April 25, 2014 Policy Brief: Volume 14, Number 21

Alternative Approaches to School Property Tax Reform

Is 2014 the year that will mark the beginning of the end of school property taxes in Pennsylvania? Right now there are two separate proposals in the General Assembly to put in place the mechanisms to shift school property taxes onto alternative sources of revenue.

Color us a bit skeptical. It is a big undertaking as school property taxes statewide raised over $11 billion in revenue in 2012-13 and shifts have been talked about for a long time. When voters have had the chance to vote on shifts the response has not been favorable (as of 2011-12 twelve districts across the state were collecting earned income taxes under Act 1 of 2006, which allowed voters to raise wage taxes to pay for school property tax relief). This is not to say it cannot happen, but the Institute has written before (most recently in 2006, 2008, 2011, and 2012) about tax shift proposals.

In 2006, we noted that an Issues PA survey found that the most supported option for a tax shift was for the sales tax, beating out the options of a higher state personal income tax or local wage tax, but the level of support was a mere 24 percent. In 2008 we produced a full length study on the impact of Act 1 in Allegheny County and noted that not a single district saw its taxpayers vote to enact a higher earned income tax in order to fund property tax reductions. And a proposal from two years ago that we wrote about to end all property taxes in Allegheny County by shifting to new sources of taxation seems like a distant memory.

Here is a summary of the main tax shifting aspects of the two proposals:

> *Property Tax Independence Act (Independence Act)*—This proposal would "eliminate all school property taxes across the Commonwealth and would replace those taxes with a combination of funding from the personal income tax and the sales and use tax" according to a memorandum on the legislation. Specifically, the sales tax would apply to additional items and services and the rate would rise from 6 to 7 percent (corresponding changes to the base and the rate would occur where local option add-ons exist, namely Philadelphia and Allegheny County). The state income tax would increase from 3.07 to 4.34 percent.
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> *Optional Property Tax Elimination Act (Optional Act)*—This proposal would "allow a school district to implement an additional earned income tax, mercantile tax, or business privilege tax with additional revenues used solely for the reduction or elimination of school district property taxes" according to a fiscal note on this proposal. If a district board decided to reduce or eliminate school property taxes through the levy options the gross receipts taxes could not account for more than 50 percent of the revenue generated.

There are stark differences that jump out from the summaries on these proposals. There are different taxes involved in a possible shift and those taxes are levied by two different levels of government. One is mandatory and state driven while the other is optional and locally driven. Once the proposals are analyzed a bit deeper other differences come to the surface as well. While the Independence Act would apply to all school districts in Pennsylvania, the Optional Act would not apply to Philadelphia. The Independence Act would give taxpayers a chance (once the statewide shift from school property taxes to sales and income taxes was complete) to have referendum approval of a district based wage or personal income tax to fund projects or programs. The Optional Act would not have voter referenda.

But are these two proposals completely dissimilar? Both the Independence Act and the Optional Act would be targeted at school property taxes paid by all classes of taxpayers (residential, commercial, industrial, etc.) and would not affect property taxes paid to counties and municipalities to fund general services. Neither the Independence Act nor the Optional Act would alter the school funding formula used by the state to deliver funding to school districts. The Independence Act would use a formula to replace the money raised by school property taxes with the state levies by a dollar for dollar swap in the first year of implementation and then annual increases after that would be determined by changes in the statewide annual weekly wage. Note that any distribution formula of the property tax replacement funds will likely cause controversy.

Both the Independence Act and the Optional Act would leave largely untouched the non-property taxes levied by school districts (taxes on wages, realty transfers, gross receipts, mechanical devices, etc.) that raised close to $1.7 billion statewide in 2011-12. Obviously under the Optional Act wage and gross receipts taxes could climb to pay for property tax reductions, and, as mentioned above, under the Independence Act voters could boost income levies.

And both could leave a portion of school property taxes in place: in the case of the Independence Act, if a district was debt-free it would immediately cease levying property taxes. If it had debt, the portion of property taxes servicing the debt would stay in place until the debt was retired. Under the Optional Act if a district opted to reduce and not eliminate property taxes the remaining portion would stay in place.

Only time will tell if school property tax reform happens and what it will look like.

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