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Evaluating the House's Property Tax Relief Bill

Since April of last year we have analyzed and reported on three separate proposals to provide taxpayer relief for school property taxes including the one that was part of the Governor's budget message in early March (see *Policy Briefs Volume 14, Number 21 and Volume 15, Number 13*).

Now comes a fourth plan out of Harrisburg. The House of Representatives recently passed legislation to provide school property tax reductions by raising the rates of the income tax and sales tax to provide dollar for dollar cuts. The income tax would be raised from 3.07 percent to 3.7 percent (identical to the Governor's plan) to fund millage rate reductions and the sales tax would rise from 6 to 7 percent (8 percent in Allegheny County, 9 percent in Philadelphia), with no changes to taxable items, to provide homestead property tax relief. Existing homestead exemptions from legalized slot gaming would stay in place, and funds would be available to expand the property tax/rent rebate program.

So how would the plan change the total taxes paid by property owners? Like other tax shift plans, it will depend on how much the taxpayer earns, spends on taxable items, the value of property and the school district in which they reside. Earlier this year when we examined the Governor's plan we used the example of a person earning the median household income for Allegheny County ($51,366), spending a certain amount on taxable goods ($25,000 estimated based on typical Pennsylvania household spending patterns), and owning a $100,000 home that qualifies as a homestead property.

For the Governor's scheme, when the person's income went up slightly and the amount of goods subject to the broadened sales tax was calculated, we estimated that the boost in income and sales taxes would result in $927 in additional tax payments. Homes in three Allegheny County school districts (West Mifflin, Cornell, and Hampton) were used to determine how the increase in income and sales taxes would compare to the decrease in school property taxes. A taxpayer in the West Mifflin or Cornell district would come out ahead (their school tax reduction would be greater than the increase in income and sales taxes); while a taxpayer in Hampton would essentially break even. Note however, that in most districts homeowners with much higher home values and considerably higher family incomes than used in our example above would be net losers under the Governor's plan, reflecting a heavily redistributionist element of his plan.

We have replicated this analysis for the House bill after reviewing the legislation and obtaining a data set from the House outlining the district by district impact of the homestead exemptions and the millage rate cut. All districts will see both components of property tax reductions as opposed to the Governor's plan wherein millage might be cut in only a few selected, mostly poorer districts.

First, the House plan boosts the income tax rate by the same amount as the Governor's plan. The sales tax change is different since there is only a rate hike but no broadening of the base. That means not as many items would be taxable but people will pay a higher rate on the items that are and will remain taxable. Our estimate shows the boost in income and sales tax rates would mean an additional $705 for the Allegheny County taxpayer earning around $51,000. Bear in mind that this is a based on family with an average level of expenditures on items subject to the sales and use tax.

This increase in additional taxes is compared to the reductions to school property taxes the House bill will produce. As pointed out earlier, the net effect depends on the district in which the person resides. The potential impact of the House plan is calculated by first applying the projected homestead relief, which effectively lowers the assessed value of the home for tax purposes for qualified property owners. Then the impact on tax payments from the district's millage rate reduction (estimated by the House based on projected revenue from the income tax hike) is calculated. Note that all classes of real property will get tax relief since a millage reduction will mean lower taxes for homeowners, residential rental properties, commercial property, land, etc. This is a major difference from most property reducing plans that are based on homestead exemptions. Recall that a homestead exemption provides a flat dollar amount reduction for all homestead properties in a taxing district, so a $10,000 reduction for the assessed value of a $75,000 home and the same reduction for a $350,000 home paying 20 mills will lower the tax bill by $200 for both homes, but results in a 13 percent lower tax bill for the $75,000 home and only a 3 percent reduction for the $350,000 home.

The initial estimates for millage reductions (data provided by the House) range from a pre-set low of 20 percent to a pre-set high of 30 percent, that is to say they are arbitrarily imposed by the part of the plan's design, which is not spelled out clearly in the bill. Whatever the rationale, according to the House provided data, a taxpayer in West Mifflin will end up with a net tax reduction (amount property taxes are lowered minus amount paid in higher sales and income taxes) of $257, in Cornell $344, and in Hampton $150. The table below compares the Governor's plan to the House plan for these three districts.

Estimated Net Results from Tax Shift Proposals

School District	2014-15 Millage	Home Value	Net Tax Change from Shift (Governor)	Net Tax Change from Shift (House)	Difference between Plans
West Mifflin Area	24.4965	$100,000	-$337	-$257	-$80
Cornell	22.7460	$100,000	-$207	-$344	$137
Hampton	17.8500	$100,000	$28	-$150	$178

While the taxpayers in West Mifflin and Cornell would see net savings under both plans, the House plan offers less for West Mifflin in this scenario and more for Cornell. Hampton moves from paying more under the Governor's plan to becoming a net gainer under the House plan. This result stems primarily from the House's limiting the range of millage rate reductions to 20 to 30 percent. This ensures that higher valued homes in wealthier districts receive tax bill reductions that are a minimum of 20 percent based on millage rates cuts alone.

In general, for higher income households, the greater the ratio of home value to income, the more likely they are to see a reduction in total taxes. Conversely, the greater the ratio of income to home value, the more likely the homeowner will pay more in total taxes.

Of course, the scenarios we have presented have been consistent in terms of level of income, level of spending, and type of real property. So we constructed several other scenarios to measure under the House plan. A non-homestead property, such as an apartment building, would not qualify for any homestead property relief, but would partake of the millage reduction. So an apartment building assessed at $300,000 in the Cornell School District would get a school property tax reduction of $2,048 based on paying at 15.9 mills, which is where the millage would be based on the estimated 30 percent reduction the District would see (currently 22.74 mills). How renters might be affected is a complex issue and depends on many factors that we will not go into here.

As with other tax shift proposals, there are plenty of variables that go into determining whether someone comes out ahead or not. In addition, shifting to taxes that could fluctuate widely with the level of economic activity as opposed to a stable tax source (property) can lead to problems. Could the state guarantee that a 30 percent reduction in school millage rates in school year 2016-2017 will stay in place the next year if there is a major contraction in economic activity and income and sales taxes drop dramatically? Should the legislation call for building a reserve against such a contingency that could not be drawn on for other purposes? Or should school districts and taxpayers be warned that the money coming from the scheme might vary significantly from year to year? The possibility that district might be forced to drastically raise property taxes in an economic downturn would be public policy at its worst.

Then there is the issue of keeping school district control over property tax millage under the Act 1 mechanism, which does set a ceiling for how high taxes can climb but allows for annual increases to that cap and the possibility for exceptions to the cap upon request to the state.

Finally we note that just as in the 2014 session when we noted the alternative visions of school property tax relief (elimination vs reduction, mandatory vs optional) these two 2015 plans do have some differences. But at this point the chasm does not seem to be as wide. The House plan is superior in several important ways to the Governor’s plan in that millage rate cuts will guarantee significant benefits for all property owners. Still, there are plenty of potential pitfalls and inadequacies remaining that should be dealt with before this legislation is passed in final form.

Jake Haulk, Ph.D., President **Eric Montarti, Senior Policy Analyst**

Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079 * Fax (412) 440-0085
E-mail: aipp@alleghenyinstitute.org