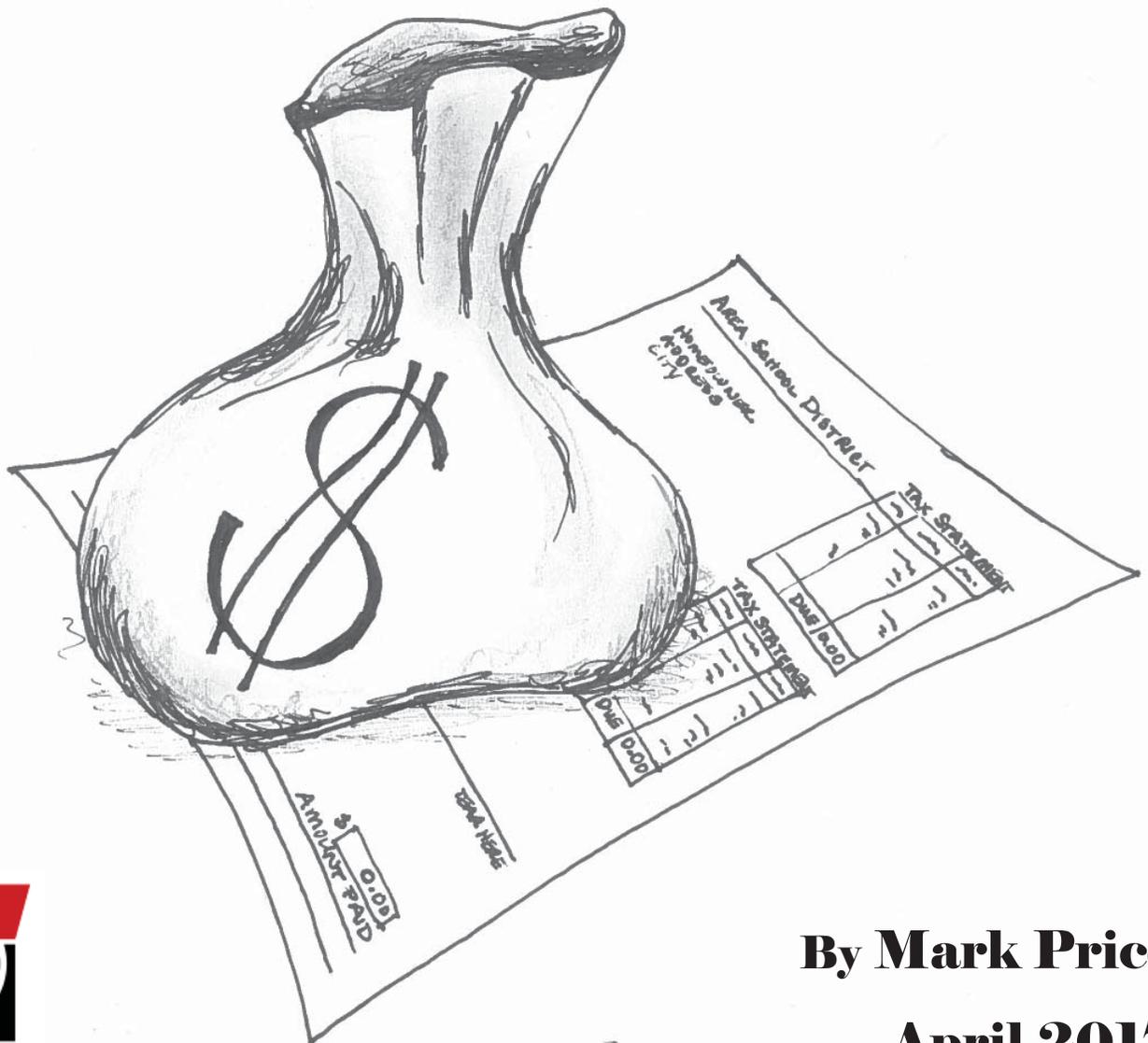


Who Pays for School Property Tax Elimination?

An analysis of school property
tax burdens in Pennsylvania



By Mark Price

April 2017



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Acknowledgments

The opinions expressed in this paper are those of the author alone. Thanks to Aidan Davis and Meg Wiehe and the rest of the team at The Institute on Taxation and Economic Policy for providing tax incidence analysis and comments on early drafts. Thanks also to Michael Churchill, Donna Cooper, Jeffrey Ammerman, Eric Elliot, Kelly Hoffman, Charlie Lyons and Stephen Herzenberg for comments and thanks to Sean Brandon and Karen O'Neill for assistance understanding and accessing public data. Thanks to Ryan Markel for his assistance creating maps in ArcGIS. Thanks to Michael Wood and Sharon Ward for their careful previous work on this issue which greatly facilitated the analysis here. Thanks to John Neurohr, communications director for KRC and its Pennsylvania Budget and Policy Center (PBPC), for editorial assistance and guidance, and to Stephanie Frank, KRC office manager, for designing the cover page, laying out the report and generating the charts and figures in the report.

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Executive Summary

Far from providing relief for working families, recent proposals to eliminate school property taxes in Pennsylvania would increase taxes on the middle class while sabotaging the chance to adequately fund Pennsylvania schools for middle- and low-income families.

This report provides the first estimates of the impact of property tax elimination proposals on families in Pennsylvania. Echoing recent debates about U.S. health care policy, our findings demonstrate that, in the case of proposed property tax elimination in Pennsylvania, the devil is in the details.

Across all Pennsylvania families, property tax elimination would increase taxes by \$334 per family. While property taxes would fall by an average of \$1,685 per family, sales and income taxes would rise by over \$2,000 on average per family.

Moderate-income families (earning between \$22,000 and \$63,000), many of who live in rural areas, would see the biggest increase in taxes as a share of their income (0.6 percent). In dollar terms, these moderate-income families would see an average increase in taxes of around \$300 (\$269 to \$326).

There are two main reasons that the proposed property tax elimination increases taxes on middle-class families. First, the proposal would shift taxes from corporations to families, exacerbating a decades-old shift of taxes in Pennsylvania away from corporations.

Second, the largest amounts of property tax relief would go to affluent families in rich school districts that have the highest property taxes because those school districts choose to amply fund local schools:

- Affluent Lower Merion School District in Montgomery County, for example, would receive 22 times as much in state funds for school property tax elimination as the high-poverty Reading School District in Berks County (\$23,219 per student versus \$1,034).
- In the 125 most affluent (lowest-poverty) school districts as a group, school districts would receive \$10,703 per student in property tax relief, nearly three times as much as the \$3,721 on average in the 125 highest-poverty school districts – half of them in rural communities.

In 2015, the legislature achieved a bipartisan, bicameral consensus that any additional education funding should be distributed based on a scientific formula backed by research on the actual cost of a quality education in each district. Yet property tax elimination would distribute funds to districts in roughly opposite proportions to the basic education funding formula. Under the formula:

- The highest-poverty 125 school districts would receive over four times as much as the lowest-poverty 125 (\$12,647 per student versus \$3,107 per student).
- Reading would receive 21 times more than Lower Merion (\$26,327 per student versus \$1,251 per student).

Adding the additional state funds for property tax elimination to existing state funding for districts, the state would now provide an average of \$12,198 per student to the richest quarter of districts, 39% more than the \$8,802 per student in the poorest quarter of districts. That outcome fails the fairness test even before you consider the reality that it costs more to educate lower-income students.

The proposed property-tax elimination would also lock in for decades one of the nation's most unequal state education finance systems. It provides no increase in overall education funding, while increasing Pennsylvania's income and sales taxes to their highest levels ever, making it unlikely that the legislature would be able raise new revenues for schools for many years. Families in the moderate income rural and urban communities that see the biggest increases in taxes would pay the price again, with their children's educational opportunities permanently compromised by changes like large class sizes, a lack of full-day kindergarten, and few or no arts or AP classes.¹

The proposed property tax elimination is a solution for a problem that Pennsylvania doesn't have – property taxes that are high across the board. As this brief shows, property taxes are comparable to our neighboring states and modest as a share of income in most places. One problem that Pennsylvania does have is inadequate state funding for education – a major cause of current school funding inequities between districts of means that choose high property taxes and moderate income districts that struggle to make up for inadequate school funding. That problem, in turn, fuels a second problem: property taxes that ARE high in certain districts where residents are less able to afford them. Pennsylvania can solve these two problems by raising state revenues in a fair way, not to eliminate property taxes but to better fund schools; and by using some state revenues to reduce property taxes in a targeted way where they are high relative to what people can afford.

¹ For a careful review of the challenges facing rural schools see Pennsylvania Partnerships For Children, *Spending Impact on Student Performance: A Rural Perspective*, March 2017, <https://goo.gl/TLA7Kc>. For a comprehensive review of the need for more equitable school funding see The Education Law Center, *Money Matters in Education Justice*, March 2017, <https://goo.gl/xHStEu>.

Residential Property Taxes in Pennsylvania Are Similar to Other States in the Region

Residential property taxes in Pennsylvania pay for county and municipal services (e.g., libraries, local roads, police, and fire protection) as well as local schools.

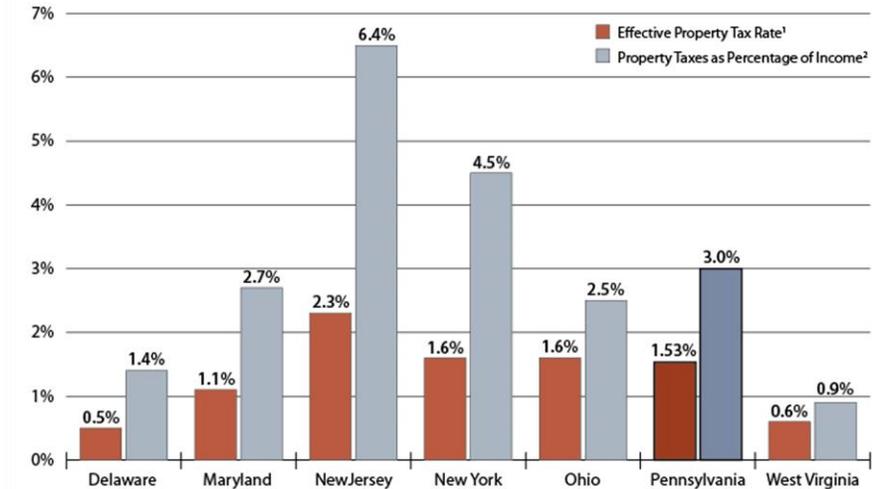
The Institute on Taxation and Economic Policy (ITEP) estimates that for all families (renters and homeowners) the average property tax bill in Pennsylvania will be \$2,180 in 2017.

To facilitate comparisons across states, we rely on median property tax payment data available for homeowners from each state (and for sub-

state areas) in the American Community Survey (ACS).² Because these data don't capture the property taxes faced by renters, the annual property tax bills are higher than estimates for all families. According to the ACS, the typical (median) property tax bill for residential homeowners in Pennsylvania was \$2,533 over the period from 2011 to 2015. With a median home value of \$166,000, the effective property tax rate is 1.5%.

Figure 1.

Property Taxes for Homeowners in Pennsylvania are In-line With Property Taxes in Neighboring States



Notes: ¹Median property taxes as a percentage of median home values. ²Median property taxes as a percentage of the median income of homeowners. Source: Keystone Research Center based on American Community Survey data.

Table 1.

County, Municipal and School Property Taxes for Homeowners

State	Median Family Income	Median Home Value	Median Real Estate Tax	Property Taxes as a % of Home Values ¹	Property Taxes as Percentage of Income ²
Delaware	\$91,122	\$231,500	\$1,243	0.5%	1.4%
Maryland	\$115,323	\$286,900	\$3,142	1.1%	2.7%
New Jersey	\$116,367	\$315,900	\$7,410	2.3%	6.4%
New York	\$102,899	\$283,400	\$4,600	1.6%	4.5%
Ohio	\$82,042	\$129,900	\$2,032	1.6%	2.5%
Pennsylvania	\$84,999	\$166,000	\$2,533	1.5%	3.0%
West Virginia	\$63,900	\$103,800	\$607	0.6%	0.9%

Notes: ¹Median property taxes as a percentage of median home values. ²Median property taxes as a percentage of median family income for homeowners

Source: Keystone Research Center analysis of American Community Survey data

² Unless otherwise specified data from the American Community Survey (ACS) is reported for the most recent five-year pool covering the period from 2011 to 2015.

Property taxes for all levels of county and municipal government account for 2.9% of the median family income of homeowners in Pennsylvania. As illustrated in Figure 1 and Table 1, property taxes in Pennsylvania, whether measured relative to home values or homeowner income, are in-line with other states in our region. They are lower than New York or New Jersey, comparable to Ohio and Maryland, and higher than Delaware and West Virginia.³

School Property Taxes

Narrowing our focus to property taxes levied to fund schools, The Institute on Taxation and Economic Policy (ITEP) estimates that for all families (renters and homeowners) the average school property tax bill in Pennsylvania in 2017 will be \$1,685.

To examine how property taxes have changed over time, it is necessary analyze data on changes in school property tax millage rates.⁴ In Figure 2 we present the average annual change in school real estate millage rates⁵ in Pennsylvania since 1999-00 alongside the average annual change in school property taxes collected over the same period.⁶

Figure 2.

After Falling For 10 Years, Annual Increases in School Property Tax Rates Have Been Rising Since 2013-14

Average percent change from the previous year 1999-00 to 2016-17 in school property tax millage rates & property taxes collected.



The sharp decline in property taxes collected in 2008-09 reflect the impact of the Great Recession.
 Note: The state average annual change in school property tax millage rates is calculated from the change in millage rates in each school district after excluding districts located in counties that reassessed property taxes in the previous year. The state average annual change in school property taxes collected include all school districts.
 Source: Keystone Research Center analysis based on Pennsylvania Department of Community and Economic Development and Department of Education data.

³ Separate analysis by the Independent Fiscal Office finds that property taxes considered relative to personal income are slightly below average in Pennsylvania considered relative to the rest of the country. See "School District Property Tax Elimination", Independent Fiscal Office, January 2017, <https://goo.gl/zUGlwl>. Our findings are also consistent with previous research conducted by Michael Wood and Sharon Ward, *Reform Not Repeal: Pennsylvania Can Provide Property Tax Relief and Protect Public Schools*, Pennsylvania Budget and Policy Center, October 2, 2014; <https://goo.gl/evxQVh>.

⁴ ACS data which are the primary input in ITEP's analysis are only available in seven five-year pools starting with the period 2005 to 2009 thus limiting our capacity to use this data to evaluate annual changes in property taxes.

⁵ Estimating the percent change in millage rates for school districts located in a single county is straightforward. For the 88 school districts that serve more than one county, and thus have millage rates which are not comparable, we calculate the percent change in millage rates in each county and then estimate a weighted average of the change in millage rates for the whole district, where the weights applied to the percent change in millage rates in each county are calculated as the share of school district property values in each county as estimated from data provided by the State Tax Equalization Board.

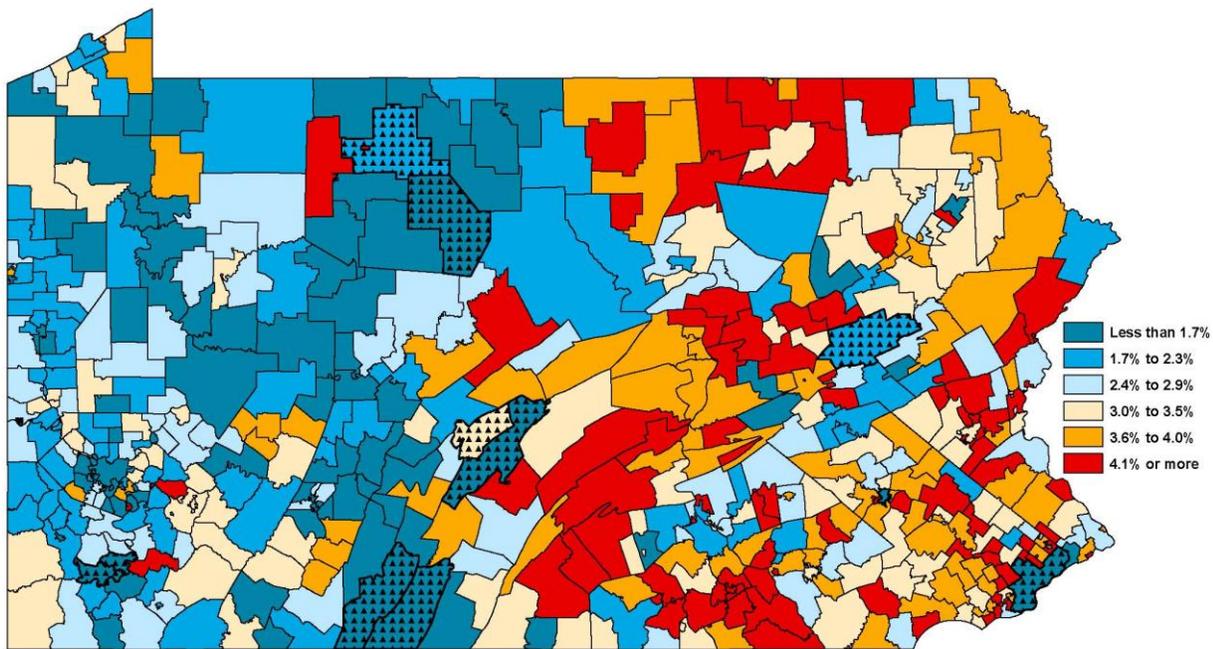
⁶ One of the barriers to analyzing millage rate data is that county governments periodically reassess the value of all property which typically results in a downward adjustment of millage rates which precludes us from calculating the change in millage rates from the year before reassessment. Our analysis here excludes any change in millage rates in which a county reassesses property values. We present alongside our millage rate data the percent change in total property taxes collected which is available for every school district for every year since 1999-00. Except for the Great Recession, which radically reduced property tax collections in 2008-09 our estimates of the change in millage rates mirrors property tax collections.

Over the whole period 1999-00 to 2016-17, school property tax rates rose 2.6% a year, while property taxes collected rose an average of 3.9% per year.⁷ For the typical homeowner with a home valued at \$166,000, a 2.6% increase in millage rates translates into an increase in property taxes of \$47.⁸ As illustrated in Figure 2, the annual increase in property tax rates has been smaller in recent years; for example, on average since 2010-11 property tax rates in Pennsylvania rose by 1.7% percent per year (roughly in line with average annual increases in consumer prices of 1.6% in this period). For the typical homeowner, a 1.7% increase in millage rates translates into an increase in the average property tax bill of \$30.

Changes in School Property Tax Millage Rates by School District⁹

Maps 1 and 2 below present the average annual change in millage rates and property taxes collected by school district, with the highest values shaded in orange and red and the lowest values shaded in light and dark blue.

Map 1. Average Annual Change in Millage Rates by School District



 *Note: These districts shifted away from property taxes to other local taxes between 1999-00 and 2014-15; as a result, property tax millage rate changes may be lower than average due to a reliance on other local revenue sources to fund schools.*

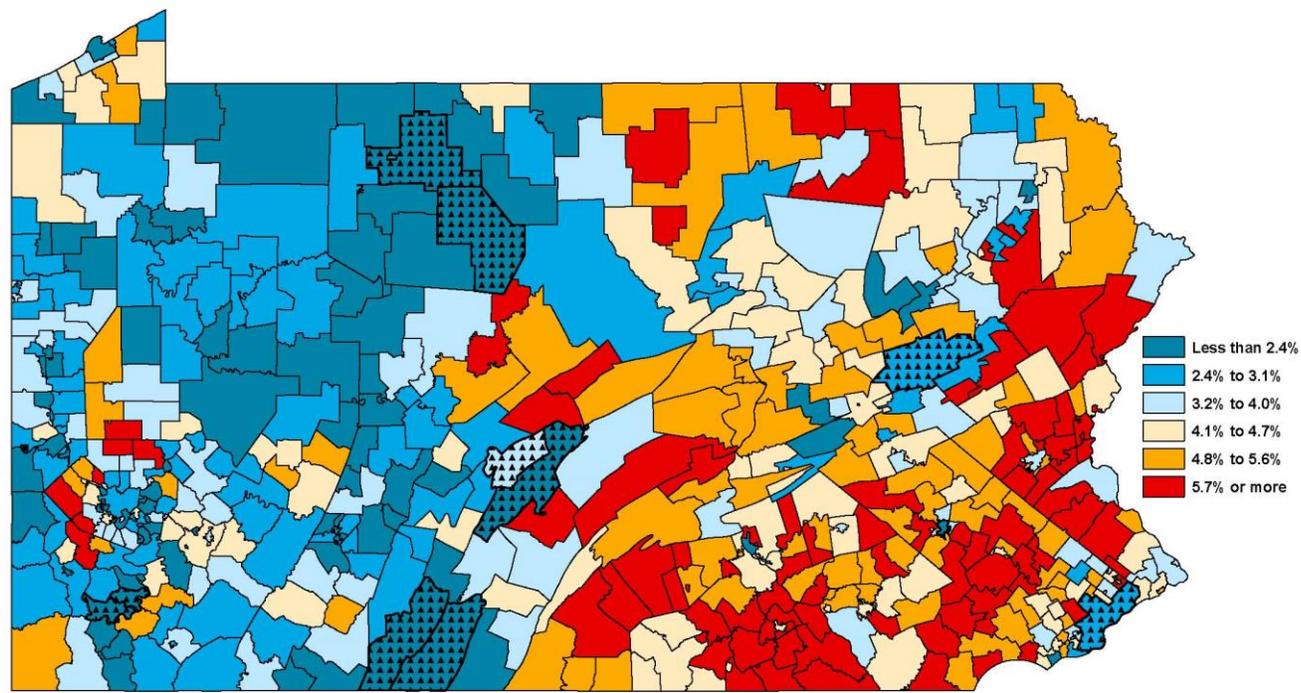
Source: Keystone Research Center

⁷ When you exclude the percent change in property taxes collected in 2008-09 (fell 2.8%) the average annual increase in property taxes collected since 1999-00 rises to 4.4%.

⁸ To arrive at this calculation, we take from the American Community Survey our estimate of the effective tax rate for school property taxes ($\$1,813 / \$166,000 = 1.09\%$) for the median homeowner and increase it by 2.6% ($=1.12\%$). Multiplying 1.12% by the median home value of \$166,000 yields a total property taxes collected of \$1,860 which is \$47 higher than our initial estimate of school property taxes.

⁹ See tabs “Table A1” and “Table A2” in the online technical appendix for school district level data on the percent change in property tax millage rates and property taxes collected since 1999-00 <https://goo.gl/29lwb3>

Map 2. Average Annual Change in Property Taxes Collected by School District



 Note: These districts shifted away from property taxes to other local taxes between 1999-00 and 2014-15; as a result, the change in property taxes collected may be lower than average due to a reliance on other local revenue sources to fund schools.

Source: Keystone Research Center

Although there are some exceptions, in general property tax rates (and property tax collections) in the last 16 years have grown the most in the eastern half of Pennsylvania. In eastern Pennsylvania, property taxes in many districts grew at an average annual rate of 4.8% or more (orange and red hues). In much of the western half of the state, property tax rates typically grew 3.1% or less (the two darkest blue hues).

The Relationship Between Local Property Taxes and State Support of Schools

As local taxes are not the only source of school funding, it is instructive to view the pattern of change in property tax rates within the context of trends in school revenues broken out by local, state and federal sources.

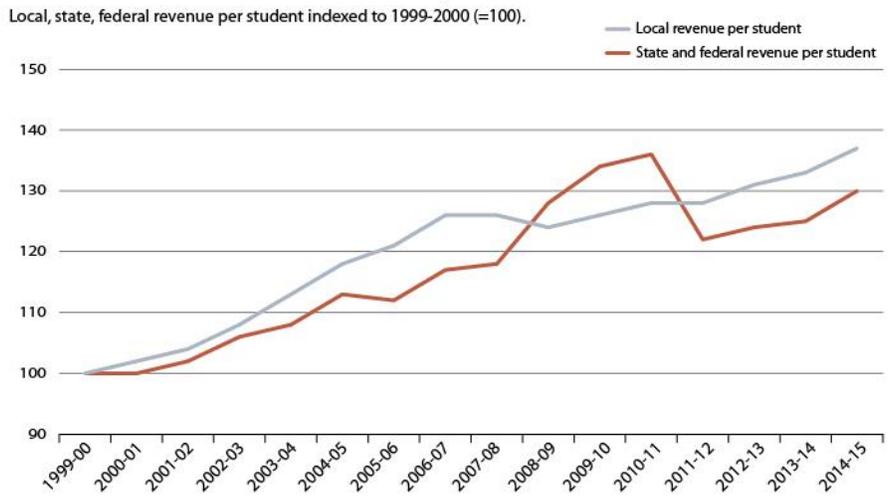
In Figure 3 we present local revenue per student for schools in Pennsylvania as a whole. The chart captures all sources of revenue including, but not limited to, property taxes and earned income taxes.¹⁰ Alongside local revenue we present state and federal school revenues, also on a per student basis. Both figures are adjusted for

¹⁰ On average across the commonwealth property taxes represented 78.8% of all local taxes collected in 1999-00, that figure has risen slightly to 81% in 2014-15. In 2014-15, Act 1, Act 511 and First Class SD Taxes represented 14.4% of local taxes, that figure in 1999-00 was 14.7%.

inflation (2014-15 dollars) and indexed to their respective levels in 1999-00 to facilitate comparisons of growth over time.

Locally-collected revenues per student have grown faster in the last 16 years than state and federal revenues (37% versus 30%) reflecting the fact that elected school boards have sought to raise more revenue to support their schools than their elected counterparts in the General Assembly in Harrisburg and U.S. Congress in Washington D.C.

Figure 3.
Locally Raised School Revenues Have Grown Faster Than State and Federal Revenues in the Last 16 Years in Pennsylvania



Source: Keystone Research Center analysis based on Pennsylvania Department of Education data.

Table 2 breaks up the change in revenues into three distinct periods. From 1999-00 to 2007-08 (just before the worst of the Great Recession), the growth in local revenues outpaced state and federal revenue growth (26% versus 18%). Recall from Figure 2 that property tax millage rates were growing 3.4% a year during this period (the fastest pace of growth for these rates over the whole period).

Table 2.

Percent change in local and state and federal revenue per student

<i>Period</i>	<i>Local revenue per student</i>	<i>State & Federal revenue per student</i>
1999-00 to 2007-08	26%	18%
2007-08 to 2010-11	1%	15%
2010-11 to 2014-15	7%	-4%
1999-00 to 2014-15	37%	30%

The Great Recession slowed the growth of local tax collections to just 1% from 2007-08 and 2010-11. In this period, state and federal revenue per student rose rapidly (15%) reflecting the best practice in macroeconomic policy which replaced local revenues with federal sources during and immediately after the recession.¹¹ With the end of fiscal stimulus, state and federal revenues per student fell 10% (\$654 per student) in 2011-12.¹²

¹¹ The rise in state and federal funding per student in Figure 3 for the three years from 2008-09 to 2010-11 reflected first a rise in state funding in 2008-09 and then a rise of federal funds from the American Recovery and Reinvestment Act (ARRA) in 2009-10 and 2010-11.

¹² Ownership of the responsibility for cuts in funding for local schools in the 2011-12 state budget was a contested political issue in the run up to the 2014 gubernatorial election, with former Governor Tom Corbett arguing that responsibility for the cuts was Congress's decision not to extend aid to state local governments, a key component of the American Recovery and Investment Act (ARRA). In our view, aid to state and local governments did end too early, but that mistake was compounded when Governor Corbett and the leadership of the General Assembly made the decision not to replace federal revenue with new state revenues, and thus cut the state subsidy to schools. That's illustrated most clearly by the decision to replace ARRA funds allocated to state corrections with state revenues in 2011-12 state budget rather than cut spending on corrections as was done to the state subsidy to schools. That decision ultimately rippled through local school district budgets as layoffs, rising student fees, and property tax increases.

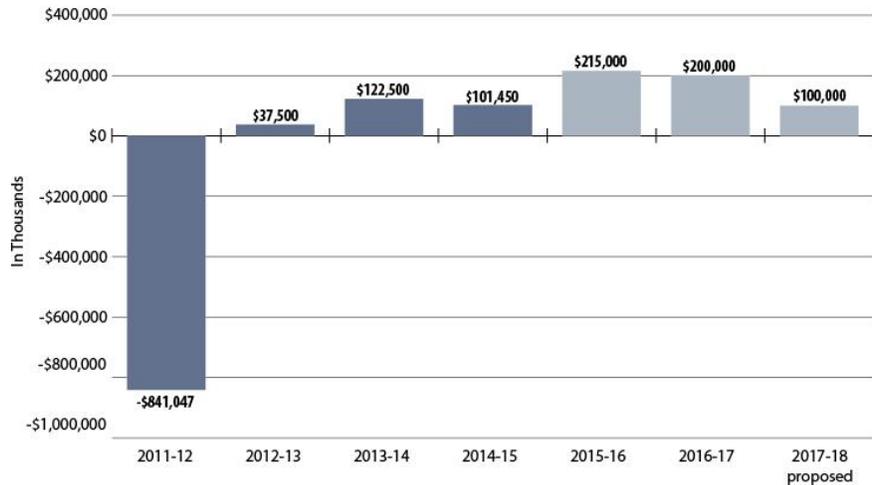
Including federal fiscal stimulus funds (from the American Recovery and Reinvestment Act (ARRA)), state and federal revenues from 2010-11 fell by 4% per year. If you exclude the drop in ARRA funds, state and federal revenues per student have grown by \$368 per student since 2011-12 (an increase of 6%), while local revenue per student over this period has grown \$607 per student (an increase of 7%). The relatively stronger pace of state revenue growth since 2011-12 reflects a bipartisan consensus in both chambers of the General Assembly on the need to increase the state contribution to schools, especially following the funding cuts of 2011-12.¹³

The notion of consensus in Harrisburg might seem misplaced given the closely-contested gubernatorial election of 2014, followed immediately by a six-month stalemate over the 2015-16 state budget between Governor Tom Wolf and the General Assembly. However, in each state budget, including the last three budget agreements signed by former Governor Tom Corbett, the state subsidy to local school districts for education spending increased (Figure 4 see also Figure 5 for all state¹⁴ spending on education line items).

Figure 4.

Deep Cuts in 2011-12 to the State Subsidy for Education Spending Have Been Followed by Six Years of Modest Increases

Changes in the State Subsidy for Basic Education since 2010-11.

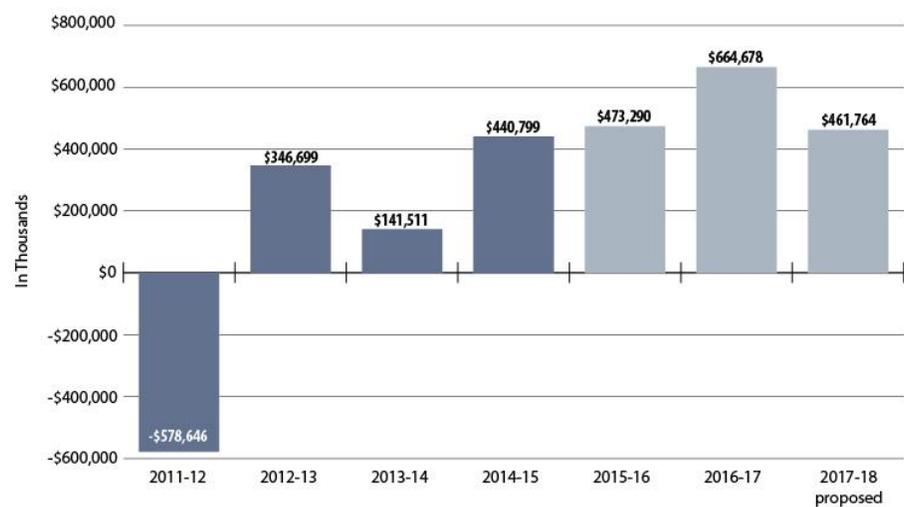


Source: Pennsylvania Budget and Policy Center state budget line item data.

Figure 5.

Change in State Spending for all PreK to 12 Education Budget Line Items

Changes in state spending for all education related line items since 2010-11.



Source: Pennsylvania Budget and Policy Center state budget line item data.

¹³ Wherever blame is directed for the education funding cuts of 2011-12, lawmakers of both parties, largely because of those cuts, have been eager in subsequent years to increase the state funds available to education from existing revenues.

¹⁴ Figure 4 represents most years' basic education funding line item; Figure 5 captures all education related line items including but not limited to state funds for school bus transportation, school lunch and employee pensions.

The source of conflict in each of the last six state budget agreements was not whether the state subsidy for schools should increase, but by how much, with sufficient increases in state education spending precluded by the absence of a legislative majority in support of raising new state revenues.

Boosting spending for education given revenue constraints has become increasingly difficult as state tax collections are falling short of expenditures due to both falling corporate taxes, as well as a greying population that is reducing personal income tax and sales tax collections while increasing the demand for many state services. An example of these strains is evident in the 2017-18 budget process. The Independent Fiscal Office estimates under current law a shortfall between revenues and expenditures in 2017-18 of \$2 billion, on top of a shortfall of \$774 million for 2016-17.¹⁵ Because of these budgetary pressures, Governor Tom Wolf has proposed an increase in the basic education subsidy of only \$100 million for 2017-18, half the increase in the subsidy in 2016-17. The Republican controlled house has since submitted its own 2017-18 budget proposal which although includes \$800 million less in total state spending matches the Governor's proposal for another \$100 million for the basic education subsidy.

Without agreement to raise new ongoing revenues, state revenue per student will continue to lag behind the growth in need in local school districts. As illustrated previously in Figure 2, property tax millage rates in the last three years of data (2014-15 to 2016-17) are on the rise again. Structural budget deficits are reducing the new state funds available for local schools, thus shifting the burden of financing schools to local taxes including the property tax.

Box A: State Support for Local Schools Is 46th Lowest in the Country

According to Census Bureau data 37% of total revenues in Pennsylvania schools were from state sources.¹ The national average is 46.7% and Pennsylvania's state share of local revenues is lower than all but Illinois (36.7%), New Hampshire (34.1%), Nebraska (32.7%), and South Dakota (30.8%). A low state share of revenues puts more of the burden of financing schools on property taxes and increases disparities in school funding between low and high wealth communities. As a result, Pennsylvania is the worst state in the country for funding inequality between its wealthiest and poorest school districts, with the spending gap per student between these two groups more than double the national average.²

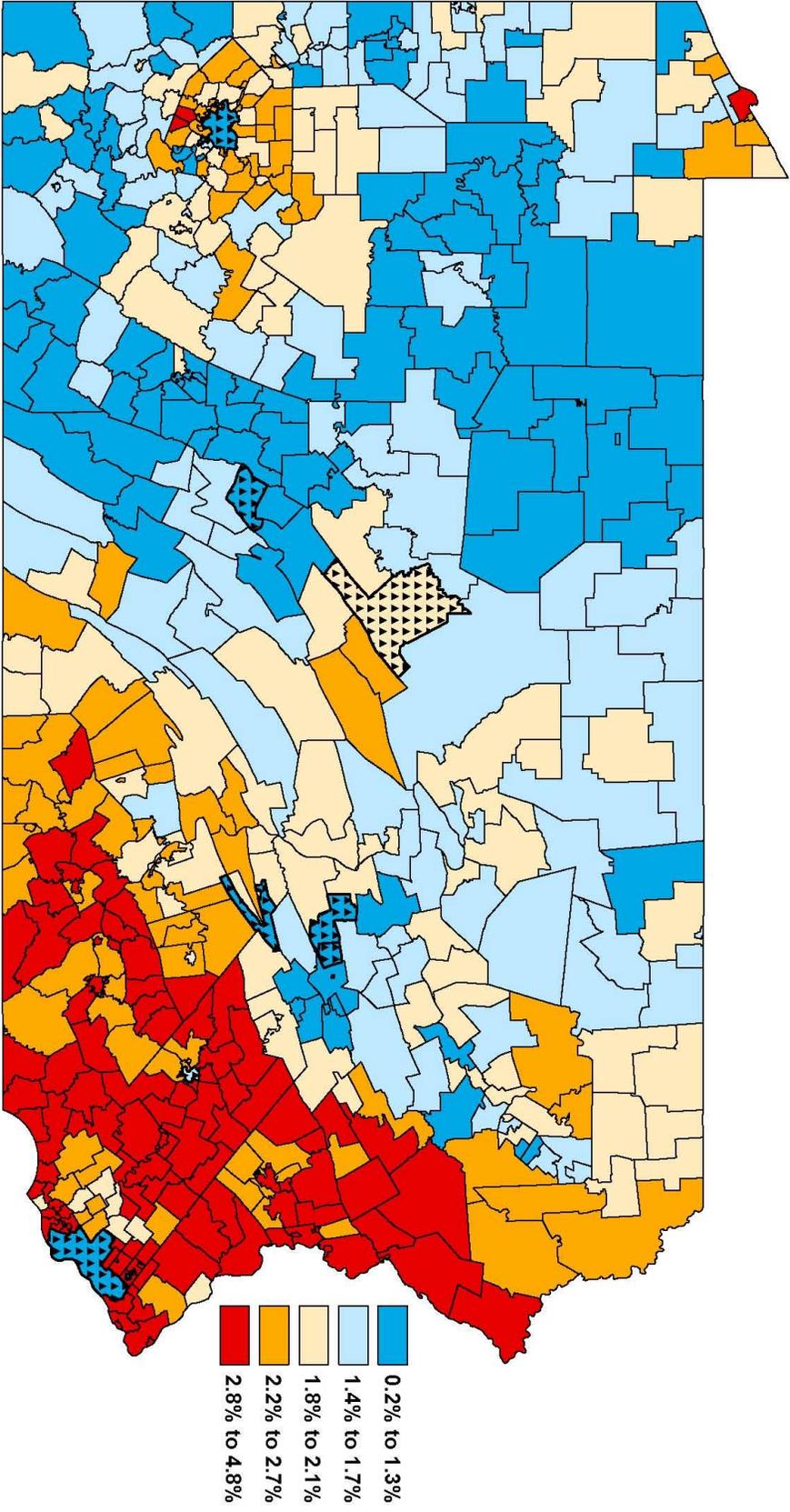
¹United States Census Bureau, Annual Survey of School System Finances, 2014.

<https://goo.gl/gGdIO5>

²Brown, Emma. "In 23 states, richer school districts get more local funding than poorer districts." The Washington Post, 2015. <http://wapo.st/18fFt2F>

¹⁵ See Slide 20, Long-Term Structural Imbalance, <https://goo.gl/WJsFkB>

Map 3. School Property Taxes as Share of Mean Family Incomes by School District



Note: Property taxes in these school districts account for less than 60% of local school revenues and therefore are not a complete measure of the local tax effort to fund schools. For example, Philadelphia and Reading have relatively low property taxes, but adding in other local taxes these two districts have the 7th and 8th highest school-district tax effort in the Commonwealth.

Source: Keystone Research Center

Regional Differences in School Property Taxes as a Share of Income¹⁶

The discussion of property taxes so far has focused on statewide averages, which as we illustrated when examining the average annual change in property tax rates (Map 1 on page 8) tends to obscure substantial regional variation in property taxes.¹⁷ Map 3 on the previous page presents school property taxes as a share of mean family income,¹⁸ with districts shaded in orange and red representing relatively high property taxes and school districts shaded in darker blue representing relatively low property taxes.¹⁹ Unlike Map 1, which examined the change in property tax rates, Map 3 evaluates the burden of property taxes relative to family earnings. Not surprisingly, for the most part the school districts where relative burdens are the highest (red and orange hues in Map 3) also tend to be the districts (from Map 1 on page 8) where property tax rates have grown the most on average since 1999-00, specifically the eastern half of the state. Property taxes tend to be the highest relative to income in a narrower group of school districts from the northeast corner of the state down into the southeast.

Specifically, the highest relative school property taxes are in 107 school districts shaded red in Map 3, where school property taxes account for more than 2.7% of mean family incomes. Except for three school districts in Allegheny county and one in Erie County, the remaining high property tax districts are in the eastern half of Pennsylvania running from the Poconos in the Northeast (Northampton, Pike, Monroe, and Carbon counties)

Box B. Low Property Tax Burdens in Philadelphia & Reading Don't Mean Low Local Tax Effort for Education

Ranked from highest to lowest (out of 500) school property taxes as a share of family incomes in Philadelphia ranked 455th and ranked 324th in Reading, both low relative to the statewide average. But property taxes as a share of all local taxes for education are 57% in Philadelphia and 52% in Reading (the statewide average is 81%). Each city relies more heavily on other local taxes to fund education. To account for all local tax effort the Pennsylvania Department of Education produces a measure called the Local Effort Capacity Index under which Philadelphia is ranked 27th and Reading is ranked 8th, indicating high local tax effort. See the tab labeled "Table A8" in the online technical appendix for school district level data on local tax effort <https://goo.gl/29lwb3>

¹⁶ See the tab labeled "Table A3" in the online technical appendix for school district level data on school property taxes as a share of mean family income <https://goo.gl/29lwb3>

¹⁷ Data at the school district level on the mean or median school property taxes paid by all families (renters and homeowners) is not available but there is data from the American Community Survey on median real estate taxes paid by homeowners (the data we summarized in Figure 1). We combine this data with property tax millage rate data made available by the Pennsylvania Department of Community and Economic Development (DECD) for every county, municipality, and school district. Specifically, we estimate the share of property taxes paid to county and municipal governments and the share paid to schools for each school district. These shares are then multiplied by the median property tax payment in each school district to derive the portion of each payment going to schools and the rest of local government. Because our estimate excludes the property taxes paid by renters our estimates will be higher than the actual average for all families, however our purpose in this section is to compare how property taxes differ between school districts. The relative differences we observe between homeowners across school districts is a reasonable approximation for the differences we would observe if we had an estimate for the property taxes paid by renters and homeowners.

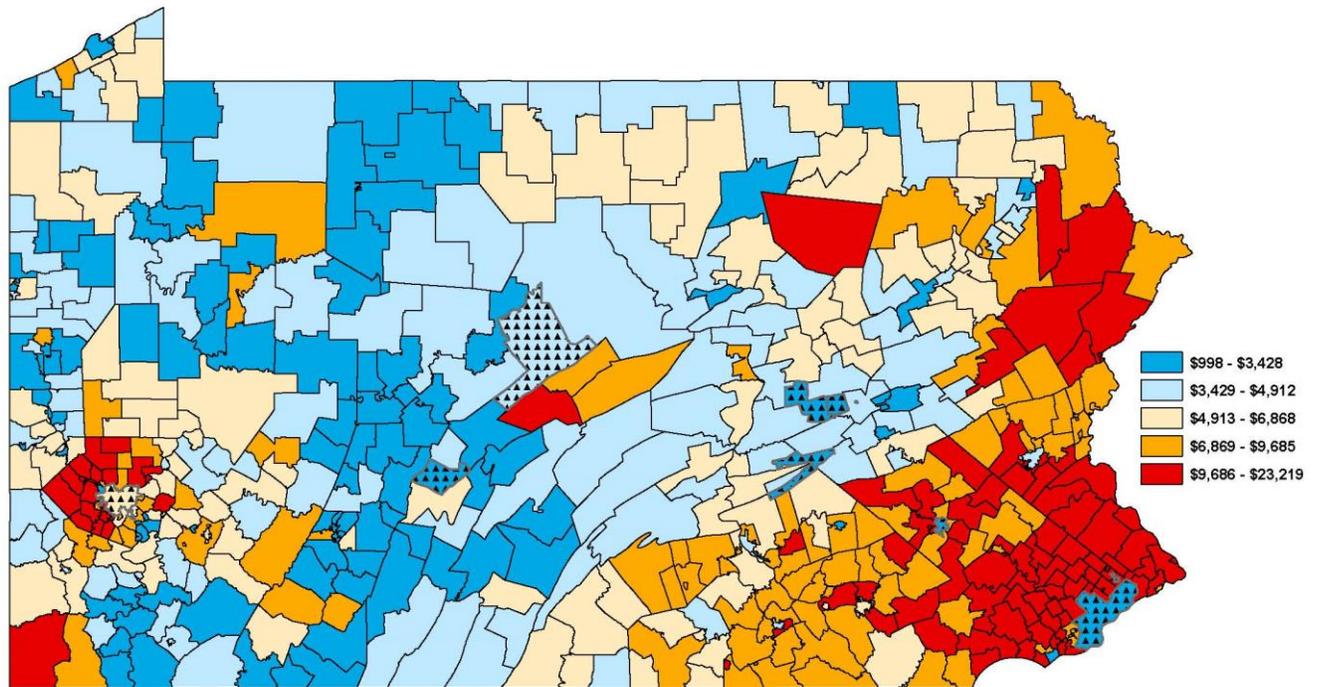
¹⁸ In our comparison across states we compared median property taxes for homeowners with the median family income of homeowners. Neither mean nor median family income for homeowners is available at the school district level from American Factfinder or in public use microdata of the ACS. In this section, we therefore compare median property taxes for homeowners to mean family incomes. This comparison will overstate the share that property taxes represent of the income of the typical homeowner as the mean income of homeowners statewide is 19% higher than the mean income of all families (renters and homeowners).

¹⁹ See Appendix B for Map B1 which presents all property taxes (county, municipal and school) as share of mean family income for each school district in the commonwealth and Map B2 which presents the share of mean family income accounted for county and municipal property taxes.

down into the Lehigh Valley (Lehigh and Berks County), through to Lebanon, Lancaster and York and Adams County and finally the four suburban Philadelphia counties (Bucks, Montgomery, Chester, and Delaware county).

On the other end of the spectrum, school property taxes as a share of income are the lowest (less than 1.7% of average family incomes) in 87 school districts in dark blue. These districts include Pittsburgh and Philadelphia plus mostly rural school districts located in the western half of what is commonly referred to as the “T.”

Map 4. School Property Taxes Per Student 2014-15



▲▲▲▲▲ Note: Property taxes in these school districts account for less than 60% of local school revenues and therefore are not a complete measure of the local tax effort to fund schools.
 For example, Philadelphia and Reading have relatively low property taxes, but adding in other local taxes these two districts have the 27th and 8th highest school-district tax effort in the Commonwealth.

Source: Keystone Research Center

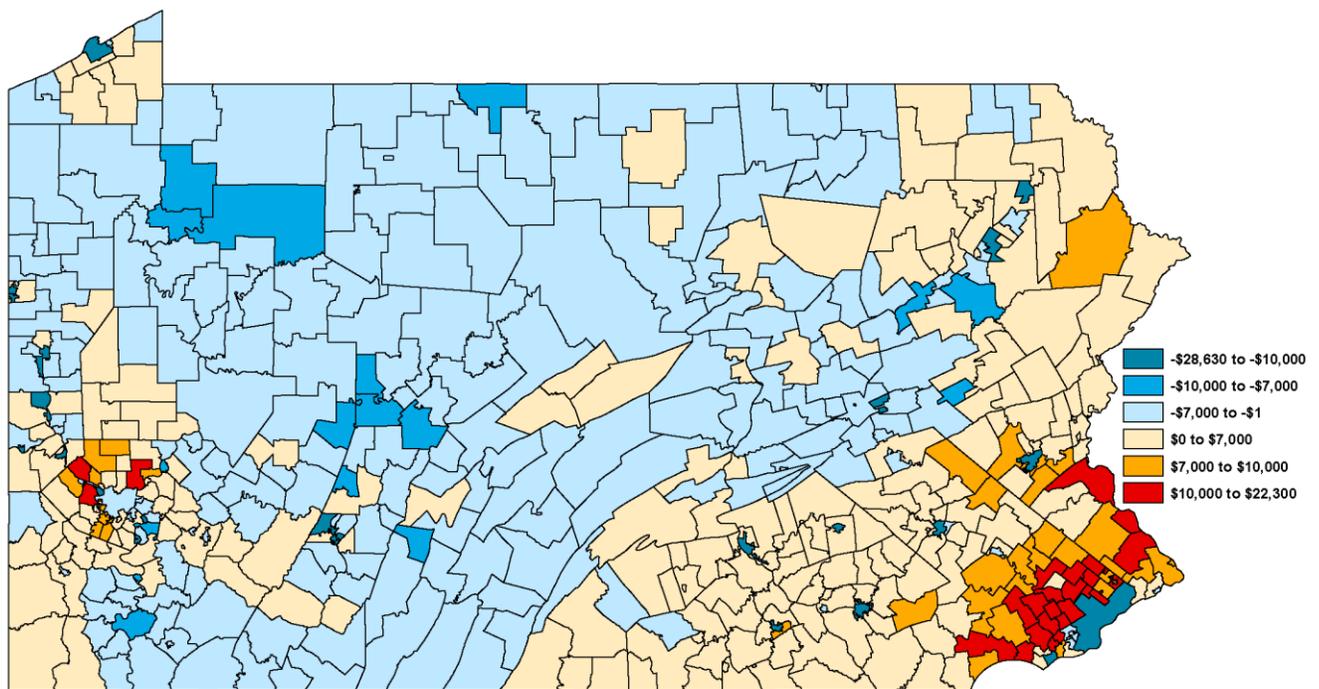
Another way to examine the distribution of property taxes by school district is to consider the total property tax revenue collected per student (Map 4 above).²⁰ Unlike the property tax analysis on the previous page, which focuses on the property taxes for the typical homeowner, this comparison considers all property taxes raised from both residential and non-residential taxpayers. While there are some subtle differences, the regional patterns in property taxes as a share of family income roughly matches the regional variation in the property taxes per student. The highest property taxes per student (\$9,686 to \$23,219) fall in Allegheny County, the Poconos, and the Lehigh Valley down into the suburbs of Philadelphia.

²⁰ See the tab labeled “Table A4” in the online technical appendix for school district level data on school property taxes collected per student <https://goo.gl/29lwb3>

As these data make clear, proposals aimed at eliminating school property taxes confront a highly unequal distribution of property taxes per student. Replacing local property taxes with state revenues involves a large regional redistribution of state spending that is inconsistent with the education funding formula that currently governs the distribution of additional state revenues provided to local schools.

For example, under property tax elimination, Lower Merion School District in Montgomery County would receive state funds to replace local property taxes equaling \$23,219 per student, while Reading School District in Berks County would receive state funds equaling \$1,034 per student.²¹ Distributing the same total of state funds through the basic education funding formula would result in Lower Merion receiving \$1,251 per student in state funds and Reading receiving \$26,327 per student.²²

Map 5. Difference in Per Student Funding Between Distributing State Funds to Schools Through the Education Funding Formula and Through School Property Tax Elimination



Source: Keystone Research Center

Map 5 (previous page) presents for each school district the difference in per student funding under the education funding formula and under property tax elimination. Negative values (shaded blue) identify districts

²¹ We are using here the most recent available data on property taxes collected per student from 2014-15. See tab “Table A5” in the online technical appendix for the data for all 500 school districts <https://goo.gl/29lwb3>

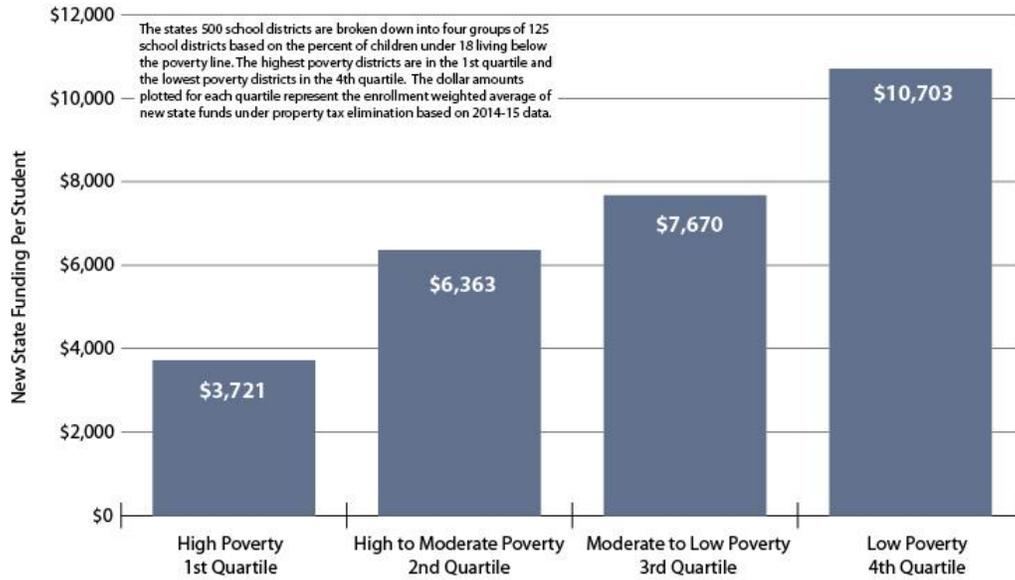
²² Here we assume that the total property taxes collected in 2014-15 (\$12.3 billion) are distributed according to the funding formula as of February 2017, see tab “2017-18 Proposed” and divide column H “Dollar Change” by \$100 million to estimate each district’s share of the total new funds to be allocated <https://goo.gl/bsYZe6>

that receive more funding under the funding formula and orange and red hues identify districts that receive more funding per student under property tax elimination. The school districts that gain more new state funding under property tax elimination tend to be in affluent communities.

To see this more clearly, Figure 6 on the next page breaks up Pennsylvania's 500 school districts into four groups of 125 school districts based on the percent of children under 18 living below the poverty line. The highest poverty districts on the left are in the 1st quartile and the lowest poverty districts on the far right in the 4th quartile. The dollar amounts plotted for each quartile represent the enrollment-weighted average of new state funds made available under property tax elimination. Under property tax elimination, the highest-poverty school districts receive on average state funds of \$3,721 per student. The lowest-poverty school districts receive on average \$10,703 in state funds per student. In contrast, Figure 7 presents for each quartile of school districts the per student funding received after distributing through the basic education funding formula the same amount of state funding as under property tax elimination. The distribution of state funds in Figure 7 is the reverse of Figure 6; most funds go to the lowest-income school districts and the least to relatively affluent districts.

Figure 6.

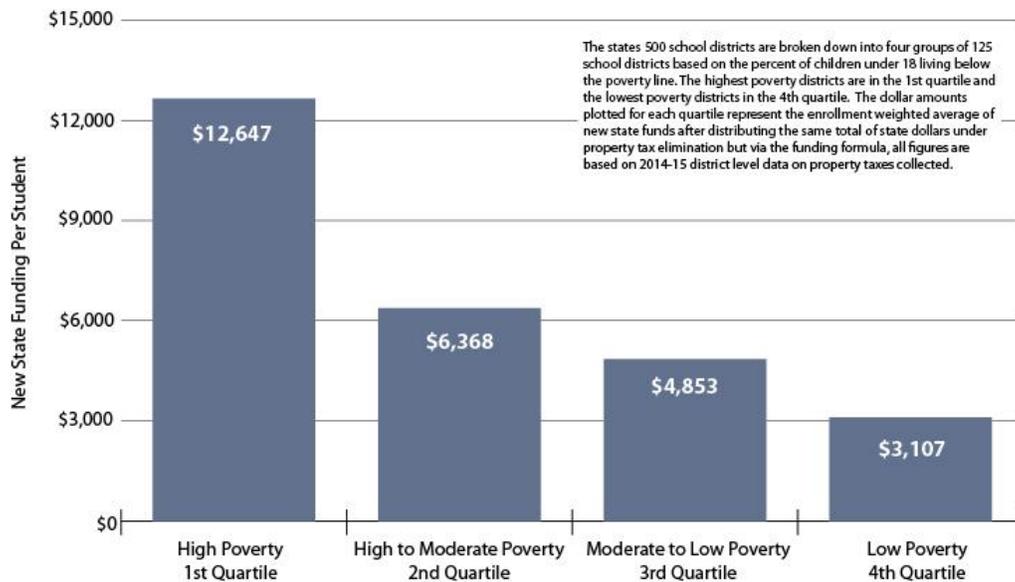
Replacing Local Property Taxes with State Funds Delivers More Dollars Per Student to Affluent School Districts than Poor School Districts



Source: Keystone Research Center analysis of data from the Pennsylvania Department of Education.

Figure 7.

If the New State Funds to Finance Property Tax Elimination were Distributed According to the State Funding Formula, State Aid Would Favor Children with the Highest Need



Source: Keystone Research Center analysis of data from the Pennsylvania Department of Education.

School Property Tax Elimination

The details of a proposal to eliminate property taxes have yet to be introduced in the General Assembly in this legislative session, but proposals introduced in prior years allow us to estimate the impact of such a proposal on the typical taxpayer.

During the last legislative session, it was proposed that school property tax elimination could be funded through a 61% increase in the personal income tax rate (3.07% to 4.95%); increasing the sales tax rate 14% to 7% (from the current 6%); and expanding coverage of the sales tax to previously untaxed goods such as food and additional services.

Using these previous proposals, the Institute on Taxation and Economic Policy (ITEP) estimates that higher sales and income taxes would fund a reduction in property taxes (for residents and nonresidents) of \$14.1 billion.

In terms of the impact on individual taxpayers, ITEP estimates that, while property taxes will on average fall by \$1,685, the total tax bill for Pennsylvania residents will **rise** by \$334 in 2017. Pennsylvania families end up paying more total taxes even with elimination of their school property taxes because a portion of the revenue collected by the property tax comes from non-residential property owners.²³ The revenue collected from non-residential property owners is not fully replaced without asking families to pay more in sales and income taxes than they are currently paying in property taxes. Under school property tax elimination, a portion of the tax burden of financing local schools shifts from the shareholders of large multi-national firms like Wal-Mart to Pennsylvania families through higher sales and income taxes.

This illustrates the hard choices faced by legislative advocates of school property tax elimination: a proposal that doesn't raise taxes on average would result in cuts in school funding. As illustrated in Map 1 and Map 2, the failure to fully replace local property tax collections would necessitate the largest school funding cuts in communities that currently have the highest property tax burdens (taxes relative to family incomes) and highest property taxes collected per student. Would it then not be a simpler approach to let local school boards make the decision whether to reduce local property taxes or increase the number of students per classroom? In the short run, the need for school budgets to balance necessitates that legislative advocates of school property tax elimination endorse raising taxes on families.

Box C. Will School Property Taxes Be Eliminated Quickly?

Our analysis here assumes that school property taxes are eliminated in 2017. However, school districts with outstanding debt may be required under property tax elimination to maintain property taxes to fund debt service in order to satisfy bond holders. As debt is paid off, the property tax is phased down and eventually eliminated.

Using data from the 2014-15 school year total outstanding debt represented 2.8 years of total property collections across all school districts. In the 87 school districts with the lowest property taxes relative to mean family incomes, property taxes represent 3.9 years of total debt outstanding. In the 107 districts with the highest property taxes relative to mean family income, property taxes represent on average two years of total debt outstanding.

Our analysis therefore overstates the amount of property tax reductions Pennsylvania residents will accrue if the final version of the legislation requires school districts to use local property taxes to fund debt service on their outstanding debt obligations.

²³ Local property taxes are also paid by out of state residents who own residential properties (2nd homes and vacation property) in Pennsylvania.

Tax Changes by Income Quintile

ITEP also examines how property tax elimination would impact low, middle, and high income families. The typical middle-income family (with an income between \$40,000 and \$63,000 a year) would see its tax bill increase in 2017 by \$326 dollars. Families with incomes between \$22,000 and \$40,000 (the second-lowest income fifth) would see their tax bills rise by \$269 dollar on average next year, and the bottom 20% of families (those with incomes less than \$22,000 a year) would see their income tax bill rise on average by \$36.²⁴

Table 2.

Dollar change in taxes by income group and tax under property tax elimination

<i>Income Group</i>	<i>Income and Sales Tax Increase</i>			<i>Property Tax Reduction</i>	<i>Net Tax Increase</i>
	<i>Income tax</i>	<i>Higher Sales Tax Rate</i>	<i>Sales Tax Base Expansion</i>		
Lowest 20% Less Than \$22,000	\$116	\$68	\$259	(\$407)	\$36
Second 20% \$22,000 - \$40,000	\$297	\$144	\$486	(\$658)	\$269
Middle 20% \$40,000 - \$63,000	\$555	\$201	\$665	(\$1,096)	\$326
Fourth 20% \$63,000 - \$104,000	\$1,119	\$256	\$784	(\$1,744)	\$415
Next 15% \$104,000 - \$215,000	\$2,104	\$350	\$1,019	(\$3,248)	\$225
Next 4% \$215,000 - \$535,000	\$4,613	\$499	\$1,325	(\$6,081)	\$357
Top 1% \$535,000 Or More	\$21,870	\$1,315	\$3,331	(\$18,808)	\$7,708

Source: The Institute on Taxation and Economic Policy

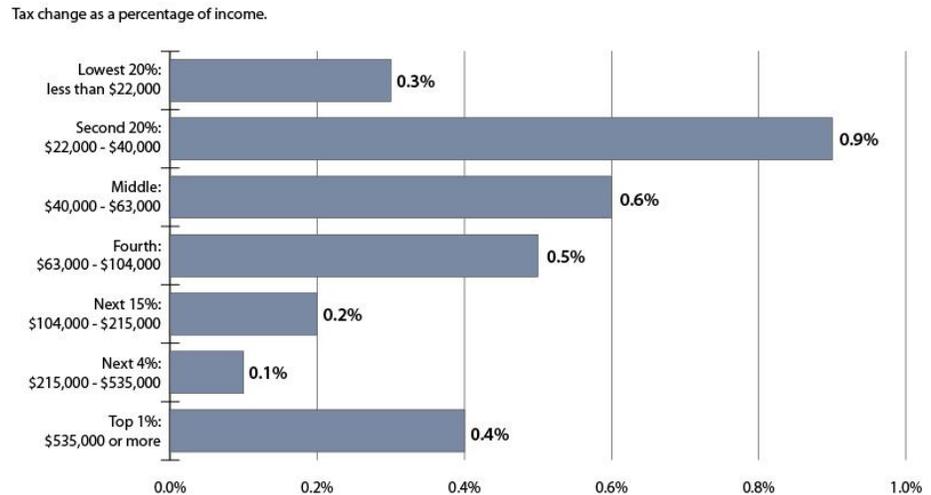
²⁴ The smaller impact on the lowest-income households reflects the impact of existing income tax forgiveness which shields low income taxpayers from the personal income tax increase. These estimates also assume property tax relief currently provided to taxpayers over 65 is not eliminated as part of school property tax elimination.

<http://www.revenue.pa.gov/GeneralTaxInformation/PropertyTaxRentRebateProgram/Pages/Request-an-Application.aspx#.WJzfU28rKM9>

Moving up the income distribution, higher-income families (with incomes between \$63,000 and \$104,000 a year) would see their tax bill rise by \$415. Dividing the top fifth of families into three groups, the tax bill rises on average \$225, \$357, and \$7,708 for the next 15%, the next 4% and top 1% of families respectively.

As illustrated in Figure 8, relative to incomes, these tax increases impact middle-income families the most (between 0.9% and 0.6% of income) and impact the lowest 20% and highest 20% the least (less than 0.4%).

Figure 8.
Middle Class Taxpayers See the Biggest Tax Increase Under School Property Tax Elimination



Source: Institute on Taxation and Economic Policy.

Boosting State Funding for Schools

School revenues collected per student from local communities have grown faster in the last 16 years than state and federal revenues reflecting a greater commitment by elected school boards to funding their local schools. A step towards relieving the financial pressures that drive local property tax increases is an increase in the state share of local education spending. The Public Interest Law Center estimates that the commonwealth must provide between \$3.036 and \$4.073 billion more in funding to local schools to help their students meet state standards.²⁵

Box D. School Funding Inequities Feed Racial Inequality

Analysis by the Education Law Center¹ finds “Pennsylvania’s school funding scheme further entrenches already significant racial disparities in education quality across the Commonwealth.” The researchers demonstrate that school districts in Pennsylvania with high concentrations of students of color receive less state funding per pupil and tax themselves relatively more than districts with fewer children of color.

¹The Education Law Center, *Money Matters in Education Justice*, March 2017, <https://goo.gl/xHStEu>.

Property tax elimination replaces locally-collected revenues with state revenues but does not boost overall funding for schools. It thus makes no progress towards achieving the funding necessary to help students meet the state’s educational standards or towards closing shameful gaps in funding by race and class (See Box D). In

²⁵ The Public Interest Law Center, *The Cost of Adequate Education Funding: An Updated Report*, <https://goo.gl/BnTJ8x>

addition, while failing to address the most pressing education finance issues in the commonwealth, property tax elimination also raises taxes for most Pennsylvania families.

An alternative approach that would raise at least \$2 billion in new revenues to support increased state funding for local schools includes a higher personal income tax rate of 6.5% (up from 3.07%) on all classes of income other than wages and interest, combined with a lower personal income tax rate of 2.8% (down from 3.07%) on wage and interest income.

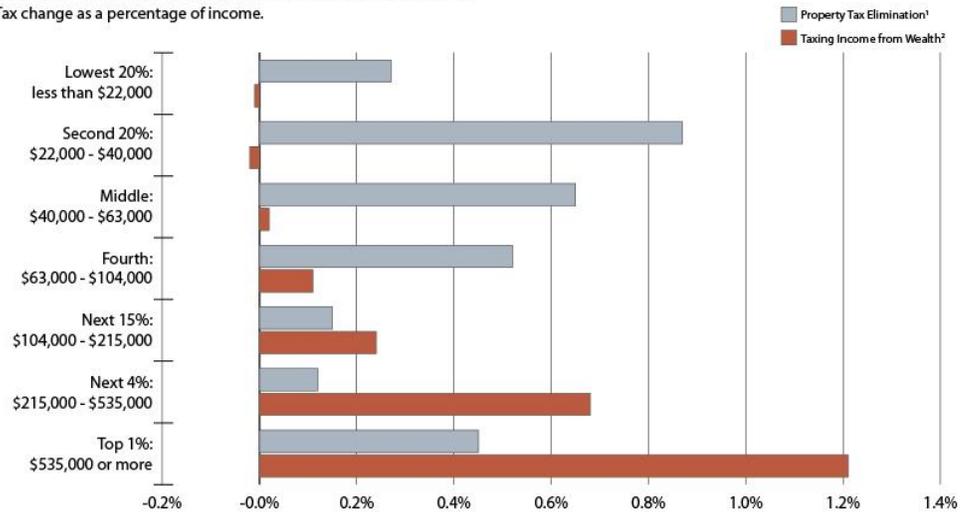
As Figure 9 illustrates, cutting taxes on wage earners while raising them on all unearned income other than interest income levies the highest tax burden on the highest earners. Contrast this with property tax elimination, which puts the largest tax burden (tax changes as percent of income) on

middle-income families (those earning between \$22,000 and \$63,000 a year). For example, under property tax elimination, families earning between \$22,000 and \$40,000 would see their tax bill on average rise by \$269 dollars in 2017, whereas the combination of lower taxes on wages and interest and higher taxes on all other unearned income would mean on average a slight reduction (\$5) on average in their bill in 2017. The next highest fifth of families, those earnings \$40,000 to \$63,000, would see an average increase in their tax bill of \$326 under property tax elimination but an increase of just \$11 with a combination of lower taxes on wage and interest income and higher taxes on all other unearned income.

Figure 9.

Property Tax Elimination Shifts the Tax Burden to Middle Income Families, Taxing Income from Wealth Shifts the Burden to the Highest Earners

Tax change as a percentage of income.



¹ Increase the personal income tax rate to 4.95%; increase the sales tax rate to 7%; expanding coverage of the sales tax to previously untaxed goods like food and services. ² Reduce the personal income tax rate on salaries and interest to 2.8%, raise the personal income tax rate on income that is not wages or interest to 6.5%
Source: Institute on Taxation and Economic Policy.

Table 3.**Comparing the tax changes associated with property tax elimination to a higher tax on the income from wealth**

<i>Income Group</i>	<i>Property Tax Elimination¹</i>		<i>Cut taxes on wage earners and interest while raising taxes on all other income²</i>	
	<i>Average tax change</i>	<i>Tax change as a % of income</i>	<i>Average tax change</i>	<i>Tax change as a % of income</i>
Average	\$334	0.5%	\$365	0.10%
Lowest 20% Less Than \$22,000	\$36	0.3%	-\$1	-0.01%
Second 20% \$22,000 - \$40,000	\$269	0.9%	-\$5	-0.02%
Middle 20% \$40,000 - \$63,000	\$326	0.6%	\$11	0.02%
Fourth 20% \$63,000 - \$104,000	\$415	0.5%	\$84	0.11%
Next 15% \$104,000 - \$215,000	\$225	0.2%	\$343	0.24%
Next 4% \$215,000 - \$535,000	\$357	0.1%	\$2,158	0.68%
Top 1% \$535,000 Or More	\$7,708	0.4%	\$20,979	1.21%

¹ Increase the personal income tax rate to 4.95%; increase the sales tax rate to 7%; expanding coverage of the sales tax to previously untaxed goods like food and services.

² Reduce the personal income tax rate on salaries and interest to 2.8%, raise the personal income tax rate on income that is not wages or interest to 6.5%

Source: The Institute on Taxation and Economic Policy

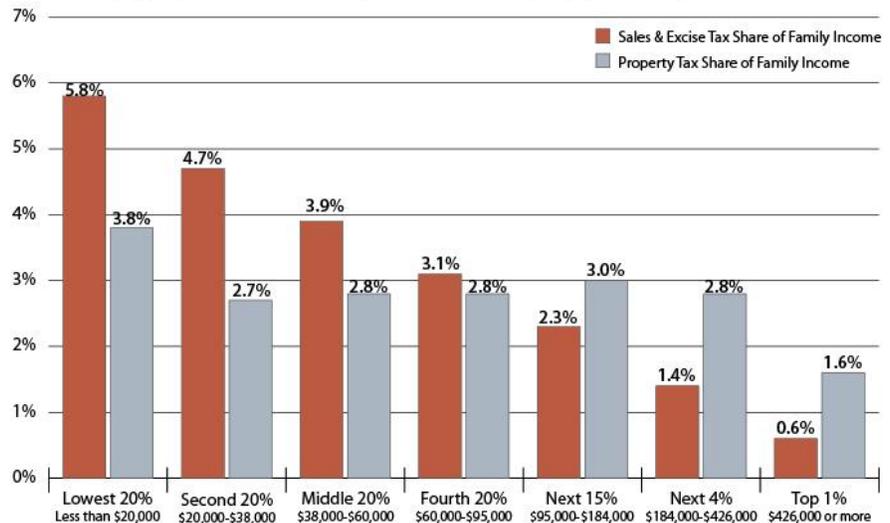
Box E. Improving the Property Tax

Non-elderly Pennsylvania middle-class families with incomes between \$20,000 and \$95,000 pay 2.8% of their income in taxes, 1.75 times as much as the top 1%. Low-income families (with incomes less than \$20,000 per year) pay 3.8% of their income in property taxes, well over twice the 1.6% share paid by the top 1%. So, while less regressive than the sales tax, the property tax does

Figure 10.

The Property Tax in Pennsylvania, like the Sales Tax, Imposes the Highest Tax Burden on the Lowest Income Families

Sales, excise, and property taxes as a share of family income for non-elderly taxpayers in Pennsylvania



Source: Institute on Taxation and Economic Policy <http://www.itrep.org/whopays/states/pennsylvania.php>.

impose a higher tax burden on middle- and low-income families in Pennsylvania. One way to address this problem is to extend credits to families with moderate incomes when property taxes take a large bite out of their income. Targeting credits to those families with property taxes high relative to income addresses Pennsylvania's real property tax problem – high property taxes in a few places – surgically. This approach avoids using a property-tax-elimination meat cleaver that wastes property-tax rebates on people who don't need them and, as we have seen, burdens moderate-income people with paying more in sales and income tax increases than they get back in property tax reductions.

Pennsylvania established in 1971 the Property Tax Rent Rebate Program (PTRR) to help senior citizens, widows, and widowers age 50 and over and adults with disabilities pay with high property taxes relative to income. To receive rebates ranging from \$250 to \$975, depending on income, homeowners must have an income below \$35,000 and renters one below \$15,000.¹ Only half of social security income counts towards the limits.

Extending property tax relief to the non-elderly would help low- and middle-income families whose incomes have fallen because of job loss, retirement, or divorce. Programs that provide targeted property tax relief are typically known as property tax "circuit breakers." When property taxes get above a certain share of income, the circuit trips and people get a rebate check. In 2001, we proposed a rebate for non-elderly households whose property taxes exceed 3.5% of their income. Capped at \$500 for households with incomes up to \$50,000, the proposal would have cost \$690 million in 2001.²

¹ For more on the Property Tax/Rent Rebate Program see <https://goo.gl/xzZdRI>

² Stephen A. Herzenberg and Eileen Healy McNulty, "Property Tax Rebates: Relief for Working Families and Underfunded School Districts", March 2001 <https://goo.gl/HPVM2C>

Conclusion

The low state share of education funding in Pennsylvania is the common thread that binds together two of the biggest challenges in education finance in the state – wide disparities between low- and high-income school districts in per student education funding, and concern over local property tax burdens. State lawmakers have been unable to assemble and sustain coalitions to increase state funding to match the rising commitment that elected school boards and the property taxpayers that elect them have made in communities throughout the commonwealth. Thus, the capacity of schools to help students meet the state's rising education standards remains largely a function of local tax capacity.

To redress the education spending disparities between school districts, legal action is now before the state Supreme Court that argues the Commonwealth of Pennsylvania has failed to uphold its constitutional obligation to provide a thorough and efficient system of public education. The aim of the plaintiffs is to ask the judicial branch to force the executive and legislative branches to put forward a plan to reduce funding disparities.²⁶

To redress local property tax burdens, policy makers of both political parties have put forward several proposals aimed at reducing local property taxes. In 2015, Governor Tom Wolf and the Pennsylvania House of Representatives each put forward competing proposals to raise between \$4 billion and \$5 billion from higher income and sales taxes to fund property tax reductions. Our analysis at the time found the Wolf proposal provided more state money to reduce property taxes to lower-income communities, while the legislation passed by the House provided more relief to high-income school districts.²⁷

Both those property tax reduction plans pale in comparison to the effort to eliminate school property taxes entirely, which would require \$14 billion in tax revenues. As the scale of the effort rises, so too do the distributional consequences of school property tax elimination. As we have shown in this report, even after accounting for property tax reductions, school property tax elimination on average raises taxes on Pennsylvania families and raises taxes the most (as a share of income) for middle-income families.

Equally troubling, property tax elimination shifts state funding in a manner completely contrary to the education funding formula that has governed the distribution of new state funds to local schools since 2014-15. By far the biggest beneficiaries of property tax elimination are the state's most affluent school districts, which would receive 2.9 times as much state funding per student than the state's poorest schools under property tax elimination.²⁸

The most direct route to address both education spending inequities and property tax burdens is through increased state funding for schools. The General Assembly enacted a school funding formula that allocates new state funds according to need; with enough new state money, the formula will meaningfully close education funding gaps.²⁹ Increased state funding will also reduce the fiscal pressures that drive local property tax

²⁶ See William Penn School District et.al. v. PA Department of Education at <https://goo.gl/o6dKw4>

²⁷ Pennsylvania Budget and Policy Center, "Follow the Property Tax Money: The Wolf Plan and HB 504 Compared", July 2015, <https://goo.gl/G6vNVb>

²⁸ On average state funding per student in the highest poverty school districts would rise \$3,721, while on average state funding for the lowest poverty schools would rise \$10,703 on a per student basis. See the discussion of Figure 6 in the main body of the report.

²⁹ Currently only new state aid appropriated to school districts after 2014-15 is distributed using the school funding formula, reallocating state aid appropriated to school districts prior to 2014-15 is another avenue for closing inequitable funding gaps but this option would not eliminate the need to raise an additional \$3 to \$4 billion in state funds to move the bulk of Pennsylvania schools towards funding adequacy.

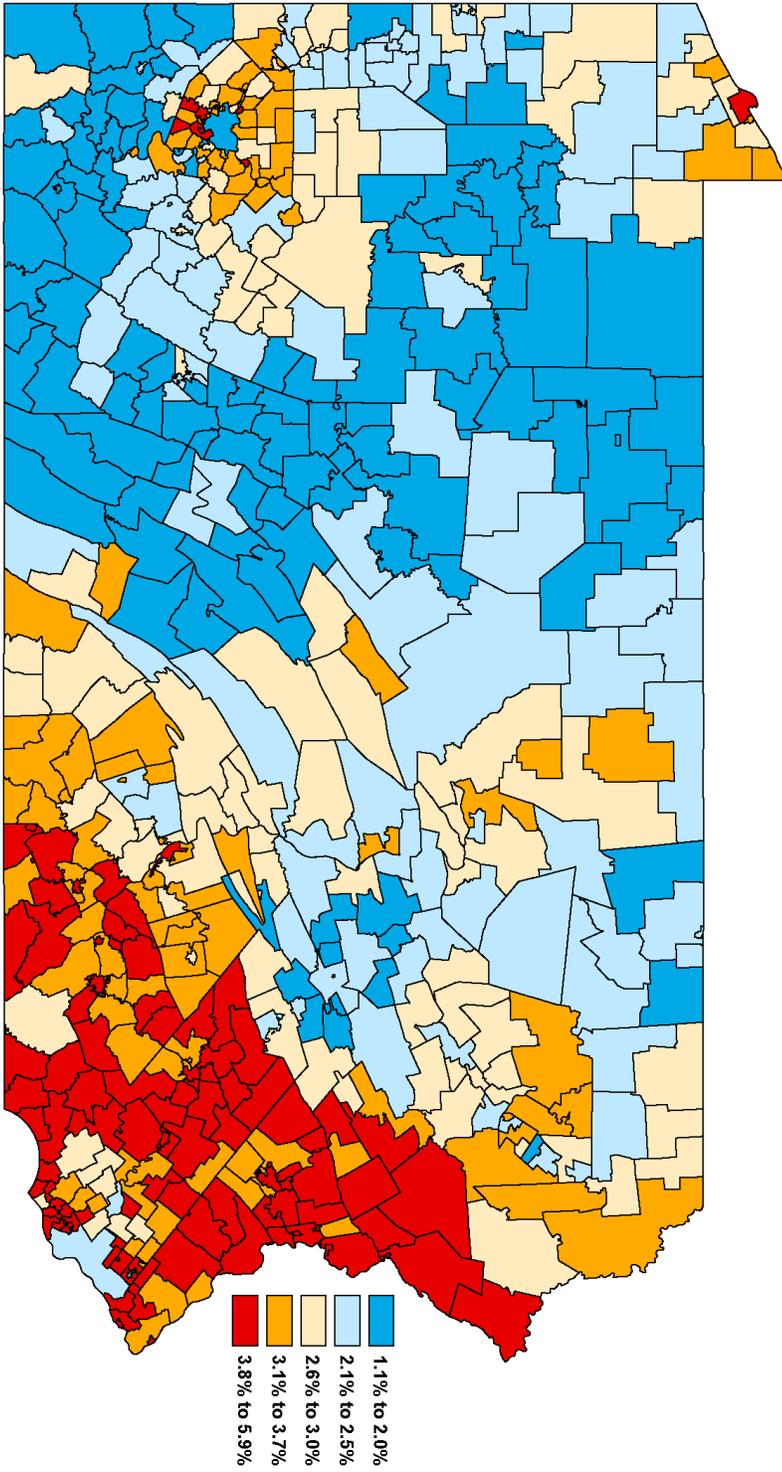
increases. Our analysis of millage rate increases finds that since end of the Great Recession property tax rates on average are rising 1.7% a year, a figure well below the average annual increase of 3.4% that prevailed before 2007-08. Keeping the rate of increase in millage rates low hinges critically on more state funds supplanting the need to raise local revenues.

In this report, we put forward a proposal to alter the personal income tax that would raise at least \$2 billion in new tax revenue, but would do it in a manner that asks the most of the highest-income families, the very families that have been the primary beneficiaries of income growth in the past 36 years.³⁰ The new revenue raised by this tax could equitably be distributed by the state's education funding formula and make significant progress towards providing the \$3 billion to \$4 billion in new state funds required to help local schools meet the state's education standards. We also recommend policy makers consider establishing a property tax circuit breaker to target property tax rebates to families for whom the property tax is a critical burden on household well-being.

³⁰ For a summary of income trends among the top 1% of families in Pennsylvania and the rest of the country see Estelle Sommeiller, Mark Price, and Ellis Wazeter, "Income Inequality in the U.S. by state, metropolitan area, and county", Economic Policy Institute, June 2016, <http://www.epi.org/publication/income-inequality-in-the-us/>

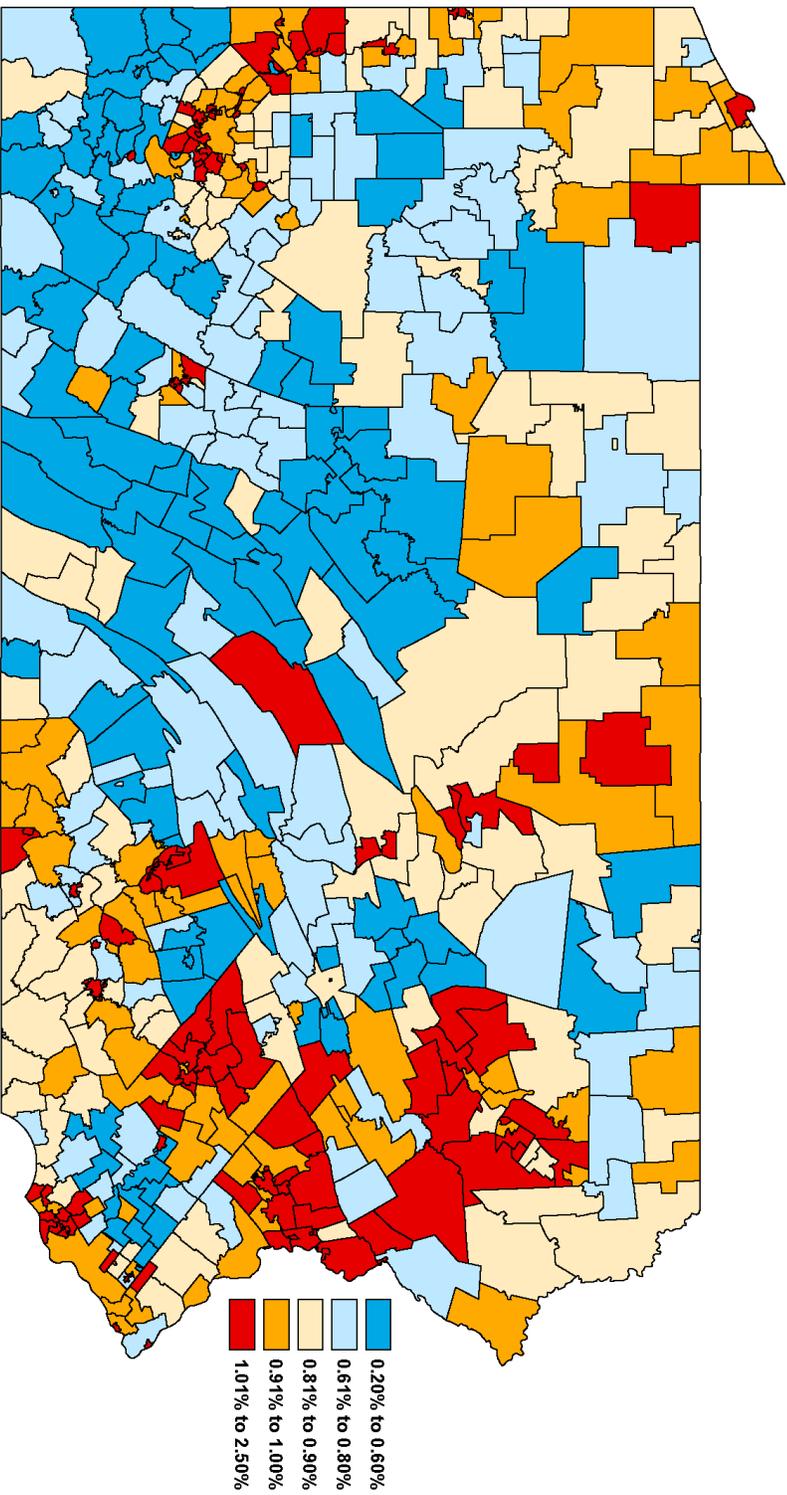
Appendix B

Map B1. County, Municipal & School Property Taxes as a Share of Mean Family Incomes by School District



Source: Keystone Research Center

Map B2. County and Municipal Property Taxes as a Share of Mean Family Incomes by School District



Source: Keystone Research Center