

The Center for



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IMPACT AND ANALYSIS OF ACT 50

A report by
William T. Hartman
Pennsylvania State University

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Introduction

In 1998, the Pennsylvania legislature passed and the governor signed Act 50, a local tax reform law. At the time, it was the first major change in the local tax structure for Pennsylvania school districts in 25 years. Since its passage, only four of the 501 school districts throughout the state have enacted Act 50.

This study was conducted to document the fiscal outcomes for the four districts that implemented Act 50 and to provide an understanding of how the major features of Act 50—local tax reform, property tax reduction, limitation on local tax revenue increases—actually functioned. To that end, a series of fiscal analyses of the four districts was conducted, and the analyses were supplemented with additional information that profiled the school environment, community demographics, and fiscal characteristics of the districts and their communities. Additionally, results from interviews with key district administrators and school board members provided background information about the situations leading up to the authorization of Act 50 in the districts and their assessments of how it has functioned.

Review of Act 50 of 1998

The overall purpose of Act 50 was to provide local tax shifts within individual school districts. It was not a general tax reform approach for school funding since its effects were limited to only the local tax revenues of those districts that enacted its provisions. State funding for education was not involved. It represented a philosophical approach that emphasized local control of local tax growth through voter approval of increases beyond an annual inflationary increase. This was a potential major shift in the

governance structure of school districts since it removed some of the taxation authority from school boards and replaced it with the local electorate.

A second reform aspect was the shift in local school taxes from some of the Act 511 “nuisance taxes,” particularly the occupation assessment tax (OAT), and possibly property taxes, to an increased local earned income tax (EIT). This tax shift represented a more equitable tax structure within an individual school district since it was based more on the ability to pay, the generally used measure of the fairness of a tax.

The legislation required school districts that adopted Act 50 to modify their local revenue structure to levy a new earned income and net profits tax at one of three prescribed rates (1.0 percent, 1.25 percent or 1.5 percent) approved by their voters. The proceeds from this new tax would be used to:

- 1) Replace the revenues from certain Act 511 taxes (existing local earned income tax, occupation assessment tax, occupational privilege tax, and per capita taxes) that would be eliminated;
- 2) Increase operating revenues at a controlled rate; and
- 3) Reduce property taxes through homestead/farmstead exemptions and a general millage reduction (if funds were available after other prescribed uses).

Act 50 was optional for school districts and required voter approval by a “front end” referendum held at the general election prior to the fiscal year of implementation. If approved, the district would implement the local tax changes and could only return to their original local tax structure through another vote by the eligible voters in the district after a minimum of three years; this was known as a “back-out” or “opt-out” referendum.

Once in operation, Act 50 limited the ability of the district to increase local taxes without prior voter approval. Any proposed property tax rate increase that would cause

growth in budgeted local tax revenues to exceed the percentage growth in Statewide Average Weekly Wage (SAWW) required voter approval in a “back-end” referendum. Certain exceptions to the requirement for a back-end referendum required permission from the Court of Common Pleas or from the Pennsylvania Department of Education.

Initially, five districts had referenda for local tax reform on the November 1999 ballot. Voters in three districts, Central Dauphin (Dauphin County), Hazleton Area (Luzerne County), and Williamsport (Lycoming County), approved the optional tax structure, while Cambria Heights (Cambria County) and Dover Area (York County) rejected Act 50. In 2001, two additional districts held referenda; Southern Columbia (Columbia County) voters approved Act 50, while Oley Valley (Berks County) voters did not. The study focused on the four districts that have implemented Act 50.

Research Methodology

The time frame for the study was from the 1998 school year through the 2004 school year; this allowed a minimum of two years of information prior to the implementation of Act 50 through the latest year for which data were available at the time of the research. Through this time period, the study analyzed the fiscal changes that occurred with the implementation of Act 50 for these districts.

Data Sources

Secondary data sources were the primary basis for information. The principal state-level data source for district fiscal and student data, and demographic data was from the Pennsylvania Department of Education (PDE) Web site.

At the district level, data specific to Act 50 implementation and not collected by the state were obtained directly from the four districts. In addition to collection of fiscal data, site visits and telephone interviews were conducted with superintendents, school business managers, and school board presidents in each Act 50 district. The interviews discussed the background leading up to Act 50 for the district, the intentions of the board and the expectations of the public in adopting Act 50, the use of funds from the new local tax structure, the need for a back-end referendum, the number of homesteads and farmsteads and the possible real estate tax reduction amounts, and the impact that the tax limitation provision has had on district operations.

Data Analysis

District information, community characteristics, and district financial data elements were analyzed separately for each Act 50 district and then compared with other Act 50 districts to uncover similarities and differences that might exist. Using the annual district fiscal data, a series of calculations were done to investigate fiscal trends and patterns. The types of fiscal analyses carried out were: major revenue sources; local tax revenues; Act 511 taxes; property tax base and tax rates; fund balance; SAWW limitations; enrollments; and expenditures.

Overview of Fiscal Impact of Act 50

District Fiscal Comparisons

Central Dauphin, Hazelton, and Williamsport passed the front-end referendum initiating the Act's provisions in November 1999, the first available date for an election. Southern Columbia passed the referendum to enact Act 50 in November 2001. Central

Dauphin, Southern Columbia, and Williamsport used the maximum EIT rate of 1.50 percent to raise the maximum amount of revenue with this tax. However, Hazelton choose the minimum 1.00 percent EIT rate after projecting that a higher rate would cause a general property tax rate reduction instead of focusing the property tax relief on homeowners.

Interviews with district administrators and school board members revealed that a primary reason for voter approval of Act 50 was to limit future tax increases. Only Hazelton provided any significant property tax relief through the homestead exclusion, which matched their original intentions. Central Dauphin provided a small, almost token, amount for property tax relief. Southern Columbia and Williamsport used all of their new EIT monies to eliminate their very high occupation taxes and other Act 511 taxes.

Southern Columbia was the only district that went to a back-end referendum; it was proposed only once and it failed to receive voter approval. Otherwise, the districts were able to operate within the SAWW limitations on local tax revenue increases. Hazelton, Southern Columbia and Williamsport did find additional operating revenue through the reduction of relatively high fund balance amounts. By contrast, Central Dauphin experienced higher than anticipated real estate tax revenues after initiating Act 50 and used them to build up its depleted fund balance rather than increase expenditures.

Pre and Post Act 50 Local Tax Revenues

Act 50 caused a change in the local tax structure for the four districts. It eliminated certain Act 511 taxes, increased the EIT rate, and limited the budgeted increase in local tax revenues. In the first year, real estate taxes in the districts either decreased or had very small increases; EIT revenues were up sharply with the higher

permitted tax rates; and per capita and occupation taxes under Act 511 were eliminated. The analysis of first year differences indicates that the changes in total local tax revenues ranged from a 3 percent reduction to a 7 percent gain; all Act 50 districts were below the 10 percent state average gain in local tax revenues for that year.

For the 2004 school year, the final year of the analysis, Central Dauphin, Hazelton, and Williamsport had been operating under Act 50 for four years and Southern Columbia completed its second year with the new system. Central Dauphin (29 percent), Southern Columbia (5 percent), and Williamsport (9 percent) had real estate tax increases, while Hazelton (-7 percent) still had lower real estate taxes after four years. However, except for Central Dauphin, the real estate tax increases were well below the statewide four-year total increase of 28 percent. As expected, the EIT revenues increased substantially and certain Act 511 taxes were eliminated entirely. Overall, Hazelton, Southern Columbia, and Williamsport had total local tax revenue increases in the 7 percent to 10 percent range, well below the statewide average of 26 percent during the same time period, while Central Dauphin was a bit above the state average.

Conclusions

The school districts learned to live with the limitations of Act 50 on local tax revenues, and realized several other impacts to accommodate the new local tax structure. For example, having to live within revenue limitations forced districts to find some efficiencies in their operations to control expenditures. It also had some impact on negotiations with employee unions since there was a clear limit on revenue increases to pay for increases in salaries and benefits. The limitations also required districts to set priorities and make choices among competing programs and services when there were not

sufficient funds. Education programs were also limited or reduced, some students did not have all the classes they expected, and supplies were cut.

Over time, the impact on facilities could be a potentially serious feature, particularly in new construction or renovation and in deferred maintenance, which could require bond issues with consequent higher taxes for debt service. Examples of short-term responses were stretching out a bond issue for a new building to stay within the annual limitations, and attempting but failing to pass a back-end referendum for a needed building expansion. Since the back-end referendum is the only time in which Pennsylvania voters have the opportunity to vote directly on any of their taxes, it can become an outlet for frustration over taxes in general.

Property tax reduction was provided in only one district in any substantial way. Other uses for the increased EIT funds had greater priority, primarily the elimination of unpopular Act 511 taxes. However, voters were concerned about future tax increases and this was a primary reason cited for the passage of Act 50. In this area, Act 50 seems to have been effective in the short term as three out of four Act 50 districts had substantially lower growth in local tax revenues over the last four years compared to the statewide average.

The back-end referendum, a major cited feature of Act 50, was not a significant feature in actual operations. Districts deliberately avoided the backend referendum, except in one case for a new building. They used several strategies to stay under the local tax revenue limitation, including: maximizing the annual tax increase allowed under the SAWW; using their relatively high fund balances as a temporary source of additional revenue; and restricting expenditure growth. In particular, use of their fund balance is a short-term strategy since once the fund balance is depleted, it is no longer available for

supporting expenditures, and taxes need to be increased to replace these funds and/or expenditures reduced further.

One of the major concerns of districts was the change of focus of the school board from a balance between educational programs and fiscal responsibility to an emphasis on taxes and revenues. It was seen as a short-term orientation, more concerned with holding on to what the district had in terms of staff and programs, and less weight given to the future and longer-term needs of the district. SAWW annual percentage increases, which became the local tax revenue driver, were unstable and unreliable, ranging from under 2 percent to over 5 percent over the past several years. This variability inhibited effective long-range planning since districts could not count on a reliable revenue source for program and operational planning.

Based on the study sample, the researcher concluded that school districts least likely to be affected from an Act 50-type local tax system would be those that are fiscally strong. Fiscal strength would enable these districts to avoid the restrictions that local tax revenue limitations would potentially place on educational programs in the district. More affluent districts, which typically have a higher percentage of local funding, have more flexibility in absorbing state funding shortfalls; further, with a larger amount of local tax revenues, any percentage increase would give them a greater dollar increase. Districts with a growing property tax base and/or an increasing level of earned income could use the natural increases in tax revenue to fund programs without increasing taxes.

In contrast, districts more likely to be affected from an Act 50-type local tax system are those that are less wealthy and have fewer fiscal resources or strong community economic conditions. The effects on these districts would more likely come in the form of educational program reductions as operating efficiencies are exhausted.

These districts typically rely more heavily on state funding to support their operations and would not have the capacity to increase local taxes to make up for state funding shortfalls. The result of revenue restrictions could result in expenditure increases below the level of inflation and potentially cause program cuts, curtail program improvement opportunities, and/or place limits on needed facility expansions or renovations.

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The Center for Rural Pennsylvania
200 North Third St., Suite 600
Harrisburg, PA 17101
Phone: (717) 787-9555
Fax: (717) 772-3587
www.ruralpa.org
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