

# Local Taxes & Our Community

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## Tax Fairness: What's Fair for Our Community?

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Many people have strong opinions about local taxes. They might believe that some local taxes are fair and that others are unfair. Being able to describe *why* they view these taxes this way is important, especially in Pennsylvania. Unlike many other states, Pennsylvania's local tax codes provide a wide variety of different local taxes that can be used by municipalities and school districts. If local tax reform occurs, the options will become even greater. Having a variety of local taxes available means that communities can pick and choose the taxes that they feel are fairest and best for themselves, taking into account their local needs, values, and population.

Because people have such strong opinions about local taxes, having objective and civil discussions about which taxes should be used (and for what percentage of a local budget) can be difficult. Stereotypes about who pays and who doesn't pay, which taxpayers have the ability to pay and which taxpayers don't, and who benefits the most from local services. Reasoned discussion often is difficult because emotions run so high.

Yet such objective and civil discussions about local taxes are essential if local tax decisions are to be based on facts and not on mere emotions and stereotypes. For civil discussions to occur, community members need a common language for understanding why some taxes seem fairer

than others. They also need a basic understanding of the local tax options, so they know what choices they have. In addition, people need accurate information about who lives in the community, who creates demands for local services (and thus influences the level of taxes), which general groups in the community have the ability to pay, and how the different taxes may affect these people.

This workbook is intended as the first step in a local dialogue about which taxes should be used in your community. It is designed to help you think about which fairness criteria are important for deciding who should bear the local tax burden in your own community, and to foster general discussion about the *values* and *concepts* needed to achieve local agreement on what makes taxes fair or unfair. Other publications in this *Local Taxes and Our Community* series of publications help you apply your community's tax fairness principles to specific local taxes, determining which taxes may be fairest and most appropriate for your own community. They also will help you determine the impact of different local taxes on typical taxpayers in your community.

Although this workbook can be useful on its own, it is intended to be used with the Penn State Cooperative Extension video, *Local Taxes in Pennsylvania: What's Fair?* Many of the discussion questions relate directly to individual taxpayer perspectives

**“I’m retired now, getting by on Social Security and a small pension. I want to pay my fair share of local taxes, but I can’t afford to pay what they say I owe on my house. It’s my house—I worked hard to buy it. Why should I have to pay on it? It’s not right.”**

**“I rent my apartment, and it angers me when I hear people say I don’t pay any real property tax. Don’t people realize that my landlord bases my rent on her costs, including taxes? I may not get the tax bill, but I end up paying it.”**

**“I hear people in my community say that people over the age of 65 shouldn’t have to pay any local tax. That’s not fair because many of us are better off than young families who are working full time. Why should age make a difference? Those who have money should pay their fair share, regardless of their age.”**

**“We have a major racetrack in our township that brings in thousands of nonresidents every weekend. Because of the visitors, we have extra police officers, more overtime, bigger troubles. Is it fair for the township residents to have to pay these extra costs? How do we get them to pay their share?”**

**“Everyone wants to make businesses pay a huge share of local taxes. But we don’t contribute to high tax bills, homeowners do when they send their kids to school. And they want businesses to help them pay.”**

**“My buddies and I own a hunting camp up north of here. We only visit a few weeks a year, yet that community taxes us to pay for the services year-round residents use. What local services do we use? We throw our trash out there instead of bringing it home. Big deal.”**

presented in the video. These perspectives also appear as highlighted text throughout this publication.

## Are Concerns About the Amount of Tax Monies Needed, or Which Taxes are Used?

In local tax discussions, it is important to determine whether the issue of concern to taxpayers is the total *amount* of tax dollars collected by the school district, county, or municipal government, or *which* local taxes the school district, county, or municipality uses to get those monies. Sometimes it is a combination of both. If the concern largely is the *amount* of tax dollars needed, simply talking about the relative fairness of this local tax compared to that local tax will not solve local concerns because it doesn’t address the underlying issue. In that case, focusing on costs and expenditures would be more necessary than focusing on which local taxes are used. Careful discussion is necessary to determine what local concerns really are about.

This workbook series focuses almost exclusively on issues of fairness about *which* taxes are used, not the total *amount* of money collected across all local taxes. Issues of how much local money is needed in total, which services should be provided, and the cost-effectiveness of those services are very important, but they are beyond the scope of what can be addressed here. Nevertheless, no matter how much local tax revenue is needed in your community, the fairness of *how* that tax burden is distributed will remain important.

## An Introduction to Tax Fairness Principles

Two main concepts typically are used to evaluate the fairness of taxes: the “ability-to-pay principle” and the “benefits principle.” The two principles provide a useful way to think about how the tax burden is distributed. Because they also underlie much of the public debate about taxes, they are extremely helpful to understand.

### 1. Ability-to-pay principle

The ability-to-pay principle states that the tax burden should be distributed on the basis of people’s ability to pay those taxes. People with lower ability to pay should pay less than people with greater ability to pay.

The ability-to-pay principle applies both *across* all income classes and *among* people with the same income. The former, called “vertical equity,” is exemplified by the statement, “poor people shouldn’t pay a larger share of their income in taxes than do wealthy people.” The latter, called “horizontal equity,” is best expressed by the sentiment that “all people with the same ability to pay should pay the same amount in taxes.” According to the ability-to-pay principle, it wouldn’t be fair for some individuals to pay more than others who have the same ability to pay—a situation that can occur if taxes discriminate between types of income or wealth.

The terms “progressive tax” and “regressive tax” are based on the ability-to-pay principle. A tax is “progressive” if people with lower ability to pay owe a smaller share of their income or wealth than do more well-to-do people. A progressive tax might collect one-half percent of the income of people making less than \$5,000 a year, for example, and one percent of the income of people making over \$65,000 a year.

A tax is “regressive,” according to this principle, when people with lower ability to pay owe a larger share of their income

or wealth than do people with greater ability to pay. A regressive tax might collect one percent of the income of people making less than \$5,000 a year, for example, and one-half percent of the income of people making over \$65,000 a year. Regressive taxes place a heavier burden on the poor than on the rich.

The most difficult and controversial aspect of the ability-to-pay principle is deciding how ability to pay should be measured. Should it be by annual income? By net wealth? By consumption? Some economists even argue that *lifetime* income, not just *annual* income, should be the deciding factor. The value of a house, for example, often reflects its owners' *lifetime* incomes, not just the income they make in any one year. Simply comparing a property tax bill in any one year to income in that same year may be unfair because it ignores overall wealth and ability to pay.

## 2. Benefits principle

The second common tax fairness principle, the benefits principle, states that people should pay taxes in direct relation to the benefits they receive. In other words, people who receive more local services or benefits should pay more in taxes than those who receive less.

The principle can work well when benefits are readily identifiable and easily quantified. The amount of public water a household uses, for example, usually is easy to determine. The benefits of most local services, however, are not as easily assigned to specific taxpayers. How, for example, do you accurately measure and compare the benefits that different families receive from the local police force, from snowplowing of public streets, or from their children attending good schools?

In addition, relying purely upon the benefits principle can ignore the public good or welfare justification for local services; we don't pay for Medicaid entirely through taxes on Medicaid

recipients, for example, or ask low-income people receiving winter heating assistance to pay the entire cost of the program.

## 3. Other principles

Tax fairness also can be considered from the perspective of different groups. Is it fair, for example, to rely heavily on tax sources that impose a disproportionately high burden on one group of taxpayers versus another group? Farmers, for example, tend to be affected disproportionately by the real property tax as compared to other businesses, because land generally comprises much of the value of their business. Many nonfarm businesses, in contrast, tend to have more of their productive assets in inventory or machinery, which are not taxed at the local level. Working-age, working-class people tend to be affected disproportionately by the earned income tax as compared to other taxpayers, because a larger share of their household income comes from wages, salaries, and other compensation for work. The pension income of well-to-do retirees and the dividend income of wealthy investors, by contrast, is exempt from this tax.

### How Useful are These Principles in Practice?

The ability-to-pay and benefits principles sometimes are inconsistent with each other, but they are important to understand because many opinions expressed about local taxes arise directly from their concepts. Having a basic grasp of these principles can provide you with a language for understanding and comparing peoples' opinions about tax fairness, and can help you identify some of the reasons people might disagree about these issues.

## Other Important Criteria Used to Evaluate Taxes

Tax fairness is only one of several criteria that local government experts recommend for evaluating the appropriateness of specific local taxes. Some others include adequacy, adaptability, administrative ease and economy, economic effects, and social acceptability. Local officials and communities must balance all of these considerations when choosing between different taxes, and should not rely entirely upon any one criterion. A tax may be fair, for example, but if it provides insufficient revenue for the local government or school district to provide necessary services, relying solely on that tax instead of others would be a poor decision. These criteria are described below.

### 1. Adequacy

An adequate revenue source is one that is regular and reliable in the face of fluctuations in economic activity. A flexible revenue source, such as an income tax, generates expanding levels of revenue when economic activity and incomes are rising, helping local governments and school districts meet their expenditure needs. When economic activity declines, however, collections from such flexible tax sources fall and perhaps threaten local government financial stability. With a relatively inflexible revenue source, such as the real property tax, revenues may be inadequate during periods of strong economic activity. When the economy declines, however, collections do not fall as much as with a flexible revenue source.

### 2. Adaptability

The ease with which tax rates can be changed to meet changing needs is another method of judging tax alternatives. For example, real property taxes are reasonably adaptable because millage rates can be changed, up to their legal maximum, in accordance with revenue requirements. The occupational privilege tax levied under Pennsylvania's Act 511, in

contrast, is less adaptable. The maximum legal rate for this tax is \$10, leaving little room for adapting to changing fiscal needs.

When tax sources are adaptable, local governments are able to adjust their revenue-raising strategies to meet emerging needs. When tax sources are less flexible, local governments may be faced with revenue shortages or surpluses as needs or revenues change.

### 3. Administrative ease and economy

This criterion focuses on the complexity and costs of administering revenue from varied sources. In general, the more complex a given tax is to administer, the more costly and inconvenient to the citizen its administration will be.

### 4. Economic effects

The way different taxes affect community growth and the use of society's resources also must be considered. Taxes, for example, can affect the way resources are used by changing the relative prices of goods and services. When a tax is placed on the sale of a product, its price may rise in comparison to other goods. As a result, fewer resources may be devoted to the consumption and production of the higher-priced product. Taxes also may encourage economic growth. Tax incentives for commercial and industrial development may lead to increased community income and employment.

### 5. Social acceptability

The social acceptability of a tax has to do with the way people perceive that revenue source. People may feel that a particular tax is unfair, administratively and operationally complex, too costly to administer for the revenues derived, or detrimental to local economic growth. In such an instance, that tax may be deemed unacceptable by most people.

On the other hand, socially acceptable tax sources tend to be those with which people are familiar. This factor may work against the adoption of an unfamiliar tax alternative even though it may be better in some ways than existing alternatives.

Local tax decisions must balance fairness concerns with these other criteria. The fairest tax might not be viable in your community, for example, if it fails to produce sufficient tax revenues for your school district, county, or municipality to operate, or if it is too difficult to administer.

#### What's Fair for Our Community?

Tax fairness is a value judgment, subject to different interpretations depending upon individuals' beliefs. Because of this, decisions about "what's fair" shouldn't be imposed upon or made outside of the community—they must be based on values that arise from within the community itself.

A useful method of determining what's fair in your own community is to hold a community dialogue through small group discussions. The goal of these group discussions is to develop a general consensus about which principles are viewed as most important by community members. Once identified, these community-specific tax fairness concerns can be used to evaluate the fairness of specific taxes and to explore local tax alternatives (as outlined in the *Local Taxes and Our Community* workbook series).

The following questions provide a good starting framework for conducting discussions, in small groups of six to eight people, as a way of clarifying and exploring the values in your own community. Because local taxes often are a highly emotional issue, the participants need to be respectful of others, even if they disagree with each others' comments. Good listening skills probably are the most important part of the process. The community-level discussion needs to be

an inclusive process, including different points of view and opinions, so people do not feel that their perspectives are ignored or judged as unimportant. The answers that come out in your discussions reflect the values and concerns that should be expressed in local tax policy.

#### References

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*Local Taxes in Pennsylvania: What's Fair?* Video. University Park, PA: Penn State Cooperative Extension. 1998.

“My late husband and I have lived in this community all our lives. I want to stay here in my home, but the property taxes just keep going up. I can’t afford to live here anymore.”

“Local businesses need to pay their fair share, too. We recently had a small shopping mall built here, and we taxpayers ended up paying to widen the roads, add stop lights, and increase the level of police patrols.”

“I don’t have a lot of patience for the wealthy retirees who complain that their property taxes are too high. I know many elderly are struggling, but others live in homes worth more than mine, and when they worked they made more money than I’ll ever make. The well-to-do elderly should pay their share—don’t put the tax burden entirely on working-age peoples’ shoulders.”

“My taxes aren’t based on what I can afford to make from farming my land. People think I’m rich because I own a lot of farmland, but I need that land to farm, and farming sure doesn’t give me a lot of money to spend. People say farmers are land rich and cash poor. I sure am.”

“Wealthy retirees are moving into our township from Washington and Baltimore because their retirement income is exempt from our earned income tax. But they make more money in retirement than me! And I work! Is it fair that I pay more than them?”

## Discussion Questions

1. In general, what do you think about the fairness of local taxes in your community? Why do you feel that way? What do your opinions have in common with the ability-to-pay and benefits principles?
2. How much of your concern is about the *total amount* of tax dollars collected, and how much is about the *specific* taxes used in your community? If the level is most important, will a change to a more fair local tax make any difference? Why or why not?
3. How can (or should) concerns about the *amount* of tax dollars collected and *which* taxes are used be separated in local discussions of tax fairness? Does it make any difference? Why or why not?
4. Do you identify or disagree with some of the concerns expressed by the people in the video (also quoted in this publication)? If so, which ones stand out for you, and why?
5. What are some other opinions about the fairness of local taxes? Why might people feel that way?
6. How should the ability-to-pay principle be measured? By annual income? Wealth? Lifetime income? Other? Why?
7. What does the term “benefit” mean to you? Does a community benefit from an educated workforce? From keeping members out of poverty? From keeping citizens safe from fire or crime? From maintaining public parks? For which services in your community does the benefits principle work, and for which services are the benefits (or the groups who receive the benefits) too abstract or hard to measure or identify?
8. Given that some local taxes always will be necessary in your community, how can they be distributed fairly among local taxpayers? Which fairness consideration do you believe should be the most important in local decisions about local taxes? Why?

*Local Taxes and  
Our Community:  
A Comprehensive  
Program on Local Taxes  
and Tax Reform*

Pennsylvania's local tax codes provide a variety of different local taxes for use by municipalities and school districts. Communities can pick and choose the taxes that they feel are fairest and best for themselves, taking into account their local needs, values, and population. Understanding the available options and their effects on the community is important if local taxes are to be used appropriately.

The *Local Taxes and Our Community* series of workbooks is intended to help local officials and citizens move beyond stereotypes to better understand local taxes in their own community. The series is participatory and discussion-oriented, and extensively uses community-level information. It helps people collect and discuss accurate information about who lives in the community, who creates demands for local services (and thus affects the level of taxes), how groups in the community vary in their ability to pay local taxes, and how the different taxes may affect these people. It provides a basic background of available local tax options, so communities will know what choices they have, and explores the effects of those options on local residents and taxpayers. The series does not advocate for one tax over another, but instead tries to teach people objective local information so they can use their own experiences and values to make local tax decisions appropriate to their community.

For more information, contact your local Penn State Cooperative Extension office or access <http://www.psu.edu/dept/aers/ltoc/> on the World Wide Web.

*Local Taxes and  
Our Community:  
Materials List*

**Workbook 1, *Tax Fairness: What's Fair for Our Community?***

Workbook introduces basic concepts of tax fairness and provides a common language for understanding why some taxes seem fairer than others.

**Video, *Local Taxes in Pennsylvania: What's Fair?***

Introductory video on tax fairness, designed to complement Workbook 1, *Tax Fairness: What's Fair for Our Community?*

**Workbook 2, *What's Going On in Our Community?***

Workbook to help you better understand your community, who creates demands for services, and who has the ability to pay local taxes. It also helps develop profiles of key taxpayer groups in your community.

**Workbook 3, *How Do We Currently Use Taxes?***

Workbook to help you examine the current uses of local taxes in your community, including which taxes are being used, which public services are provided, the role of nontax revenue, and the size of the tax base.

**Workbook 4, *How Do the Taxes We Use Affect Taxpayers?***

Workbook and computer spreadsheet to help you examine the effect of local taxes on key taxpayer groups in your community, and how this compares to the demand for services, the ability to pay, and other tax fairness principles.

**Workbook 5, *What Should Be Our Local Tax Distribution?***

Workbook and computer spreadsheet to help you learn about the available tax alternatives and how these alternatives might affect various taxpayer groups, and to reach a community consensus on which taxes should be used.

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This publication is intended strictly to help you know and understand more about local taxes. The material is general and educational, and is not intended to be legal advice nor to replace the need for such advice. If you need legal advice, you are encouraged to seek the aid of a competent professional in your area.

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