



Pennsylvania Association of School Business Officials

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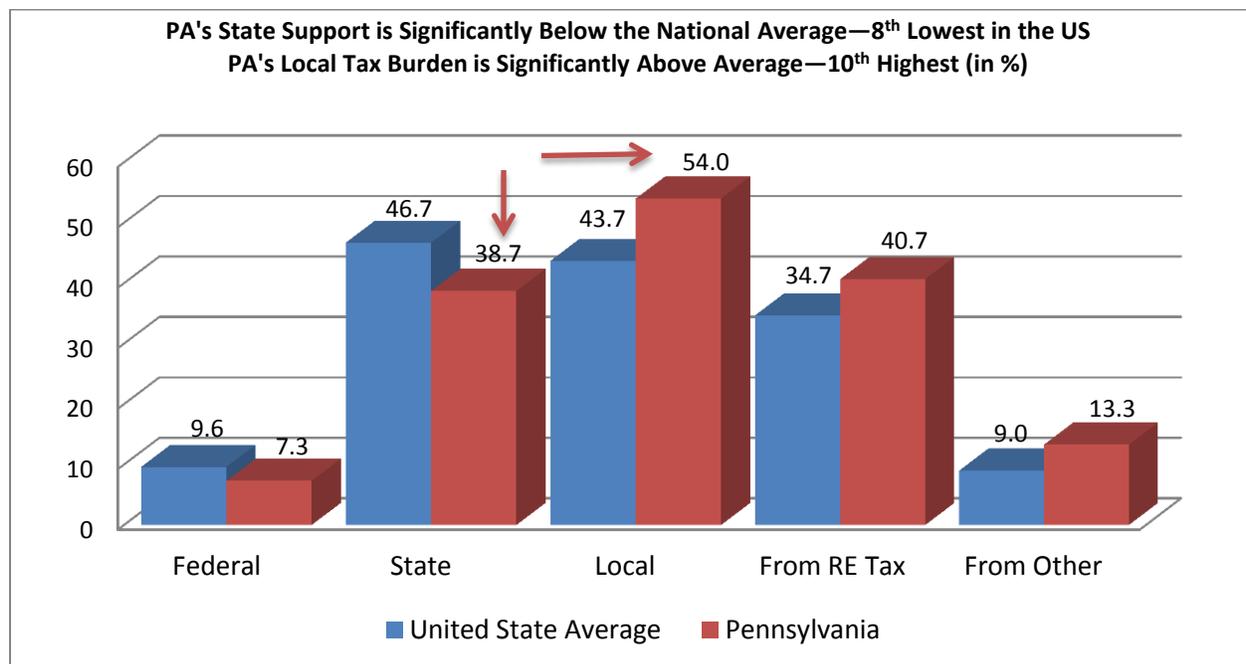
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Testimony on Senate Bill 1400
Senate Finance Committee
July 26, 2012
Jay Himes, Executive Director

Good morning. I am Jay Himes, executive director of the PA Association of School Business Officials (PASBO). We are a statewide organization of school employees other than superintendents and teachers who are responsible for management of finance and operations in schools that support classroom learning. With me is Richard Vensel, business and operations manager at South Middleton School District in Cumberland County.

Senate Bill 1400 is another attempt to change how schools are funded. We have no shortage of ideas about how to change k-12 education funding but the only public policy consensus that seems to emerge is that school boards, school administrators, taxpayers and parents don't like the status quo.

Let's take a quick look at school finance in PA and how it compares with surrounding states. As the chart below indicates we have placed significant revenue responsibilities at the local level which helps to assure the decision-makers can address local needs with local resources.



We continue to use local revenues to fund more than half of the cost of public education. For the 2008-09 fiscal year, according to US Department of Education Data, we ranked 10th highest of all states in the percent of total revenue from local sources. This reliance on local taxes also means our reliance of state revenues is well below average at 38.7%--8th lowest in the country.

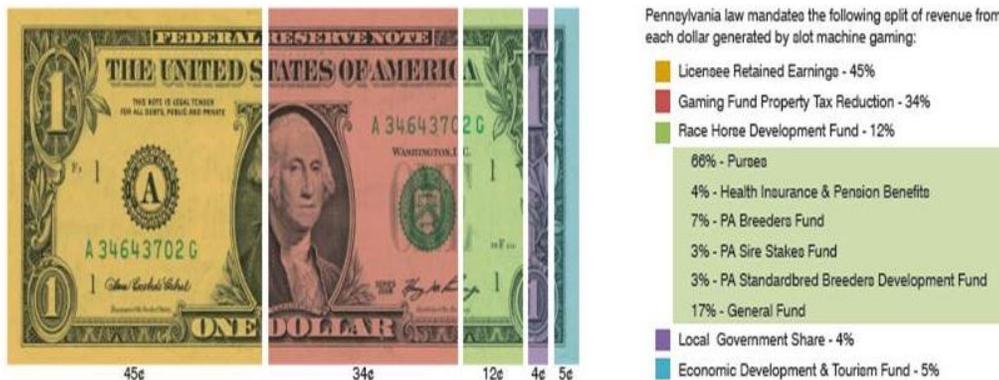
These sources are the major contributors to school budgets. In PA, federal revenue accounts for 7.3% of total revenues with most of that funding targeted to poorer districts. There is also a cause and effect—generally the more reliance on state funding the lower the local burden, which means less onerous property taxes.

Since schools have limited options in local taxes, we have a high reliance on the property tax to fund schools. For the 2010-11 fiscal year, of the nearly \$13.5 billion in total local revenues, 83% was property tax with the Local Earned Income Tax generating 12% and other tax sources combined making up the remaining 5%.

To reduce the burden of the property tax there are any number of measures that could be taken:

1. Provide additional tax capacity (other than real estate) at the local level to balance out property taxes and income or other taxes. The General Assembly passed and the Governor signed such a plan in 2006 but voters in only 8 of 501 school districts thought it was a good idea and approved the tax trade by referendum.
2. Increase state funding that would reduce the local burden and as a result property taxes. Clearly we understand and appreciate that there is no new state revenue but there could be other shifting of funds from existing programs. For example the gaming fund has been providing about \$600 million in annual property tax reduction through the homestead/farmstead exclusions that appear on school district property tax bills. But the Gaming Fund is generating much more than the amount that goes to the Property Tax Relief Fund as indicated in the chart below. Specifically, we suggest that using economic development funds for a targeted senior citizen homestead/farmstead relief would help the lower the residential tax burden for means tested additional homestead/farmstead exclusion. For 2011-12 about \$124 million was generated in gaming taxes for this purpose.

Distribution of Slot Machine Gross Terminal Revenue



3. Reduce or eliminate state mandates with savings dedicated to generate property tax reductions.
While I am sure members of the General Assembly hear the mandate refrain often, it is no doubt a significant contributor to our property tax dilemma. Indirectly, curtailing the expenditures for mandates such as retirement funding, special education, charter and cyber charter tuition, non-public transportation, Prevailing Wage Law, property tax collection, etc. would allow for diminishing the property tax burden.
4. Fully evaluate the impact Act 1 has had and will have on property taxes. Act 1 was designed to establish a ceiling on property tax increases and I believe it has accomplished that objective. Originally, the Act 1 Index as indicated below was near or above 4%. However due to economic circumstances the Index is now trending downward at its lowest point since the enactment of the law. We do not know what the effect of the reduction of the index will be on property taxes for 2011-12 and 2012-13 since we do not have the data from the Annual Financial Report.

However, we can conclude that property tax revenues should be down in comparison to previous years based on the reduction in the Index and with the enactment of even further restrictions on exceptions to the Index in Act 25 of last year. Prior to Act 1, for 2000-01 to 2005-06 total schools expenditures statewide increased by 32.7% and total property taxes increased by 36.0%. If we take the same time period after Act 1, we see total expenditure increases of 19.6% and 15.0%, respectively. While there are other factors, there does seem to be a downward trend of increases in total expenditures and property taxes as seen in the table below in tandem with the reduction in the Act 1 Index.

	2010-11	2009-10	2008-09	2007-08	2006-07	Prev. 5 Yr. Avg.
Total School Expenditures	2.3%	3.5%	2.5%	5.1%	4.7%	5.8%
Property Taxes	3.5%	3.1%	-0.3%	4.6%	5.9%	6.3%
Act 1 Index Change	2.9%	4.1%	4.4%	3.4%	3.9%	NA

Obviously, there have been other significant factors that prevent a direct correlation from this data, but it does appear Act 1 has moderated property tax increases. I would expect future data to support the decline in the growth rate of property taxes in the past two fiscal years even with the huge financial mandate for pension funding.

We believe these ideas could form the base of policy changes that would have a beneficial impact on property taxes for taxpayers AND schools. However, we believe the drastic approach taken in SB 1400 will create a whole host of related problems that makes the legislation unworkable from a school finance perspective.

Here are the problems we see:

1. At the core of any shortcomings of the legislation is the huge tax shift that occurs. If property taxes are eliminated then non-residential properties receive a huge windfall. Business and corporate taxpayers will receive a huge reduction in property taxes that will be offset by significant personal tax increases via the state's Personal Income Tax and Sales Tax. By calling for property tax elimination in this legislation some residential property owners will likely be calling for an increase in their state taxes.
2. Almost as critical is the lack of any mention of how the increased state Personal Income Tax and Sales Tax revenue would be distributed. It is an extraordinary leap of faith to set forth a goal of replacing more than \$11 billion in school revenues with unspecified replacement by state taxes. Not only would schools object to the lack of a distribution plan, taxpayers should also object to a plan that sends significant new revenue to Harrisburg with no knowledge about how it comes back to their school district.
3. The bill would impose a more complex transition period in which school property taxes are only partially eliminated. In fact, if the goal is to eliminate property taxes SB 1400 fails. Not only is there a transition year gap but in years following there is still school district property taxes (as well as municipal property taxes). As a result there is no savings in terms of eliminating the all the local assessment functions.
4. From our review of the PA Department of Revenue's projection of revenue created by SB 1400 there will not be sufficient revenue to eliminate property taxes—the numbers just do not add up. The DOR data indicates that even by 2016-17 there would still be a shortfall of more than \$840 million to eliminate current school property taxes. Further if all discretion for local taxes is removed, will the Commonwealth guarantee that it will fund not half, but 100% of the spiraling increase in the cost of pensions, not to mention healthcare?
5. School budgeting will become chaotic as school funding is determined year to year in a last minute fashion as the state budget is finalized. Now more than ever schools need predictability in crafting more complex school budgets.
6. Schools need stability to continue to balance growing expenditures and reduced state resources. This legislation removes any stability by taking away the largest tax source and more importantly a front-ended revenue stream that assures revenues at the beginning of the fiscal year. Cash flow needs alone will send many districts into emergency borrowing if simultaneously front-end local revenues are replaced with evenly distributed state revenues. With districts spending fund balance at alarmingly levels, there will be no financial buffer to allow for this drastic change in cash flow.
7. Thousands of hours of implementation and savings now going into the state mandate to implement Act 32 (countywide EIT collection) are wasted. By allowing the Earned Income Tax by referendum only the time, effort and resources to create countywide income tax collection mechanisms in each county just two years ago was not needed.
8. We don't see any guarantee that schools will not see a cut in their property tax reimbursement when the next recession creates a reduction in state PIT or Sales Tax revenues. Would schools be stuck with the only option of going to the taxpayers in a recession and asking for an income tax increase? If the answer is yes, then we need a lot of other solutions including the ability to address long-term collective bargaining obligations that may be in place.

If the real intent of SB 1400 is to address residential property taxes then we suggest that throwing the baby out with the bathwater is not justified and not necessary. With a redistribution of gaming monies we could target seniors for additional homestead/farmstead exclusions.

Perhaps more ambitiously, the residential property tax could be replaced by a local Personal Income Tax while keeping the real estate tax for commercial and industrial properties.

In its present form SB 1400 is a drastic and unworkable departure from our current method of funding education. It is drastic from the perspective that the local property tax base that gives local officials some degree of local discretion for addressing local priorities will be cast off and replaced with a state controlled tax base where local dollars are returned back to where they were collected. This legislation not only shifts the tax burden but it shifts control of education from the local level to the state level.

I would be glad to respond to your questions after Mr. Vensel's remarks. Thank you again for the opportunity to present our views on this important issue.

ABOUT PASBO

www.pasbo.org

Smart Business + Informed Decisions = Great Schools

The Pennsylvania Association of School Business Officials (PASBO) is a statewide association, 3,000 members strong, devoted to helping the business of schools stay on the right track through education, training, professional development and timely access to legislative and policy news. Our membership base covers school professionals working in finance, accounting, operations, facilities, transportation, food service, technology, communications, human resources, purchasing and safety services. While diverse in areas of specialty, all members share a common goal - to support classroom learning in schools during good and bad economic times through smart business practices. PASBO helps make that goal a reality.



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Testimony on Senate Bill 1400
Richard R. Vensel, Business and Operations Manager, PRSBA, MBA
South Middleton School District
July 26, 2012

Chairman Brubaker and Members of the Senate Finance Committee:

Thank you for inviting PASBO to testify on Senate Bill 1400. My name is Rick Vensel, and I am the Business and Operations Manager for South Middleton School District, located in Cumberland County, Pennsylvania.

I also serve as an adjunct professor in the Department of Educational Leadership at Shippensburg University and Widener University teaching graduate level educational school finance. When Act 1 of 2006 was enacted, I was the Business Manager for one of the largest school districts in Pennsylvania to initiate, by public referendum, the shift of increased Earned Income Tax rates for decreased real estate tax. I also served as Chair for PASBO's Act 32 Committee which worked on the change in the collection of Earned Income Tax in Pennsylvania based on Act 32. Additionally, I also served on DCED's Act 32 Implementation Committee.

The tax equity to support education has been and always will be debated. How to successfully fund the education of children of the Commonwealth is the basis of Senate Bill 1400.

Several laws have been enacted over the past fifteen years in attempts to change the funding mix and taxation authority of school districts. Act 50 of 1998, Act 72 of 2004 and Act 1 of 2006 all represent legislation that addresses this issue. All of these acts incorporated the homestead/farmstead exemption process.

My testimony is based on what we have learned from the past legislation, and what we need to consider in designing taxation as is proposed in Senate Bill 1400.

In considering taxation to fund education, several questions need to be asked:

1. The ability to collect the tax;
2. The ability to administer collection of the tax;
3. The consistency and reliability of the revenue source;
4. When distributing revenue to local school districts from the state, what methodologies should be used; and
5. What is the most equitable form of taxation for taxpayers?

These issues are essential in determining how to effectively and adequately provide educational funding for the children of Pennsylvania.

Real estate taxes have historically been the major local revenue source for local educational funding. It has proven to be a reliable source of revenue, collected with relative efficiency by tax collecting bodies, but is, in many ways, inequitable for many classes of taxpayers.

If real estate taxes were totally eliminated in South Middleton School District as proposed by Senate Bill 1400, thirty-five percent of our real estate tax revenue would need to be shifted to the individual taxpayer in one form or another. To eliminate this potential tax shift, a methodology would need to be implemented, as the Homestead/Farmstead exemption, to provide the real estate tax relief. This is the present method used for real estate tax reduction in Act 1 and is used for the distribution of slot machine money and earned income tax money to reduce real estate tax.

Earned Income Tax, the second major source of local revenues for local educational funding, has been established through a combination of Act 511 of 1965, Act 24 of 2001 (elimination of the Occupational Assessment Tax) and of Act 1 of 2006. Act 1 presently gives districts the ability to increase their income tax rates to relieve real estate taxes.

Senate Bill 1400, which proposes to increase the income tax rate to alleviate real estate tax, offers two different income taxes: the Personal Income Tax or Earned Income Tax.

Personal income tax has been an option for local educational funding through public referendum since Act 1 of 2006, but to date no school district in Pennsylvania has enacted a personal income tax. While personal income tax does more equally represent the “ability to pay concept”, it is not a viable option for school districts if we continue to have dueling income taxes with different bases and different collection requirements. We should have one or the other approaches on income but having both income tax options is inefficient.

A local Earned Income Tax, which would be collected through County’s Tax Collection Committee (TCC’s), based on Act 32, can effectively be collected at the local level because of the new Act 32 mechanisms in place. Local TCC’s have the ability to access State tax records to assure appropriate collection. Combined with the new requirements in Act 32, we have in place the opportunity to make the Earned Income Tax collection effective and efficient. Again, both taxes have benefits but we should have state policy that provides a single option so we don’t further fragment the local tax structure.

School districts have the option, through Act 1, of swapping real estate tax for income tax through appropriate referendums. This option, although having limitations, can also serve to eliminate real estate taxes. In the 2007 referendum which every school district participated in, only eight of five hundred school districts approved the switch through referendum. At that time I was the Business Manager for the Chambersburg Area School District, where one of the largest changeovers was completed.

Although the transition was challenging and burdensome, it was an effective method for increasing funding through the Earned Income Tax while applying real estate tax relief through the Homestead/Farmstead Exemption. Several issues in this changeover must be managed such as revenue cash flow delays and other operational issues, and while not perfect, every school district in Pennsylvania currently has this option, on a biannual basis, to swap out a limited portion of real estate tax for income tax.

A sales tax, as proposed in Senate Bill 1400, is an effective value added tax by which to fund education. This tax which would need to be collected at the State level would have the challenge of determining how the revenues would be equitably distributed between school districts. One potential way this could be distributed is through the Homestead/Farmstead Act.

In conclusion, while the Senate Bill 1400 has some valid concepts, several of the elements in the bill would be burdensome or non-functional:

1. The element of total elimination of real estate tax. Elimination of real estate tax not using the homestead/farmstead act would shift a significant burden of taxation to residents/individuals and away from commercial concerns.
2. Dual local income taxes are not a viable option for local educational funding since we would have different collection processes and more confusion by taxpayers.
3. A sales tax or value added tax could be an effective methodology to fund education.
4. In addition, mechanisms exist in Act 1 for communities to reduce real estate taxes by increasing Earned Income Tax, should they desire.

Thank you for the opportunity to share my view on this Senate Bill 1400 and I am available at this time or at any time in the future to answer your questions.