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Homestead Exclusion Remodel Faces Major Hurdles

Summary: A ballot question asking Pennsylvania voters to alter the existing constitutional language on the homestead exclusion was approved in November 2017. The new provision will allow the General Assembly to write legislation allowing local taxing authorities (counties, municipalities, and school districts) to have homestead exclusions of up to 100 percent of the assessed value of each homestead, rather than the current maximum of 50 percent of the median assessed value. Many problems face implementing the amendment provisions and will make writing enabling legislation very tedious and difficult.

For many years there have been political efforts to get substantial property tax relief for homeowners approved by the Legislature. A recently approved constitutional amendment is aimed at permitting the Legislature to draft legislation that will offer expanded relief. Currently, the homestead exclusion, enabled by a constitutional amendment question in 1997 and legislation to carry out that amendment (Act 50 of 1998), provides for a uniform, flat-dollar deduction from the assessed value of primary owner-occupied dwellings. The exclusion amount is limited to 50 percent of the median assessed value of owner-occupied homes in the taxing body's jurisdiction.

As an example of how the current law works, a \$10,000 homestead exclusion (say 10 percent of the median home assessed value) would lower the taxable value of a home assessed at \$500,000 and a \$250,000 home by the same \$10,000 before millage rates are applied. Local taxing bodies under current law are permitted, but not mandated, to enact homestead exclusions. And if they adopt an exclusion they are not allowed to increase property tax millage rates to fund the revenue shortfall the exclusion would create. With three separate local taxing entities it is possible for a homestead to be taxed on three separate assessed values depending on the amount each taxing body adopts as its exclusion.

The November ballot question passed with 54 percent of the 1.7 million votes cast, and in all but 11 of the state's 67 counties. Strong approval of the question (70% or greater) came in counties in eastern Pennsylvania. Curiously, two of the counties where the question failed were Philadelphia and Allegheny, which are the only places where homestead exclusions for county or municipal taxes are currently in place. Allegheny County offers an exclusion for county taxes, the City of Pittsburgh for city taxes, and Philadelphia (a combined city-county) for its municipal taxes.

Current Homestead Exclusions in Allegheny County

Exclusion For	Offered By	Statute	Exclusion Amount	Tax Savings
County Property Taxes	Allegheny County	Act 50	\$18,000	\$85
Municipal Property Taxes	City of Pittsburgh	Act 50	\$15,000	\$120
School Property Taxes	School Districts in Allegheny County	Act 1	Varies	Ranges from \$77 to \$404

It should be noted that Act 50 permitted school districts to shift to higher earned income taxes or personal income taxes in order to first eliminate nuisance taxes and then fund homestead exclusions but it did not itemize alternative sources of taxation for counties or municipalities to pay for homestead exclusions. However, a 2007 study found that only four school districts in Pennsylvania had gone through with such a shift.

A more significant change came when the General Assembly met in a special session in 2006 and produced Act 1. Taxes on slot machines are pooled in the Property Tax Relief Fund and then returned to all 500 school districts on a formula basis to pay for homestead exclusions for school taxes (in Philadelphia the money reduces the wage tax). In all there is roughly \$619 million available to be divided among 2.9 million approved homesteads, an average of \$182 in savings statewide on school property taxes based on 2017-18 data on estimated relief from the Department of Education. The allotment received by districts is used to calculate an exclusion that is applied equally to all homesteads regardless of assessed value. Like Act 50, Act 1 permitted voters in school districts to consider higher income based taxes to fund homestead exclusions above what was provided by slot machine revenues. Only 13 districts collected such taxes as of last year.

Thus, as of the end of 2017 homestead exclusions are offered via Act 50 and Act 1 but, outside of the gaming money funding exclusions for school taxes, there has been minimal use of existing exclusion provisions or to shift to income based taxes.

There are obstacles to moving forward with the language approved by the voters in November. The underlying purpose of the new and potentially far more generous homestead exclusion as contained in the constitutional amendment is to allow taxing bodies to make major reductions in homeowner tax burdens or possibly eliminate them altogether. Of course, absent dollar-for-dollar cuts in spending, that means the loss of tax revenue from homestead exclusions must be made up by shifting the burden to other taxes and/or other taxpayers. For certain, property owners other than homesteads would see their share of paying for government increase whether the millage rates are raised or not. In the extreme case wherein the homestead exclusion is 100 percent of the home's value, any future millage rates hikes would fall totally on other properties.

Given the pressure most school districts are under to find more revenue because of pension liabilities and rising compensation and other costs, it seems improbable that cutting expenditures is an option for most districts any time soon. Thus, any loss of revenue from homestead exclusions would be made up by shifting taxes to other sources, primarily residents' income. In that event, renters and business owners of property would incur added tax liability with no offsetting property tax reduction.

The second consideration is the almost total absence in interest by schools, municipalities and counties in using the current homestead exclusion. Nor has there been much interest by school districts or the residents of districts in availing themselves of the Act 1 provisions to shift property taxes to income, even though that presumably would be an option of choice in communities with a high percentage of older residents.

It is easy to understand the wishes of homeowners to want relief from property taxes. On the other hand, schools, municipalities and counties need revenue to provide services. Efforts to shift a large share of the burden to other revenue sources must of necessity create political opposition from those for whom the tax burden would be increased. The questions of fairness and detriment to the business community and potentially employment of tax shifting must be a consideration by elected officials when they contemplate burden shifting.

Then there are the issues raised by the proposed new exclusion system. Currently, the exclusion cannot exceed 50 percent of the median assessed value and is a uniform flat dollar amount which means all homeowners get the same dollar reduction in their tax bills. Under the system just made by the constitutional amendment, if acted on by the Legislature, could give homeowners an equal percentage reduction in taxes. Thus, 20 percent exclusion by a school district with a tax rate of 20 mills would reduce the taxes on a \$500,000 home by \$2,000 while the tax cut for a \$150,000 home would be \$600. Would most property owners be happy with this outcome? Indeed, is the equal dollar exclusion currently permitted deemed fair or equitable by owners of high-value homes? To date there has not been much vocal opposition.

Second, would counties or municipalities using the current system be required to eliminate their exclusion and come up with another one acceptable under the terms of the constitutional amendment? Indeed, would this amendment obviate the current homestead exclusion law altogether or just make it optional for local taxing entities as the case is currently?

Third, how does this amendment, if adopted by the Legislature, affect the long-running efforts to eliminate school property taxes for all types of property? If an appreciable number of school districts were to adopt a significant exclusion and shift taxes to income or other permitted taxes, the elimination of school taxes statewide would become even more cumbersome than it is already for the reasons we have outlined at length in earlier *Policy Briefs*.

Fourth, in light of the outdated and likely extraordinarily unfair assessed values in many counties, would exclusions based on percentage of assessments simply exacerbate the taxation unfairness?

In sum, all these and doubtless many more hurdles to passage of legislation to adopt the provisions in the constitutional amendment point to a very long, contentious and arduous road ahead.

In an upcoming *Policy Brief* we will examine some of the numbers behind homestead property value and what would be required as replacement revenue to pay for exclusions of 100 percent.

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