



### Tax Foundation critiques PA local taxes

**Summary:** A recent report from the Tax Foundation entitled “*Pennsylvania: A 21<sup>st</sup> Century Tax Code for the Commonwealth*” examined the state’s tax system, with particular attention to local taxes.

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“No review of Pennsylvania’s tax code is complete without diving into the complexities of local taxation.” That is the opening sentence to the local section of the Tax Foundation’s report on tax reform.

In Pennsylvania counties, municipalities and school districts can levy a variety of taxes as permitted by state law with limits on the rates each tax can be imposed. There are taxes levied on residents and paid to the governmental entity where the resident lives. These include taxes on property, earned income, deed transfers, per capita and occupations. Businesses, which are subject to property and earned income taxes, may also have to pay gross receipts taxes like the business privilege tax and the mercantile tax where the business is located. Patrons of places of entertainment or recreation are subject to the amusement/admissions tax. Workers pay the local services tax where they work.

Not all taxing bodies levy all taxes available to them. When a municipality and a school district both levy a tax (other than the property tax) they must split the overall rate. Home Rule municipalities can levy rates that exceed tax rates the state has set for the same classes of counties and municipalities that have not adopted a Home Rule charter. Tax rates can also be set above regular statutory limits in Act 47 distressed municipalities if the courts approve the distressed community’s request. Property tax levies for general purposes can come up against a limit (25 mills for counties of the third through eighth class, for example) but numerous special purpose levies have no limit.

Then too, tax rates can be changed by tax-shifting provisions that require voter approval. Special state permission may grant authority to impose a tax for just one local government class. Only counties are permitted to tax hotel stays. Taxes on sales, alcohol and vehicle rentals are levied only by Philadelphia and Allegheny County and Pittsburgh is the only municipality with a payroll preparation tax.

Earned income tax payments by non-residents are subject to crediting requirements if the resident's home municipality also levies the tax. There is statutory language governing the payment of the local services tax in cases where a worker has multiple jobs in one municipality or has jobs in more than one municipality. Exemptions and exclusions to all of the foregoing local taxes also exist.

In all, according to the state's Taxation Manual, in 2013 Pennsylvania's local governments collected \$24.8 billion in taxes; \$16.9 billion came from property taxes and \$7.9 billion from all other taxes. Of the latter group, earned income taxes accounted for \$4.4 billion. Collections by school districts accounted for 69 percent of all property taxes while collections by municipalities accounted for 63 percent of all other taxes.

What changes did the Tax Foundation recommend for local taxes? First a general streamlining of tax codes and statutes was suggested. Second, rather than having separate tax collectors for county, municipal and school property taxes, the foundation recommended consolidation of collections at the county level. That proposal likely stems from a good government efficiency perspective but also takes into account the near-decade-long experience with centralized county collection of the earned income tax and distribution back to the municipalities and school districts under Act 32 of 2008.

More importantly, the report suggested that the state mandate reassessments at regular intervals in order to address the inequities of the property tax system. We have addressed the multitude of problems created by outdated assessments many times over the years and concur completely. A state mandate to reassess regularly would lead to major improvement in transparency and equity in the imposition of the most burdensome tax authorized for local taxing bodies in Pennsylvania. Property taxes as a percentage of owner-occupied housing value was 1.48 percent in 2016—lower than New Jersey and Ohio but higher than West Virginia and Maryland. A property tax ranking for businesses placed Pennsylvania 33<sup>rd</sup> out of the 50 states—better than New Jersey and Maryland but lower than Ohio and West Virginia.

Due to widely varying reassessment years and pre-determined ratios, the lack of reassessment cycle and three separate tax bills, there is widespread lack of understanding of how the property tax system works and the frustration with property taxes is very high. All of that led the foundation to conclude “this is no way to operate a major system of taxation.” Harsh words for the tax that is the lifeblood of local government but there is much resistance to adopting mandated reassessments.

On the earned income tax the foundation suggested that the tax base at the local level be switched to the state's personal income tax base which is broader and would tax unearned income (interest, dividends, capital gains, etc.). By making such a change, the foundation projected that any additional revenue could be utilized to eliminate “nuisance” taxes like the per capita, occupation and gross receipts taxes.

Surely if there were to be a significant change—such as converting the earned income tax to a personal income tax for municipalities and school districts—there would be

pushback from taxpayers who are not paying taxes on unearned sources of income currently at the local level. No doubt an income threshold exemption and reductions in existing municipal and school district taxes would be part of the discussion. This proposed tax could produce very difficult enforcement and collection problems.

To be sure, a tax system that emphasizes efficiency and transparency would be a welcome change indeed. At this point, what that looks like and when it will be put in place remains to be seen.

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