

**House Select Committee on Property Tax Reform**  
**Final Report**

November 30, 2012

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## **CHAIRMAN'S REMARKS**

The issue of property tax reform has vexed this General Assembly for more than four decades, now, and has been an ongoing concern in my district, specifically, since before I took office eight years ago. After being a perennial political issue for so long, with its history of special committees and special sessions, the same debates and more reform proposals than one would wish to catalogue, the words "property tax reform" may actually arouse as much tired skepticism as they do passion, here in Harrisburg.

Therefore, while I understand why it may be tempting to dismiss the idea of another committee, commission or study, I think it would be a mistake. As the prime sponsor of the House Resolution that established this Select Committee on Property Tax Reform, I believe that it is imperative to keep moving forward with the dialogue and the examination of the many issues that make up the issue of "property tax reform." If we don't move forward, the inertia of the status quo will pull us backward.

This Committee has not attempted to re-invent the wheel or find the proverbial silver bullet. Rather, we have attempted to find common ground on initiatives or actual legislation that can be acted on in short order when the General Assembly reconvenes in 2013. An example of this would be one of the Committee's recommendations to re-introduce House Bill 2300. This bill passed unanimously in the House in May 2012. This bill would amend the Pennsylvania Constitution in a way that would allow two specific things to occur: It would give local taxing authorities the power to completely exclude homesteads from property taxes (right now they can only exclude 50 percent of the median homestead's assessed value in the taxing jurisdiction), and it would remove the constitutional barrier that prevents the General Assembly from enacting legislation that would provide 100 percent property tax exclusion. Enabling legislation would need to be considered to make up the revenue for the exclusion of property taxes on homesteads, but the constitutional amendment process would be started by the re-introduction and passage of this bill.

Although the issue of school property tax dominates the debate, the Committee was charged with investigating all property taxes: municipal, county and school. The Committee heard testimony from the Pennsylvania State Association of Boroughs and the County Commissioners Association of Pennsylvania regarding issues with assessment and collections. Through their testimony it is obvious that the property tax issue is becoming an increasing concern for local governments and more importantly the taxpayer. The Committee has recommended possible amendments to Title 53 that would enable local taxing jurisdictions to make the most effective use of the tax and municipal debt collection methods currently provided. We also recommended directing the State Tax Equalization Board to develop best practice guidelines for local governments to streamline and more efficiently administer all aspects of the property tax system.

In this past Session, much of the discussion on the school property tax issue centered around House Bill 1776. This proposal would eliminate the school property tax and replace that revenue with an increase in the Pennsylvania State Income Tax and an increase/expansion of the Pennsylvania State Sales and Use Tax. I, along with other members of the Committee, signed on to this bill. The House Finance Committee conducted a series of hearings on the bill. One of the

most disconcerting points in the testimony came when the Department of Revenue projected that collections coming from a combination of increased sales revenue, increased personal income tax and expanding sales tax on a goods and services that are not subject to taxation would raise only \$9.1 billion for the bill's first year of operation. This figure fell far short of the approximately \$12.5 billion currently generated annually from the state's more than 500 school districts. At this point the Chairman of the House Finance Committee requested that the Independent Fiscal Office (IFO) review the bill's projected revenue estimates, economic impact and impact on school districts.

The Chairman of the House Finance Committee graciously agreed to hold a joint hearing with the Select Committee and the Senate Finance Committee to review the findings of the IFO. Although the IFO report also indicated that there was a shortfall in the revenue needed to replace the school property tax, this report marks the first comprehensive, truly independent analysis of such a proposal. I believe this Select Committee played a part in bringing this IFO report to the forefront of the discussion and providing a blueprint for future efforts.

Another aspect of the school property tax issue centered on the state's funding formula for public education. This has also been a contentious issue for some time. The Committee heard testimony suggesting changes to the funding formula that would reflect certain measures, such as student enrollment, consideration of the economic situation of certain school districts, and the impact of special education. The Committee has recommended enacting a new funding formula for special education based on the actual costs of providing special education instruction and services. The funding formula for public education will continue to be debated in the General Assembly and I know that members of the Committee will continue to fight for a "fairer" formula and one that accounts for the aforementioned factors. Governor Corbett's administration has also hinted at possible changes to this funding formula. This funding approach bases funding on the number of students, with extra funding or "weights" based on per pupil needs, which include free or reduced-price lunch, special education, English language learners, and other factors. It is my hope that the General Assembly and the Administration will continue to pursue these changes to the basic education funding formula.

Finally, I want to commend the Members of this Committee for their serious approach and dedication to the work of the Committee. Despite the brief time we had to conduct hearings and deliberate the recommendations, I believe that everyone had the opportunity to contribute and voice their opinion. I know that these Committee Members will continue the fight for property tax reform.

State Representative Tom Quigley

## **COMMITTEE STRUCTURE**

In accordance with HR 774, the House Majority and Minority Leaders each appointed one member from the following standing committees: Education, Finance, Urban Affairs, Local Government, Environmental Resources and Energy and Transportation. The Majority Leader appointed one additional member, for a total of thirteen members.

In further accord with the Resolution, a chairman was selected by the appointed members. Upon the request of a member of the minority delegation and the unanimous consent of the members, a minority chairman was also selected.

## **COMMITTEE MEMBERS**

Chairman: Representative Thomas J. Quigley, Education Committee

Minority Chairman: Representative Tim Briggs, Transportation Committee

### **Majority Members**

Representative Matt Gabler	Finance Committee
Representative Justin J. Simmons	Urban Affairs Committee
Representative RoseMarie Swanger	Local Government Committee
Representative Timothy Krieger	Environmental Resources and Energy Committee
Representative Nicholas A. Micozzie	Transportation Committee
Representative Rosemary M. Brown	At Large

### **Minority Members**

Representative Madeleine Dean	Finance Committee
Representative W. Curtis Thomas	Urban Affairs Committee
Representative Matthew D. Bradford	Local Government Committee
Representative William C. Kortz	Environmental Resources and Energy Committee
Representative Jake Wheatley	Education Committee

## **PURPOSE**

The Select Committee on Property Tax Reform was created by Resolution of the House of Representatives for the purpose of investigating all aspects of the property tax problem and to recommend possible solutions.

Although school districts, local governments, and especially homeowners have long decried the over-reliance on real property taxes and the burdens created by this over-reliance, there is a marked lack of consensus as to how property tax reform should be accomplished. The discussion surrounding the issue often reveals a lack of understanding of the basic facts, data and policy considerations underlying the problems, or forming the basis for proposed solutions. This lack of understanding may exacerbate disagreement over the relevance or trustworthiness of available data.

House Resolution 774 of 2012 recognizes the fact that this lack of understanding and agreement presents a significant obstacle to policymakers charged with identifying and implementing long-term solutions to this problem. The purpose of the Committee, therefore, was to investigate the factors identified in the Resolution with a level of open-mindedness and objectivity that will promote greater commonality and a more favorable environment for reform in the next legislative session.

Specifically, the Select Committee was created to investigate, review and make recommendations regarding, but not limited to, the following:

- relative levels of all current sources of school district and local government tax revenue, with a focus on property taxes;
- the relationship between sources and levels of local and state funding of school districts and local governments;
- historical changes in the levels of tax revenues from the various sources and the effects of these changes on public education and other local government functions;
- connections between these and other property tax issues, such as assessments, local collection systems, revenue shortfalls, unfunded mandates, state funding cuts, infrastructure, and pension issues; and
- current property tax reform proposals.

## **METHOD**

Over a period of two months, the Committee held six public informational hearings at the State Capitol, including one joint hearing with the House and Senate Finance Committees. This was followed by four public meetings at the State Capitol during which the Committee discussed its findings and deliberated proposed recommendations. During this time, the Committee members also studied other available resources, including, among others, a chronology of tax reform initiatives from 1971 to the present; details on basic education funding; information on the current property tax collection and valuation and assessment systems; property tax relief approaches in other states; and the final reports prepared by previous tax reform commissions and committees.

The first public hearing included the selection of the Chairman and Minority Chairman of the select committee, Representatives Tom Quigley and Tim Briggs, respectively. The Committee then heard from Representatives Seth Grove and David Maloney and Senator David Argall regarding existing legislation they had introduced on the topic of property tax relief.

The second public hearing focused on cost drivers and other local government budget issues. Committee members heard testimony from Douglas Hill, Executive Director of the County Commissioners Association of Pennsylvania, and Ron Grutza, Assistant Director of Government Affairs for the Pennsylvania Association of Boroughs.

During the third public hearing, members discussed property valuation and reassessment issues, primarily relating to recent reports issued by the Legislative Budget and Finance Committee. Testimony was presented by Maryann Nardone, Project Manager for the Legislative Budget and Finance Committee; Philip Durgin, Executive Director for the Legislative Budget and Finance Committee; and Danette Magee, Research Associate with the Local Government Commission.

The fourth public hearing related to principles of taxation and school budgets. Testifiers at that meeting included Jay Himes, Executive Director of the Pennsylvania Association of School Business Officials; Nathan Benefield, Director of Policy Analysis for the Commonwealth Foundation for Public Policy Alternatives; and Sharon Ward, Executive Director of the Pennsylvania Budget and Policy Center. Additionally, written testimony was submitted by the Pennsylvania School Boards Association relating to the impacts of cost drivers and mandates, property taxes, and property valuation and reassessment on school districts.

The fifth public hearing was a joint meeting with the House and Senate Finance Committees to discuss the fiscal impact of HB 1776 (Cox) and SB 1400 (Argall), both introduced in the 2011-2012 Legislative Session with the goal of eliminating property taxes through sales and income tax increases. Select and respective Finance Committee members heard from Matthew Knittel, Director of the Independent Fiscal Office; Mark Ryan, Deputy Director of the Independent Fiscal Office; and Jason Horwitz, Consultant with the Anderson Economic Group, on behalf of the Pennsylvania Association of Realtors.

The sixth and final public hearing related to municipal and public debt collection, public pension issues, and structural changes to systems of local taxation. Testifiers at the final hearing were

Steve Nickol, Assistant Director of Retirement Programs for the Pennsylvania State Education Association; Rob Dubow, Finance Director for the City of Philadelphia; Michael Crotty, Esq., of Siana, Bellwoar & McAndrew, LLP; and Michael Simone, Government Accounts Manager for NCSPlus. Written testimony was submitted by the Pennsylvania Municipal League on the fairness and equity of the municipal government finance and tax structure.



## **TESTIFIERS**

### **Senator David Argall**

Senator David Argall represents the 29th Senate District, which includes Schuylkill County and parts of Berks, Carbon, Lehigh, Monroe and Northampton Counties. In 2006, Senator Argall earned his Ph.D. in public administration from Penn State. His doctoral dissertation reviewed the benefits and drawbacks of Pennsylvania's tax-free "Keystone Opportunity Zones" for economic development.

During the 2011-2012 Legislative Session, Senator Argall served as Vice Chairman of the Senate Urban Affairs and Housing Committee and as a member of the Senate Appropriations Committee, among others. He is also a member of the Local and School Property Tax Relief Caucus. Senator Argall's top legislative priorities are promoting job growth and revitalizing downtowns and older industrial areas, and he has been a leading advocate for real property tax reform. Senator Argall was the prime sponsor of SB 1400 of 2012, which was identical to HB 1776, and which is discussed at some length in this report. At the initial meeting of the Select Committee, Senator Argall presented the key components of his proposal and made a fervent case for the need to eliminate, rather than merely reduce or otherwise reform, property taxes.

### **Representative Seth Grove**

A lifelong resident of York County, Representative Seth Grove has been serving the 196th district since 2008. Prior to his election, Grove served as a legislative assistant for Congressman Todd Platts and Representative Stan Saylor, and as a chief of staff for Representative Keith Gillespie.

Representative Grove's main priorities as a legislator include reducing state spending and working to eliminate school property taxes. He has worked to protect property owners from property tax increases due to public pensions with legislation to lock employer contributions for public school employee pensions. In 2012 Representative Grove introduced HB 2230, which he presented at the initial meeting of the Select Committee. The plan set forth in HB 2230 would allow counties, municipalities and school districts to diversify their revenue sources in order decrease their reliance on property taxes. Specifically, the proposal would provide for an optional county sales, use and occupancy tax and optional income tax, with proceeds being used for property tax reduction.

### **Representative David Maloney**

Representative David Maloney has been representing the people of the 130th district in southeastern Berks County since his election to the House of Representatives in 2010. In his freshman term, Maloney served on the Local Government Committee, and was also a member of the School Property Tax Reform caucus. Prior to his election, Maloney served on the Oley Valley School Board until 2009, where he says he witnessed the pressures of public education and unfunded or underfunded mandates, as well as inequities in of school funding at the local and state levels. Representative Maloney supports the elimination of school property taxes.

Representative Maloney was the prime sponsor of HB 2300 of 2012, which would amend the Pennsylvania Constitution to permit homestead and farmstead exclusions of up to 100 percent.

He presented testimony on this initiative in the first public meeting of the Select Committee, explaining the necessity of a constitutional amendment to achieve the purpose of the legislation as well as the benefits of his proposal. House Bill 2300 passed the House unanimously in May 2012, and Representative Maloney plans to reintroduce the legislation in the next session.

### **The County Commissioners Association of Pennsylvania**

The County Commissioners Association of Pennsylvania (CCAP) is a statewide, nonprofit, bipartisan association representing the county commissioners, chief clerks, and solicitors, and their home rule counterparts, in all of Pennsylvania's 67 counties. The Association serves to strengthen Pennsylvania counties' ability to govern their own affairs and improve the well-being and quality of life of their constituents. To this end, the Association effects the achievement of favorable state legislation, programs and policies, and provides appropriate programs and services to member counties. The general theme of the Association's legislative and regulatory policy is greater flexibility and autonomy for county government within in the context of the broader intergovernmental system. However, recognizing the interdependence of federal, state, county, and local government, the Association will in some circumstances support legislation or regulations contrary to this general rule of flexibility and autonomy. Mr. Douglas Hill is the Executive Director of CCAP.

### **The Pennsylvania State Association of Boroughs**

The Pennsylvania State Association of Boroughs (PSAB) is a nonprofit, nonpartisan local government association comprised of over 900 boroughs and over 10,000 elected and appointed borough officials. For the past 100 years PSAB has helped shape the laws that govern boroughs and municipal officials across the Commonwealth. Mr. Ronald Grutza is the Assistant Director of Government Affairs for PSAB.

### **The Legislative Budget and Finance Committee**

The Legislative Budget and Finance Committee (LBFC) is a bipartisan, bicameral legislative service agency. In accordance with its legislative mandate, the Committee conducts studies and makes recommendations aimed at eliminating unnecessary expenditures, promoting economy in the state government, and assuring that state funds are being expended in accordance with legislative intent and law. To carry out these mandates, the LBFC is authorized to conduct a wide range of research activities pertaining to the operation and performance of state-funded programs and agencies. The staff includes persons with extensive experience in a wide range of issues, with graduate degrees in public administration, business administration, law, and journalism. Ms. Maryann Nardone, Ph.D., is one of two Project Managers on the staff. Dr. Nardone oversaw the 2010 LBFC study on Pennsylvania's system for property valuation and assessment, called for in HR 334 of 2010. The study was completed in cooperation with the Local Government Commission, the State Tax Equalization Board, and the Assessors' Association of Pennsylvania, and the resulting report, titled Pennsylvania's System for Property Valuation and Reassessment (September 2010), is generally regarded as the most accurate and comprehensive resource available on the issue to date.

### **The Pennsylvania Association of School Business Officials**

The Pennsylvania Association of School Business Officials (PASBO) is a statewide organization of school employees other than superintendents and teachers who are responsible for

management of finance and operations in schools that support classroom learning. PASBO members lead and manage accounting, budgeting, facilities, food service, human resources, purchasing, safety, technology, transportation, and communications services for local education agencies in Pennsylvania. Mr. Jay Himes is the executive director of PASBO. In addition to his many other duties, he is responsible for the legislative activities of PASBO and outreach to partner organizations, the media and other stakeholders.

### **The Commonwealth Foundation for Public Policy Alternatives**

The Commonwealth Foundation is a free-market think tank based in Harrisburg. Its mission is to craft and advocate for free-market policies, and counter attacks on liberty. Nathan Benefield is the Director of Policy Analysis for the Foundation. He holds degrees in political science and economics and public service management. He has researched and written extensively on such public policy issues as taxes and tax policy, government spending, education reform, transportation funding, health care policy, and economic development. Mr. Benefield's work has been featured in the Philadelphia Inquirer, Pittsburgh Post-Gazette, Pittsburgh Tribune-Review, Harrisburg Patriot News, and Allentown Morning Call, amongst others.

### **The Pennsylvania Budget and Policy Center**

The Pennsylvania Budget and Policy Center (PBPC) is a statewide, nonprofit, research and policy organization based in Harrisburg. The organization provides independent analysis and disseminates information on the impact of state budget and tax policies on services, citizens and communities, with an emphasis on the impact of those policies on low and middle income individuals and families. The Pennsylvania Budget and Policy Center is a project of the Keystone Research Center. Sharon Ward is the Executive Director of the PBPC. Her work at PBPC includes educating policymakers, community groups, and the public on state budget and tax policies, and she has also worked with various coalitions to advocate for health care and education reforms, to support a fair and equitable tax system, and to advance policies to reduce poverty.

### **The Independent Fiscal Office**

The Independent Fiscal Office (IFO) was created in 2010 to provide revenue projections for use in the state budget process, along with impartial and timely analysis of fiscal, economic and budgetary issues to assist Commonwealth residents and the General Assembly in their evaluation of policy decisions. The IFO seeks to establish collaborative relationships with the General Assembly, executive agencies and various non-governmental organizations that have an interest in the policy making process. In accordance with its purpose and mission, the IFO will not support or oppose any policy it analyzes, and discloses all methodologies, data sources and assumptions used in published reports and estimates. Matthew Knittel serves as Director of the IFO. He was formerly employed as a financial economist by the US Department of Treasury and an economist by the Michigan Department of Treasury. Mr. Knittel holds a M.A. and Ph.D. in Economics from Michigan State University and a bachelor's degree in Economics from Hope College in Holland, Michigan. Mr. Knittel has taught courses at George Washington, Johns Hopkins, and Penn State Universities and published several articles in the National Tax Journal, the NBER and US Treasury's Office of Tax Analysis working paper series.

### **The Anderson Economic Group**

The Anderson Economic Group provides consulting services to private firms, publicly traded companies, state & local governments, and non-profit organizations. Anderson Economic Group is one of the few professional service firms in the United States that follows a quality assurance program based on ISO 9000 principles. The firm carefully documents methodology and sources and insist on high standards of organization, writing, and graphics in its reports, resulting in work that consistently withstands scrutiny. Mr. Jason Horwitz is a consultant with AEG, working in the Public Policy and Economic Analysis practice area. His recent work includes an assessment of the effects of personal property tax reform in Michigan, an assessment of the effects of proposed reforms to state pension and retiree health care systems, and analyses of the fiscal conditions and tax policies of Michigan's state and local governments.

### **Michael G. Crotty, Esq. and Michael Simone, MBA**

Michael Crotty is a partner in the law office of Siana, Bellwoar & McAndrew, LLP. He primarily practices in the area of municipal law, representing a number of municipalities and municipal authorities throughout the Commonwealth. He also serves as Solicitor to several municipalities and municipal entities, and frequently represents municipalities as Special Counsel for debt collection matters. Over the past several years, he has frequently lectured on practical and cost-effective debt collection practices for municipalities to adopt and employ. He and Michael Simone have given numerous presentations on debt collection matters before the Pennsylvania State Association of Boroughs, the Pennsylvania State Association of Township Supervisors, and the Bucks County Association of Borough Officials.

Michael Simone is the National Government Accounts Manager for NCSPlus, and is based in Harleysville, PA. NCSPlus provides responsive, transparent third party debt collection services to municipalities through an equitable process that does not rely on industry-standard account scoring methods. Integral in this effort have been agency education, agency control over the process, and a shift away from a traditional contingency fee arrangement. In his position with NCSPlus, Mr. Simone has frequently lectured municipal officials and public agencies on cost-effective, practical and ethical debt collection practices. In assisting public agencies with their collection deficiencies and challenges, he has successfully employed an economical, citizen-friendly service with the aim of providing high recoveries.

### **City of Philadelphia, Rob Dubow, Finance Director**

Rob Dubow, Director of Finance, was appointed on January 7, 2008. The Director of Finance is the Chief Financial Officer of the City. Prior to his appointment, Mr. Dubow was the Executive Director of the Pennsylvania Intergovernmental Cooperation Authority (PICA), which is a financial oversight board, established by the Commonwealth in 1991. He served as Chief Financial Officer of the Commonwealth of Pennsylvania from 2004 to 2005. From 2000 to 2004, he served as Budget Director for the City of Philadelphia, where he had also been a Deputy Budget Director and Assistant Budget Director. Before working for the City, Mr. Dubow was a Senior Financial Analyst for PICA. He also served as a Research Associate at the Pennsylvania Economy League and was a reporter for the Associated Press. Mr. Dubow earned a Master in Business Administration degree from the Wharton School of Business and a Bachelor of Arts degree from the University of Pennsylvania.

### **Pennsylvania State Education Association**

The Pennsylvania State Education Association (PSEA) represents more than 187,000 public school teachers and education support professionals, including staff in state higher education institutions, nurses in health care facilities, retired educators, and college students preparing to become teachers. The PSEA serves its members in all aspects of their working lives: compensation, working conditions and professional development. Mr. Steve Nickol is the Assistant Director of Retirement Programs with PSEA. He is also a former member of the House of Representatives, as well as the Public School Employees' Retirement System (PSERS) Board.

### **The Pennsylvania School Boards Association**

The Pennsylvania School Boards Association (PSBA) is a nonprofit, statewide association of public school boards. The PSBA was founded in 1895, and has a rich history as the first school boards association established in the United States. Membership in PSBA is by school district or other eligible local education agency such as intermediate unit, vocational school or community college. Over the past several decades, voluntary membership by local school entities has been virtually 100%.

### **The Pennsylvania Municipal League**

The Pennsylvania Municipal League (formerly the Pennsylvania League of Cities and Municipalities) is a nonpartisan organization whose membership includes cities, townships, boroughs and one town. Its core mission is to strengthen, empower and advocate for effective local government. To this end, the League also strives to partner with organizations, corporations and educational institutions to advance its goals and objectives.

## **DISCUSSION**

### **Introduction**

The property tax is widely regarded as an important component of the tax system for a number of reasons. It provides a comparatively stable and predictable revenue stream, which is especially important in times of recession or slow economic growth. Because the subject of taxation is not portable, compliance is easier to gauge and enforce than with some other taxes. Despite these advantages, however, the property tax continues to be one of the most unpopular taxes levied. Perhaps the most common, and the most troublesome, criticism is the fact that the level of taxation is not directly based on the taxpayer's income or access to other liquid assets. Thus, the real property tax has a greater potential than most other taxes to create actual hardship. Historical justification lies in the theory that property generates income, but this sometimes seems more fiction than theory – especially when one considers its application to purely residential property.

Other criticisms of the property tax actually lie not in the nature of the tax, but in its application or in ancillary issues, such as assessments and collections. For instance, critics frequently cite the burden that is often created by the property tax, especially upon homeowners. Yet this is not really a feature of the tax, itself, but the result of an overall scheme of taxation that includes a disproportionately heavy reliance on the property tax. Similarly, wide disparities which sometimes exist in the level of taxation between neighboring areas, or even properties, tend to engender resentment and an overall sense of unfairness. Yet, such disparities may be the result of a taxing jurisdiction's unwillingness or inability to conduct a reassessment, or from misplaced reliance on incomplete or inaccurate data.

### **Classifications of Approaches to Property Tax Reform**

Proposals to reduce or eliminate the property tax generally fall into the following categories: “statewide” plans, “local option” plans, and targeted relief.

#### Statewide Plans

Statewide (or sometimes, “state funded”) plans generally feature increases in various state taxes to reduce or eliminate the property tax burden. Revenues collected by the state are distributed to local governments and/or school districts according to a defined formula. Proposals may increase the total level of funding - especially for public education – or they may be formulated to achieve revenue neutrality or a dollar for dollar offset of the property tax. Some plans in this category also include a component whereby the state absorbs costs which are currently borne locally.

Statewide plans sometimes face “geographically sensitive” challenges, due to the fact that they call for the broad distribution of wealth that had previously redistributed only locally. The actual local impacts depend on the subjects and rates of increased state taxation, local economic factors and the redistribution formula. However, as a general rule, areas with average or above average household incomes will typically contribute more in taxes than they receive in the redistribution.

### Local Option Plans

Local option proposals generally provide for the flexibility to offset or eliminate property taxes through a variety of alternative local taxing options. Generally, these proposals authorize the imposition of a new or increased local earned income tax, per capita tax, or personal income tax. Emphasis in this category of proposals may be on local control as much as property tax relief, and historically, they have frequently included local referendum components.

Real property taxes are, by far, the primary source of local tax revenue for county governments.<sup>1</sup> School districts rely primarily on the property tax for local revenues, but also have access to the earned income tax, realty transfer tax, and so-called nuisance taxes. Municipalities have the broadest tax portfolio, with the property tax, earned income tax, local services tax, realty transfer tax, per capita tax, occupational tax, business privilege or gross receipts tax, mercantile tax, and a few special purpose taxes (e.g. open space and libraries) available to them.

Local option plans ensure that revenues raised in a taxing jurisdiction remain in that taxing jurisdiction. This tends to provide a certain level of comfort which, based on the ongoing discussion in Pennsylvania, tends to be as much about local control over education as preservation of wealth.

With local option plans, areas with average or above average income levels could feasibly achieve greater tax fairness, increased economic health, and significant property tax reductions by shifting toward income-based taxes. However, areas with lower than average income levels may realize little or no property tax relief, as they may not have a sufficient local tax base under any combination of options. Also, local option plans do not address school funding disparities, which many see as one of the main problems with the current property tax system.

### Targeted Relief

Proposals in this category provide a complete or partial property tax exemption for a specific class of taxpayers. In some proposals the relief is needs based, and in other proposals the relief is based on a broad classification, such as the age of the taxpayer or use of the property. Targeted property tax relief may be state or locally funded, or may call for a combination of state and local funding. Examples in current law include the Property Tax and Rent Rebate Program, the Homestead and Farmstead exemption, and the Property Tax Relief Fund.

### **Testifiers' Recommendations and Policy Positions**

Testifiers who spoke before the committee or submitted written testimony provided detailed policy positions and made a number of recommendations which, due to time and space constraints, cannot be described here in full. However, all written testimony submitted to the Committee can be found in Appendix D. It is important to note that several testifiers limited their testimony to one general subject, or a narrow set of subjects, in accordance with their expertise, while others testified on a broader range of issues, according to the priorities of their organizations' membership.

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<sup>1</sup> Some counties also levy per capita, hotel, occupation, sales, and/or other local taxes. Counties have the ability to levy a personal property tax on stocks, bonds, and privately held mortgages, but for a number of reasons, no county has levied the tax since 1996.

## **Property Tax Elimination and HB 1776**

House Bill 1776 of 2012 and companion SB 1400 set forth an ambitious proposal to completely eliminate school property taxes.<sup>2</sup> Under the proposal, school districts would receive distributions from a new Education Stabilization Fund (ESF) in lieu of their ability to levy a property tax. The distributions would be based on FY 2012-13 property tax collections, less debt service, and adjusted annually by a cost of living factor. Four revenue sources would fund the new ESF: 1) an increase in the state sales and use tax rate from 6 to 7 percent; 2) an expansion of the state sales and use tax base; 3) an increase in the state personal income tax from 3.07 to 4.01 percent; and 4) a redirection of certain monies transmitted to school districts through the Property Tax Relief Fund.

The bill was intended to be revenue-neutral, but whether or not that goal was achieved was a point of considerable skepticism, even among its supporters. The Department of Revenue predicted that revenues from the increased taxes would fall far short of that which is currently collected in property taxes, and an analysis of HB 1776, prepared by the House Appropriations Committee, largely corroborated that conclusion. That notwithstanding, anecdotal evidence continued to suggest significant support for the concept of eliminating school property taxes among the electorate – particularly in certain districts.

In June 2012, the Chairman of the House Finance Committee requested that the IFO conduct a thorough and independent fiscal analysis of the proposal. During this same time, the Pennsylvania Association of Realtors commissioned an independent analysis by Chicago-based Anderson Economic Group (AEG). The much-anticipated results of both studies were presented publicly at the October 1st joint hearing of the House and Senate Finance Committees and the Select Committee.<sup>3</sup> Both studies concluded that implementation of the plan would result in a significant negative net impact to the state and decreased educational funding.

Although this conclusion was hardly newsworthy, given the earlier estimates of the Department of Revenue and the House Appropriations Committee, the hearing and the IFO report in particular were nevertheless significant for a number of reasons. The level of specificity and thoroughness make the IFO report extraordinarily valuable for purposes of understanding and, if desired, revising the proposal. More broadly, the case study, as it were, is a tremendous resource for anyone seeking to better understand the systems of taxation in Pennsylvania and the relationship and effects of the various taxes on the state and local economies, school districts, and individual taxpayers. Thus, the information and analysis can be used for a variety of approaches within the context of property tax reform, a point which was illustrated by the questions and observations of the members present at the public hearing.

### Summary of Findings

According to the AEG study, the proposal would have a net negative fiscal impact on the state budget of approximately \$1.8 billion in the first fiscal year following implementation. Additionally public education funding would decrease by approximately \$760 million. The

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<sup>2</sup> HB 1776, P.N. 3369 and the identical SB 1400, P.N. 2123

<sup>3</sup> The IFO study included the changes proposed in two amendments, which were submitted to the IFO by the bills' sponsors. The same amendments were not included in the AEG proposal.



shortfall in education funding would result from the fact that the state's funding through the ESF would fall \$252 million short of the foregone property tax revenues and the sudden unavailability of the \$510 million school districts would have otherwise received from the Property Tax Reduction Fund. The IFO determined the shortfall in the first year would be \$1.51 billion. This figure would grow to \$2.02 billion by FY 2017-18, and the revenues actually available to schools would fall roughly \$1 billion short of the proposed distributions. That is, funding available from the state would fall between \$1 and \$1.5 billion short of that which would have been collected through school property taxes.

The AEG study estimated that making the plan truly revenue neutral by further increasing the personal income tax would require an additional increase of .52 percent. This would bring the state personal income tax up to 4.53 percent, compared with the 4.01 percent provided in the bill, and the current rate of 3.07 percent. This estimate does not take into account any potential taxpayer responses to the rate increase, which may result in a smaller tax base.

### Economic Impact

The probable impact of the proposal on general business conditions is unclear. Although the elimination of property taxes would provide significant tax relief to most businesses, the impact of the other tax increases contained in the proposal would affect different types of businesses differently. For instance, real property intensive businesses such as golf courses or hotels would realize a substantial decrease in operating costs due to the property tax elimination, while non-property intensive firms such as cleaning services or law firms may realize only a marginal decrease in operating costs, and tax-exempt entities which, while they do not pay property taxes, nevertheless contribute to the overall economy, would not benefit at all. Retailers and providers of previously untaxed services may face decreased volume due to the higher consumer prices resulting from the expanded and increased sales and use tax. Owners and shareholders of pass through entities will face higher marginal tax rates as a result of the increased personal income tax. Finally, neither business entities nor homeowners would realize the full benefit of the property tax cut due to reduced deductions for federal income tax purposes.

### Secondary Effects

The IFO study also identified a number of secondary effects that it did not include in its analysis because the effects do not directly affect the ESF or the revenue neutrality of the proposal. For instance, the elimination of school property taxes would increase the federal tax liability of Pennsylvanians by an estimated \$550 million in the next fiscal year, due to the fact that property taxes are deductible for federal income tax purposes while sales taxes are not. Other secondary effects of the proposal include net gains in corporate net income tax and realty transfer tax revenues, due to the elimination of the school property tax deduction and higher home prices, respectively. The analysis projects those additional revenues would total \$40 to \$80 million per year over the first five years.

### Policy Considerations

Opponents of the proposal point out that the property tax is by far the most stable and reliable revenue source for school districts and local governments. This offers essential predictability and protection during economic downturns when more volatile taxes such as income and sales tax may produce sharply reduced revenues. This is seen as especially problematic by some when

viewed in conjunction with the funding limitations contained in the bill, which are tied to the consumer price index and sales tax growth.

Eliminating the property tax would shift a portion of the local tax burden away from business and corporate taxpayers and to individual taxpayers. According to the IFO study, the proposal would result in a net tax cut of \$2.27 billion for business entities and a net increase of \$240 million for “non-business entities.” The IFO also analyzed the tax shift that would occur among four classes of individual taxpayers: retired homeowners, working age homeowners, retired renters, and working age renters. It determined that retired homeowners would realize the greatest benefit, with a 38 percent tax cut. Working age homeowners would realize a seven percent overall tax cut, and renters would generally pay more, with an increase of eight percent for retired renters and 11 percent for working age renters.

The particular proposal set forth in HB 1776 is conspicuously silent on the subject of redistribution. This is a cause of serious concern for many – even among those who are generally in favor of total elimination. One testifier called support for a proposal to eliminate more than \$11 billion in school revenues without specifying how the replacement revenues would be distributed “an extraordinary leap of faith.” Additionally, some critics warn that removing the capacity to generate revenues locally would also remove - or greatly reduce - local control over the delivery and administration of public education, and would essentially create a state-operated system of public education in Pennsylvania.

Proponents of property tax elimination argue that it would dramatically reduce wide disparities in the levels of funding among school districts, which they see as fundamentally unfair. Property taxes are based on the value of a property, which may change over time based on community and property factors. However, in practice, property owners can see property taxes increasing dramatically from year to year not as a result any increase in the value of their property, but due to schools needing additional revenue to balance their budgets. These year to year changes can create a hardship for homeowners.

Additionally, the relative levels of state and local funding can vary dramatically from one district to another, with district A receiving a large proportion of state funding which permits lower local property taxes, while neighboring district B sees lower state funding and higher local taxes. Were property taxes to be eliminated and some other array of taxes be used, such as a combination of state and local taxes, it could be possible to reduce the disparities currently seen from one school district to another.

Another arguably positive impact would be the effect on the housing market. The IFO study predicts that property values would generally increase to some extent as a result of property tax elimination. Current homeowners would experience a windfall gain, with the amount of the gain depending on the degree to which property taxes are built in, or “capitalized,” into the current market price of the home. The IFO estimates an average rate of approximately one-third, but cautions that actual rates of capitalization vary widely across the state, with generally higher rates in more developed areas. For those areas, more of the gains from the property tax cut would accrue to current homeowners. For less developed areas, prospective homebuyers would also benefit, due to an expanded supply of housing and resulting reduced prices, which, the

report notes, would have occurred in the absence of the proposal. The analysis also indicates that benefits would accrue to home builders, home developers and other land owners who convert current holdings into new housing plots. Finally, employment in the construction sector would likely increase, albeit temporarily.

## COMMITTEE RECOMMENDATIONS

At the start of the 2013-2014 Legislative Session, introduce a resolution to re-establish the select committee created under House Resolution 774 of 2011-2012 to monitor the progress of its recommendations and legislation that comes from this effort, as well as to conduct further hearings and issue additional research-based recommendations.

Amend the Pennsylvania Constitution to provide for a homestead and farmstead exemption of up to 100% of the property value.

Develop legislation to grant local taxing jurisdictions more diversified taxing options that allow revenue-neutral tax shifts in the collection of local revenues.

Direct an independent entity or entities to study the fiscal impact of property tax relief up to and including property tax elimination at various levels of income.

Direct the State Tax Equalization Board to develop a "best practices" guide for use by local governments for the streamlining and more efficient administration of all aspects of the property tax system, including but not limited to protocols for valuation, assessment and appeals; development of a database for the uniform reporting of property values and data; and guidance for contracting for assessment services with outside entities.

Direct the State Local Government Commission to study the actual and potential incentives for local governmental entities to enter into consolidation or intergovernmental cooperation agreements for the provision of services and administrative functions.

Review all state-imposed public education requirements that are not mandated by Federal statute or regulation for cost-effectiveness, fairness, and/or educational value for students.

Amend the Right-to-Know Law to allow public agencies to recoup the actual costs of responding to Right-to-Know requests, in particular for commercial requests.

Consider amending the Blight Act to enable local governments to make the most effective use of the tax and municipal debt collection tools currently provided, thereby increasing local revenues and promoting greater tax fairness.

Direct the State Local Government Commission to develop a "best practices" guide for local taxing authorities engaged in debt collection, including but not limited to collections through third party contracts.

Develop recommendations for achieving efficiencies and increasing cost-effectiveness in the construction, maintenance, renovation and disposition of public buildings and school facilities, helping to ensure that students have access to adequate facilities.

Develop a new funding formula for special education based on the actual costs of providing special education instruction and services.

Direct an independent entity or entities to determine the actual costs of educating a student at a charter school and at a cyber charter school, and the effects on local school budgets and property taxes.