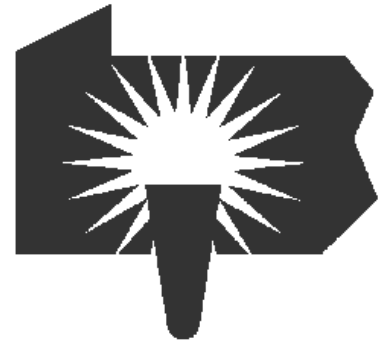


CAPITAL

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THE

PENNSYLVANIA ECONOMY LEAGUE - CAPITAL DIVISION 5/1/98

General Assembly Passes “Taxpayers’ Local Control Act”

Overview

On April 29 the General Assembly passed local tax “reform.” The approved package is significantly trimmed down from the version passed by the Senate last year. The governor is expected to sign the measure.

The Taxpayers Local Control Act provides new optional taxing authority for school districts only. In exchange for increases in the earned income tax, school districts would first have to eliminate a number of nuisance taxes and then apply the remaining new income to property tax reduction. A referendum is required before a school district could opt into the new taxing structure. A second referendum is required before a school district could raise property taxes if they opt into the new taxing scheme.

The Act also includes the following provisions:

- a local “Taxpayer Bill of Rights”;
- a homestead exemption for property taxes;
- an optional local tax deferral program; and
- a reduction in the threshold for school district debt without obtaining electoral approval.

Local Tax Restructuring

Optional and Mandatory Tax Structure Provisions

As noted above, school districts can now choose to alter their local tax structure. Upon completion of the prescribed process, a school district may levy a new earned income and net profits tax. The base of the earned income and net profits tax is the same as the present earned income and net profits tax now authorized in Act 511 (existing law) and used by most municipalities and school districts. The school district would have the option to levy the tax at one of three rates - 1%, 1.25%, or 1.5%. Any person earning \$7,500 or less may be exempted from paying the tax.

In exchange for the increased tax authority, the school district is disallowed from levying an occupation tax, an occupational privilege tax, a per capita tax, or the earned income and net profits tax under Act 511.

Because a school district and municipality can now share revenue from an earned income tax under Act 511, the new Act prohibits a municipality from increasing its earned income tax rate in those cases when the school district loses its authority to levy the Act 511 earned income tax. However, it appears as though no such prohibition exists for other taxes which are now shared such as the occupational privilege tax.

The added earned income tax receipts must be used for the following purposes and in the following order of priority:

1. to offset lost revenue from prohibited nuisance taxes;
2. to provide for percentage increase in school spending at or below the percentage increase in the statewide average weekly wage in the preceding year; and
3. to reduce school property taxes first using the homestead exemption (see below) and then reducing the millage rate for all property tax payers.

The law contains the following special provisions which address other local taxes for both school districts and municipalities:

- Real Estate Transfer tax provisions are totally unaffected by the law.
- Local Amusement tax rates for school districts are frozen at June 30, 1997 levels. If a school district did not levy an amusement tax in 1997, it is prohibited from instituting one. A municipality may continue to levy an amusement tax at the rate of the tax levied on December 31, 1997 or 5% whichever is greater. A municipality which does not now levy an amusement tax can institute the tax using a rate up to 5%.
- Provisions related to mercantile and gross receipts taxes are unaffected.
- School districts and municipalities which levied a sign or sign privilege tax as of December 31, 1997 can continue to levy that tax at the same rate. Those that did not, can not levy the tax in the future.
- School districts and municipalities which levied a motor vehicle transfer tax as of December 31, 1997 can continue to levy that tax. Those that did not, can not levy the tax in the future.

A tax credit would be allowed individuals paying the Philadelphia non-resident wage tax. The credit of .2756% is available to individuals who reside in school districts which opt into the new Act.

Tax Restructuring Process

The law specifies a process to be followed before a school district can adopt the new earned income tax. Should a school district board of directors elect to adopt the new system, approval for the change must be first given by the electorate through a referendum. The referendum would be held at the November election in an odd year (municipal election) prior to imposing the new tax. The ballot question must be accompanied by an interpretive statement which outlines several aspects of the proposed change such as rate of the tax to be imposed, the taxes to be implemented, and the amount of real property tax reductions. A similar process can be used if a school district decides to end participation in the new tax.

Upon a successful referendum, the school district may elect to establish a study commission made of residents of the school district which are representative of all residents. The school district would be responsible for paying the expenses of the study commission. The study commission would have 90 days to make a non-binding recommendation to the school board. The school board must accept or reject the recommendation no later than 90 days before the next municipal election occurring at least 150 days after the submission of the recommendation. If the commission fails to submit a recommendation, the school district may adopt its own proposal.

The Act outlines a process for adopting the new provisions should the school directors fail to act within two years. Electors may circulate a petition, to be signed by 2% of the people voting for Governor in the previous election, to require the school board to establish a study commission. If the school board does not place the recommendation on the ballot for public approval, a second petition signed by 5% of the residents voting for Governor in the previous election would force the recommendation to be placed on the ballot at the next municipal election.

If a school district has opted into the new tax structure, another referendum would be required if a school district wants to increase the rate of property tax rates. This “back-end” referendum is designed to provide greater control for taxpayers and at the same time provide some protection for non-homestead owners of property from disproportionate increase in property tax. A back-end referendum would not be required if the purpose of the property tax rate increased is to:

1. respond to or recover from an emergency or disaster;
2. implement a court order or administrative order;
3. pay interest and principal on certain indebtedness;
4. respond to conditions which pose an immediate threat of serious harm to students or staff;
5. adopt special purpose tax levies approved by the electorate; and
6. maintain per student local tax revenue for growing school districts (this exception applies only to school districts which average over 10% growth over three years).

An increased tax requires court approval for all of the above items except 2 and 5.

Another major exception to the requirement for a referendum is a real property tax increase which produces a percentage increase local tax revenue which is less than or equal to the percentage

increase in the state wide average weekly wage in the preceding year. The court must approve this increase in millage as well.

Homestead Property Exclusion

The Act implements the authorization given to the General Assembly this past November to establish a homestead exemption for a portion of property tax assessments. The Constitutional Amendment permits the General Assembly to exempt up to half of the median assessed value of homestead property in the taxing jurisdiction. The provisions of this section of the Act apply to municipal and school district taxing bodies.

A homestead is defined as “a dwelling primarily used as the domicile of an owner who is a natural person.” It appears as though those people who maintain a business in part of their home would qualify. A building owned by a business (not a natural person) would not qualify.

To implement the homestead provisions, owners would file an application with the county assessor. The county assessor would make a qualifying determination which could be appealed in the same manner as other assessment disagreements.

In addition to homesteads, farmsteads would qualify for the exemption. A farmstead includes the buildings and structures devoted to farming on a farm of at least ten acres. Any taxing jurisdictions adopting a homestead exemption must include farmsteads as part of the exemption. The law contains special provisions for making adjustments for taxing jurisdictions in more than one county, reassessments, jurisdictions with split rate taxes, and new construction.

A one-time appropriation of \$6 million is made to the Department of Community and Economic Development to reimburse counties for the added costs of implementing the homestead property exclusion provisions.

Local Taxpayer Bill of Rights

The Local Taxpayers Bill of Rights applies to all local taxes including levies on income, gross receipts, net profits, occupation, amusements and admissions. It requires the local taxing authority to:

- provide a written explanation in plain English of 1.) the taxpayers’ rights and the authority’s obligations during an audit or administrative review 2.) the procedures for appeals and for tax refund claims, and 3.) the procedures available to taxing authorities to enforce payment of local taxes;
- accept written requests for tax refunds or credits of overpaid tax within three years of the request filing date or within one year of actual payment, whichever is later;
- pay the taxpayer interest on any tax amount overpaid to the local taxing authority;
- inform the taxpayer, in writing, of the basis of any underpayment the authority believes to exist;

- provide the taxpayer at least 30 days to respond to requests for information;
- establish an administrative process to address taxpayer appeals based on guidelines laid out in the statute;
- decide on a taxpayer petition within 60 days of its receipt; and
- keep confidential any tax information gained through an audit, return, investigation, hearing or verification for all but official purposes or as provided for by law.

The Act also allows for the abatement of the interest on underpaid tax if it was caused by the taxing authority's error or delay, and requires the abatement of any penalty or excess interest if a tax was underpaid as a result of erroneous written advice from the taxing authority. It also allows for a negotiated installment plan for the collection of delinquent taxes.

Real Estate Tax Deferment Program

The Real Estate Tax Deferment Program allows municipalities and school districts to defer the payment of property taxes by property owners until they are able to pay or until the homestead property is sold. While the program was designed with the elderly in mind, any property owner can benefit if he or she meets certain qualification requirements.

In order to qualify, the taxpayer must meet the household income limits defined in the Senior Citizens Rebate and Assistance Act – a maximum of \$15,000 annually as of this writing. In addition, the amount owed on the property may not exceed 70% of the market value, and the mortgage principal plus any unsatisfied liens plus the amount of deferred taxes may not exceed 85% of the market value.

Once qualified, the taxpayer may defer payment of property taxes which exceed a base payment, defined at the time of application. The tax deferral is provided in exchange for a lien against the property which gives the taxing authority first claim on the homestead.

The property owner can pay the delinquent tax in part or in full at any time during his or her lifetime. The delinquent taxes only come due, however, if the property is sold, or when the owner dies and the property is conveyed to the heirs.

School District Debt

Under prior law, school districts were limited to 350% of the borrowing base (average of three prior years of total revenue) without securing voter approval. This Act reduces that threshold to 225%. As a result, more school districts will seek referendums for borrowing.

Conclusions

The new “Taxpayers’ Local Control Act” provides school districts and school district taxpayers with a new option for restructuring their taxes. The trade would increase taxes for those working in exchange for eliminating “nuisance” taxes and lowering property taxes for all taxpayers, including those not working. It also give local taxpayers a new avenue to limit tax increases should they so choose.

The extent of actual impact is not clear. Because the provisions of the law are optional, it is unlikely that many school districts will seek to adopt the trade. This is due in large part to the so-called back-end referendum which requires voter approval for increasing property tax rates, a provision deemed to be a major cap on the spending ability of school districts.

In addition, the longer term impact on the publicly stated goal of reducing property taxes is less dramatic than expectations. Since the reduction of property taxes is the third priority for use of new revenues, the actual impact will be significantly diminished and will vary widely from district to district. Research developed by the Senate Policy Development and Research Office supports this point. A number of school districts will have little or no property tax relief. In fact, 11 school districts would not take in enough new revenue from the increased earned income tax to fund total elimination of the nuisance taxes and an increase in expenditures equal to the percentage increase in the statewide average weekly wage. These districts use nuisances taxes for a large part of their revenue stream. The majority of school districts could reduce property taxes by 20% to 40% if the full 1.5% wage tax was employed.

Additional questions will arise as the details of this law are discussed and debated. PEL will continue to stay abreast of these developments through local implementation.