

# ACT 72 OF 2004: THE HOMEOWNER TAX RELIEF ACT

## PROPERTY TAX RELIEF-FREQUENTLY ASKED QUESTIONS

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The Following pages contain questions and answers on five Act 72 topics:

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### HOW TO QUALIFY FOR PROPERTY TAX RELIEF

#### 1. When does a school district have to act to qualify for state-funded property tax relief? What does it have to do?

All school boards must pass a resolution by May 30, 2005, in order to be eligible for state-funded property tax relief.

The resolution must do one of the following to qualify:

- Authorize the levy of an additional 0.1% Earned Income Tax (EIT). The revenue from the additional local EIT must be used to reduce local property taxes.
- Propose a ballot questions for the 2005 municipal election to ask voters whether they want to reduce property taxes by shifting towards a local income tax. If voters reject the ballot question, the district must follow the steps described in the response to question 14.
- *For school districts that do not currently levy an EIT only, there is a third option: propose a ballot question for the 2007 municipal election, as described in the response to question 4. (Section 331)*

#### 2. Can a school district decide not to participate in Act 72?

Yes. Participating in the provisions of Act 72 is optional, not mandatory. School district that do not participate in Act 72 property tax relief are not subject to the Act's taxpayer referendum requirements and will not qualify for state property tax relief funding.

#### 3. If a school district doesn't qualify by may 30, 2005, can the school district

## **Qualify at a future date?**

No. School boards must pass a resolution by May 30, 2005, in order to qualify for state-funded property tax relief.

### **4. May school districts that don't currently have an EIT participate in the property tax relief program?**

School districts that do not currently impose an EIT may qualify for state-funded property tax relief by adopting a resolution by May 30, 2005, to do one of the following:

- Levying a 0.1% EIT (the same as other school districts)
- Proposing a referendum question at the 2005 municipal election (the same as other school districts)
- Proposing a referendum question in the 2007 municipal election (an option only available to districts that do not currently have an EIT). Voters will be asked to agree to an EIT or Personal Income Tax (PIT) that will provide total property tax relief equal to at least 50% of the maximum amount allowed. If voters approve this ballot question, the new EIT or PIT will take effect in the 2008-2009 fiscal year. If the voters do not approve the ballot question, the board of school directors must enact a resolution to levy the 0.1% EIT in order to maintain eligibility for a state property tax reduction allocation. (Section 332 (b), (c), (e))

### **5. How does this law impact Act 50 districts?**

Four school districts are currently participating in Act 50. These school districts can choose to opt-in to the new property tax relief system. By opting in, they will qualify for the state property tax relief funding and be subject to the same referendum requirements as all other school districts. (Section 332 (h))

### **6. How does the laws address school districts where the fiscal year runs January - December instead of July - June?**

The provisions of Act 72 are applied to the school district's own fiscal year calendar. In school districts that run on a calendar-year basis (none in Somerset County), the referendum provisions in Section 333 take effect in the year beginning on January 1, 2007.

### **7. Can Pennsylvania residents who pay income taxes to another state or any**

**political subdivision located outside the boundaries of the Commonwealth claim that payment as a credit against the local EIT or PIT that is used to provide property tax relief?**

Pennsylvanians who pay income taxes to another state or any political subdivision located outside the boundaries of the Commonwealth will continue to receive a tax credit against the school district's existing EIT – exactly as they currently do. But out-of-state taxes *cannot* be claimed as a credit against a local EIT or PIT that is levied in accordance with Act 72 in order to fund homestead exclusions – since those funds will be used to provide property tax relief to all eligible homeowners in the school district. (Section 323)

## **HOW STATE PROPERTY TAX REDUCTION FUNDING IS DISTRIBUTED**

### **8. When will state property tax relief start? How much will there be?**

The Commonwealth will use a portion of the tax revenue from expanded gaming to provide state funding for property tax relief. There is a slight possibility that state funding for property tax relief could begin as early as the 2005-2006 school year, but the first distribution will more likely occur in 2006-2007 or 2007-2008.

Act 72 indicates that the distribution of state funding for property tax relief can occur once the Property Tax relief Reserve Fund has a total of \$500 million available for distribution to school districts and the Property Tax Relief Reserve Fund has a total of \$400 million. (Sections 504 (d); 504)

Spreadsheets prepared by the Pennsylvania Department of Education provide projected distribution amounts for the minimum distribution of \$500 million and the upper level projection of \$1 billion annually.

### **9. How much state-funded property tax relief will each school district receive?**

The amount of property tax relief will vary from one school district to another. The property tax relief formula is designed to take *equity* into account – sending the most state resources to the school districts with the greatest tax burden and least local wealth.

The formula is based on the school district's 2003-2004 average daily membership and its property tax reduction index. The property tax reduction index is the sum of its rankings on the following four factors divided by 1,000:

- The school districts 2002 personal income per 2003-2004 average daily membership
- The school district's 2004-2005 market value/personal income aid ratio
- The school district's 2002-2003 school tax ratio, which is the 2002-2003 local tax revenue collected, divided by 2002 personal income

Act 72 also guarantees a minimum reduction in property tax revenue and sets a maximum cap. For example, with \$1 billion in state funding for property tax relief, property tax revenue will go down in each school district by at least 12.5%, up to a maximum of 50%, of the residential property taxes collected in the 2001-2002 school year. The minimum and maximum percents change based on the total amount of money that the state has available for property tax relief:

If the total amount for Property tax relief is at least...	THEN	The minimum reduction is...	The maximum reduction is...
\$500 million		approx. 7.4%	approx. 31%
\$550 million		approx. 7.9%	approx. 32.8%
\$600 million		approx. 8.4%	approx. 34.6%
\$650 million		approx. 8.9%	approx. 36.4%
\$700 million		approx. 9.5%	approx. 38.2%
\$750 million		10%	40%
\$800 million		10.5%	42%
\$850 million		11%	44%
\$900 million		11.5%	46%
\$950 million		12%	48%
\$1 billion		12.5%	50%
\$1.05 billion		13%	52%
\$1.1 billion		13.5%	54%
\$1.15 billion		14%	56%
\$1.2 billion		14.5%	58%
\$1.25 billion		15%	60%

If property tax relief funding exceeds \$1.25 billion, then the minimum remains at 15% and the maximum remains at 60%. If funding for property tax relief is less than \$750 million, then each district receives a prorated share of the \$750 million distribution formula.

**10. If there is not enough revenue in the Property Tax Relief fund and the Property Tax Relief Reserve Fund to make an allocation in the 2005-2006 school year, does the Budget Secretary still certify the amount in the funds – and does that still trigger the May 30 qualifying date?**

Yes. The secretary of the Budget will certify the total amount of revenue in the funds no later than April 15, 2005 – regardless of whether there is enough revenue to begin the state property tax relief allocation in the 2005-2006 school year. Also, regardless of the amount of revenue in the funds, school boards must pass a resolution by May 30, 2005, in order to qualify for state-funded property tax relief once it begins.

**11. Must school districts use the state property tax reduction allocation for property tax relief? What happens if the state allocation increases or decreases?**

All revenue that a school district receives from the state property tax reduction allocation must be used for homestead and farmstead exclusions. If the state allocation changes from one year to the next, the school district may calculate a new homestead and farmstead exclusion level. However, the formula is designed so that school districts will not realize reductions in state funds. If a reduction in gaming revenue should occur, a reserve fund exists to compensate for it.

**12. What is the Sterling Act tax credit?**

Right now, a resident of a suburban school district who commutes to Philadelphia for work is able to deduct city commuter wage taxes from any local EIT that the school district of residence levies. As a result, many suburban communities lose EIT revenue – and some find that it is not even worthwhile to levy the tax. This legislation compensates school districts for their lost revenue. The “tax credit” paid by the state must be used to further reduce property taxes. (Section 324)

## **OPTIONS FOR LOCAL TAX RELIEF REFERENDA IN 2005 AND 2007**

**13. What is the purpose of the November 2005 referendum? Is it mandatory?**

School districts have the option of offering a referendum question in the November 2005 municipal election to further reduce property taxes by shifting towards a local income tax. A school district can choose to offer voters one of the following to further lower local property taxes:

- Increase the local EIT or
- Levy a local Personal Income Tax (PIT)

This is a dollar-for-dollar shift: all revenue raised from the increase in EIT or PIT is used to reduce property taxes.

If a district decides to propose a referendum question for the November 2005 election, it can choose how much property tax relief to provide by shifting to a local income tax – up to the maximum homestead exclusion allowed in the Pennsylvania Constitution. Unlike in the November 2007 referendum, there is no requirement to reach at least 50% of the maximum allowable homestead exclusion.

If voters approve the November 2005 referendum, then the district automatically qualifies for the state property tax relief funding.

#### **14. What happens if a school district proposes the November 2005 referendum but voters reject it?**

By proposing the November 2005 referendum question, the school district is declaring its intent to participate in the provisions of Act 72 and qualify for the state property tax reduction allocation. As a result, if voters reject the referendum question, the school district must then levy the 0.1% EIT by school board resolution; the school district does *not* have the option of opting-out at that point. (Section 332 (d.1))

#### **15. What is the purpose of the November 2005 referendum? Is it mandatory?**

To continue eligibility for state property tax reduction allocations, all school districts that have qualified for the state property tax relief funding are required to put a referendum question on the ballot for the 2007 municipal election. This requirement *does not apply* to school districts that will have already reached at least 50% of the maximum homestead exclusion allowed by state law. (Section 332 (g))

A school district must choose to offer voters one of the following to further reduce local property taxes: (1) increase the local EIT or PIT or (2) levy a local PIT. (Section 332 (e))

If voters approve this ballot question, the total property tax relief in the school district will be at least 50% of the maximum homestead exclusion allowed in the Pennsylvania

Constitution. (Section 332 (c))

If a board of school directors fails to propose a referendum question at the municipal election of 2007, the school district will no longer qualify to receive a property tax reduction allocation from the state until a referendum question is proposed in a subsequent general or municipal election. (Section 332 (e))

**16. What if voters reject the 2007 referendum? Would the school district still qualify for the state property tax reduction allocation?**

Yes. The school district will continue to be eligible for the state property tax relief allocation as long as the question is *proposed* at the municipal election of 2007. Voters may choose to approve or reject the question; either way, the school district will still qualify for the state funding for property tax relief.

**17. School districts are required to propose a referendum in 2007y offering voters the option of raising the EIT or PIT to reach at least 50% of the maximum allowable homestead exclusion. If a school district's median assessed homestead value increases in subsequent years – thereby also increasing the maximum allowable homestead exclusion – is the school district required to offer another referendum?**

No. The 2007 referendum is the only time that school districts are required to offer voters the opportunity to raise the EIT or PIT enough to reduce property taxes by 50% of the maximum homestead exclusion (which is 50% of the school district's median assessed homestead value). After that any additional referendum to increase the EIT or PIT and further reduce property taxes is optional. (Section 332)

**18. If a school district does not take the required steps to qualify, must the school district hold the 2007 referendum?**

No. The requirement for a 2007 referendum applies to school districts that have qualified for property tax relief. (Section 332 (e))

**19. Must a school district convert its local Earned Income Tax into a local Personal Income Tax?**

No. School districts have the option of converting from an EIT to a PIT, but it is not mandatory. A school board can offer voters the choice to levy a PIT instead of an EIT at the 2005 municipal election, 2007 municipal election or any subsequent municipal election. (Sections 321 (c); 332)

## **20. May a school district still levy an EIT if it converts its existing EIT to a PIT?**

No. School districts that convert to a PIT to fund property tax relief will not be able to levy an EIT. Municipalities that agreed to split the current EIT with their school districts will not be able to increase their share of the EIT beyond the agreed-to amount. (Section 321 (c))

## **HOW TO GET A HOMESTEAD EXCLUSION**

### **21. Will every property owner receive tax relief?**

This tax reform legislation only applies to residential property owners. Pennsylvanians in 66 counties will receive property tax relief through homestead and farmstead exclusions.

In Philadelphia, the state funding for tax relief will be used to reduce wage taxes instead of property taxes. Wage taxes will be reduced for both resident and commuter wage tax payers. The property tax reduction formula generates a specific amount of wage tax reduction for city residents and for non-residents.

Because many senior citizens in Philadelphia pay property taxes but don't pay wage taxes, the law also includes tax relief for low-income senior citizens who live in the city. Pennsylvania's Property Tax/Rent Rebate program currently provides rebates up to \$500 for senior citizens whose household income does not exceed \$15,000 per year. Under the provisions of Act 72, low-income senior citizens in Philadelphia will be eligible for up to a total of \$750 in property tax rebates. (Section 704)

### **22. What are homestead and farmstead exclusions?**

The homestead and farmstead exclusions are the methods of property tax relief allowed by state law. An exclusion reduces the assessed value of the property, which leads to a lower property tax bill. For example, if the assessed value of a house is \$60,000 and the exclusion is \$20,000, the homeowner would only pay taxes on \$40,000 of assessed value – a reduction of 33%.

The Pennsylvania Constitution allows an exclusion of up to 50% of the median assessed value of all homesteads in the school district. The same exclusion applies to every homeowner in the district – which means that everyone receives the same dollar amount of tax relief.

A homestead must be a Pennsylvanian's permanent primary residence on which property taxes are paid. A farmstead exclusion provides property tax relief to farmers; it applies to

buildings used for agricultural purposes on a farm that is at least 10 contiguous acres. The farmstead must also be the primary residence of its owner. Farmers can be eligible for both a homestead exclusion and a farmstead exclusion since each covers a different part of the property.

### **23. How do you receive a homestead or farmstead exclusion?**

To receive a homestead or farmstead exclusion, a Pennsylvania resident must submit an application to the county assessor.

Homestead exclusion applications are due by March 1 of each year. Homeowners cannot be required to resubmit their application more than once every three years. In addition, school districts are required to mail notices each year to homeowners who have not yet qualified or whose application is due to expire.

Residents that acquire property in the school district after the March 1 deadline must wait until the following year to qualify for a homestead or farmstead exclusion. (Section 341)

### **24. Do all the funds collected through the additional local EIT or PIT have to be used for property tax relief?**

In the first year of implementation, the additional 0.1% local EIT that school districts levy in order to qualify must be used to reduce property taxes. If voters agree to increase the EIT or PIT above the additional 0.1% to further reduce property taxes, the board of school directors must use at least 98% of the revenue from that additional EIT or PIT to further reduce property taxes. In the fiscal year immediately following the year in which the tax is implemented and each fiscal year thereafter, any revenue above the amount collected in the first year of implementation may be used to support the school district's operations. (Section 321 (b), (c); 334)

### **25. What happens if the school district collects more or less revenue from the EIT or PIT than it did in the prior year?**

Each school district is required to annually calculate its homestead exclusion based on the amount of local EIT or PIT revenue and the state property tax reduction allocation. EIT or PIT revenue must first be used to maintain the total EIT or PIT revenue amount used to fund homestead and farmstead exclusions from the first year the tax was levied.

If excess revenue remains, the school board may 1) increase the homestead exclusion up to the maximum allowed by law, with any further excess being used to lower the EIT or

PIT tax rate, or 2) use the excess funds for the school district's operations.

If the school district collects less EIT or PIT than the prior year, the school district may consider that reduced revenue when it determines the value of the homestead exclusion. (Sections 334 and 342)

**26. What if the number of qualifying homesteads and farmsteads increases over time? Does the school district have to maintain the amount of the homestead exclusion applied in the first year?**

No. The school district is required to use only the state property tax reduction allocation and the local EIT or PIT revenue used to fund the homestead and farmstead exclusions. If there is not enough revenue from those sources to maintain the amount of the homestead exclusion, then the district may calculate a lower homestead exclusion. (Section 342)

## **HOW THE BACKEND REFERENDUM WORKS**

**27. Will school districts have to go to a referendum in order to raise school taxes again?**

The law requires a voter referendum if a school district proposes to raise its property tax rate – or the rate for other school taxes – faster than the inflation index.

The Index is the average of the percent increase in the Statewide Average Weekly Wage and the Employment Cost Index for elementary and secondary schools. For school districts with an aid ratio above 0.4000 in the prior school year, the index is calculated as follows:

$$\text{School District's Index} = \text{Index} \times (.75 + \text{school district's aid ratio})$$

For example, if the Index is 3.1% and a school district's aid ratio is 0.6000, then the Index that would apply for that school district is  $3.1\% \times (.75 + .60) = 4.185\%$ . The department of Education will provide each school district with its Index annually by September 30. (Section 302)

School Districts may also qualify for one or more referendum exceptions; these exceptions allow school districts to further raise tax rates beyond the index for specific purposes.

**28. What are the referendum exceptions? How do they work?**

The referendum requirement allows exceptions for specific cost increases.

Districts can apply for an exception for the following reasons:

1. Costs incurred responding to or recovering from an emergency or declared disaster.
2. Costs to implement a court order or administrative order from a federal or state agency.
3. Costs associated with the incurring of debt that is used –
  - To pay interest and principal on indebtedness incurred *prior to the effective date of the referendum provisions*.
  - To pay interest and principal on electoral debt.
  - To pay interest and principal on academic construction projects for up to 60% of the average construction cost per square foot calculated by the Department of Education and adjusted annually by the Index.
  - To pay interest and principal on the cost of non-academic construction projects up to \$250,000, annually adjusted by the Index.
4. Costs incurred responding to conditions that pose an immediate threat of serious physical harm or injury.
5. Costs to provide special education programs and services if special education expenditures have increased by more than 10%. In this case, the district can apply for an exception for the amount that expenditures exceeded 10%.
6. Costs to implement a school improvement plan required under No Child Left Behind, minus any state funds that the district received for this purpose.
7. Costs to maintain either –
  - Total local tax revenue per average daily membership (ADM) adjusted by the school district's Index, if ADM has increased by more than 7.5% over three years; or
  - Actual Instruction Expense per ADM adjusted by the school district's Index, if the AIE per ADM has failed to keep pace with the Index.
8. To maintain the combined revenue from local property taxes, earned income and net profits taxes, personal income taxes, and state Basic Education Funding and Special Education Funding allocations – adjusted by the school district's Index – if that combined revenue total has failed to keep pace with the Index.
9. Costs to provide health care benefits that were part of collective bargaining agreements agreed to before the effective date of the referendum provisions. In this case, the school district can apply for an exception for projected costs that exceed the Index.
10. PSERS payments that increase by more than 7.5%

For exceptions 1,2 and 4, a district must seek approval from the Court of Common Pleas. For the remainder of the exceptions, a district must seek approval from the department of Education. (Section 333)

**29. When do the referendum requirements for increasing certain taxes take effect?**

The referendum requirement is applicable to tax increases that take effect beginning in the 2006-2007 school year, and only for school districts that have qualified for property tax relief. Millage increases before the 2006-2007 school year are not subject to referendum approval.

The bill provides for special consideration of the impact of existing health benefit agreements contained in existing collective bargaining agreements and with respect to existing school construction debt. With multiple interpretations on the relevant dates affecting these costs/exceptions, each school district should consult with its solicitor and make its own decision on how best to proceed between now and the beginning of the 2006-2007 fiscal year, including how they set their 2005-2006 millage rates. When a school district requests a referendum exception, the Department of Education will review the request and issue an approval or denial. (Section 333)