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Proposal would erase school property taxes for homesteads

Summary: Pursuant to voter approval of last November's ballot question to amend the Constitution to permit homestead exclusions of 100 percent for property taxes, the Legislature recently held a hearing on legislation that would raise the state personal income tax to provide money to eliminate school property taxes on homesteads.

How does this tradeoff sound? In exchange for a 1.72 percentage point hike in the state's personal income tax, taking the rate from 3.07 percent to 4.79 percent (a 56 percent increase), school property taxes on homesteads would be eliminated. That's the legislative proposal the Pennsylvania House Finance Committee recently discussed at a public hearing.

Last November voters approved a ballot question (54 to 46 percent) to amend the state Constitution that would permit local taxing bodies (counties, municipalities and school districts) to expand homestead exclusions. Among the state's 67 counties, Monroe County, the location of the public hearing, had the highest approval rate for the measure at 83 percent.

Prior to the amendment flat dollar reductions of up to 50 percent of the median value of homesteads in all taxing jurisdictions were permitted. The new language in the Constitution allows for exclusions of up to 100 percent of assessed value of each individual property. Moreover, under current law local taxing jurisdictions cannot raise millage rates to replace funds lost due to a partial homestead exclusion. The proposed legislation addresses school taxes only—typically the largest piece of most homeowners' tax bill—and includes complete elimination.

The committee heard testimony from two local government associations and one Realtor. The association representing counties did not directly take a position on the proposal since it deals with school taxes, but it was hopeful the discussion would eventually expand to alternative sources of revenue for counties. The association representing school boards looked at the issues facing school districts and the Realtor was in favor of the proposal.

According to an estimate by the state's Independent Fiscal Office, in fiscal year 2016-17 homesteads accounted for $7.048 billion, or 54 percent, of all current and interim property taxes collected by Pennsylvania school districts with non-homestead properties paying the other 46 percent. Each percentage point of the state's personal income tax raised $4.1 billion that same fiscal year, meaning the additional 1.72 percentage point would have brought in $7.095 billion more— assuming changes in behavior of income earners caused by the higher tax rate would have no negative effect on taxable personal income.

The legislation calls for the creation of an account that would hold the receipts from the 1.72 percentage point portion of the personal income tax (35.9 percent of total collections). In order to opt in to the program, school districts will be required to enact a 100 percent homestead exclusion resolution. Going forward districts would annually certify the amount of property taxes that would have been generated from homesteads and then receive that amount from the fund.

If a school district is reluctant to participate pressure to do so would almost certainly come from homeowners who would be paying the higher personal income tax rate but not enjoying an elimination of their school taxes. Prior to the constitutional amendment voters in only a handful of districts approved adopting the provisions in Act 1 of 2006 that allow districts to shift property tax burden to local earned income or personal income tax at the district level. The possibility of complete elimination of homestead property taxes will almost certainly produce a different result. After a number of eager districts opt in, it will be virtually impossible for other districts not to participate.

Of course, shifting such a large tax burden to another tax source can lead to opposition from those who will see their tax payments increase. For the most part, homestead owners also pay the personal income tax, thus there will be a net savings or a net increase tax cost depending on a household's personal income payment and the amount of school property taxes paid. Thus homeowners living in high-value homes with low taxable income (possibly retirees with income primarily from pensions and Social Security) would benefit greatly. High-income earners who have bought or remained in homes that are valued well below what they can afford could well be losers.

One group is a certain loser. Residential renters, whose rent payments cover all or part of taxes paid on the property they occupy, would pay the increased personal income tax rate but would receive no offset from the homestead exclusion. Businesses, including rental properties, will still be liable for school taxes. It is very likely the homestead exclusion will be an incentive for many of those living in the 1.56 million renter occupied properties (31 percent of total) in Pennsylvania to own a home.

Then too, all future property tax hikes by the district would fall upon non-homestead property while taxes other than property taxes levied by school districts, such as the earned-income tax, would stay in place with tax rates that are limited by existing law unless or until those laws are changed. Reassessments, when they occur, could increase the amount a district can draw from the fund if the value of homestead property in the district rises significantly and/or millage rates are raised. And if values fall, the district might see a reduction in the income tax funding.

Districts that have much higher-than-average-value homesteads and higher school property tax payments on a per student basis will receive more—in some cases far more—per student from the fund than districts with lower property taxes per student. Even within districts a higher-value home is going to get a bigger reduction than a lower-value home on a dollar basis since the new language would eliminate the school tax bill for all homesteads completely.

It is also possible that the state's recently adopted student weighted funding formula could be impacted inasmuch as the local property tax effort component of the formula will have been replaced by the personal income taxes paid statewide. And the formula for determining how much gaming money is sent back to each district for current school homestead relief may need to be re-examined.

Moreover, it is likely that most school districts will continue to face rising costs from pensions, salaries and benefits that keep growing because of union contracts—some that were settled by the threat of a strike or an actual strike—along with other financial pressures. This could create a situation wherein school districts have to ask the General Assembly to boost the personal income tax rate in order to raise adequate revenue to replace homestead property taxes that can no longer increase. To be sure, if a further increase in the personal tax rate is enacted, all those income taxpayers who are already heavily subsidizing the elimination of school property taxes on homesteads will get hit even harder.

In light of all the problems this legislative plan creates, the homestead exclusion as currently proposed should undergo serious alterations in order to avoid creating greater inequities in tax burdens.

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