Eliminating the Property Tax

By: Joshua Vincent

As the first punches from Covid 19 landed on state and local government revenues in spring 2020, it was clear that the virus's impact, compounded by mandated shutdowns, blew holes in budgets. Public health and the economy both slumped quickly, draining revenue for essential services. Tax holidays gave the illusion over the early summer that the nation could bounce back soon. Well, no.

It all depended on perspective. Think tanks such as The Tax Foundation, which pulls in the direction of broader-based sales and use taxes, looked at the rosy April to June receipts, barely considering that panic buying had a lot to do with it (How much toilet paper do you have?). The American Enterprise Institute predicted a several years-long depression in income tax receipts (notwithstanding the reality that low-income workers have borne the brunt of unemployment). Brookings observed that while sales taxes were cratering (along with levies on hotels, air travel, and amusement), the property tax was still holding the fort, observed by dozens of local to national studies. The Tax Foundation grudgingly acknowledged that the few states with a real property tax had maintained robust tax collections. In the narrow spectrum of center-left/-right perception, all would be well, but lousy, into 2022.

The stability of the property tax in this crisis has been overlooked. The few states that do have a real property tax are doing just fine, thank you. Municipalities with higher than average tax levies on wages and sales are suffering more than cities that kept property taxes front and center as revenue sources, like Boston.

There are still narrow interests in the middle of all this evidence trying to roll back this crucial revenue source. The self-regarding tax protesters of Pennsylvania haven't given up!

Should we eliminate the property tax? Not that again!

Recently, an active and conservative member of the Republican Party in central Pennsylvania sent us a copy of something called the "Property Tax Independence Act" (PTIA) with the portentous subtitle of "Liberty Equality and Prosperity." More accurately, the legislation, a proposal for a constitutional amendment in the state of Pennsylvania, is given the sentimental sobriquet of "House Bill 1776." As yet, this is not an actual bill, however. Long story short, the PTIA wants to eliminate the property tax and cut off schools (And cities).

Moves to eliminate the property tax have been frequent in recent decades. As a rule, actual elimination is rare. Some putative tax relief bills and constitutional amendments (such as Proposition 13) passed with disastrous results. Passionate defenders of Proposition 13 take on the tone of bitter-enders who see the writing on the wall, as their gravy train goes off the tracks.

Yet, CPTR has always researched and helped implement programs that reduce taxation pressures on all strata of society from poor to prosperous. We also believe that a functioning market system, coupled with a stable and efficient revenue system, in the end, is the best option for the government. State and local government fiscal wonks quiver in their cubicles as federal aid dries up, never to return.

The Commonwealth of Pennsylvania is a relatively high-tax state. The nonpartisan Tax Foundation has consistently placed Pennsylvania around 15% of state and local tax burden from 2003 to 2016 (last year available). However, blaming the property tax, while fashionable and certainly knee-jerk, does not withstand scrutiny. Again, using Tax Foundation figures, the Pennsylvania property tax share of state and local revenue is 29.9%. That places Pennsylvania in the middle of the pack at 22nd-highest, and significantly below the national median of 32.4%.

All property taxes are local.

That heading is accurate, and that's not necessarily good news. One unappreciated fact about property taxes is that it is a local tax and responds to the local environment. Citizens CAN have an impact, for good or ill. A Pennsylvania state legislator or County Commissioner from an area close to a state border like Maryland sees growth from inflow, with attendant increased government spending that is contrary to decades of tradition. We shouldn't be surprised when the newbies want goodies.

Most Pennsylvanians live in rural areas with one big town, usually serving as the county seat. It might surprise a citizen of Blair County, for example, that the property tax burden in that county comes in at 1,089 out of the nation's 1,823 counties. Yes, the property tax is a bargain in Blair, Elk, Cameron, and many other rural and aging counties in Pennsylvania. Eliminating the property tax will launch these affordable places into uncertainty with a statewide system that surely won't be one-size-fits-all.

Looking at every tax in use is key to understanding the relative lack of competitiveness that Pennsylvania has. The Pennsylvania income tax is flat and wage-based; it captures revenue from the poorest wage earner. State and local income taxes boost Pennsylvania's US standing to number 16 in the US. Pennsylvania suffers broadly higher than average business income taxes. Also, a dog's breakfast of nuisance taxes generally increases the cost of doing business without bringing any significant revenue for necessary government expenditures.

The Spirit of 76?

Tax protesters put the economic and human costs squarely on the property tax while ignoring Pennsylvania's other, far more harmful taxes. The solution proffered to the property tax "problem" is to increase the sales tax (or the state income tax). Their boilerplate handouts claim that cross-border sales jumping will not occur because neighboring sales taxes are higher than Pennsylvania, which is 6% statewide. The document does not count local levies, as it does for localities in New York State, thus excluding taxes like Philadelphia's extra 2% sales tax, as an example

Pennsylvania's 6% rate is higher than Ohio's 5.5%, the same as Maryland's 6%, a little under New Jersey's 6.625%, and higher than New York's state rate of 4% (leaving out eye-watering local levies like New York City's of 4.875%). And who can forget Delaware's sales tax of 0%? Shoppers in the six-county Southeast Pennsylvania area sure don't

The PTIA bill would have to raise about $25 billion a year to replace the school property tax. The plan would have to increase the sales tax rate by at least several percentage points. Pennsylvania would become less competitive and certainly hit small businesses hard. They have to do their commerce inside Pennsylvania cities, towns, and boroughs. Among the goods taxed under this program would be food, textbooks, flags, horses, and services like trucking, funeral parlors, cable TV, veterinarians, etc. You get the picture.

Other States' Property Taxes.

An underpinning of the rationale to eliminate the property tax is that people leave Pennsylvania because of property taxes. There are many reasons people are leaving Pennsylvania, but property taxes are not one of them. Pennsylvania is gaining.

Let's go back to the assumption that regional tax competition is real, as it likely is. New Jersey indeed has very high property taxes, high enough to cause real distress, especially in the face of very high income, sales, and business taxes. New Jersey is almost an outlier when it comes to levels of taxation on investment and work.

Yet, when we look nationally at states that rely on one tax more than others, differences begin to tell. For example, states that dodged the Great Recession - like Texas, New Hampshire, Nebraska, and the Dakotas - have historically high property taxes coupled with minimal to no income tax.

Historically poor states like New Mexico, Louisiana, and Mississippi, have relied to a far higher degree on local and state sales taxes. Why? They use semi-feudal 19th Century tax systems still based on race and class-based separation. They still ladle up privilege to landed wealth and near-monopoly business.

These states have lousy schools, lousy public health, terrible infrastructure, and, overall, are not great places to build a future. It is doubly true if trying to raise children and grow your family's wealth.

Income taxes

The bill also swaps out locally controlled and collected income taxes (which citizens can theoretically battle at the municipal level) to a newly increased statewide personal income tax. Proponents don't even know the tax rates they want, but they're not letting that stop them.

Pennsylvania is top-heavy with retirees. A one or two-point increase in the income tax will put the Commonwealth into Connecticut, California, and Ohio territory for income tax burden. The numbers don't add up. In a flat tax state, the PTIA protesters now suggest a tax on retirement income. Floated by an HB1776 allied member of the General Assembly. What a Hail Mary. How does taxing retirement income helphe senior citizen demographic?

In the next segment, we respond to the high-flying predictions of what the Property Tax Independence Act offers up.

HB1776 has a 10 point plan for changing the Pennsylvania Constitution. Let's open Pandora's box.

1. "Achieve true homeownership."

The idea here is that you don't own your own home because if you don't pay your property taxes, you lose it. Very accurate, but a non sequitur. If I do not pay my income tax, which seems okay under the PTIA plan, I bet I go to jail. That's true of all taxes, not just the property tax. It also applies to the real world of free markets: if I decide I don't want to pay my mortgage or the loan on my car, the lenders who have taken a risk on me repo the house or car. Are the proponents of this bill going to start suggesting that you don't own your home or car unless we can eliminate the debt you assumed? This logic could go to some strange places.

2. "Stabilize school funding."

The two taxes chosen for PTIA, the income tax and the sales tax, are the first revenue sources to disappear during a recession. It's as accurate in Pennsylvania as elsewhere. The property tax is, without question, stable. As this pertinent quote from the state Department of Taxation in Minnesota indicates:

> *"The three major sources of revenue are the state income tax, sales tax, and property tax. The income tax is the most unstable and unpredictable. The sales tax is relatively unstable because it exempts several major categories of personal spending, such as clothing and most services. The property tax is the most stable.*

3. "Help prevent foreclosures."

Yes, residential property taxes during times of financial stress can exacerbate foreclosure numbers. Our proposal to restructure the tax helps the situation. However, taxes, as a component of the mortgage, are usually modest. Of course, a higher income tax burden reduces the amount of mortgage one can get from the bank. Hence, the property tax *per se* was not a direct factor in the foreclosure crisis of 2007/8: unemployment was.

4. "Restore plummeting real estate values."

Ask a Pennsylvanian in a town like Sharon if real estate values dropped due to property taxes, or because the city has lost about half of its population. The decline of Pennsylvania's manufacturing base has pushed our youth and families to states like Texas and Florida, not taxes.

Replacing the property tax would likely produce a capitalization effect for investment properties encouraging conversion of single-family homes to rentals. Most Pennsylvanians would not say that's a good thing. We also suspect the evidence shows increases in state income tax rates have a more direct effect on reducing property values.

Meanwhile, New Jersey is not known for low property taxes (or any other tax for that matter). Yet, the Garden State enjoys a robust statewide real estate market while Covid 19 rages on.

5. Boost the sagging housing market."

Yes, a straight reduction in property taxes in a vacuum might make an area like a neighborhood or block cheaper. Slim chance. States renowned for low property taxes like Hawaii or California encourage inflationary property prices, which price many out of the market. HB 1776 is not a tax or revenue cut: it's a tax swap from fixed and immobile assets to mobile assets like sales, wages, and other taxes on work and investment.

6. "Attract businesses to Pennsylvania."

Low taxation on investment capital would attract business, particularly from high tax states like New York and New Jersey. Yet the tax penalty on increasing sales and use taxes and a tax penalty of a higher state income tax will contribute more drag than lift to the economy.

7. "Generate jobs for Pennsylvanians."

“The property tax is the second-largest fixed cost for Pennsylvania business owners,” is asserted in the piece. Why was job creation throughout the Great Recession (plus before AND after) in Texas higher than any other state? Again, Texas is number one in property taxes as a percentage of property value. High-income taxes in a geographically circumscribed geography reduce the amount of employment in that area. In other words, Pennsylvania may run the risk of job loss, like Philadelphia experienced in the past five decades.

8. Create a massive stimulus for Pennsylvania."

It is unclear how a stimulus can happen when swapping out one tax for another tax (or taxes) without addressing the expenditure side. The literature on the PITA produced thus far indicates a revenue swap, with savings going to a small subset of property owners: the vacant lot, absentee landlord, or speculative landowner. Everyone else will shoulder the hidden burden of the sales tax or state income tax. Money lifted from homeowners' wallets cannot create a stimulus, much less help small to medium businesses, now groaning under higher sales and use taxes. Once again, the numbers don't work.

9. "Increase personal wealth."

See above for most of the answers, but Americans traditionally didn't consider a home purchase to be an investment. Free and easy credit, skilled marketing by mortgage lenders, and quasi-official federal government agencies fed a delusion that one's home is also one's casino. Home purchases ought to be a relatively inexpensive matter relating to the goal of shelter for one's family. Anyone will do better in the stock market.

10. "Stop costly reassessments."

This supposed benefit of the PITA is irrelevant and confusing for several reasons: most Pennsylvania counties have resisted revaluation for decades. When reassessment does occur, it is with years-long lags, thereby increasing the expense and dooming assessments to a nationally recognized out-of-whack system. Most states and counties across the United States revalue on a reasonably consistent basis, without increasing expenditure. A free-market solution to reassessments would employ Realtor and property insurance databases, which will continue valuing land and buildings, as no market can operate without this information.

Observations and Alternatives

The sponsors of HB 1776 pointed to the one state that was considering eliminating its property tax in recent years. North Dakota is one of the most sparsely populated and agricultural states in the USA.

Note: ND *WAS* considering a change to its constitution to eliminate the property tax. Many in that state cautioned against a simple (or simplistic) solution. The property tax dumpers' vision is that North Dakota's coffers are full of revenue from gas, oil, and other natural resources. That won't last forever and is in a long trough.

North Dakota would be scrounging for revenue streams to pay for the basics with the property tax eliminated. After all that drama, citizens would still be subject to statewide income, business, and sales taxes. One-size-fits-all? No. Just like HB 1776 (and California after Prop 13), after Saturday night, comes Sunday morning.

In our federal system, the states are indeed the laboratories of future policy. The differences between North Dakota and Pennsylvania are extreme, however. There is no natural – or Commonwealth – resource tax in Pennsylvania. The population of Pennsylvania and the infrastructure within are many magnitudes larger than North Dakota's. Apples and kumquats. Also ignored by the tax rebels: the North Dakota measure failed at the voting booth! And wouldn't you know it, though thrashed at the polls, they're going to try it again? In a sense, perhaps North Dakota should have passed the measure, so that other states can see what happens.

The property tax, as constructed, is indeed lousy. In Pennsylvania, the property tax falls disproportionately on what people do with their dimes and their time. The property tax is two taxes, as it is a tax on land value and a tax on building value.

The tax on land values is the only tax that collects what a community creates. What do we mean by that? It means that with every police department, fire department, and yes, excellent schools, land values increase. No individual and no company spark land value increases. All of us create land value.

Commonwealth's meaning implies an environment in which to make a living, be a success, be happy, and be legally secure in what you have earned with your labor and capital. The corollary is that Commonwealth provides for all, not just a few.

The other part of the property tax, the tax on buildings and structures, is corrosive to prosperity and freedom, much like the worst income tax, business tax, or sales tax. As we all know, when you buy a house or fix it up or build one from scratch, your tax liability increases significantly. On that, we can all agree.

That's why Pennsylvania has the Keystone Opportunity Zones (KOZ), a confused, privileged, and clumsy subsidy program to get out from under a broad-spectrum lousy tax system.

Pennsylvania must chart a careful, yet daring course to a place that encourages economic growth, and reasonable level of government, and leaves people alone.

Don't trade one lousy tax for a basket of corrosive taxes. Pennsylvania must expand the land value tax, so Pennsylvania resembles nations that encourage economic freedom and broad-based prosperity like Australia, Singapore, and Hong Kong.

The land value tax serves 20 cities and school districts in the state of Pennsylvania. In jurisdictions like Clairton and Aliquippa, property taxes were cut for some homeowners up to 70% a year. And all of this without resorting to other, higher taxes. Instead, needed revenue comes from land value, an immobile source of community income created by local effort, taxes, and community. We have seen the future, and it's not 1776.

Red Herring Alert! Pennsylvania's real estate values increased at an annual rate of 3.44% since 2000![i]

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[i] https://www.neighborhoodscout.com/pa/real-estate