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Unbundling the Governor's Proposed Tax Shift

How would the state budget proposal, specifically the concept of a tax shift from property to sales and incomes, affect a typical person in Allegheny County? It will depend on how much income that person makes, how much the person spends on items that are and will become subject to the sales tax, and where that person resides.

Let's start with the state's personal income tax, which is a flat 3.07 percent. If a person brings home what the Census puts at the median household income ($51,366), they currently pay $1,577 in state income tax. If compensation remains unchanged after the income tax is raised 20 percent to 3.7 percent, the payment to the Commonwealth would increase $324 to $1,900. If the person's earnings increased to $52,900 (3%), the increase in income taxes would be $381 to $1,957.

If the person spends $25,000 on goods currently subject to the sales tax (6% statewide, with a 1% add-on in Allegheny County, a reasonable assumption based on the ratio of taxable sales to income in the state as a whole), the total sales tax bill would be $1,750. If the rate is increased 0.6 percent, and the sales tax is expanded to additional goods and services, we could reasonably expect that the $25,000 spent by this typical person will increase. Based on the implied assumptions in the Governor's proposal, the amount of spending subject to the expanded, higher sales tax will rise about 20 percent to around $30,000. At a 7.6 percent rate in Allegheny County, the sales tax bill would be $2,280, or $530 higher than before the change. If spending rose with income, the new sales tax would be $546 higher than the year earlier.

At this point, we estimate this typical person in this scenario would pay $927 more in income and sales tax.

Now the tradeoff is that the higher state taxes will fund reductions in school property taxes. The budget address stated the average homeowner will see a 50 percent reduction. From published reports and data available from the state Department of Education, the impact of tax relief under the tax shift proposal will vary. After paying for residential tax relief via the homestead exemption (the Pennsylvania Constitution allows for a homestead exemption to reduce taxes by half of the median assessed value "…within a local taxing jurisdiction", which can be a county, municipality, or a school district) some school districts may see further reduction to millage that would affect all classes of real property (residential, commercial, industrial, land, etc.). By the Department's estimate five school districts in Allegheny County would see more than 100 percent relief while five districts will get 17 percent or less in residential property tax reduction.

In West Mifflin, the estimated relief following the tax shift is expected to be on average 67 percent. In Cornell, it is estimated at 44 percent. In Hampton, the reduction is estimated at 21 percent. Since millage rates levied by school districts don't go away, that could explain some of the trepidation the proposal has been met with initially, noting that nothing will prevent a hike in millage rates in the future that will chip away at the estimated tax savings. Note too, that the reduction in taxes is paid for by state subsidies. These funds will not represent additional money for the schools to spend. Thus there is legitimate concern that millage rates will need to be hiked in the future as teacher contracts boost compensation to higher levels.

We examined the Department of Education's data on the projected dollar figure of residential tax relief, current millage rates, the number of qualified homestead properties in each district from Act 1 gaming relief data, and calculated the taxes paid on a home assessed at $100,000 with no homestead relief against the expected taxes that home would pay after the residential tax relief is applied to lower the assessed value of the home via the homestead exception. When balanced against the $927 increase in state income and sales tax, the $50,000 income homeowners in West Mifflin and Cornell would come out ahead based on the school property tax reduction, while the homeowner in Hampton would pay slightly more overall.

Tax Shift in Three County Districts

School District	2014-15 Millage	Home Value	Taxes on $100,000 Home	Home Value after Exemption Applied	Taxes after Exemption Applied	Difference in Property Taxes	Boost in Income and Sales Taxes	Overall Change from Shift
West Mifflin Area	24.4965	$100,000	$2,450	$48,415	$1,186	-$1,264	$927	-$337
Cornell	22.7460	$100,000	$2,275	$50,163	$1,141	-$1,134	$927	-$207
Hampton	17.8500	$100,000	$1,785	$49,657	$886	-$899	$927	$28

By and large it appears that households living in owner occupied houses who have an income of around $55,000 will come out slightly ahead, break even or come out slightly behind in terms of the net change arising out of increased sales and income taxes and lower property taxes. And win, lose, or stay even depends on the particular district. It appears the system is designed to cut home owner taxes across the state around $1,000 a year, give or take a couple hundred dollars or so. There are some outliers higher and lower than $1,000 due to special circumstances.

Homeowners with substantially higher incomes than $55,000, say $80,000 and above, will be significant losers in the tax shift system. The higher the income, the greater the net loss will be. Homeowners with less than $50,000 in income will come out ahead in the tax swap game and those at $40,000 or less come out even more ahead. But those gains will be limited relative to the losses of the higher income homeowners. There is a major redistribution element in this scheme. In very poor districts which will see complete elimination of homeowner taxes, the gains will be greater than for poorer homeowners in a more typical district.

Most renters of residential properties will be losers since they will be paying higher sales and income taxes while there is no plan to reduce the taxes on rental properties and thus rents will not be reduced. There is a provision to pay some low income renters $500 per year. But that leaves many who are going to be big losers.

Finally, it is not clear how business owners in nonresidential properties will fare. There are no significant provisions to reduce school taxes on commercial property and the impacts of the higher taxes will be felt, but by how much and by whom will require another detailed analysis.

It bears repeating that the reduction in school taxes does not add a dime to the money available for districts to spend since the property taxes are being reduced dollar for dollar of the state funds received through the tax reduction program. Thus, it is a virtual certainty that school property taxes will be raised again in the future as spending rises. And it will rise as union contracts push compensation higher, new programs are put in place and the pension crisis requires more money to fill the funding gap.

Too bad the tax shift proposal does not address the spending side of education and recommend the elimination of teacher strikes. No doubt employees will view this tax shift plan as a gravy train of dollars to be tapped into.

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