likely political pushback. H.B. 1776 does go one step further than that original proposal as it eliminates all school district property taxes, not just residential. The bill would strictly prohibit districts from levying any property taxes. But that only increases the amount needed from the alternative sources. According to the most recent data from the Department of Education for the 2010-2011 school year, \$11.14 billion in real estate taxes were collected by school districts across the Commonwealth.

Originally, alternative sources to replace property tax revenue were to be an increase to the state income tax and an increase and broadening of the state sales and use tax. In the current bill, an additional revenue source has been included—a hotel occupancy tax.

H.B. 1776 will increase the income tax by 0.94 percent—slightly higher than the proposed rate last fall of 0.92 percent. Based on the State's income tax revenues from 2010-2011 fiscal year, \$10.44 billion on a rate of 3.07 percent, the estimated total amount of taxable income is \$339.93 billion. The proposed increase of 0.94 percent should generate another \$3.196 billion. The bill will place this extra tax revenue into the "Education Stabilization Fund" (ESF). But this alone will not be sufficient to replace school property taxes.

The second source is the sales tax. If H.B. 1776 were to become law in its current form there will be three major changes to the sales tax. First the rate will increase from six to seven percent (increasing to eight and nine respectively in Allegheny and Philadelphia Counties). Second, the sales tax base will expand the number of items subject to the sales tax. Items that are specifically targeted in the bill are telecommunications service, coin-operated vending machines that dispense food and beverages, prepaid telecommunications, prebuilt housing and home providers of telecommunications services.

While many other previously exempted goods and services will now be subject to the sales tax, there is a long list of items in the bill that will still be exempted—89 in total. Among the more notable exclusions are prescription drugs/medical supplies, clothing with a retail sale price of less than \$50, along with food and beverages that are federally approved items for the Women, Infants, and Children Program. This list of exclusions makes estimating the amount of sales tax revenues that will be collected very difficult. This of course leads to the question as to whether or not this change will collect enough, more than enough or fall short on the goal of replacing the school district property tax. If nothing else the long list of exemptions will likely create a nightmare for collectors and enforcement officials.

And third, all of the money collected from the sales tax will go directly to the ESF and not to the state's General Fund. The current six percent sales tax brings in about \$8.6 billion, which works out to about \$1.43 billion per percentage point, assuming no change in spending habits. A seven percent sales tax, with the current system of exemption, would bring in roughly \$10 billion. Add that to the nearly \$3.2 billion from the increase to the income tax and it would appear the new bill collects more than enough revenue to replace the school property tax revenue. However, with all sales tax revenue directed to the ESF, the state will be short in General Fund revenue by about \$9 billion. Whether or how any revenues directed to the ESF over and above the amount needed for replacing property taxes can be used for the state's normal allocation to k-12 education have not been spelled out in the legislation.

But as mentioned above there is another added revenue source in the bill, a hotel occupancy tax. The bill calls for "an excise tax of 7 percent of the rent on every occupancy of a room or rooms in this Commonwealth..." There is no indication as to whether this occupancy tax replaces the tax in counties which already impose an occupancy tax or will it be an add on tax. Allegheny County for example has a seven percent hotel occupancy tax in place. If the seven percent tax is added on, hotel taxes in Allegheny County would be 22 percent including the new eight percent sales tax. This would be a prohibitive level and sure to find resistance from hoteliers and visitor bureaus. Once again there is no estimation as to how much money this tax would collect.

Finally, note that H.B. 1776 contains a provision to place some of the ESF revenue into a Public Transportation Reserve Fund. Under terms of section 781.2 a fund will be established for public transportation "to replace the revenue earmarked for transportation

under 74 PA.C.S. subsection 1506 (relating to fund), not to exceed 4.4% of such additional revenues...”

But why create a public transportation funding component in this bill? Will the transportation funding be used for transit systems? Using hotel taxes and other school property tax replacement taxes seem to be the wrong sources of revenue for transit subsidies. And if the new taxes are insufficient to fund education why use some of them for transit. Better to take on the transit issue as part of an omnibus transportation funding bill.

In sum, there are many questions raised by H.B. 1776 that need to be answered before it gets passed into law. The notion of reducing school property taxes is a worthy endeavor and one to be applauded, but this plan needs some work.

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