



**House Bill 2230  
House Finance Committee  
March 12, 2012  
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Good morning. I am Dr. Dave Davare, Director of Research Services at the Pennsylvania School Boards Association (PSBA), and I thank the committee for allowing me to testify today on House Bill 2230. PSBA applauds the efforts of the committee to tackle the issue of property tax reform, and we support the idea of tax base diversification; however, PSBA has some concerns with the proposal and believes strongly that any comprehensive property tax proposal must also address the budgetary items that are causing school districts to increase property taxes.

In Pennsylvania, school districts have been forced to depend entirely too much on property taxes to fund an extraordinarily large part of the expenses associated with operating a school district. Since 1988 there have been 4 "tax reform" attempts. Each of these including Act 50 of 1998, Act 72 of 2004 and Act 1 of 2006 have eliminated non-property non-income taxation alternatives. In 1993-94 Pennsylvania school districts received 76.4% of total local revenue from the property tax. By 1996-97, the reliance declined to 74.9%, but for 2009-10 the reliance increased to 78.1% of local revenue. In 2008-09, the most recent year in which there is national data, the state only funded 38.7% of elementary and secondary education costs, when the national average for state funding for education was 46.74%. This forced school districts to look

to their local taxpayers for 56.5410 of their education expenses (78.1% was property tax), when the national average for the local share of elementary and secondary education was 43.8%.<sup>1</sup>

This over-reliance on local school property tax by the state ensures that school districts have nothing to fall back on and are forced to rely on increases in property taxes to generate the dollars necessary to fund school programs. The over-reliance on school property taxes is also the primary cause of funding inequity among school districts. Districts with greater property values have greater access to resources and tend to spend more local dollars per student. The current difference in total spending between the highest and lowest spending school districts is 516,992 per average daily membership. Finally, a school district that has high property values can levy relatively smaller millage rates to generate a specific dollar amount of revenue, while districts with lower property values must levy much higher millage rates to generate that same amount.

To begin to alleviate the Commonwealth's over-reliance on school property taxes, diversification of the tax base is necessary. We support the concept of diversifying the tax base to reduce the overall burden of property taxes on local taxpayers, and PSBA believes that shifting the focus from school property taxes to other taxes will benefit taxpayers and begin to mitigate some of the losses in our school districts with declining local revenue. However, PSBA recognizes that a local property tax must remain a portion of local education funding. A shift to only income-based taxes would be of assistance only to taxpayers who happen to live in districts that have a sound income tax base. Additionally, the elimination of property tax for funding education would, in essence, create a state operated system of public education in Pennsylvania and would entirely undermine Pennsylvania's historic principle of local control of education.

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<sup>1</sup> US Census Bureau — June 2011

With respect to House Bill 2230, PSBA has some specific concerns about the current language regarding both the increase in the sales and use tax (SUT) as well as the implementation or increase in earned income tax (EIT) and net profits tax and the conversion to a personal income tax (PIT).

### **Cap on Millage Rate**

One of PSBA's biggest concerns with House Bill 2230 is that it caps the millage rate for political subdivisions implementing or increasing EIT and net profits tax or converting to PIT. If a school district would implement or increase an income tax under the bill, the school district would, in effect, be foregoing its ability to increase the property tax rate under Act 1 and to apply for the exception to the voter referendum requirement. In situations when a school district is faced with declining state dollars, dramatically increasing pension costs, special education costs, charter school costs, fuel costs, and employee health costs, just to name a few, school districts have only two options: cut programs or raise taxes, and on many occasions, a district must do both to balance the budget. PSBA is concerned that House Bill 2230 basically eliminates the option of a school district to raise their property tax rate to the index and prohibits them from applying for an exception under Act 1 to cover their skyrocketing pension and special education obligations. If mandated costs such as pension contributions or special education expenditures rise significantly, insufficient state funding is provided to school districts, or we are plunged into another economic recession and EIT/PIT revenues plummet, school districts that decided to implement or increase the EIT or to convert to a PIT will have no safety valve to raise additional revenue through property taxes to meet their obligations, forcing school districts to make cuts to educational programs. As a result, PSBA fears that the millage rate cap in House Bill 2230 will

either hasten the creation of a number of new financially distressed school districts or do little more than ensure that no school districts takes advantage of the provisions to implement or increase an income tax.

### **Unfair Application**

Because the overall goal of this legislation is to use the implementation or increase in the EIT and net profits tax or the conversion to the PIT to reduce the property tax by 30% by decreasing the millage rate, certain property tax payers will benefit from this reduction without contributing to the EIT or PIT. Where a political subdivision chooses to implement or increase the EIT or net profits tax, individual taxpayers as well as businesses that are sole proprietorships will be subject to this increase; however, C-corporations, S-corporations, partnerships, and some limited liability companies will not, as the income that passes through to taxpayers is not considered earned income. Additionally, if a political subdivision converts to a PIT, income received by individual taxpayers from a sole-proprietorship or as shareholders of a partnership, an S-corporation, or a limited liability company will be taxed as PIT; however, shareholder income from a C-corporation will not. As a result, regardless of whether a political subdivision chooses to implement or increase the EIT or convert to a PIT to reduce property taxes, some entities, such as Rite-Aid or Wal-Mart, will receive the benefit of lower millage rates without paying increases due to EIT or PIT, which is unfair to the residential property tax payer who is paying their fair share for the reduction.

## **Flexible Property Tax Reduction**

Another concern we have with this bill is that there are some political subdivisions in which a 30% reduction in property taxes is simply impossible. In one district where property values have been in decline, the median household income is \$15,286 or less than one-third of the state median of \$49,288. In this type of situation, a 30% reduction in property taxes is not realistic. However, in these communities, it may be realistic for a lesser reduction, such as a 5%, 10%, or even 20%, in property taxes. Recognizing that such significant tax reduction is not an option for all political subdivisions across the state, PSBA suggests that political subdivisions be given flexibility to institute the level of reduction through implementing or increasing EIT and net profits or converting to PIT that is most appropriate for their community. While we hope that the current economic downturn is ending, we must be mindful of the adverse impact that the downturn had on both state (PIT) and local (EIT) tax revenues.

## **Timing**

PSBA also has some significant concerns regarding the timing of notice related to the disbursement of money to school districts in an SUT opt-in county. The bill requires these disbursements to be made on July 1 of each year and gives school districts 30 days after July 1 to revise their property tax millage rates; however, these deadlines conflict with Act 1 requirements. Act 1 of 2006 requires school districts to develop and adopt a preliminary budget at least 90 days prior to the primary election date each year. This preliminary budget must include estimated revenues and expenditures and any proposed tax rates for the next fiscal year. Additionally, school districts are required to adopt their final annual budgets for the next fiscal year by the last day of the current fiscal year. School districts are also required to have their

annual budget on display for public inspection at least 20 days prior to its adoption. These annual budgets must include estimated revenues and expenditures and also must include proposed tax rates. Therefore, while the July 1 disbursement by the State Treasurer may be appropriate, notice of the amount to be disbursed is far too late for the school districts. A school district must know how much revenue it will receive and how much it must adjust the millage rate, or at least have a reasonable estimate so that they can adopt their preliminary budgets in December/January and apply for Act 1 exceptions, if necessary, and they must have precise figures to prepare and adopt their final budgets by June 30. School districts need this information far in advance of July 1 so that they can properly prepare and adopt their budgets without running afoul of Act I.

### **Collection Costs of Department**

The bill allows the Department of Revenue to collect a sum equal to its costs of collection from each county that increases its tax rate. However, because the Department is currently collecting this revenue, PSBA questions the need to make an additional payment to the Department when simply increasing the rate of this tax. At the very least, we recommend placing a cap, such as no more than 1%, on the amount that the Department can retain for its collection costs.

### **Need to Address School District Costs**

Finally, and most importantly, while PSBA understands the need to alleviate the burden of property tax on local taxpayers, this cannot be done effectively by diversifying the tax base alone. To reach a comprehensive and lasting solution, action must also be taken to examine and address the factors driving the cost of public education. Reducing property taxes without

addressing cost containment and state funding simply puts the problem off for another few years when rising expenses and insufficient funding jeopardize our school districts' ability to provide our students with a quality education. The only way to ensure that a property tax reduction plan has the intended impact on local property taxpayers and does not negatively impact the quality of education in the school district is to address those factors that continue to drive up the cost of education. For example, a comprehensive solution would revise the Funding formula for cyber charter schools to ensure that school districts are not paying more to each cyber charter school than is necessary to educate a cyber charter student, it would tackle the issue of funding for special education and provide a more fair formula that reflects the needs of the students in each school district, and it would alleviate the burden and cost that comes with some mandates such as paying prevailing wage and complying with the Separation? Act, which drive up the cost of education and keep dollars out of the classroom. A successful and effective property tax reform plan must diversify the tax base while simultaneously addressing the costs that drive a school district budget.

Thank you for allowing me to testify today on behalf of PSBA, and I am happy to try to answer any questions you might have.