



a closer LOOK



Proposed constitutional amendment would enable future tax reform legislation

This November, voters will have the opportunity to consider an amendment to the Pennsylvania Constitution proposed by Joint Resolution 1 of 2017.

Recently passed through the General Assembly as House Bill 1285, the resolution proposes to amend the constitution by authorizing the General Assembly to enact legislation allowing local taxing authorities (counties, municipalities and school districts) to exclude from property taxation up to the full assessed value of each homestead property within the taxing jurisdiction. Currently, the constitution caps homestead exclusions at 50% of the median assessed value of all homestead property within a local taxing jurisdiction.

What does this potential change mean for school boards? What actions will they have to, or be able to, take if the resolution is approved by the voters? The answer is that there will be no requirement or authority for school districts to do anything, unless and until the General Assembly enacts implementing legislation. Voter approval of the proposed constitutional amendment by itself will not change anything with regard to what taxpayers, school districts or taxing bodies can or must do. It simply expands the options available to the General Assembly for future legislation affecting homestead exemptions.

Until subsequent legislation is enacted, school boards have no duties to make changes to their budget and taxing decisions, policies and processes.



The impact of a constitutional change on tax reform efforts

Understanding the impact of the amendment proposed by Joint Resolution 1 of 2017, requires a brief review of earlier amendments to the Pennsylvania Constitution as well as a bit of legislative history. Until 1997, preferential tax treatment for homeowners was prohibited by the constitution's Uniformity Clause, which states:

All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws. (Article VIII, Section 1)

Article VIII of the state constitution includes authority for certain kinds of exemptions from property taxation, but the constitution itself does not create exemptions directly. The authority in the constitution permits the General Assembly to enact laws granting exemptions within the boundaries set by Article VIII, Section 2. Among the existing exceptions to the requirement of uniformity, are provisions allowing the General Assembly to enact exemptions from taxation of property owned by charitable organizations (Article VII, Section 2(a)(v)), and specific authorization for special tax treatment of land devoted to agricultural use (Article VIII, Section 2(b)(i)).

In 1997, Pennsylvania voters approved an amendment to the state constitution adding a new uniformity exception, allowing the General Assembly to authorize local taxing authorities to exclude from taxation an amount based on the assessed value of "homestead property." The effect of the amendment was to permit a limited kind of preferential tax treatment for homeowners. However, the amendment included two limitations. First, the exclusion could not exceed one-half of the median assessed value of all homestead property within the local taxing jurisdiction. Second, it prohibited taxing authorities from increasing the millage rate on real property in order to pay for the

exclusion. (Article VIII, Section 2(b)(vi)).

So, what did this exclusion mean to a property owner? If the General Assembly enacted enabling legislation, eligible properties could have a portion of their assessed value excluded from taxation, therefore lowering the property owner's tax bill. The dollar amount of the exclusion would be the same for all homestead properties.

The 1997 homestead exemption question was approved by 62% of those voting, with only seven of the state's 67 counties voting against it. Passage of the amendment provided the incentive for the General Assembly to work on the specific details of a local tax reform plan.

The first component in implementing this new authority was entitled the "Homestead Property Exclusion Program Act," which became law as a part of legislation enacting a larger school district property tax relief program, Act 50 of 1998. The Homestead Property Exclusion Program Act allowed, but did not require, local taxing authorities to create homestead exclusions subject to the constitutional limitations, and provided pertinent definitions and procedures for applications.

Previous amendments to the state constitution enabled earlier tax reform efforts.

Although the constitution does not mention farmsteads, the act provided for farmstead exclusions pursuant to the same constitutional authority. Under this legislation, only owner-occupied residential and farm properties are eligible for exclusions.

However, it is important to keep in mind that as a practical matter, even with legislative authorization, homestead/farmstead exclusions are only possible if there is some source of new revenue to fund them. The constitution does not permit property tax millage rates to be increased in order to replace the revenue



foregone due to the exclusions. If there is such an alternative source, the amount of the exclusion, while the same for all properties, may vary depending on how much alternative revenue is available and how many property owners apply and are approved for exclusions.

Other provisions of Act 50 offered an optional tax relief program that included a tax shifting mechanism that would help to fund the exclusions, at least partially. Among other provisions, Act 50 authorized school districts to levy an additional earned income tax in order to reduce property taxes and fund homestead/farmstead exclusions. Districts that opted into Act 50 would also be subject to limits on their ability to increase taxes without voter approval. Act 50 proved to be extremely unpopular with school districts and citizens, and only a handful of districts opted to use it.

The tax shifting scheme in Act 50 was replaced with a modified version by Act 72 of 2004. That law contained provisions that affected the procedures for developing school district preliminary budgets, and spelled out a process by which districts could receive allocations of state revenue derived from expanded casino gambling to be used for property tax relief. It also contained procedures for supplementing gambling revenues with local tax revenues for property tax relief, for front- and back-end referenda, and a distribution formula for allocating state gaming revenues to school districts. However, like its predecessor, Act 72 was unpopular and very few districts chose to use its authority.

Act 1 of 2006

Consequently, Act 72 was repealed and replaced with Act 1 of 2006, which is the current law governing property tax relief. Act 1 bears many resemblances to Act 72, with some twists. First, it required all school districts to participate. Among other provisions, it expanded the Senior Citizens Property Tax and Rent Rebate program, called for changes in how the local tax shift from property taxes to income taxes occurs, and changed the thresh-

old at which gaming funds would be available to school districts for property tax reduction. It also allowed districts to bypass the requirement for a preliminary budget by resolving to keep taxes at or under the Act 1 index.

The Act 1 index, established by the Pennsylvania Department of Education (PDE) and adjusted annually, is used to determine the maximum tax increases for each tax the school district levies. It serves as a cap on each district's allowable tax increase. A district that intends to raise taxes by more than the index can only do so by either voter approval or applying and qualifying for one of the referendum exceptions allowed under the law. Districts were originally given 10 exceptions to this requirement for a back-end referendum, many of which dealt with the increasing costs of state programs. However, Act 1 was modified by Act 25 of 2011 to remove a majority of the back-end referendum exceptions. Today, only four exceptions remain for these costs: pension, special education, electoral debt and grandfathered debt related to prior school construction projects.

Districts that believe they may need to use any of these exceptions must first seek approval from PDE.

They can use the total amount of their approved referendum exceptions if needed to balance their budgets, or they can use a lower amount or not use it at all.

Historically, about half of the districts that seek referendum exceptions end up using them. Most of exceptions sought are for pension obligations and special education expenditures.

Most of the referendum exceptions now sought by districts are for pension obligations and special education expenditures.

Joint Resolution 1 proposes authority for further property tax relief

Current law allows school districts to use the homestead/farmstead exclusion to reduce



property tax rates for those who own and reside in eligible property by utilizing income taxes and gaming allocations. The maximum permissible exclusion in a district is equal to 50% of the median assessed value of all eligible homestead/farmstead property in the district.

If approved by the voters in November, Joint Resolution 1 will amend Article VIII, Section 2(b)(vi) of the Pennsylvania Constitution to expand the current exclusion to allow local taxing authorities to exclude from property taxes up to the full assessed value (100%) of each homestead and farmstead within the taxing jurisdiction.

Currently, because the exclusion for each property is capped by the constitution and existing legislation at 50% of the median assessed value of all property within the taxing jurisdiction, the dollar amount of the exclusion is the same for each eligible property. The proposed amendment would allow the General Assembly to make it theoretically possible to entirely eliminate property taxes on all owner-occupied residences. However, this theoretical possibility can become a reality only if there is another source of revenue that could replace all the taxes currently being paid on account of homestead and farmstead properties.

What the General Assembly might do with this expanded authority is unknown. We can only speculate about what further property tax relief the constitutional amendment would look like, how increased exclusions would be funded, and what actions school districts would need to take to put any of it into action. The most that can be said at this point is that by expanding the constitutional limits on ex-

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clusions, the General Assembly will be able to adopt legislation to provide additional options for property tax relief for residential property owners, likely with shifts in other tax and revenue sources to help fund the exclusions and replace the revenue needed for educational programs.

Conclusion

Once approved, the amendment proposed by Joint Resolution 1 would allow taxing authorities to provide additional tax relief only if enabling legislation to implement the constitutional language is signed into law. Until such new legislation would be enacted, school boards have no duties or actions that they must take.

The immediate need is for school boards to remain active advocates in the ongoing statewide discussions on property tax reform and its impact on school funding. It is critical that any enabling legislation continue to give options to school boards in making their budget and tax decisions.

PSBA believes that the historical concept of a state-local partnership in funding public education is more important than ever, and that school districts must have the greatest flexibility in providing their local financial contribution to this effort, including a variety of local taxes and the development of available funding bases that are suitable to each school district's economic capabilities and conditions that exist locally. The state must continue to enable the utilization of an appropriately tailored mix of local taxes for public education, as determined by each school district.