



# New Handbook Finds Pennsylvania Tax and Spending Levels Moderate and Stable Over Time

## PBPC Releases Primer on State Tax System

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Pennsylvania ranks favorably when compared to the nation and to competitor states in overall tax and spending levels, according to a new report from the Pennsylvania Budget and Policy Center (PBPC).

Pennsylvania state taxes, when measured as a share of state personal income, ranked 32<sup>nd</sup> among the 50 states in 2005, while state spending ranked 30<sup>th</sup>. Pennsylvania taxes were 6.3 percent of state personal income, a half-percentage point less than the average of competing states.<sup>1</sup>

But Pennsylvania's tax system is highly regressive, taking a significantly larger share of the incomes of the poorest 20 percent of earners than of the incomes of more affluent Pennsylvanians. The bottom fifth of earners paid 12.3 cents in taxes on every dollar of income, while the top 1 percent paid only 4.3 cents.

PBPC's new report, *The Common Good: What Pennsylvania's Budget and Tax Policies Mean to You*, is an easy-to-read guide to state and local taxes and Pennsylvania's budget process. It is a resource for policymakers, journalists, advocates and all Pennsylvanians. It can be viewed online by [clicking here](#).

The report finds that, over the past three decades, Pennsylvania state government taxes have held steady as a share of income, while state expenditures have stayed below the national average for 27 of the last 30 years.

The report argues that investments in public goods, including public and higher education, workforce development, and transportation, make a vital contribution to the state's economy and are critical to economic growth.

The report puts the larger discussion of the state budget and taxes in context by showing that Pennsylvania spending and taxes are both competitive and necessary for the state's economy to grow.

### Among the Report's Major Findings

- **State Taxes Are Relatively Low:** The personal income tax rate, at 3.07 percent, is the second lowest top rate in the country, while the 6-percent sales tax in all counties but Philadelphia and Allegheny (which have a 7-percent rate) is in the middle range of all states. The corporate net income tax rate of 9.99 percent is relatively high, although loopholes in the law (and other factors) mean that 71 percent of companies don't pay any of that tax.
  - Pennsylvania state taxes and spending are less than a majority of U.S. states when measured as a share of state personal income. In 2005, state taxes were 6.3 percent of personal income, ranking the state 32<sup>nd</sup> in the nation.
  - Pennsylvania state taxes are less than competitor states. New York and Ohio had slightly higher rates as a share of personal income, while Delaware exceeded 8 percent and West Virginia hit 9 percent.

1. State personal income measures a state's economic activity. It includes the total of all wages, salaries, employer-contributed pensions and insurance, business earnings, rental earnings, dividends, and interest earned by commonwealth residents.

- **Pennsylvania Relies Heavily on Local Taxes:** Pennsylvania state and local taxes combined rank 21<sup>st</sup> nationally, at 10.7 percent as a share of personal income, compared to 32<sup>nd</sup> nationally for state only taxes. This reflects a heavy reliance on local taxes, and especially on local property taxes, to fund public services.
  - In 2005-06, local governments and school districts relied on property taxes to fund 71 percent of services and public education.
- **Local School Districts Shoulder Large Share of Public Education Funding:** Pennsylvania, in fact, ranked near the bottom, 47<sup>th</sup>, in the share of state funding for public education. In 2005-06, 57.1 percent of all school funding was raised locally by school districts, while the national average for local support of schools was 44.4 percent. That has created school funding disparities across Pennsylvania's 501 school districts.
- **Local Property Taxes Are Comparatively Low But Contain Significant Disparities Across Districts:** Across the state, property taxes average 3.1 percent of personal income, compared to 3.3 percent nationally, 3.3 percent in Ohio, more than 4 percent in New York, and 5 percent in New Jersey.
  - At the same time, average property tax rates on residential property can range from 0.9 percent to 9.7 percent of personal income across Pennsylvania's 501 school districts. It is not uncommon for poorer school districts to have higher school property tax rates than more affluent districts in the same county.
- **Pennsylvania's Tax Structure Squeezes Low-Income Workers:** Low-income Pennsylvanians, living paycheck to paycheck, pay much higher percentages of their income in taxes.
  - The lowest quintile of Pennsylvanians spends 2.5 percent of their income on sales tax, while the wealthiest fifth spend 1.5 percent or less.
  - Overall, the poorest 20 percent pay nearly three times their share of income in state and local taxes than the richest 1 percent—12.3 cents out of each dollar of income compared to only 4.3 cents for the richest families (once you take into account that state and local taxes reduce federal taxable income for most affluent families). Middle-class families also pay a higher share of their income in state and local income taxes than the wealthiest 20 percent.

## A Regressive Tax Structure

The commonwealth has one of the most “regressive” state and local tax systems in the nation, based on the share of income paid in state and local taxes by poor vs. affluent families. One reason for this is Pennsylvania's flat personal income tax rate.

While most states have graduated income taxes that assess higher rates on affluent earners than on middle-class and low-income families, Pennsylvania's Constitution requires all earners (except for the poor and elderly) to be taxed at the same, or “uniform,” rate. That prevents Pennsylvania from using a progressive income tax. As a result, lower-income workers end up paying a bigger chunk of their paychecks in taxes than wealthier Pennsylvanians, contributing to the overall unfairness of Pennsylvania's tax structure.

The report proposes that policymakers consider an amendment to the state Constitution so that a graduated income tax could be introduced to Pennsylvania. That would tax the income of wealthy earners at a higher rate than lower-income workers.

## Toward a Stable Tax System

The report suggests the state needs a stable stream of revenue that grows over time to keep up with the cost of services, and highlights challenges to a stable tax system. They include declining corporate tax revenue, the aging population, and a tax system that has not been comprehensively updated and reformed in generations. To address these issues, state policymakers should:

- Review tax exemptions and tax credits for effectiveness.
- Close loopholes in the corporate net income tax system that allow multistate and multinational companies to hide Pennsylvania earnings in lower-tax jurisdictions. That would generate \$616 million a year, according to the Department of Revenue.
- Broaden the state sales tax base to include currently exempt luxury items and expand tobacco taxes to include smokeless tobacco. Pennsylvania is the only state that does not tax smokeless tobacco.
- Implement a “severance” tax on the extraction of state resources from the ground, such as natural gas. Estimates show that such a levy on natural gas drilling could raise \$200 million in new revenue annually.

To learn more, you can download a copy of *The Common Good: What Pennsylvania’s Budget and Tax Policies Mean to You* by [clicking here](#). If you would like PBPC to send you a copy of the new tax and budget policy handbook, [click here](#) to fill out a request form.