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Dear Local Tax Study Commission Members:

Thank you for agreeing to help make property tax relief a reality in your community. I am grateful that you have chosen to give your time and energy to serving the taxpayers of your school district as part of this historic opportunity for local tax reform.

The new property tax relief law represents a fundamental change in the Commonwealth's school funding system. An anticipated $1 billion from gaming will be used to provide dollar-for-dollar local tax cuts. School boards will be required to seek voter approval for future tax increases that rise faster than an inflation index and also fall outside of 10 carefully crafted exceptions (for specific costs that are outside of a school district's control). And the voters in each community will have unprecedented control over the way their schools are funded.

Your role in this third element of reform is extremely important. The tax relief law allows voters to choose the best mix of local taxes to fund their schools based on the specific needs of each community. Voters will have the power in the Spring 2007 primary election to reduce their property taxes by $1.4 billion by shifting to local income taxes – but the choice rests entirely within each community to determine whether this shift is in the best interest of the local taxpayers. As members of the Local Tax Study Commission, you will make a recommendation to your school board on the tax mix that you believe is most appropriate for your community.

The attached Local Tax Study Commission Guide was developed to provide helpful information regarding your role. We have also prepared a data sheet specific to your school district that we will be mailing next week.

Thank you again for serving as a local leader in reforming Pennsylvania's school funding system.

Sincerely,

Gerald L. Zahorchak

Gerald L. Zahorchak, D.Ed.

Attachment

Local Tax Study Commission Guide

Overview

Pennsylvania's property tax relief law allows the voters of each school district to decide in Spring 2007 whether they want to reduce their property taxes by shifting to a local income tax. Here are a few important facts about this *tax shift*:

- School districts are required to give voters the choice to shift from property to income taxes at the primary election of 2007.
- If voters approve, then the local income tax will increase and local property tax bills will be reduced.
- All of the revenue raised by increasing a local income tax will remain in the community. At least 98% will be used to reduce local property taxes. Up to 2% can be used for school district operations.
- The choice before voters in Spring 2007 is <u>only</u> whether to reduce the local property tax by increasing a local income tax. The referendum does <u>not</u> determine whether the school district will receive funding from the state to reduce the local property tax burden using gaming revenue. It also does <u>not</u> determine whether the school district must comply with the limits on future tax increases that are also contained in the state's new property tax relief law.

This document is intended as a tool to help members of the Local Tax Study Commission make recommendations to their local school board on two questions:

1. Which type of income tax should voters be asked to levy in order to reduce local property taxes: an Earned Income Tax (EIT) or a Personal Income Tax (PIT)?
2. At what rate should the income tax offered to voters be set?

Background

What does the law require?

Pennsylvania voters must be given a local tax choice when they go to the polls for the 2007 primary election. They will be asked: "Do you want to increase local income taxes in order to reduce local property taxes?" School boards have two decisions to make before this happens. First, will voters be asked to increase their Earned Income Tax (EIT) or Personal Income Tax (PIT)? Second, how much property tax relief will voters be asked to approve? The law allows the ballot question to offer property tax relief equal to anywhere from <u>half</u> of the "maximum homestead exclusion" to the <u>full</u> "homestead exclusion." No matter what, the proposed new tax does not have to be more than a 1% EIT increase.

What is the difference between an EIT and a PIT?

There are several types of income – ranging from the hourly wage that a worker earns to the dividends on an investor's stocks. The EIT and PIT include different types of income.

The EIT is a tax on <u>compensation and net profits</u>, including:

- Salaries
- Wages
- Commissions, bonuses, stock options and incentive payments
- Fees
- Tips
- Net profits from the operation of a business, profession or farm

The PIT taxes compensation, net profits <u>and</u> other kinds of income:

- Compensation and net profits (everything that is taxed by the EIT)
- Interest
- Dividends
- Net gains or income from the dispositions of property
- Net gains or income from rents, royalties, patents and copyrights
- Income derived through estates or trusts
- Gambling and lottery winnings

<u>Neither</u> the EIT nor the PIT taxes Social Security and retirement pensions.

What is a "homestead exclusion"?

The Pennsylvania Constitution requires that taxes be applied evenly to residential, agricultural, commercial and industrial properties. So if a school district's property tax rate is 25 mills, then that tax rate applies to all property – no matter what kind. (A mill is a tax of $1 for every $1,000 of assessed value.) Since it is not possible to reduce millage just for residential property, the Constitution allows what is known as a "homestead exclusion" as a way to provide property tax relief to homeowners and farmstead owners without reducing the revenues generated from property taxes on business and other kinds of property. Any property tax relief that voters approve in Spring 2007 will be provided to homeowners through a homestead exclusion.

A homestead exclusion reduces the assessed value of a home or farmstead for the purpose of paying school property taxes. For example, let's say that the average house is assessed at $50,000, and the school district's property tax is 25 mills. The average property tax bill would be:

$$\$50{,}000 \times 25 \div 1{,}000 = \$1{,}250$$

If the school district has a $5,000 homestead exclusion, then the assessed value for a $50,000 home would be reduced by $5,000 before the tax bill is calculated:

$$\$45{,}000 \times 25 \div 1{,}000 = \$1{,}125$$

A $5,000 homestead exclusion would therefore save the average taxpayer $125.

The same homestead exclusion applies to every eligible residential property in the school district. In this example, the homestead exclusion would be $5,000 for everyone regardless of whether their house is assessed at $30,000, $50,000 or $100,000.

What is the "maximum homestead exclusion"?
The largest homestead exclusion allowed by the Constitution is equal to 50% of the assessed value of the median home in the school district. For example, if a school district has five homes assessed at:

$10,000 $15,000 $28,000 $40,000 $45,000

then the median assessed value is $28,000. The maximum homestead exclusion would be 50% of $28,000, or $14,000.

What effect does the property tax relief law have on the Property Tax/Rent Rebate Program?
The Pennsylvania Department of Revenue administers the Property Tax/Rent Rebate Program, which is available to senior citizens 65 years of age or older, widows or widowers 50 years of age or older and the permanently disabled 18 years of age or older.

This program was significantly expanded to include more Pennsylvanians and to increase the maximum rebate by 30% starting with 2006 taxes. Under the old rebate system, seniors could receive a property tax or rent rebate if they earned up to $15,000 a year (excluding ½ of Social Security) and the maximum rebate was $500. The new provisions increase the income limit to $35,000 for homeowners and boost the maximum rebate to $650.

The following are homeowner eligibility requirements and rebate amounts beginning with 2006:

Income	Rebate
$0 to $8,000	$650
$8,001 to $15,000	$500
$15,001 to $18,000	$300
$18,001 to $35,000	$250

The following are renter eligibility requirements and rebate amounts beginning with 2006:

Income	Rebate
$0 to $8,000	$650
$8,001 to $15,000	$500

In addition, Property Tax/Rent Rebate Program recipients in every school district except Philadelphia, Pittsburgh and Scranton who pay more than 15% of their income in property taxes will also have their property tax rebate increase by an additional 50% if their income is under $30,000.

What could this tax shift mean for me?
The impact of approving the Spring 2007 referendum will depend on how much income you collect and whether you own a home.

For example, let's say that a school district levies a new 0.4% Earned Income Tax under the property tax relief law, and is able to use the revenue to provide a $10,000 homestead exclusion for every homeowner. The school district's property tax rate is 25 mills.

For a retired homeowner who owns a home assessed at $30,000…

- This retiree collects $10,000 per year in Social Security and $13,000 per year as a pension; therefore they will not pay any additional EIT.
- The retiree currently pays $750 in school property taxes:

  $30,000 x 25 ÷ 1,000 = $750
- With a $10,000 homestead exclusion, the retiree will pay $500 in school property taxes:

  $20,000 x 25 ÷ 1,000 = $500
- The retiree also submits a claim for a rebate through the Department of Revenue's Property Tax/Rent Rebate program, resulting in a property tax rebate of $300.
- The retiree will save $550 each year – which is a 73% property tax reduction.

For a family that earns $40,000 each year and owns a home assessed at $60,000…

- The family will pay an additional $160 from the new 0.4% EIT:

  $40,000 x 0.4% = $160
- The family currently pays $1,500 in school property taxes:

  $60,000 x 25 ÷ 1,000 = $1,500
- With a $10,000 homestead exclusion, the family will pay $1,250 in school property taxes:

  $50,000 x 25 ÷ 1,000 = $1,250
- The family will save $90 each year – which is a 6% property tax reduction:

  $1,500 old property tax bill - $1,250 new property tax bill - $160 EIT increase = $90 savings

For a family that earns $120,000 each year and owns a home assessed at $200,000…

- The family will pay an additional $480 from the new 0.4% EIT:

  $120,000 x 0.4% = $480
- The family currently pays $5,000 in school property taxes:

  $200,000 x 25 ÷ 1,000 = $5,000
- With a $10,000 homestead exclusion, the family will pay $4,750 in school property taxes:

$190,000 x 25 ÷ 1,000 = $4,750

- The family will pay and additional $230 per year:

  $5,000 old property tax bill - $4,750 new property tax bill - $480 EIT increase = -$230

For a renter who earns $50,000 per year…

- The renter will pay an additional $200 from the new 0.4% EIT:

  $50,000 x 0.4% = $200

- The renter does not pay property taxes and will not receive a property tax reduction

Role of the Local Tax Study Commission

Special Session Act 1 requires the Local Tax Study Commission to:

- Hold at least one public hearing prior to making a recommendation to school board.
- Make a nonbinding recommendation at a public meeting of the school board.
- Turn over all records, including receipts, tapes, meeting minutes and written communications, to the school board to be made available for public inspection during the regular business hours of the school district.

The law requires each Local Tax Study Commission to consider:

- Historic and present rates of and revenue from taxes currently levied, assessed and collected.
- The percentage of total revenues provided by taxes currently levied, assessed and collected.
- The age, income, employment and property use characteristics of the existing tax base.
- Projected revenues of taxes currently levied, assessed and collected, including taxes authorized and taxes not levied under this chapter.

The commission's recommendation should include:

- The type of the proposed income tax increase (EIT or PIT), and
- The amount of the proposed income tax increase rounded to the nearest tenth of a percent (0.1%).

Suggested Questions for Consideration

The following questions can guide Local Tax Study Commissions as they address these issues:

School District Population
The right combination of local taxes for each community will depend on its population. For example, a school district with a significant number of retired homeowners might seek to reduce property taxes as much as possible in order to relieve the burden of those on fixed incomes – while a school district with a large proportion of renters (who will not receive a property tax reduction) might propose the smallest possible increase in income taxes.

Questions to consider…

1. What proportion of the school district is at retirement age? Near retirement age?
2. What percent of households are homeowners and what percent are renters?
3. What is the average household income in the school district? What is the average income of homeowners? Of renters?
4. What percentage of senior citizens would be eligible for Property Tax/Rent Rebate program?

School District Tax Base
It is important to understand where the school district's current tax revenue comes from. Most school districts rely on several local taxes to fund schools. Each tax impacts residents in a different way:

- Earned Income Taxes are paid by everyone in the school district who is employed and are based on how much they earn
- Property taxes are only paid by those who own their home (or business) and are based on the assessed value
- Per Capita taxes require everyone to pay the same dollar amount regardless of their income or homeownership.

Questions to consider…

5. Which taxes does the school district currently levy?
6. How much of the school district's local revenue comes from each type of tax that the school district levies?
7. What other local taxes do residents of the school district pay – including county and municipal property taxes and municipal Earned Income Taxes?

Tax Burden
Determining how current taxes impact different types of school district residents is one way to measure the effects of the existing tax system. It will also enable the Local Tax Study Commission to recommend ways to make local taxes more equitable.

Questions to consider…

8. What is the local tax burden for a typical household in the school district?
9. What is the effect of the local tax burden on different types of households – including retired homeowners, moderate-income homeowners, high-income homeowners and

renters? Note that the expansion of the Property Tax/Rent Rebate Program will reduce the tax burden on some senior citizen residents of the school district.

10. How would the local tax burden change for different types of households if the school district:
    a. Increases the EIT enough to fund 50% of the maximum homestead exclusion?
    b. Increases the EIT enough to fund the full maximum homestead exclusion?
    c. Levies a PIT at a level that funds 50% of the maximum homestead exclusion?
    d. Levies a PIT at a level that funds the full maximum homestead exclusion?

    Note: To answer these questions, you may need to ask your school district's Business Manager to estimate the EIT or PIT increase that would be needed in order to fund different levels of homestead exclusions.

11. What combination of local income and property taxes seems most equitable for the school district's population?

Future Revenue Projections

In determining the best combination of local taxes to fund schools, the Local Tax Study Commission will want to ensure that the tax base is stable (i.e., does not fluctuate too much from one year to another under normal conditions) and to determine whether it provides opportunities for natural growth that would increase classroom resources without the need for increases in the tax rate (e.g., as local income or property values rise or additional houses are constructed).

Questions to consider (with assistance from your school district's Business Manager)…

12. Has the school district experienced any major changes that could dramatically impact the tax base? Are any anticipated? These could include new housing developments, a new shopping center, or the opening or closing of a large business.
13. How has the assessed value of taxable property in the school district changed each year over the last five years? How has it changed for residential property only?
14. How has the EIT base of the school district changed each year over the last five years?
15. How has the PIT base of the school district changed each year over the last five years?
16. How are each of these tax bases projected to increase in the coming years? What are the implications for ensuring that the schools have sufficient revenue?

For Additional Information

Please contact the Pennsylvania Department of Education for additional information or assistance. You can reach the Department at:

ra-propertytax@state.pa.us or (717) 787-5423