Pennsylvania School Boards Association

House Bill 1776
House Finance Committee
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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 1776. PSBA believes that public education funding should be an equal partnership between local school districts and the state government. The diverse economy of our state requires a local mix of taxes to provide school districts with the greatest flexibility in providing their local financial contribution to this effort. This includes a variety of local taxes and the development of available funding bases that are suitable to each school district's unique economic capabilities and conditions. While PSBA supports the concept of diversifying the local tax base to reduce the burden of property taxes on local property taxpayers, PSBA does not support any proposal to totally eliminate school property taxes.

In 1993-94 Pennsylvania school districts received 76.4% of total local revenue from the property tax. By 1996-97, the percentage 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 46.7%. This forced school districts to look to their local taxpayers for 56.54% of their education expenses (78.1% was property tax), when the national average for the local share of elementary and secondary education was only 43.8%.[1]

[1] US Census Bureau—June 2011

As a result, Pennsylvania school districts are forced to rely too heavily on property taxes to fund an extraordinarily large portion of the costs of operating a school district, and this over-reliance ensures that school districts are forced to rely on increases in property taxes to generate the dollars necessary to fund school programs. In addition to the state paying its fair share of education funding to alleviate the over-reliance on school property taxes, the diversification of the local tax base also has the potential to mitigate the property tax burden placed on individuals; however, PSBA recognizes that local school property tax must remain a portion of the local funding mix. Property tax needs to be part of local education funding because it is the most stable and reliable form of revenue for school districts: it has an immobile base and as property values increase over time, revenue grows with no rate change. 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. In addition to our general concerns regarding the total elimination of school property taxes, PSBA has the following specific concerns with House Bill 1776.

History Repeating

It is important to remember that the proposal in House Bill 1776 is not a new proposal, and over the years there have been multiple attempts at reforming both the property tax system and the school funding system in Pennsylvania. Many of these attempts included a shift to earned income tax (EIT) or personal income tax (PIT) to reduce the overall burden of property taxes. In every case, there has been little enthusiasm for such a shift. Act 145 of 1988 attempted to increase PIT to reduce overall residential property taxes; however, the voter referendum on the constitutional amendment failed overwhelmingly by a 3 to 1 margin with many senior citizens opposed to any increase in PIT. Then in 1998, Act 50 was passed, giving school districts the authority to decide if they wanted to increase EIT to reduce school property taxes. Only 4 school districts chose to participate in the shift. In 2004, Act 72 gave school districts the authority to implement an EIT or net profits tax to reduce school property taxes, and only 8 of 501 school districts elected to do so. Finally, in 2006, Act 1 required school districts to ask voters if they wanted to implement an EIT or PIT to reduce property taxes. Overwhelmingly across the state, these referenda failed by margins of 2 to 1 and 3 to 1 and not a single school district (other than the 8 currently implementing the EIT under Act 72) was able to implement an increased EIT or PIT. This history has shown that Pennsylvania residents are hesitant to increase EIT or PIT to supplant a portion of their school property taxes, even when such a proposal is limited to residential property taxpayers.

With Pennsylvania's poor track record of voters approving shifts to EIT or PIT to reduce their school property taxes, it is unlikely that a referendum under House Bill 1776 would be met with universal approval. What happens to a school district if a voter referendum to implement EIT or PIT fails? Will there be enough money in the Education Stabilization Fund to cover the costs of property tax elimination for those school districts whose voters failed to approve a shift to an EIT or PIT? If voters refuse to implement or increase local income taxes, how will a school district get the revenue necessary to operate once property taxes are eliminated?

Unfair Application

One of PSBA's largest concerns with House Bill 1776 is that the shift to EIT and PIT moves the local tax burden away from businesses and to individual taxpayers, allowing some businesses to benefit from the elimination of their school property taxes without contributing a dime to the EIT or PIT. Where voters in a school district choose to implement or increase the EIT, individual taxpayers as well as businesses that are sole proprietorships, S-corporations, partnerships, and some limited liability companies will be subject to this increase; however, C-corporations, will not, as the income that passes through to taxpayers is not considered earned income. Additionally, if school district voters decide to implement 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, income to a C-corporation will not. As a result, some businesses will have their school property taxes eliminated without paying a penny more, making this proposal unreasonable to the individual taxpayers who are paying their fair share for the elimination.

Based on the most recent data from 2010, just over 70% of all assessed property is, on average across all counties, residential property. This means that about 30% of property is assessed as commercial, industrial, or agricultural, with commercial property making up the largest percentage in most counties. Also, it needs to be pointed out that agricultural property currently benefits from preferential assessment under Clean and Green. As a result of House Bill 1776, the roughly 25-30% of commercial property that makes up the property tax base will be taken out of the local school funding equation. The burden of making up this deficit will fall entirely on those individuals and small businesses paying EIT or PIT. This 25-30% of property tax revenue currently paid by commercial entities represents approximately $2.69 billion to $3.27 billion for school districts across the state annually, and to make up for the loss of this revenue, it would require the implementation of a 1% to 1.2% increase in PIT statewide (See Table 1). Looking at the impact on individual school districts, the local EIT and PIT rates would be even more dramatic. For example, in Ephrata Area School District where approximately 75%

of the property is assessed as residential, local individual taxpayers absorbing the cost of the elimination of property taxes for commercial properties would face a 3.48% PIT or a 1.30% EIT just to cover the cost of commercial properties and without considering the increase needed to cover all school property taxes on residential property (See Table 4). While this shift may not have a significant impact in all school districts, individual taxpayers in school districts that currently depend on significant revenues from commercial businesses will be hit hard.

No Safety Valve For Districts

Another of PSBA's concerns with House Bill 1776 is that it provides school districts with no safety valve to cover rising education costs. In situations where 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 currently have only two options: cut programs or raise taxes, and on many occasions, districts have done and are doing both to balance the budget. There are no provisions for the increase of an EIT or PIT other than through a voter referendum, and with the elimination of the property tax, House Bill 1776 eliminates a school district's ability to raise taxes under the Act 1 exceptions to cover mandatory employer contributions to school employee pension expenditures 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 if EIT or PIT revenues decline due to the economy, school districts will have no safety valve to generate additional revenue to meet their obligations, forcing school districts to make cuts to educational programs or face state takeover as distressed districts.

Additionally, House Bill 1776 prevents school districts from incurring any electoral debt, lease rental debt, or non-electoral debt, which will tie a school district's hands and significantly undermine its ability to respond to immediate district needs. If a school district roof needs essential repairs, a 30 year old HVAC system fails in the middle of the school year, or increased enrollment in the district has resulted in the need for additional classrooms to provide students with an appropriate learning environment, it is unlikely that the district could move forward with any repairs or alterations without incurring debt. House Bill 1776 prevents a school district from engaging in a project to fix a leaking roof or to add two classrooms to reduce overcrowding even where school district voters approve the project via referendum. Even with the cost of living adjustment provided to school districts in House Bill 1776, which would likely not even begin to cover rising pension and special education costs, school districts would never be able to amass the funds necessary to take on necessary school building projects without incurring debt, and as a result, school facilities across the state would simply deteriorate.

Feasibility

Another major concern we have with this bill is that the elimination of school property taxes is simply not feasible in some school districts. While many school districts are facing declining property tax revenues, many of these districts do not have the local income tax base to support an elimination of property taxes. In Duquesne City School District where property values have been in decline, the median household income is $21,909 or less than half of the state median of $49,288. In this school district, which is made up of just about 63% of residential property, they collected just over $1.3 million in property taxes in 2009-10, the most recent year for which we have data, and just $194,658 as a result of a 0.5% EIT. If the district were to eliminate the property tax and shift entirely to EIT, the EIT rate would skyrocket from 0.5% to 3.35% just to make up the $1.3 million deficit (See Table 2). In another example, in Penns Valley School District, where 65% of the property is assessed as residential, and the school property tax raised over $9 million in 2009-10, the district would have to jump from a current local EIT of 1.30% to one of 4.70% just to make up this deficit. (Please see the attached Tables 2-6 showing the impact of House Bill 1776 on the local EIT and PIT rates for a sample of school districts). Based upon the diversity of communities across the state, it is unrealistic to expect that such a dramatic shift to EIT or PIT is feasible for all districts, especially where individuals will have to absorb the cost of taxes previously paid by commercial businesses. In communities where such a dramatic shift is infeasible, how is a school district to obtain the necessary revenue to operate its schools?

Education Tax

In addition to the shift from property taxes and to EIT and PIT in school districts, House Bill 1776 also requires the implementation of an additional state PIT, an "Education Tax," imposed on every resident or non-resident individual, estate or trust at a rate of 0.94%. This would be a tax on income in addition to any newly implemented local EIT or PIT. In Hamburg Area School District, for example, if voters approved a referendum to shift to a local PIT to eliminate property taxes, the local PIT rate would be 5.15%. However, when adding the new state PIT, or Education Tax, the overall PIT rate for residents of that school district would jump to 6.09%, generating just over $22 million in revenue (See Table 5). While this increase would allow the school district to eliminate the property tax, the significant jump would likely pose a concern for many residents.

Administrative Cost of SUT

In addition to the shift to an increased local EIT and PIT and the imposition of the new state PIT, House Bill 1776 proposes to increase the sales and use tax (SUT) and to eliminate many of the current exemptions. PSBA's largest concern with the implementation of an increased and expanded SUT is the cost of administration, which reduces the amount revenue that can be distributed to school districts. The SUT collected under House Bill 1776 is collected at the state level and put into the Education Stabilization Fund, along with the revenue collected from the new state PIT. Because the list of items and services now considered taxable would expand vendors of these items and services not previously taxed will be required to obtain licenses from the Department of Revenue to collect and submit sales tax. Additionally, with more vendors and more items and services subject to taxation, there will be an influx of state sales tax returns filed with the department each month. As a result, the cost of administration of this increased and expanded SUT could be significant, and House Bill 1776 allows administrative expenses to be pulled from the revenue collected in the Education Stabilization Fund with no limitations and no cap on these costs.

Additionally, the bill makes clear that a portion of the total revenue collected is to be deposited in the Public Transportation Reserve Fund, reducing the revenue to Pennsylvania school districts even more. It is clear that when revenue is collected at the local level, every dollar collected remains local and goes to the school district; however, with the creation of a state fund to collect and distribute the Education Tax revenue and SUT revenue, the process is much less efficient and for every dollar collected a school district receives only a portion of that dollar in return.

Timing of Disbursement

PSBA is also concerned about the distribution of revenue from the Education Stabilization Fund to school districts. House Bill 1776 provides only a rudimentary formula for the disbursement of funds for the initial year of the program; however, beyond that it provides no guidance as to how the money will be provided to school districts. It is unclear how the bill intends to make disbursements to school districts from the fund for the 2012-13 fiscal year when the increased and expanded SUT and the Education Tax do not go into effect until January 1, 2013. Additionally, under Act 1 of 2006, school districts must 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. Therefore, without referendum results or a clear idea of how much revenue a school district will receive from the Education Stabilization Fund, it will be nearly impossible to prepare an accurate preliminary budget. Unless it is the intent of this proposal to eliminate these provisions of Act 1, it will be virtually impossible for a school district to comply with its requirements.

SUT Revenues

Another concern PSBA has with increasing SUT while eliminating many of the current exceptions, is that it is difficult to project the impact such changes to SUT will have on purchasing patterns across the state and whether this will generate the necessary revenue to allow school districts to eliminate property taxes. In areas of the state on the Maryland, Delaware, and West Virginia border, literature suggests that especially when it comes to essentials such as food, beverages, and clothing, an increase in the SUT in Pennsylvania could shift out of state buyers away from Pennsylvania, reducing the overall revenue collected. Without clear assurance that the increased and expanded SUT will generate revenue significant enough to begin to mitigate a school district's reliance on property tax, eliminating school property taxes and shifting to EIT and PIT seems premature.

Need to Address School District Costs

Finally, while PSBA understands the need to alleviate the burden of property tax on local taxpayers, to reach a comprehensive and lasting solution, action must be taken to examine and address the factors driving the cost of public education. Eliminating 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 reform 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. In fact, simply deducting retirement costs from the expenditures that are used to determine payments to charter schools to prevent a pension double dip would save school districts over $500 million by 2016-17 alone, which would make a significant impact on the overall cost of public education. A comprehensive solution to the property tax problem would also 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 the actual number of students served, and it would alleviate the burden and cost that comes with some mandates such as paying prevailing wage and complying with the Separations 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.

In conclusion, House Bill 1776 is a complex proposal, and while PSBA continues to review each facet of the plan to better understand the impact it will have on our school districts, we simply cannot support a proposal that eliminates school property taxes entirely. 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.

Table 1

Estimate of Real Estate Tax Shift under HB1776

Item	Source	Year	Amount
Real Estate Tax Revenue	PDE	2009-10	$10,695,276,136
Interim Real Estate Tax Revenue	PDE	2009-10	$62,211,401
Total Real Estate Tax Revenue			$10,757,487,536
25% of Total RE Tax Revenue			$2,689,371,884
30% of Total RE Tax Revenue			$3,227,246,261
Adjusted Personal Income	Revenue	2009	$269,983,839,121
25% of Total RE Tax as PIT			1.00%
30% of Total RE Tax as PIT			1.20%

Analysis of Impact of HB1776 in Selected School Districts

Table 2 - Tax Rates to Repeal Property Tax

District	2009-10 data Real Property Tax	2009-10 data Earned Income Tax	2009-10 data Total Local Taxes (inc RE/EIT)	20009-10 Data Non RE/EIT Tax	2010 data % Residential Property	2009 data Total Personal Income	Current EIT Rate	RE tax replacement PIT rate	RE tax replacement EIT rate
State College	69,444,550	13,720,443	85,690,462	2,525,469	63.58%	1,667,920,909	0.95%	4.16%	4.81%
Penns Valley	9,053,060	2,505,055	11,767,062	208,946	65.24%	205,457,357	1.30%	4.41%	4.70%
Lake-Lehman	9,489,079	1,494,582	11,281,747	298,086	83.41%	325,360,444	0.50%	2.92%	3.17%
Wyoming Valley West	20,674,796	3,404,773	25,804,420	1,724,851	75.28%	743,125,817	0.50%	2.78%	3.04%
Eprata	31,150,846	2,976,240	34,936,055	808,970	75.15%	673,017,334	0.50%	4.63%	5.23%
Eastern Lancaster Co.	24,347,420	2,634,760	27,939,688	957,508	65.03%	605,329,167	0.50%	4.02%	4.62%
Mt Lebanon	48,362,461	5,783,167	55,007,903	862,276	90.52%	1,369,323,778	0.50%	3.53%	4.18%
Keystone Oaks	20,091,544	2,061,248	22,479,205	326,412	65.04%	471,596,395	0.50%	4.26%	4.87%
Chester-Upland*	13,424,017	-	13,975,782	551,765	62.61%	300,450,002	0.00%	4.47%	#DIV/0!
Duquesne	1,305,368	194,658	1,542,636	42,609	63.56%	.42,419,541	0.50%	3.08%	3.35%
Hamburg	18,727,522	1,644,096	20,686,050	314,432	64.39%	$363,730,831	0.50%	5.15%	5.70%
Conrad Weiser	21,678,043	2,030,244	24,182,181	473,894	75.47%	$437,231,262	0.50%	4.96%	5.34%

*Chester-Upland does not levy an EIT.

Table 3 - Tax Rates for Repeal of All Local Taxes

District	2009-10 data Real Property Tax	2009-10 data Earned Income Tax	2009-10 data Total Local Taxes (inc RE/EIT)	20009-10 Data Non RE/EIT Tax	2010 data % Residential Property	2009 data Total Personal Income	Current EIT Rate	Local tax replacement PIT rate	Local tax replacement EIT rate
State College	69,444,550	13,720,443	85,690,462	2,525,469	63.58%	1,667,920,909	0.95%	5.14%	5.93%
Penns Valley	9,053,060	2,505,055	11,767,062	208,946	65.24%	205,457,357	1.30%	5.73%	6.11%
Lake-Lehman	9,489,079	1,494,582	11,281,747	298,086	83.41%	325,360,444	0.50%	3.47%	3.77%
Wyoming Valley West	20,674,796	3,404,773	25,804,420	1,724,851	75.28%	743,125,817	0.50%	3.47%	3.79%
Eprata	31,150,846	2,976,240	34,936,055	808,970	75.15%	673,017,334	0.50%	5.19%	5.87%
Eastern Lancaster Co.	24,347,420	2,634,760	27,939,688	957,508	65.03%	605,329,167	0.50%	4.62%	5.30%
Mt Lebanon	48,362,461	5,783,167	55,007,903	862,276	90.52%	1,369,323,778	0.50%	4.02%	4.76%
Keystone Oaks	20,091,544	2,061,248	22,479,205	326,412	65.04%	471,596,395	0.50%	4.77%	5.45%
Chester-Upland*	13,424,017	-	13,975,782	551,765	62.61%	300,450,002	0.00%	4.65%	#DIV/0!
Duquesne	1,305,368	194,658	1,542,636	42,609	63.56%	42,419,541	0.50%	3.64%	3.96%
Hamburg	18,727,522	1,644,096	20,686,050	314,432	64.39%	$363,730,831	0.50%	5.69%	6.29%
Conrad Weiser	21,678,043	2,030,244	24,182,181	473,894	75.47%	$437,231,262	0.50%	5.53%	5.96%

*Chester-Upland does not levy an EIT.

Prepared by PSBA-Research

Analysis of Impact of HB1776 in Selected School Districts

Table 4 - Tax Shift of Real Estate Tax

District	2009-10 data	2009-10 data	2010 data			2009 data		Tax Shift Impact	
	Real Property Tax	Earned Income Tax	% Residential Property	RE Tax Residential	RE Tax Non-Residential	Total Personal Income	Current EIT Rate	PIT rate	EIT rate
State College	69,444,550	13,720,443	63.58%	44,152,845	25,291,705	1,667,920,909	0.95%	2.65%	1.75%
Penns Valley	9,053,060	2,505,055	65.24%	5,906,217	3,146,844	205,457,357	1.30%	2.87%	1.63%
Lake-Lehman	9,489,079	1,494,582	83.41%	7,914,841	1,574,238	325,360,444	0.50%	2.43%	0.53%
Wyoming Valley West	20,674,796	3,404,773	75.28%	15,563,987	5,110,810	743,125,817	0.50%	2.09%	0.75%
Eprata	31,150,846	2,976,240	75.15%	23,409,861	7,740,985	673,017,334	0.50%	3.48%	1.30%
Eastern Lancaster Co.	24,347,420	2,634,760	65.03%	15,833,127	8,514,293	605,329,167	0.50%	2.62%	1.62%
Mt Lebanon	48,362,461	5,783,167	90.52%	43,777,699	4,584,761	1,369,323,778	0.50%	3.20%	0.40%
Keystone Oaks	20,091,544	2,061,248	65.04%	13,067,540	7,024,004	471,596,395	0.50%	2.77%	1.70%
Chester-Upland*	13,424,017	-	62.61%	8,404,777	5,019,240	300,450,002	0.00%	2.80%	#DIV/0!
Duquesne	1,305,368	194,658	63.56%	829,692	475,676	42,419,541	0.50%	1.96%	1.22%
Hamburg	18,727,522	1,644,096	64.39%	12,058,652	6,668,871	$363,730,831	0.50%	3.32%	2.03%
Conrad Weiser	21,678,043	2,030,244	75.47%	16,360,419	5,317,624	$437,231,262	0.50%	3.74%	1.31%

*Chester-Upland does not levy an EIT.

Analysis of Impact of HB1776 in Selected School Districts

Table 5 - Revenue - New PIT Levy

District	2009 data Total Personal Income	RE Tax Repeal	Added State PIT	Total New PIT	Total Estimated Tax Revenue
State College	1,667,920,909	4.16%	0.94%	5.10%	85,123,007
Penns Valley	205,457,357	4.41%	0.94%	5.35%	10,984,360
Lake-Lehman	325,360,444	2.92%	0.94%	3.86%	12,547,467
Wyoming Valley West	743,125,817	2.78%	0.94%	3.72%	27,660,179
Eprata	673,017,334	4.63%	0.94%	5.57%	37,477,209
Eastern Lancaster Co.	605,329,167	4.02%	0.94%	4.96%	30,037,514
Mt Lebanon	1,369,323,778	3.53%	0.94%	4.47%	61,234,104
Keystone Oaks	471,596,395	4.26%	0.94%	5.20%	24,524,550
Chester-Upland*	300,450,002	4.47%	0.94%	5.41%	16,248,247
Duquesne	42,419,541	3.08%	0.94%	4.02%	1,704,112
Hamburg	$363,730,831	5.15%	0.94%	6.09%	22,146,592
Conrad Weiser	$437,231,262	4.96%	0.94%	5.90%	25,788,016

*Chester-Upland does not levy an EIT.

Table 6 - Revenue Impact - New PIT Levy

District	2009 data Total Personal Income	Residential RE Taxes	Current EIT Revenue	Total Current Resident Revenue	Total Estimated Tax Revenue New PIT	Resident Revenue Increase	PIT Equivalent
State College	1,667,920,909	44,152,845	13,720,443	57,873,288	85,123,007	27,249,719	1.63%
Penns Valley	205,457,357	5,906,217	2,505,055	8,411,272	10,984,360	2,573,088	1.25%
Lake-Lehman	325,360,444	7,914,841	1,494,582	9,409,423	12,547,467	3,138,044	0.96%
Wyoming Valley West	743,125,817	15,563,987	3,404,773	18,968,760	27,660,179	8,691,419	1.17%
Eprata	673,017,334	23,409,861	2,976,240	26,386,100	37,477,209	11,091,109	1.65%
Eastern Lancaster Co.	605,329,167	15,833,127	2,634,760	18,467,887	30,037,514	11,569,627	1.91%
Mt Lebanon	1,369,323,778	43,777,699	5,783,167	49,560,866	61,234,104	11,673,238	0.85%
Keystone Oaks	471,596,395	13,067,540	2,061,248	15,128,788	24,524,550	9,395,762	1.99%
Chester-Upland*	300,450,002	8,404,777	-	8,404,777	16,248,247	7,843,470	2.61%
Duquesne	42,419,541	829,692	194,658	1,024,350	1,704,112	679,762	1.60%
Hamburg	$363,730,831	12,058,652	1,644,096	13,702,747	22,146,592	8,443,845	2.32%
Conrad Weiser	$437,231,262	16,360,419	2,030,244	18,390,663	25,788,016	7,397,354	1.69%

*Chester-Upland does not levy an EIT.