

The Pennsylvania School Boards Association
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Act 72: A Primer for Taxpayers

Overview of Act 72

Act 72 of 2004, the Homeowners Tax Relief Act, was signed into law by Governor Rendell on July 5 and took effect on Sept. 3. It is the Pennsylvania General Assembly's latest attempt to provide relief from rising school property taxes to the state's homeowners.

Act 72 differs from the previous version of statewide property tax relief, including Act 50 of 1998, in a number of important ways. Most importantly, it uses state revenues, in the form of proceeds from a 34% tax on profits from expanded gaming, as well as local revenues, in the form of a mandatory 0.1% earned income tax, to reduce school property taxes.

The act also allows school districts to increase their 0.1% earned income tax and use the revenues from a tax increase to further reduce property taxes. Any increases in this tax must first be approved by a school district's voters through what is called a "front-end" referendum. These questions will be proposed to voters at the fall election, almost always at a municipal election, in other words, in an odd-numbered year.

One of the act's more controversial features is that it allows voters to approve any tax increase proposed by their school board that is over and above an inflationary "index" that is set each year. This vote is what is known as a "back-end" referendum. These questions will be proposed in the spring election and potentially could be on the ballot every year.

Reducing your property taxes - how Act 72 works

It is important for all taxpayers to know that the property tax relief offered by Act 72 of 2004 will be neither immediate nor automatic. There are three things that must happen before an individual will see a reduction in his or her school property tax bill.

First, the state must confirm that there is enough money from gaming revenues to make an allocation to school districts. At the state level, a Property Tax Relief Fund, out of which will come payments to school districts for property tax relief and a Property Tax Relief Reserve Fund to ensure that there is always a minimum amount of funding on hand, have been created. However, before any state gaming allocations can be made to school

districts, a combined total of \$900 million must be in the two funds, \$500 million in the relief fund and \$400 million in the reserve fund. The big unknown in Act 72 is how soon the required amount of revenue will be available in the two funds and how much that will be. It is anticipated, but not guaranteed that the initial pay out to school districts will be in 2006. The important thing to know is that no property tax relief will be available until a payment of gambling revenues can be made to school districts.

The second thing that has to happen is that each school district (except Philadelphia) must take action to make itself eligible to receive gambling revenues. Most school districts will do this by enacting, by board resolution, a 0.1% tax on earned income by May 30, 2005. This tax is called the district's qualifying contribution and is the only one allowed by Act 72 that is not subject to voter approval. Even though the tax will be enacted next year, it will not be levied on voters until the state makes payments of gambling revenues to school districts.

The district's qualifying contribution not only makes it eligible to receive state gaming allocations, but it also allows them to put referendum questions on the ballot in the fall of any odd-numbered year thereafter to ask voters if they want to increase the 0.1% tax (a front-end referendum). By making this qualifying contribution, the district will also be subject to the act's back-end referendum requirements and must adopt its preliminary budget much earlier than it does now. Both the back-end referendum requirement and the requirement for the early adoption of its preliminary budget will begin in 2006.

School districts that do not currently levy an earned income tax can make themselves eligible for state gaming allocations in a manner that is different than the one described previously. These districts, in lieu of adopting a 0.1% earned income tax, can approve a resolution that simply says that the district will propose a front-end referendum question in the November 2007 election that allows for a minimum level of property tax relief. This action qualifies the district to receive state gaming allocations and subjects them to early preliminary budget adoption and back-end referendum requirements.

The third thing that must happen in order for an individual to get the property tax relief offered by Act 72 is that they must qualify their property to be eligible for the relief. This is done by completing a homestead/farmstead application form and sending it in to the county assessor. These application forms must be mailed to you twice during 2004 by your school district.

The first mailing will go out in mid-October and the second by the end of the year. Along with the application, the mailing must contain instructions for completing the application, a description of the homestead/farmstead program and the due date for returning the application (March 1, 2005).

As noted, these applications must be returned to the county assessor, who will make a determination on whether or not your property qualifies. If a timely application is made, it is likely that your property will qualify if you own the house and use it as your primary dwelling. If your house is divided up into mixed uses, you can still qualify for a homestead exclusion on the portion of the house in which you live.

The farmstead exclusion is for buildings located on a farm that are used in commercial agricultural production. For example, buildings that hold livestock, grain, or machinery that are used for commercial farming can receive the farmstead exclusion. An owner-occupied residence on a farm could become eligible to receive a homestead exclusion, while the farm buildings could become eligible to receive a farmstead exclusion.

So what does this exclusion mean to a property owner? Eligible properties will have a portion of their assessed value excluded from taxation, therefore lowering the property owner's tax bill. This is how you will receive property tax relief under Act 72. The adjustments will be made on an eligible individual's property tax bill. No rebate check or credit will be received separate from this process.

The amount of property tax relief you receive will depend on the amount of money your school district receives from the state in the form of gambling revenues, the amount of revenue generated by the 0.1% earned income tax, any increases to that tax that have been approved by the voters of a school district and the number of "eligible" properties. Your school board will be responsible for setting the amount of the homestead/farmstead exclusion, however they cannot set any exclusion rate until the state makes payments of gambling revenues to school districts. The front-end referendum

As mentioned previously, once a school district has made their qualifying contribution it can put a referendum question on the ballot in the fall of an odd-numbered year. This "front-end" referendum asks voters if they want to increase the district's earned income tax and use the additional revenues to further reduce its property tax. This "tax shifting" element has been a part of every major tax reform proposal in recent years, including Act 50 of 1998. It is important to note, however, that

local tax shifting is only required in a very limited sense by Act 72 because the primary funding to reduce property taxes comes from the state in the form of state gaming allocations. Other than the required 0.1% earned income tax, no other tax shifting will occur unless it has received voter approval.

A front-end referendum can take place as early as the November 2005 election. With one exception, there are no requirements on school districts for placing a specific rate of tax on a front-end referendum. The exception to the rule on tax rates comes in November 2007. Any district that has made a qualifying contribution or that has approved a resolution saying that it will propose a front-end referendum at this time must place a question on the ballot in order to maintain its eligibility to collect state gaming allocations. The increase or the rate requested must be such that it will generate enough revenue for the school district to provide its eligible property owners with at least 50% of the maximum allowable tax relief.

For districts that adopted the resolution levying a 0.1% earned income tax, failure to place the required question on the ballot in November 2007 removes a their eligibility to receive state gaming allocations. That eligibility is restored when the district proposes the question at a subsequent general or municipal fall election.

If the November 2007 referendum fails those districts that do not currently levy an earned income tax and simply adopted a resolution to hold a referendum at this time must adopt the 0.1% earned income tax in order to continue their eligibility to receive state gambling allocations.

In either case, if the November 2007 referendum is turned down by voters, school districts must continue to provide property tax relief using their state gaming allocations and revenues from the 0.1% earned income tax and any other revenues for which the district would be eligible under the act.

The back-end referendum

The back-end referendum provisions of Act 72 apply to all school districts that make themselves eligible to receive state property tax allocations. Very simply, it requires voter approval for any proposed school tax rate increases that exceed an inflationary index. This index is simply an average of two percentages. These percentages measure the increase in the Statewide Average Weekly Wage and the Employment Cost Index (ECI) for elementary and secondary schools. The ECI simply measures the increases in costs of maintaining school employees

nationwide. It is likely that index the will fall in the 2.5% to 4% range.

Districts can apply for exceptions to the back-end referendum if one of their qualifying expenditures increases from year to year. The qualifying expenditures include special education, health care for employees, school employee retirement contributions and other costs over which districts exercise little control. However, the school district must receive approval from a judge or the Department of Education in order to use one of these exceptions. The Act's back-end referendum provisions apply to districts' 2006-2007 budgets, which will be developed beginning in late 2005.

In order to help districts determine whether or not they will need to go to a back-end referendum, Act 72 requires that all districts that are eligible to receive property tax relief adopt their preliminary budgets in February, beginning in 2006. This preliminary budget will go on display in late January for the public to inspect, and then must be approved by the school board. It is likely that this budget will change before it is finally adopted by the school board each June.

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