Property tax elimination plan doesn't work for taxpayers or schools

The truth is that it is not a panacea for taxpayers or school districts. Instead, the elimination of the property tax merely serves to create additional, higher tax burdens for other taxpayers and destabilize funding for public education.

The General Assembly is expected to again consider The Property Tax Independence Act, a proposal to eliminate property taxes and shift a significant burden of funding public schools onto other taxing mechanisms, including higher personal income taxes as well as a higher sales tax with an expanded base of what goods and services are subject to tax. The proposal also includes a referendum component.

The plan, which was considered in the 2015-16 session, is being touted as a victory for homeowners and a better way of funding public education, but the truth is that it is *not* a panacea for taxpayers or school districts. Instead, the elimination of the property tax merely serves to create additional, higher tax burdens for other taxpayers and destabilize funding for public education. While PSBA supports the concept of diversifying the local tax base to reduce the burden of property taxes on local property taxpayers, the association does not support the total elimination of school property taxes as proposed under this plan.

How the plan works

(Note: As this report is published, the legislation has not been formally introduced.)

The proposal eliminates the authority of local school boards to levy real property taxes and allows school boards to impose a local personal income tax or an earned income tax at a rate determined by the district, upon voter approval. A state education funding account will be created with the following major revenue mechanisms:

- An increase in the current 6% state sales and use tax (SUT) to 7% and expands the list of goods and services that will be taxed;
- An increase in the state personal income tax (PIT) from 3.07% to 4.95%

As of July 1, 2017, school districts would lose their authority to levy, assess and collect any real property tax. However, if a school district has any annual debt service payments for its outstanding debt in existence on Dec. 31, 2016, it may continue to levy property taxes until the debt has been paid off. (Generally, school district bonds are paid back over 20 years.) Thus, the proposal places a majority of the responsibility for funding education in the hands of the state, and school districts would lose much of their local control to finance their schools. The state would make disbursements to districts on a quarterly basis with an annual cost-of-living adjustment.

Taxpayers pay more taxes

Taxpayers will be paying more taxes under this proposal. Here's why:

Taxpayers in 488 of the state's 500 school districts will continue to pay a portion of school property taxes to allow them to pay off their outstanding debt, with only 12 districts projected to be able to completely eliminate property taxes. There are 353 districts that will retain at least 25% of their existing school property tax, and 29 districts will keep at least 50% of their current property tax to pay for existing debt. A few school districts will still need all or nearly all of their current property tax levy to fund existing debt payments.

This chart (https://www.psba.org/debt-service-chart) shows the annual debt service payments for each school district in 2014-15 and the percentage of property taxes required to fund those debt service payments.

Also important to remember is the fact that other local property taxes are not eliminated. Taxpayers will continue to pay approximately $5 billion in property taxes to counties and other local governments. In addition, taxpayers will not be able to claim approximately $600 million in federal income tax deductions for school district property taxes that are eliminated, meaning that there will be hundreds of millions of dollars less to be used to generate additional sales tax revenue.

Meanwhile, taxpayers will be paying increased personal income and sales taxes. There will be a lengthy list of newly taxable goods and services. This could include food (not including items on the WIC list), personal hygiene products, diapers, textbooks, caskets and much more. Newly taxable services could include public transportation, theatre admission, services for buildings and homes, veterinary services, daycare, haircuts, non-tuition/housing charges imposed by colleges and professional schools, funeral home services and more.

These increases in personal income and sales taxes outweigh any minimal reduction in property taxes, with some of the poorest communities in the state the most impacted.

The elimination of the property tax merely serves to create additional, higher tax burdens for other taxpayers and destabilize funding for public education.

Tax burdens are shifted disproportionately

The use of income taxes shifts the local tax burden away from large businesses to individual taxpayers, allowing some businesses to benefit from the elimination of their school property taxes without paying a penny more. Across Pennsylvania, businesses are currently paying approximately $2.7 billion in property taxes, which will be shifted away from those businesses and onto individuals. Out-of-state vacation homeowners who live in our communities do not pay personal income tax and now will not pay property tax either.

The residents in some of Pennsylvania's poorest school districts will be hit the hardest by property tax elimination. Most will continue to pay some property taxes. In fact, many will maintain more than 50% of their current property taxes, but they will also be paying the increased personal income and sales taxes, which will be shipped out of their community to subsidize the education in some of the wealthiest school districts in the state.

The plan doesn't work for schools, students and local communities

The plan doesn't really address the needs of schools, students and local communities either. Here's why:

Under the proposal, the state will make payments to schools from one pot of funding that comes from the increased personal income and sales taxes. It's unlikely much of the increase in personal income or sales tax paid locally will go to the local school district because revenue collected would go to a state fund to be distributed statewide. This means that education funding is no longer local and tax dollars are likely to be shipped across the state to benefit students hundreds of miles away.

It does not address the factors driving school costs. Eliminating property taxes without addressing the factors driving districts' budgets does not help contain the cost of mandates such as pensions, charter school tuition payments, special education, health care and other areas. The provisions in the bill to send tax dollars back to districts do not take into consideration these mandated costs and are largely why this plan never will fully replace projected property tax revenue amounts needed by school districts. The state needs to provide mandate relief and reduce state-imposed costs for schools.

It removes all safety valves to cover unpredictable expenses or school construction. What happens when unexpected special education costs rise, or the roof needs to be repaired? Without the ability to raise taxes or if income tax revenues decline due to the unexpected economic factors, school districts will need to rely on the state to provide sufficient funds for all mandated costs, operations and even building construction or necessary maintenance. In the case of insufficient funding, school districts will be forced to make cuts to educational programs just to make ends meet.

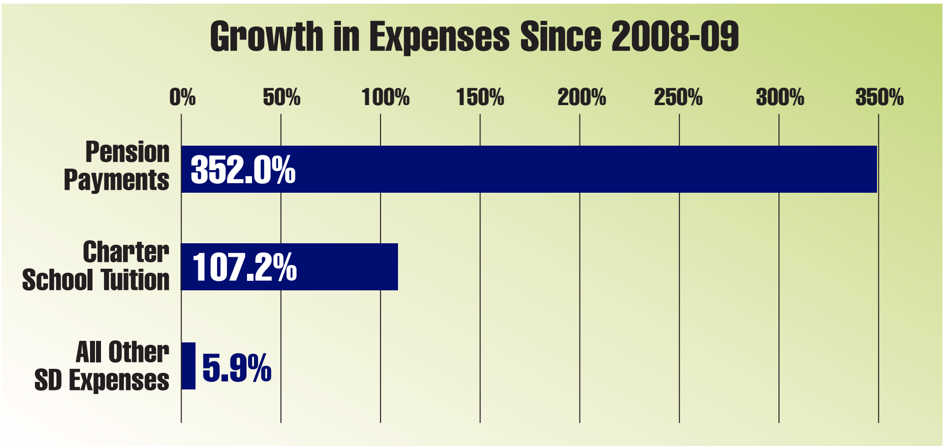
By abolishing local ability to raise revenue or make financial decisions, the proposal effectively eliminates local control. School boards are accountable for spending decisions and student performance in their local communities. Will the state become responsible for the financial health of all 500 school districts? Will the state become accountable to students, parents, teachers and communities for the performance and safety of our schools?

Meeting the instructional needs of students, rising costs of mandates

Proponents of the legislation blame school boards for out-of-control spending. The truth is that over the past several years, many school districts have been forced to cut programs, educational opportunities, services and staff while increasing class sizes due to ongoing state budget woes. Districts make tough decisions with every budget, and continue to face increased costs. School districts have controlled spending as much as they can, which was especially challenging during last year's nine-month budget impasse. Districts are still absorbing those impacts while facing climbing costs for mandated pension, charter school and special education payments.

Two of the main culprits of rising costs are required pension contributions and charter school tuition payments. When compared to all other school district expenses, it becomes clear why school district costs have been rising. *See "Growth in Expenses Since 2008-09" on page 4.*

Pensions – For school districts, pension costs are taking a greater and greater share of available state and local revenues. In 2014-15, school districts paid over $2.3 billion in pension contributions which represented 8.5% of all school district expenditures. In 2008-09, pension contributions were only $515 million, which was about 2.2% of all school district expenditures.



In January 2017, the Pennsylvania Independent Fiscal Office (IFO) released a report showing that it would take almost $14 billion in alternative revenue sources to fill the void of eliminating property taxes in fiscal year 2016-17. That number is projected to reach $16.5 billion by 2021-22. That's how much would have to be collected in higher sales and income taxes to replace the lost local revenue. Analyses of prior versions of this legislation have concluded that the funds raised by other taxes never met the projected revenue needed. In fact, a 2013 study by the IFO projected that schools would receive $2.6 billion less in funding by 2018-19 than could be expected from the current system. The study also showed that while the revenues collected were sufficient in the first year, a widening "wedge" in revenue for districts is created in subsequent years as the grandfathered debt is paid and the property tax is retired.

Charter schools – Each year, mandated charter school tuition payments continues to climb – from $717 million in 2008-09 to a staggering $1.49 billion in 2014-15. The General Assembly needs to enact changes in the law to control the spiraling costs of charter schools on school district budgets, particularly regarding special education students. Charter schools historically have received more money for some special education students than needed to meet the students' educational needs. An analysis of charter school annual financial reports showed that in 2014-15 charter schools received more than $295.8 million from school districts in special education tuition payments, yet charter schools only spent approximately $193.1 million on special education costs.

Special education – Federal and state mandates dictate that all students with disabilities be provided a free appropriate public education. In 2008-09, school districts spent $2.8 billion to provide special education programs and services to more than 271,000 eligible students. By 2014-15, special education spending had risen 33% to $3.7 billion and special education enrollment had increased to 276,000 eligible students.

Does the tax shift plan provide sufficient revenue to districts?

The tax shift that will be created under The Property Tax Independence Act does not create adequate or appropriate funding for the support of a thorough and efficient system of public education. On the contrary, it significantly underfunds schools.

Conclusion

Under the Property Tax Independence Act, school districts will be forced into a system that lacks financial equity and predictability, and robs them of local control. If mandated costs rise significantly, insufficient state funding is provided to school districts, or if revenues decline due to the unexpected economic forces, 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 financially distressed districts.

The current property tax system provides a stable foundation for local communities to use as needed to support their schools. School boards need to be able to use a mix of local taxes to fulfill their duty to provide quality educational programs and services for all of their students.

PSBA acknowledges the Pennsylvania Independent Fiscal Office and the Pennsylvania Association of School Business Officials for portions of the information used in this report.