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## What Is A Good Balance of Local Taxes?

Timothy W. Kelsey, Ph.D.  
State Program Leader, Economic and Community Development  
Professor of Agricultural Economics  
Penn State Cooperative Extension  
The Pennsylvania State University

It is important for local governments to use a balanced portfolio of local taxes, matching the strengths and weaknesses of different taxes to spread the tax burden fairly across taxpayers and to ensure a reliable source of revenue. How well they're able to do this depends in large measure upon state law; Pennsylvania municipalities and school districts have a wide range of local tax options, but county governments currently lack any effective alternatives to the real property tax (*see Research Brief Four: "Which Taxes Can Counties Use?" for more information*). It's similarly important to balance tax with non-tax revenues, such as intergovernmental transfers, user fees, and departmental earnings.

Throughout Pennsylvania tax reform efforts of the past ten years, the General Assembly and Governor consistently have tried to give school districts additional local tax options, in part to help them create a better balance of local taxes. Most of the tax reform initiatives tried to make significant cuts in school property taxes, with a few aimed at total elimination, in each case by trying to reduce reliance on that tax by spreading the tax burden across other local taxes — and, most successfully, by stepping outside the taxation model and resorting to gaming revenue.

### Why Haven't Tax Reform Efforts Eliminated The Real Property Tax?

The real property tax has some very important characteristics, which make eliminating it difficult.

1. The real property tax is relatively shielded from local business cycles, so it provides a steady source of revenue.
2. In many Pennsylvania communities, the real property tax is the only local tax paid by businesses and non-residents. The real property tax helps spread the tax burden across a wide range of taxpayers, including local businesses, non-resident property owners, and others who require public services. Relying instead only on taxes paid by residents, such as local income taxes, means these other property owners will pay little or nothing for local services. Even though it isn't perfect, the real property tax plays an important role in balancing taxation between residential and commercial, non-resident, and other taxpayers.
3. Under Pennsylvania law, the real property tax essentially is the only tax whose tax rate can be adjusted easily in response to changing revenue needs. This flexibility is important for local jurisdictions because they need the ability to adjust to changing service needs and economic conditions. Recent tax reform efforts such as Act 50 of 1998 and Special Session Act 1 of 2006 have only addressed the schools' share of local property tax bills, and did not fundamentally change this important role of the real property tax, although they did give voters the ability to approve or disapprove large tax increases.

In addition, some economists argue that the real property tax is fair if you consider lifetime income. The value of the house someone owns is based upon the person's earning and income across many years, not just in any one year, so economists argue it is not appropriate to compare the tax bill to someone's income in any one year. Pennsylvania has the second largest proportion of elderly of any state and this creates difficulties in some communities because it means there are fewer working-age residents to pay local income taxes. This also means the tax burden for an income tax-based government will fall upon an ever-shrinking proportion of the population. This will become a greater issue in the future as demographic trends continue.

## Can The Real Property Tax Be Made Fairer?

Even if the real property tax cannot be totally eliminated, there are ways that it can be made fairer, reducing some of the concerns about its impact on specific taxpayers. These actions include:

1. Consistent, quality reassessments. The real property tax is only as fair as the values used to calculate individual taxpayer's bills. Regular and consistent reassessments help keep those assessed values fair within and across jurisdictions. Unlike most states, Pennsylvania law does not require regular reassessments, which means when it occurs it is costly and easily becomes controversial.
2. Targeted tax reductions to property owners for whom the real property creates special burdens, such as:
  - Low-income seniors (currently done through the state's Senior Citizen Property Tax and Rent Rebate assistance program)
  - Homeowners through homestead exclusions (if funded by the local jurisdiction)
  - Farmers through "Clean & Green" and through farmstead exclusions (the latter if funded by the local jurisdiction)
3. Tax base sharing to equalize differences between jurisdictions. One significant reason the local tax burden currently is not fairly distributed across Pennsylvania is tax base differences between jurisdictions; wealthy jurisdictions tend to have lower tax rates than do less well-off jurisdictions, regardless of how the county, municipality, or school district is managed. This results in significant tax fairness and service quality inequities across Pennsylvania communities. Residents in poor jurisdictions often pay higher tax rates than those living in wealthier communities, but yet get poorer service since the high tax rates still yield lower revenues per capita.
4. Maintain tax effort across classes of property. Some policy decisions reduce tax effort for different sectors of the property tax base. For example, economic development tax incentives may reduce property taxes for the commercial or industrial base, or preferential assessments can reduce taxes for the agricultural sector. With less tax dollars coming from other sectors to fund government services, these well-intended policies can increase residential property taxes.

## How The Real Property Tax Is Reduced Has Important Fairness Implications

How the real property tax is reduced has an important fairness implication for who benefits from tax reform. There are two basic ways the tax could be reduced in Pennsylvania; the real property tax rate could be reduced, affecting all taxpayers, or the tax breaks could be targeted to homeowners and farmers via the Homestead and Farmstead Exclusion.

Reducing the real property tax rate gives a tax break to every property owner in the jurisdiction, including local businesses, non-resident property owners, industrial properties, and camps. The size of the tax break for individual property owners will vary directly by the value of their property; properties that are worth more will receive larger dollar tax breaks than properties that are worth less. The large 'big box' retail store, for example, will receive a significantly larger tax break than will a typical homeowner or small business, because the assessed value of the store is much more than the value of a typical home or small business. In addition, if the tax reductions are paid for through higher income or sales taxes paid by residents, residents will be paying higher taxes to give tax breaks to local businesses, vacation homeowners, and other non-residents. Indeed, statewide about 21 percent of such tax reductions would go directly to businesses.

Concern about balancing tax burden between residents and business is one major reason the General Assembly authorized Homestead and Farmstead exclusions. These target tax breaks to homeowners and farmers by reducing the assessed value of their property, thus reducing their taxes. The exclusions are a flat dollar reduction per property, irrespective of the value of the home, so every eligible taxpayer receives the same dollar savings. In addition, jurisdictions are constitutionally prohibited from raising other taxpayers' property taxes to pay for the Homestead/Farmstead.

### For More Information

Timothy W. Kelsey, Ph.D.  
State Program Leader, Economic and Community Development  
Professor of Agricultural Economics  
Penn State Cooperative Extension  
The Pennsylvania State University  
105 Armsby  
University Park, PA 16802  
814-865-9542  
[tkelsey@psu.edu](mailto:tkelsey@psu.edu)

Kristen Goshorn  
Government Relations Manager  
County Commissioners Association of Pennsylvania  
17 North Front Street  
Harrisburg, PA 17101-1624  
717-234-7554  
[kgoshorn@pacounties.org](mailto:kgoshorn@pacounties.org)

Or visit us at <http://www.economicdevelopment.psu.edu/taxes>.