Fiscal Analysis of Senate Bill 76

Testimony to Senate Joint Policy Committee

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Prepared by:
Jason Horwitz, Consultant
Anderson Economic Group

Pennsylvania's property tax system has become increasingly problematic for the Commonwealth's taxpayers. Assessments are inconsistent and outdated; millage rates, even after considerable reforms, continue to be subject to common but unpredictable increases; and the changing demographics of the state have resulted in more elderly homeowners, who are often on fixed incomes and more vulnerable to changes in property tax bills.

Taxes for school districts comprise the significant majority of property taxes, and they represent the share of the property tax burden that has increased most rapidly. Senate Bill 76 (SB 76) would eliminate school districts' ability to tax local property and replace those revenues with a transfer from the state. That transfer from the state would be funded by increased state income and sales taxes. School districts would retain the right to increase local revenues by implementing a personal income tax or earned income tax within their district.

Senate Bill 76

Senate Bill 76, as written in March 2013, contains the following major provisions:

- For all fiscal years starting after June 30, 2014, school districts will no longer have the ability to levy local property taxes to support operating costs. Local property taxes for debt service on debts outstanding on December 31, 2012 will remain in place, but no new debts can be paid with local property tax revenues.
- The state personal income tax rate will increase from 3.07% to 4.34%. All revenues from this increase will be deposited into the state Education Stabilization Fund.
- The state general sales and use tax rate will increase from 6% to 7%. All revenues from this increase will be deposited into the state Education Stabilization Fund.
- The tax base for the sales and use tax will be expanded to include additional goods and services. Some of the more notable additions include newspapers and magazines, non-prescription drugs, clothing and footwear that cost $50 or more, non-staple groceries, personal hygiene products, personal legal and financial services, dry cleaning and laundry services, and tickets to sporting events and concerts. Revenues from newly taxed goods and services will be deposited into the state Education Stabilization Fund.

- Beginning in FY 2015, to compensate districts for lost local property tax revenue, the state will allocate funds from the Education Stabilization Fund to school districts. The amount allocated will be equal to the amount of total real estate taxes collected in FY 2014 minus the debt service paid in FY 2014, times the rate of increase in the consumer price index (CPI, a measure of inflation) since that year. In years where the rate of increase in sales tax revenue falls below the rate of increase in CPI, the increase in the transfer for that year will be based on the change in sales tax revenue rather than the CPI.
- School districts will have the ability to implement a personal income tax or an earned income tax within their districts, with no limit as to rate, subject to a public referendum.

Fiscal Impact

There are two important components to the fiscal impact of this bill. They are related, but it is important that they are considered separately. The first is the solvency of the Education Stabilization Fund. Will the increases in sales and income taxes be enough to cover projected transfers to schools in the future? The second is the impact on school districts. What property tax revenues might we expect school districts to collect without SB 76, and how will projected transfers to school districts under SB 76 compare?

Below, I summarize the Independent Fiscal Office's estimates for the fiscal impact of SB 76 on the state and on school districts, respectively.

TABLE 1. Estimated Fiscal Impact of SB 76 on the Commonwealth of Pennsylvania (millions of $)

Category of Revenue Impact	FY 2015	FY 2019
State Payment to Schools	- $10,544	- $11,259
Personal Income Tax Increase (3.07% to 4.34%)	+ $4,728	+ $5,573
Sales Tax Increase on Current Base (6% to 7%)	+ $1,583	+ $1,828
Expanded Sales Tax Base	+ $4,312	+ $5,242
Secondary Effects (Changes in Tax Revenue due to Changes in Disposable Income, Consumption)	+ $222	+ $351
Property Tax/Rent Rebate Program Savings	+ $0	+ $47
Philadelphia Wage Tax Reduction Savings	+ $86	+ $86
Fiscal Impact on Commonwealth of Pennsylvania	**+ $387**	**+ $1,868**

Source: Independent Fiscal Office

TABLE 2. Estimated Fiscal Impact of SB 76 on the Pennsylvania School Districts (millions of $)

Category of Revenue Impact	FY 2015	FY 2019
Property Taxes that Would be Collected by Schools without SB 76	- $10,656	- $13,582
Philadelphia School District Non-Property Taxes that Would be Collected without SB 76	- $192	- $220
State Payment to Schools Under SB 76	+ $10,544	+ $11,259
Fiscal Impact on School Districts, in Aggregate	**- $304**	**- $2,813**

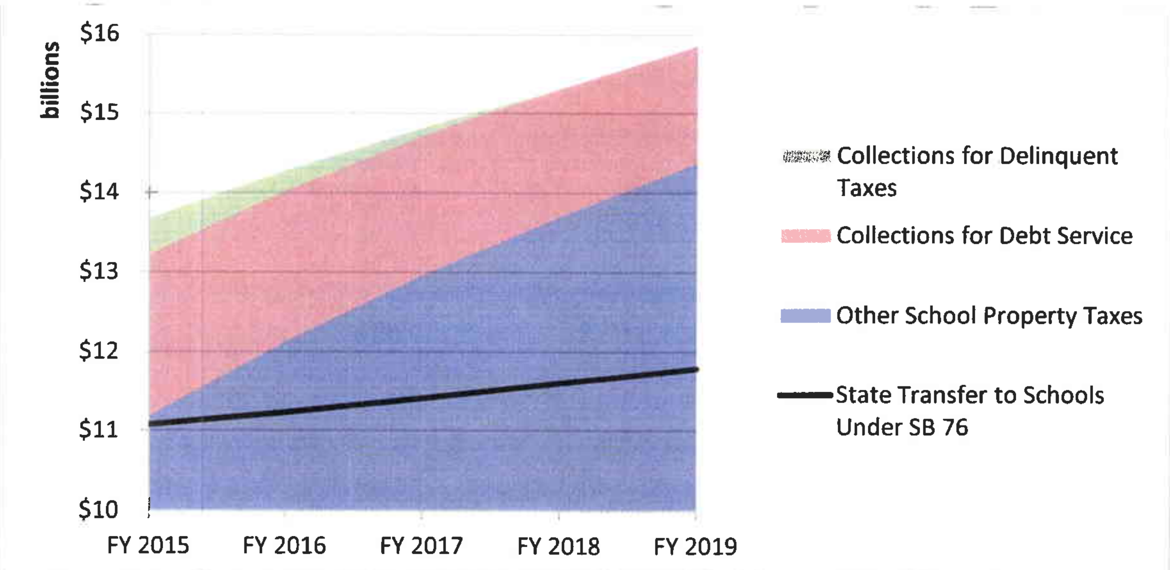
Source: Independent Fiscal Office

For the state's Education Stabilization Fund (ESF), sales and income tax increases are expected to more than cover the transfer to schools. Several years down the road, the surplus will approach $2 billion, according to IFO estimates. This is due to the fact that the growth in transfers to schools is tied to inflation, while ESF revenues will grow as income and consumption grow. Except in unusually depressed periods, income and consumption will grow faster than inflation. To summarize, the solvency of the state's ESF does not appear to be a problem. However, legislators may want to address the projected increasing surplus.

Regarding school districts, property tax revenues for school districts without SB 76 are projected to increase by approximately 4% annually for the next 5 years. Transfers from the state under SB 76 would be tied to inflation, which is projected to increase by 2% or less, annually. As a result, it is possible that there will be considerably less revenue for schools, in aggregate, under SB 76. However, note that school districts will be able to implement district-level income taxes under SB 76, which would provide a new source of revenue.

The graph below, shows projected growth in school property taxes without SB 76, as well as projected state transfers to schools under SB 76, according to the Independent Fiscal Office. The top two regions, for debt service and delinquent taxes, would continue to be collected under SB 76. However, the bottom region would no longer be collected, and instead, school districts would receive a transfer, corresponding to the black line.

FIGURE 1. Projected Property Tax Collections without SB 76, FY 2015 to FY 2019



Source: Independent Fiscal Office
Analysis: Anderson Economic Group, LLC

Anderson Economic Group performed a similar fiscal impact analysis, independently of the IFO, in July of this year. Our results generally agree with those of the IFO. The most significant difference between our estimate and that of the IFO stems from our projections for inflation. Using the Congressional Budget Office as our source, we project that CPI will be higher in future years, resulting in higher future transfers to school districts under SB 76. This reduces the surplus for the ESF and the deficit for school districts compared to the status quo, though both remain significant in our projections. We also did not account for “secondary effects” in our estimates, resulting in a smaller but still significant surplus for the state ESF.