

**Pennsylvania
Economy League**

State Office



Who Pays for Education?:

**A Comparative Analysis of the Contribution of
Business vs. Non-Business Taxpayers in the
Commonwealth of Pennsylvania**

May 2002

Table of Contents

INTRODUCTION.....	1
Purpose	1
Methodology	1
Caveats and Limitations	2
THE RESULTS.....	4
State Level Taxes and Spending – Business vs. Non-Business.....	4
Local Taxes – Business vs. Non-Business	6
Real Estate Taxes	7
Earned Income Taxes	7
Gross Receipts Taxes.....	8
Other Taxes.....	8
Total School District Taxes	8
State and Local Taxes – Business vs. Non-Business	9
FINDINGS AND CONCLUSIONS	10
Summary of Findings	10
Conclusions.....	10
APPENDIX.....	12

INTRODUCTION

PURPOSE

The analysis that follows addresses the issue of education funding in Pennsylvania. More specifically, it seeks to clarify our understanding of who pays how much for education in the Commonwealth with a particular emphasis on the contributions of business versus non-business taxpayers. It was sponsored by the Pennsylvania Business Roundtable, the Pennsylvania Builders Association, the Pennsylvania Chamber of Business and Industry and the Pennsylvania Manufacturers Association.

In the context of this analysis, education encompasses basic and higher education institutions and activities funded by local and state tax dollars. For the most part, these monies fund public rather than private education institutions. Notable exceptions include state basic education funding for non-public school costs such as transportation, textbooks, and technology. State funding of higher education includes grants to public, state-related and non-state related institutions and grants to students at both public and private colleges and universities. Local funding is almost exclusively directed to public K-12 education.

The debate surrounding Pennsylvania's education finance system has increased in volume and intensity over the last few years. This growing interest in education funding is motivated by a number of factors: widespread discontent with the property tax system that is the primary source of basic education funding in Pennsylvania; recognition that the state share of education spending has dropped significantly; questions of funding equity between school districts; and a growing trend among other states to address funding equity by shifting responsibility for education funding from the local to the state level.

The debate has prompted a number of pieces of legislation from both the Pennsylvania House and Senate, and the general topic of education finance has proven to be an important issue in the gubernatorial race. It seems certain that the debate will continue in the coming months, and may well result in legislative change of Pennsylvania's education financing system.

In this political context, factually based information is crucial to inform the discussion and contribute to the development of effective change. The sole purpose of this analysis, then, is to add critical facts to the debate. This work is not intended to offer opinions on the equity of education-related tax burdens, to support one side or another in the debate, or to offer policy prescriptions related to education financing.

METHODOLOGY

Business and non-business entities fund education primarily through tax payments to local and state governments. This analysis identifies the state and local tax revenues that provide education funding, and apportions that revenue between business and non-business taxpayers.

Because business taxpayers are a more clearly defined group than non-business taxpayers, we first identified how much business paid and assigned the remaining tax revenues to the non-business column. As a result, only those local and state taxes that are levied in part or in whole on business taxpayers are analyzed.

At the local level, school districts tax businesses via real estate, earned income, and business gross receipts taxes. These taxes are levied directly by the school district and represent the vast majority of local tax revenues collected for basic education. Revenue data for each tax was provided by the Pennsylvania Department of Education, with other agencies and private organizations providing information necessary to calculate the portion of revenue provided by business taxpayers. The data, from the 1999-2000 fiscal year, is the most recent available.

State tax revenues also fund education, although through less direct means than local school district taxes. The state collects a variety of taxes from both business and non-business taxpayers. The majority of this revenue makes its way to the state's General Fund, and from this source the state annually allots funding to basic and higher education in Pennsylvania.

In order to determine how much of the state tax revenue allotted to education comes from business and non-business taxpayers, we totaled state-level business taxes paid in fiscal year 1999-2000 using revenue data published in the 2001-02 Governor's Executive Budget. These business taxes include corporate net income, capital stock and franchise, gross receipts, insurance premiums, financial institutions, sales and use, personal income and other minor business taxes. We then calculated the percentage of General Fund spending devoted to education and applied that percentage to business tax revenues to determine the portion of state education spending that comes from business sources. The remainder of state education funding represents tax revenue provided by non-business taxpayers.

CAVEATS AND LIMITATIONS

In order to interpret the analysis and conclusions included here as clearly as possible, it is important to understand what the data tells us, but also what it does not tell us. This analysis compares the level of education funding provided by business against that provided by non-business entities for the fiscal year 1999-2000. It gives us a clearer picture of the relative contribution of each type of payer.

While the available data is comprehensive and accurate enough to make comparisons, it should not be used for an exact dollar accounting of how much businesses paid and how much non-businesses paid to fund education because:

- PEL uses data reported by government agencies and assumes it is accurate. There may be isolated inaccuracies, but we have no means of identifying or correcting them.
- There are some minor taxes and fees that are not individually reported and therefore not included in our accounting.

- Because available data is limited in scope and detail, in some cases the analysis uses estimates and makes assumptions in calculating business versus non-business tax payments.
- This study is not a comprehensive accounting of education funding in Pennsylvania. The analysis is limited to education revenue provided by local and state taxes and does not consider small amounts of revenue from other sources such as the federal government.
- This study does not account completely for business and non-business investment in education. Each year, Pennsylvania businesses contribute significant dollar and in-kind resources to schools and universities through grants, equipment, staff volunteer time, and the like. Furthermore, out of necessity, firms provide or fund millions of dollars worth of training for employees and potential employees. Individuals and communities also donate time and resources to local schools.

While the data on which this analysis rests is imperfect, PEL estimates that the sum of limitations described above will not significantly alter the relationship between business and non-business tax burdens. Therefore, these limitations will not negatively impact the overall conclusions presented in this report.

THE RESULTS

The three sections that follow describe the analysis and results of the business to non-business tax comparison at the state level, the local level, and the state and local levels combined.

STATE LEVEL TAXES AND SPENDING – BUSINESS VS. NON-BUSINESS

In the 1999-2000 fiscal year, Pennsylvania’s General Fund spending was \$19.3 billion. Of that total, 41.1 percent or \$7.9 billion went to education making it the largest item in the state’s budget.

The state provides funding for basic education, higher education and operations for the Department of Education (see Appendix for a specific breakdown of spending). Table 1 and Graph 1 summarize this spending. Basic education claims by far the largest portion of state education funding; it receives 77.8 percent of \$7.9 billion. Most of this money reaches public schools through basic education grants, and the remainder funds a wide variety of educational and administrative activities, from special education to school employee retirements. Higher education receives a much smaller share, 22 percent, which funds primarily the State System of Higher Education, state-related institutions, community colleges and grants and scholarships to Pennsylvania college students through the Pennsylvania Higher Education Assistance Agency (PHEAA). Less than one percent funds the General Government Operations of the Pennsylvania Department of Education.

Table 1: Pennsylvania State Education Funding, 1999-2000 Fiscal Year (\$000)

Program	Spending
Basic Education	\$6,169,601
Higher Education	\$1,738,995
PDE General Government	\$23,911
Total Education Spending	\$7,932,507

Graph 1: State Education Program Funding, Percent of Total

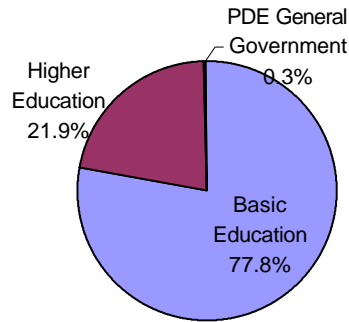


Table 2 on the next page outlines each of the General Fund tax sources and identifies revenue collected from business and/or non-business taxpayers for each source.

Corporation taxes, including corporate net income, capital stock and franchise, gross receipts, insurance premiums, and financial institutions are paid exclusively by business.

Consumption tax revenue is generated primarily by the sales and use tax that is paid by business and non-business taxpayers. A recent study¹ estimates that Pennsylvania businesses pay 36 percent of all sales taxes, and the Pennsylvania Department of Revenue agrees that the estimate is reasonable. Therefore, 36 percent of sales tax revenue is allocated to the business taxpayer column. Other consumption taxes are levied on cigarettes, beer and liquor. These taxes generate only small amounts of revenue, very little of which is likely paid by business; therefore, these totals land in the non-business column.

Personal income taxes are paid primarily by individuals. However, some income included in the personal income tax base is actually business income. For example, income earned by S Corporations is taxed not as business income but as the personal income of the business owners. Thus, businesses do pay a portion of the personal income tax. The Department of Revenue identifies the percentage of taxable personal income attributable to net profits earned by business. We applied that percentage to total personal income tax revenue to determine how much businesses pay.

All or most of the revenue generated by the remaining state tax sources is collected from non-business taxpayers.

**Table 2: General Fund Revenues,
Business vs. Non-Business Sources, 1999-2000**
(\$000)

	Business	Non-Business
Corporation Taxes		
Corporate Net Income	\$1,860,184	
Capital Stock & Franchise	\$1,083,505	
Gross Receipts	\$657,260	
Insurance Premiums	\$263,879	
Financial Institutions	\$211,983	
Other Business Taxes	\$11,065	
Consumption Taxes		
Sales and Use	\$2,526,599	\$4,491,733
Cigarette		\$272,418
Malt Beverage		\$25,776
Liquor		\$153,831
Other Taxes		
Personal Income	\$678,337	\$6,387,676
Realty Transfer		\$271,858
Inheritance		\$819,110
Minor & Repealed Taxes		\$-9,163
Total	\$7,292,812	\$12,413,239

¹ Raymond J. Ring, Jr., "Consumers' Share and Producers' Share of the General Sales Tax," National Tax Journal, Vol. 52, No. 1, (March 1999) : 79-90.

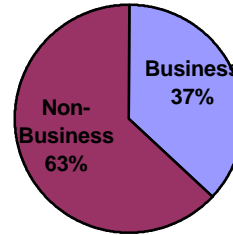
Table 2 indicates how much business versus non-business taxpayers contribute to the General Fund. It does not, however, indicate what portion of those revenues is spent on education. To determine that, we applied the percentage of the General Fund spent on education -- 41.1% -- to the tax revenues collected from business and non-business taxpayers.

Table 3: General Fund Tax Revenue to Education, Business vs. Non-Business, 1999-2000 (\$000)

	General Fund Tax Revenue	Education Revenue (41.1%)
Business	\$7,292,812	\$2,997,346
Non-Business	\$12,413,239	\$5,101,841
Total	\$19,706,051	\$8,099,187

The results in Table 3 and Graph 2 show that at the state level, businesses provide \$3 billion for education funding: \$5 billion is provided by non-business taxpayers, and, their respective contributions are 37 percent versus 63 percent.

Graph 2: Education Revenue by Source



LOCAL TAXES – BUSINESS VS. NON-BUSINESS

The major portion of funding for basic education comes not from the state, but from local school districts themselves, and most of that local funding is raised through school district taxes levied on business and non-business entities. Unlike state education funding which goes to higher and basic education, local revenue is devoted entirely to basic education with the exception of contributions to community colleges by some school districts.

In order to compare the local tax revenues from business and non-business entities, we calculated the tax payments by business and apportioned the remaining tax revenue to non-business taxpayers. Local school districts collect revenue from businesses located or operating within their jurisdiction through the real estate, earned income, and business gross receipts taxes. The real estate tax is universally applied in all 501 school districts in the Commonwealth; most but not all school districts tax earned income; and just a fraction levy business gross receipts taxes.

Table 4, below, summarizes the business and non-business collections for each of the taxes described above, as well as all other taxes levied by school districts on non-business entities.

Table 4: School District Tax Revenue, Business vs. Non-Business, 1999-2000
(\$000)

Local Tax	Business		Non-Business		Total Local Tax	
	Revenue	%	Revenue	%	Revenue	% of Total
Real Estate	\$1,605,994	24.5%	\$4,950,991	75.5%	\$6,556,984	78.2%
Earned Income	\$62,982	8.6%	\$672,795	91.4%	\$735,777	8.8%
Gross Receipts	\$42,266	100.0%	\$0	0.0%	\$42,266	0.5%
Other	\$0	0.0%	\$1,045,962	100.0%	\$1,045,962	12.5%
Total Local Tax	\$1,711,242	20.4%	\$6,669,748	79.6%	\$8,380,989	100.0%

Real Estate Taxes

School districts levy real estate taxes on all property at the same rate, as mandated by the state constitution. In order to determine what portion of the real estate tax business paid, we calculated the percentage of assessed property value that is attributed to commercial and industrial real estate in each school district². Taxes on commercial and industrial property are paid by business, while taxes on the remaining classes of property including residential, agricultural, land, lots and minerals, are likely paid by non-businesses.

To determine how much business paid in school district real estate taxes in 1999-2000, the analysis applied the percentage of assessed value attributed to commercial and industrial land to the real estate revenue for each school district. At the school district level, businesses paid as little as 3.3 percent and as much as 52 percent of real estate taxes. (See the Appendix for data on each school district.) For the state as a whole, commercial and industrial land represented 23.5 percent of the total assessed value of all taxable real estate in Pennsylvania, which translates to approximately \$1.6 billion in real estate revenue from business taxpayers versus \$4.9 billion from non-business taxpayers.

Earned Income Taxes

The earned income tax is also widely levied by school districts on both business and non-business entities. In order to determine what portion is paid by business, we used Department of Revenue data to separate taxable income into that earned by individuals and that earned by business. Non-business entities, individuals in this case, pay tax on “taxable compensation”, or income from wages, salaries, and tips minus business expenses. Businesses pay tax on “net profits” - income earned by S corporations, partnerships, Limited Liability Corporations, and sole proprietorships.

² Based on State Tax Equalization Board (STEB) data provided by Good Schools Pennsylvania.

PEL applied the percent of taxable income attributable to net profits (i.e. business income) to the earned income tax revenue in each school district to determine how much business paid. Table 4 indicates that out of \$758 million in earned income tax revenue, business paid approximately 8.6 percent and individuals paid 91.4 percent of the total.

Gross Receipts Taxes

School districts levy gross receipts taxes, which include business privilege and mercantile taxes, exclusively on businesses for the privilege of operating in a jurisdiction. Only 62 of 501 school districts levy a tax on business gross receipts. Because these taxes are paid exclusively by business, it is an easy matter of adding up the revenue to determine what business pays. In this case, the total came to \$42,265,796 in 1999-2000.

Other Taxes

For the most part, non-business taxpayers pay the remaining school districts taxes not analyzed above. These include per capita, occupation, real estate transfer, occupational privilege, amusement, and mechanical devices taxes, payments in lieu of taxes and taxes due from previous years. Although businesses pay a very small portion of these levies, data is not available to determine how much. Therefore, we included the “other tax” total in the non-business taxpayer column.

Total School District Taxes

Table 4 includes the sum total of the school district taxes described above. Pennsylvania’s 501 school districts collected \$8.3 billion in tax revenue. Businesses contributed 20.4 percent to the total, while non-business taxpayers shouldered the majority of the local tax burden at 79.6 percent.

While business pays 20.4 percent of school district taxes in the state, that average represents a broad range of responsibility. In Northeast Bradford School District in Bradford county, businesses pay just 3.4 percent of school district taxes, while in Montgomery County’s Upper Merion Area School District, business are the source of 52.3 percent of the tax revenue. (See Appendix for data by school district.) To a great extent the business to non-business tax ratio is dictated by the number of firms and level of business activity within a school district relative to the overall population wealth. With exceptions, higher business tax school districts include more suburban locations outside of large and medium-size cities, while lower business tax districts tend to be more rural in nature.

STATE AND LOCAL TAXES – BUSINESS VS. NON-BUSINESS

Table 5 below combines the results of state and local taxes devoted to education to provide a broad picture of how much business versus non-business entities pay. This analysis concludes that an estimated \$16 billion in state and local tax revenue funded Pennsylvania's basic and higher education systems in 1999-2000. Business taxpayers funded more than a quarter of that total with non-business taxpayers shouldering slightly less than three quarters of the burden.

**Table 5: State and Local Education Tax Revenue,
Business vs. Non-Business, 1999-2000**

	Business		Non-Business		Total Tax Revenue
	Revenue	%	Revenue	%	
Local Taxes	\$1,711,241,284	20.4%	\$6,669,747,157	79.6%	\$8,380,988,441
State Taxes	\$2,997,346,000	37.0%	\$5,101,841,000	63.0%	\$8,099,187,000
Total Taxes	\$4,708,587,284	28.6%	\$11,771,588,157	71.4%	\$16,480,175,441

FINDINGS AND CONCLUSIONS

SUMMARY OF FINDINGS

The analysis of “Who Pays for Education?” indicates that non-business taxpayers pay nearly three quarters of the total education-bound tax dollars. Below the aggregate level the ratios vary, but in few cases do the business taxpayers contribute a greater portion than the non-business taxpayers. For example:

- At the state level, business pays slightly more than a third of taxes; non-business payers contribute nearly two-thirds.
- Businesses pay a smaller portion of local than state taxes – 20 percent of local versus 37 percent of state taxes.
- Among the taxes paid by both business and non-business entities, business’ greatest proportional contribution is 36 percent of the state sales tax.
- The portion of total local school district taxes paid by business varies tremendously among school districts, from as low as three percent to 52 percent.

State and local tax sources of education revenue – including basic and higher education -- produce roughly equal amounts of revenue-- just over \$8 billion each. Within these totals, we find the following:

- State education spending is divided between higher education, which receives 22 percent or approximately \$1.7 billion, and basic education which receives 77.8 percent or about \$6.2 billion. Nearly all locally raised revenue funds basic education.
- Local property tax is the greatest revenue source for education, providing nearly 40 percent of these funds. No other single tax source approaches that level of revenue production.
- State and local taxes on income produce 22 percent of education-bound tax revenue.
- Sales taxes provide more than 17 percent of tax revenue going to education.
- State corporation taxes produce 10 percent of education-bound tax revenue.

CONCLUSIONS

The relationships described above can be used to provide some insight into a variety of existing proposals for school finance reform. For example, the property tax, the largest single revenue source for education, is the most frequent target of reform proposals. Because we know that non-business taxpayers provide 76 percent of real estate tax revenue, any change that reduces or even eliminates the property tax would have the greatest impact in terms of tax dollars on non-business taxpayers.

Any reduction of the property tax will require revenue to be raised from other sources. The most likely alternative sources are taxes, and a tax increase will impact the ratio of

business to non-business tax revenue and therefore the amount of taxes paid. That ratio can change significantly, depending upon the new revenue source. Alternative scenarios would shift the property tax burden to a variety of state or local taxes with the following consequences:

- If reduced property taxes were made up by increased local earned income taxes, the result would be a smaller proportion of local taxes paid by business and increased payments from non-business taxpayers.
- Proposals that would shift the property tax burden to the state sales tax would increase the proportionate burden to business taxpayers.
- A plan that would tie reduced property taxes to an increased state personal income tax would effectively shift the burden primarily to non-business taxpayers as only individuals are responsible for the income tax, with the exception of the small portion of the income tax levied on profits, which is paid by business.
- Finally, because the property tax represents that largest tax source of education funding, any proposal that reduces that tax will have to increase another tax source by a much larger percentage because it represents a smaller portion of education revenue than the property tax.

While it is certainly valuable to understand the impacts of potential tax changes described above, that shifting in relative tax burden is just one of many factors and repercussions that should be considered in revising the tax structure. Others include:

- The impact on types of taxpayers within classes such as low income versus high income individuals, capital intensive versus service industries, etc.;
- The effects on the state's business climate;
- The cost and effectiveness of tax administration; and
- The level of acceptance by the taxpaying public.

The ultimate purpose of this analysis is to help guide the formation of an education financing policy that is based on the best and most accurate information, regardless of which proposal may end up being adopted. This analysis shows that any proposal for revamping education financing in Pennsylvania must not be enacted in a vacuum. Reductions or increases in any major tax source will invariably require a change in another tax source; That change must be evaluated within the context of the entire state and local tax system. In all scenarios there will be winners and losers. Knowing the magnitude of these outcomes can only better inform the debate and ultimately improve the final product.

APPENDIX

(See Appendix file for contents)

**Pennsylvania
Economy League**



State Office

17 South Market
Square
Suite 310
Harrisburg, PA 17011

Tel: 717-234-3151
Fax: 717-234-3153

e-mail: pel@pelcapital.org
<http://www.pelcapital.org>