

Analysis of HB 1776 and SB 1400 of 2012

PA Education Finance Symposium

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The Independent Fiscal Office does not support or oppose any existing or proposed tax or budget policies. Consistent with its mission, the office will not make any policy recommendations.

Today's Presentation



- Presentation uses slides from the October 1st presentation to the House Select Committee on Property Tax Reform.
- The full presentation and report can be found at IFO website: www.ifo.pa.us.
- Office policy precludes the IFO from commenting on whether policy is good /bad or better/worse relative to current law.

Today's Presentation



- Brief overview of HB 1776 / SB 1400 of 2012.
- Analysis Objectives.
- Analysis Results (summary version today):
 - Surplus or shortfall to (1) the Education Stabilization Fund and (2) school districts.
 - Detail by revenue source.
 - Significant detail on Property Tax forecast.
 - Some general economic analysis.

The Proposal

- Eliminates local school property tax.
 - Property taxes to service debt existing as of Dec. 31, 2011 retained and phased-out.

- State funding based on FY 2012-13 district collections. Three sources for new Education Stabilization Fund (ESF):
 - Raise sales tax rate from 6% to 7%; expand tax base.
 - Raise PIT rate from 3.07% to 4.01%.
 - Transfers from Property Tax Relief Fund.

- Assumes that General Fund held harmless and DOR can separate new revenues from existing revenues.

Analysis Objectives

1. **ESF:** Are dedicated revenues sufficient to fund distributions to school districts?
2. **Local Schools:** How do those distributions compare to a “current law” property tax baseline?
3. Potential economic impacts.
 - a. Business and non-business.
 - b. Homeowners and renters.
 - c. Home prices and rent payments.
 - d. Business competitiveness.

Table 1

Overview Of Property Tax Replacement

	Fiscal Year (\$ millions)				
	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
DEDICATED REVENUES					
Sales Tax - Rate and Base	\$5,211	\$5,472	\$5,751	\$6,028	\$6,302
Personal Income - Rate	3,361	3,543	3,716	3,886	4,049
Property Tax Relief Fund	<u>526</u>	<u>539</u>	<u>552</u>	<u>566</u>	<u>580</u>
TOTAL	9,098	9,554	10,019	10,480	10,931
PROPERTY TAX REPLACEMENT					
Property Tax Forecast	12,678	13,184	13,704	14,103	14,497
Existing Debt Service	<u>-2,071</u>	<u>-1,939</u>	<u>-1,807</u>	<u>-1,675</u>	<u>-1,543</u>
Property Tax Replacement	10,607	11,245	11,897	12,428	12,954
NET ANNUAL IMPACT	-1,509	-1,691	-1,878	-1,948	-2,023

Table 2

ESF and School District Impact

	Fiscal Year (\$ millions)				
	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
EDUCATION STABILIZATION FUND					
Dedicated Revenues	\$9,098	\$9,554	\$10,019	\$10,480	\$10,931
Distributions to Schools	<u>10,453</u>	<u>10,744</u>	<u>11,097</u>	<u>11,437</u>	<u>11,802</u>
Difference	-1,355	-1,190	-1,078	-957	-871
SCHOOL DISTRICT IMPACT					
Distributions to Schools	10,453	10,744	11,097	11,437	11,802
Replacement Baseline	<u>10,607</u>	<u>11,245</u>	<u>11,897</u>	<u>12,428</u>	<u>12,954</u>
Difference	-154	-501	-800	-991	-1,152
NET IMPACT	-1,509	-1,691	-1,878	-1,948	-2,023

The Sales Tax Base Expansion



- Newly taxed goods:
 - Food items (except WIC and SNAP purchases)
 - Clothing and apparel > \$50
 - Non-prescription drugs (e.g., pain relievers, vitamins)
 - Personal hygiene (toiletries, diapers)

- Newly taxed services:
 - Certain health care (for-profit nursing homes, day care)
 - Recreation (movies, bowling, amusement parks)
 - Basic cable
 - Personal (barber, beauty salons)
 - Intrastate transport of persons (taxis, bus, rail)

Table 3

Sales Tax: Rate Increase and Base Expansion

	Fiscal Year (\$ millions)				
	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
Rate Increase: 6% to 7%	\$1,450	\$1,514	\$1,574	\$1,628	\$1,680
Food (Exclude WIC/SNAP)	1,110	1,165	1,221	1,276	1,330
Clothing > \$50	418	439	463	487	514
Recreation Services	570	589	611	633	655
Health Services	612	651	698	748	797
Professional Services	378	395	414	434	453
Personal Services	235	246	258	270	283
All Other	257	281	307	335	361
Secondary Effects	<u>181</u>	<u>192</u>	<u>205</u>	<u>217</u>	<u>229</u>
TOTAL SALES TAX	5,211	5,472	5,751	6,028	6,302

Table 5

Personal Income Tax Rate Increase

	Fiscal Year (\$ millions)				
	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
Rate: 3.07% to 4.01%	\$3,483	\$3,670	\$3,847	\$4,023	\$4,191
Increase in Refunds	-142	-148	-153	-161	-167
Secondary Effects	<u>20</u>	<u>21</u>	<u>22</u>	<u>24</u>	<u>25</u>
TOTAL PIT	3,361	3,543	3,716	3,886	4,049

Table 6

School District Property Tax Forecast

	Fiscal Year (\$ millions)				
	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
Prior Year Adjusted	12,340	12,754	13,263	13,786	14,188
Act 1 Index Growth	164	239	259	251	249
Act 1 Exceptions	<u>174</u>	<u>191</u>	<u>182</u>	<u>66</u>	<u>60</u>
Act 1 Total Increase	338	430	441	317	309
Current Law Prop. Tax	12,678	13,184	13,704	14,103	14,497
Less: Debt Service	<u>-2,071</u>	<u>-1,939</u>	<u>-1,807</u>	<u>-1,675</u>	<u>-1,543</u>
Net: Amount Subject to Replacement	10,607	11,245	11,897	12,428	12,954

Who Bears the Tax Burden?



- It was requested that the IFO examine the business vs. non-business impacts.
- Analysis considers the “statutory tax incidence” or the party with legal obligation to remit payment.
- Three cautionary notes:
 - Need NOT reflect the true economic burden.
 - Business vs. non-business distinction is not meaningful in many cases.
 - Excludes impacts on federal income taxes.

Table 7

Change in Statutory Tax Incidence

FY 2013-14

<u>Revenue Source</u>	<u>Total</u>	Non- <u>Business</u>	<u>Business</u>
Sales Tax	\$5,211	\$4,624	\$587
Personal Income Tax	3,361	3,038	323
Property Tax	<u>-10,607</u>	<u>-7,425</u>	<u>-3,182</u>
TOTAL	-2,035	237	-2,272

Note: Assumes 30% of business tax cut accrues to business entities. Assumes businesses pay 39% of sales tax rate increase.

Table 8

Median Homeowners and Renters

Current vs. Proposed Tax Law

	Change in Tax Liability	
	<u>Fully</u> <u>Phased-In</u>	<u>First</u> <u>Year</u>
Median Homeowner - Working	-7.0%	-4.6%
Median Homeowner - Retired	-37.5%	-30.8%
Median Renter - Working	10.6%	21.7%
Median Renter - Retired	7.7%	25.2%

Note: Median income data for age cohorts and housing tenure from U.S. Census Bureau. Law imposed against 2010 data.

Windfall Gain to Homeowners

- Research suggests an average property tax capitalization rate of roughly one-third.
 - Median home price 2014 \$180,000
 - Median school property tax \$2,200
 - Discount factor 4.0%
 - Gain w/ full capitalization \$55,000
 - Property tax capitalization 33.3%
 - Potential long-term gain \$18,300

- Analysis very sensitive to assumptions.

Homeowners

- Capitalization rates will vary substantially throughout the Commonwealth.
 - Higher rates in more developed areas.
 - Current homeowners capture more of tax cut.

- Two key assumptions on housing gains:
 - 1. The level of services provided to homeowners does not change.
 - 2. Prospective homebuyers convinced property taxes will not be levied in the future. If unconvinced, then lower price appreciation.

Federal Income Tax Impact



- Proposal interacts with federal income taxes.
 - Itemizers realized federal income tax increase of approximately \$550 million for 2014.
 - Firms lose roughly 25% of property tax cut benefits due to higher federal tax liability.
- **Broad view:** an exchange of tax that is deductible (property tax for business and homeowners) for one that is not (sales tax on consumers).

Summary

- Analysis suggests shortfall in proposal.
 - Revenues roughly \$1 billion short of proposed distributions to school districts.
 - Distributions roughly \$1.0-\$1.5 billion less than school district property tax baseline.

- Current homeowners clear winners. Many will realize large windfall gains.
 - Most renters likely worse off. Outcome unclear for prospective homebuyers. Depends on individual circumstances.
 - Mixed results for business too.

Full Report Available at

www.ifo.state.pa.us