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Rep. Robert E. Belfanti, Jr.
107th Legislative District
Columbia, Montour, and Northumberland counties

Revisiting the Property Tax Issue

Commonwealth Caucus sales tax plan just doesn't add up

Many Pennsylvanians have heard about a plan proposed by a mostly Republican group of state lawmakers known as the Commonwealth Caucus to replace school property taxes in Pennsylvania with an expanded sales tax.

The proposal is to lower the sales tax to 5 percent, but significantly expand it to cover most items that currently are not taxed, such as groceries, clothing, professional services and even college tuition. The Commonwealth Caucus claims this tax shift would raise enough revenue to completely eliminate the property tax.

The plan sounds appealing to some, but when the details are explored it becomes clear that, for many reasons, the plan will not work. For example:

- The sales tax plan **won't** raise enough revenue to eliminate property taxes.
- The sales tax plan could take away local school board control of curriculum and give it to an unelected committee in Harrisburg instead.
- The sales tax plan puts a major burden on lower-income households that spend a greater percentage of their income on necessities like food and clothing.
- The sales tax plan will hurt professionals and people who use their services.
- The sales tax plan raises taxes in general on the business community.

An independent study by the non-partisan Pennsylvania Economy League illustrates many of these points and others. Its conclusion: the sales tax plan will not work. Specifically, the report illustrates three major problems with the sales tax plan:

- **Many homeowners would save less under this plan than Act 72.** The plan would dramatically change Pennsylvania's tax structure by shifting the bulk of school funding from the local property tax to a statewide sales tax, but would not necessarily lower taxes substantially for many state residents. For instance, most homeowners would see a slight overall tax reduction, but in many cases it would be less than the tax relief promised by simply applying Act 72 in all school districts, as the governor has proposed.
- **All renters are losers under the sales tax plan.** Twenty-five percent of all Pennsylvanians are renters, not homeowners. Their sales tax payments would significantly increase with no reduction in property taxes or rent to offset that tax increase. Under the governor's plan, renters do not see a property tax reduction (because they pay no property taxes in the first place), but they do not see a tax increase either.
- **The Commonwealth Caucus Plan is a huge business tax increase!** The plan raises taxes on professionals, service companies, and manufacturing companies.

A portion of the Pennsylvania Economy League report is reproduced below. As you hear and read more about this sales tax plan in the coming weeks, please keep these points in mind. You can find more information about how the sales tax plan would hurt Pennsylvania, along with details on more effective and responsible property tax relief proposals

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Replacing School Property Tax with a Broadened Sales Tax: How does the Individual Taxpayer Fare?

There's a proposal in the legislature to eliminate the school property tax, the most-hated tax (but very reliable source of revenue) in Pennsylvania. What's the impact on Pennsylvania's households? IssuesPA investigates.

(October 2005) Members of The Commonwealth Caucus in the legislature have advanced a proposal to radically change the way public schools are funded – and how individuals and businesses are taxed. Their plan would replace local school tax revenue primarily with revenue from a major change in the state sales tax: an expansion of taxable items to include many goods and services not taxed in Pennsylvania today – as well as a corresponding reduction in the sales tax rate.

Who are the winners and losers under this plan? Using a model simulating tax and spending for an average family of four with average spending patterns in an average school district in Pennsylvania, IssuesPA examined how different households would be affected under The Commonwealth Caucus' plan. The analysis is based on the expansion of the sales tax to include most goods and services, taxed at 5%, and reflects the deductibility of property taxes for federal income tax purposes.

While the results are approximate and actual results would vary pending final plan details and individual households' location and spending patterns, two broad patterns are clear:

Homeowners win. Taxpayer relief from school property taxes is a major feature of the proposal, and homeowners would do well. Increases in state sales taxes paid are more than offset by decreases in property taxes. On their federal income taxes, taxpayers can deduct either property taxes or sales taxes paid – but not both. The shift away from property taxes to sales tax means a weakened deduction on the federal income tax, most likely offset by the property tax decrease.

Renters lose. Renters, who comprise more than a quarter of all households in Pennsylvania, would lose under this proposal, regardless of their income. This assumes decreases in property taxes for rental property owners won't be passed along to renters. Efforts to get rental property owners to pass along any tax decrease in the form of rent decreases would be difficult to enforce or monitor. Eliminating school income taxes would have a small impact on the increase in sales taxes paid, but overall, renters lose in this equation.

Other impacts. The overall increase in sales taxes paid as a percentage of income is higher for the average low-income family than for the average high-income household. Sales taxes paid by a low-income household would increase from 2.58% of total income to 3.24%. The sales taxes paid by a high-income household would increase from 2.04% to 2.54%. Households at all income levels would pay more in sales taxes.

So what does all this mean?

It's hard to say. What is a "fair" tax? Is this better for education funding? What's the impact of the proposal on the stability of school funding? Is this better or worse for individuals and business owners? How much extra time and money would it take to implement and enforce an expanded sales tax?

Lots of questions. The quest for answers continues – by proponents and opponents. Stay tuned.

Replacing School Property Tax with a Broadened Sales Tax: The Implications for Business

There's a movement afoot to put an end to the school property tax, the most-hated tax (but very reliable source of revenue) in Pennsylvania. What's the impact on Pennsylvania's business climate? IssuesPA takes a closer look.

(October 2005) This fall, the legislature may consider a proposal to replace school property taxes paid by Pennsylvania homeowners and businesses. The measure calls for ending local property taxes that pay a large portion of the bills for public schools and replacing them with money from a restructured sales tax. The plan calls for a reduced sales tax rate - from 6% to 5% - and a broadened base to include almost all purchases, including services, food and clothing.

The issue? Raising additional money at the state level to pay for a new way to fund public education in Pennsylvania. It's a strategy that depends on a broadened sales and use tax - and possibly a local income tax. By eliminating property and other taxes, the plan would place control of most of Pennsylvania's revenue raising capacity for public education at the state level.

Supporters call the plan "revenue neutral," but with any tax policy change there always are winners and losers. What's the impact on different households? And what's the impact on Pennsylvania's business climate? IssuesPA investigated.

Who wins? Who loses?

Who will benefit from lower property taxes? Eliminating school property taxes means a significant reduction in property taxes paid. Businesses and homeowners still would pay local property taxes for county and municipal services, but the schools portion - about two-thirds of all property taxes statewide - would be eliminated. Businesses such as manufacturers which pay property taxes on the land on which they are located would benefit the most. Service industries generally would see very little in lowered property tax burdens. But that's just the first part of the equation. To fully understand the impact on businesses, overall taxes paid - the net effective tax rate - must be considered.

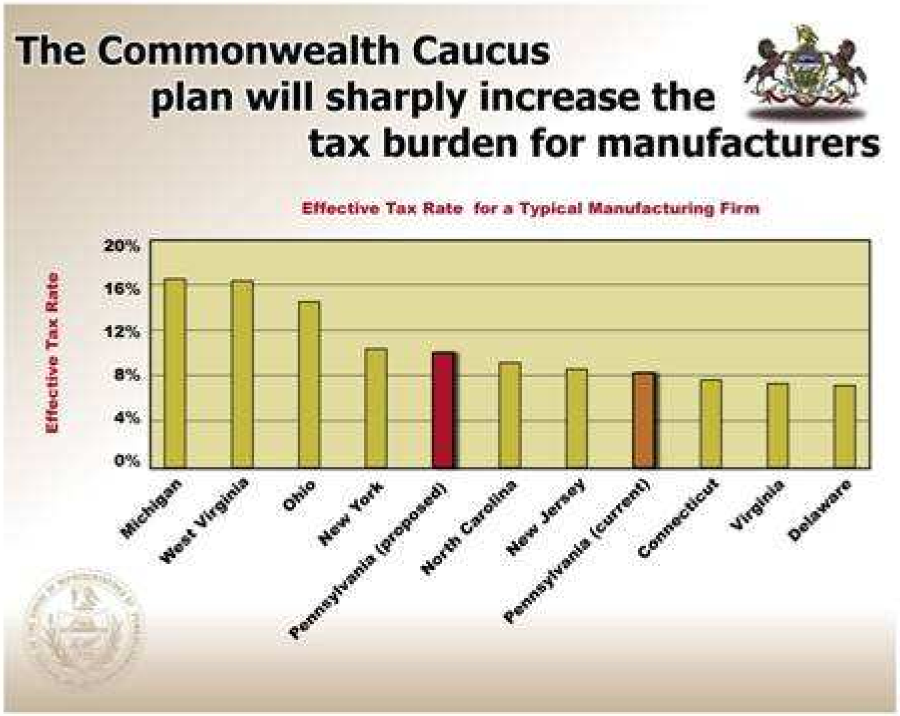
How would the sales and use tax change? The proposed broadened sales tax base means more taxes paid by businesses. After all, businesses are consumers, too. They must purchase goods and services. A Pennsylvania Economy League (PEL) analysis shows businesses would pay more in overall taxes. Some industries - such as banking, with a high reliance on information technology and other services that aren't taxed now - would pay substantially more.

How would this happen? Since many businesses are only intermediaries in the production process, taxes can "pyramid" because they're levied on every step sold up through the chain before their product reaches the final consumer. By levying the tax during each transaction in production, not only will the tax be levied on each input, but after the first transaction the initial tax collected will be subject to tax over and over again until the final sale.

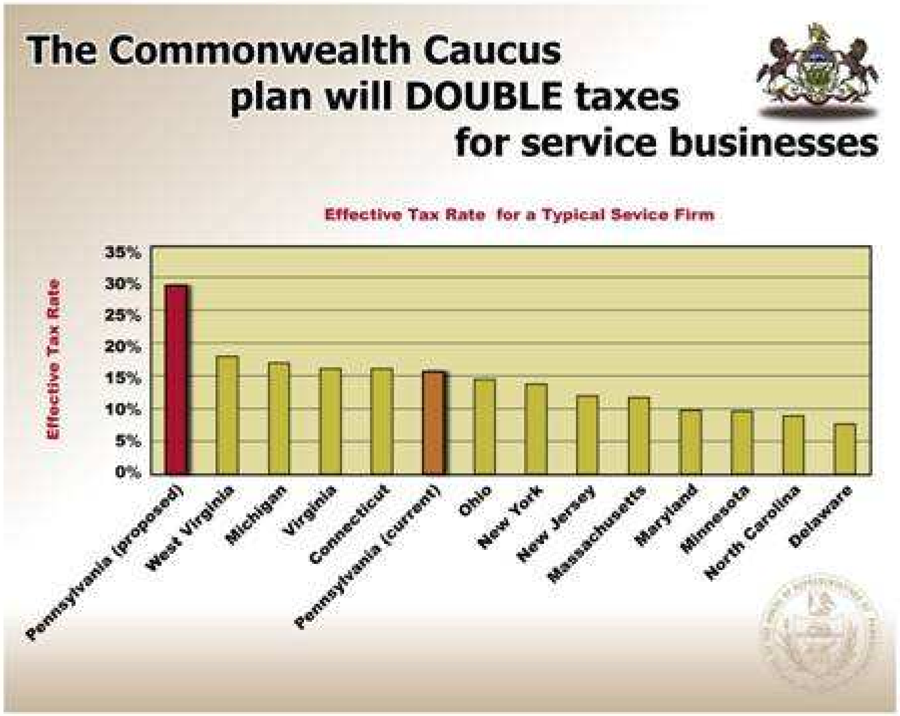
A significant increase in the sales and use tax burden would encourage many businesses to re-think how and where they purchase many of their products and services. Options, especially for larger businesses, include bringing services or production in-house to avoid paying any tax and eliminate the pyramiding costs.

How would Pennsylvania's tax burden on businesses compare under the proposed plan?

When the impact of the decrease in property taxes and the increase in sales taxes is measured on a competitive basis, Pennsylvania's manufacturing businesses lose their competitive standing compared to their regional and economic peers. For example, Pennsylvania's manufacturers currently pay an effective tax rate of about 8%. Under the new proposal, their effective tax rate would grow to about 11%, bypassing North Carolina and New Jersey and following closely behind New York.



Pennsylvania's service firms would fare even worse under the proposed tax shift. Low overhead means they benefit less from property tax reduction. Therefore, the broader sales tax base impact is not offset - and can be overwhelming. . Pennsylvania would move from a current and relatively competitive 15% effective tax rate to nearly 30%, leapfrogging Connecticut, Virginia, Michigan and West Virginia. Pennsylvania firms would become the highest taxed service firms, comparatively. While Pennsylvania currently grows service jobs faster than many of its peer states under the current tax system, that relative competitiveness is likely to diminish over time as businesses relocate or choose other states to set up shop.



Bottom line for Pennsylvania's businesses?

The legislation is deemed "revenue-neutral" by its supporters, but according to the PEL analysis, the impact isn't revenue neutral for businesses. To be truly revenue neutral to businesses, the sales tax rate would need to drop to a rate between 3-4% for the typical manufacturing firm - and between 1-2 percent for the typical service firm.

Will it be a losing economic proposition in Pennsylvania if employers decide to leave, halt expansion, or locate elsewhere to avoid the increased tax burden? Proponents say 'no,' that the net effect is neutral, based on their economic analysis. Yet there appears to be another side of the story.

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