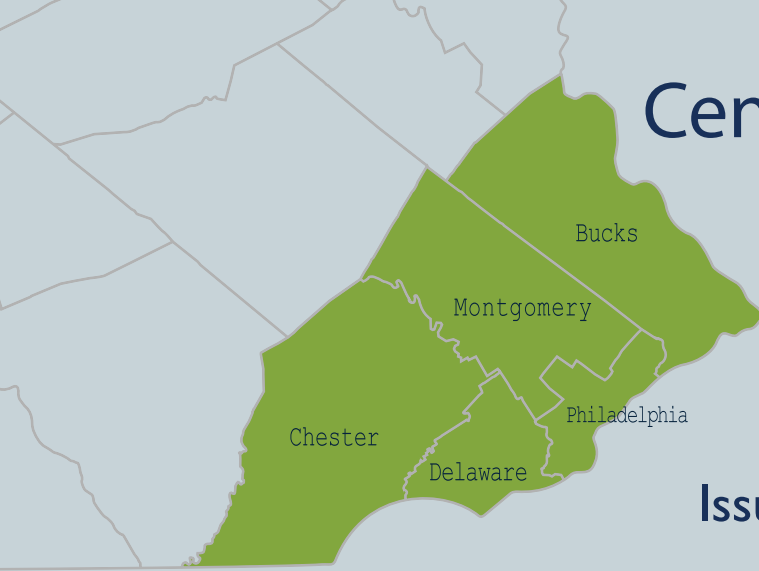


Center on Regional Politics



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Issue Memos are prepared under direction of the Center on Regional Politics (CORP) staff to summarize public policy problems deemed important by the center's Executive Committee or Policy Committee co-chairs. The memos attempt to identify options for addressing those problems, but do not make specific recommendations and do not imply endorsement by the center's Executive Committee, Policy Committees, or Board of Fellows. Policy reports issued by the Executive Committee or Policy Committee co-chairs may identify approaches that CORP working groups have found to have consensus support.

HOW PENNSYLVANIA FUNDS PUBLIC SCHOOLS: THE STORY OF THE LOCAL SHARE

Eileen McNulty

Local real estate taxes are the dominant method of supporting public schools in Pennsylvania as they are in many other states. However, there are differences in the dependence on property taxes among the various classes¹ of school districts due to differing authority to levy taxes and local variations in land use.

Table I (next page) displays the percentage reliance on different categories of local taxes for all school districts statewide and for the five largest districts by average daily membership (ADM) as of FY 2011-12.

Statewide, property taxes accounted for 85.5% of local school district tax revenues. However, there is wide disparity in dependence on property taxes among the different districts across Pennsylvania. Pittsburgh and Reading, with real estate taxes providing 56.7% of local school taxes, are less dependent on real estate taxes than the statewide average. By contrast, Allentown and Central Bucks School Districts are only slightly higher than the statewide average. The 20 districts with the highest reliance on property taxes² are located in the four counties surrounding Philadelphia.

Table I also highlights differences in the relative reliance on earned income taxes among districts. Statewide, school districts raise 10.5% of their local revenues from earned income taxes, but the range is broad. The Philadelphia School District does not receive any earned income tax revenue—wage tax revenues go to the City government.³ Another 33 school districts, including 26 in the suburban Philadelphia counties, do not impose earned income taxes. This reflects the fact that Philadelphia's city wage tax has primacy over earned income taxes imposed by the taxpayer's jurisdiction of residence, so only a limited number of residents in some suburban areas, where many work in Philadelphia, would end up paying the tax. By contrast, Pittsburgh School District relies on earned income taxes for 40.8% of its local tax revenue. Ten school districts in Pennsylvania rely on earned income taxes for more than one-third of their local tax revenue.

Neither property values nor income are distributed evenly across school districts. A high ranking number, as shown in Table 2, for either market value per weighted student count (MV per WADM) or personal income per student (PI per WADM) indicates a lower than average tax base

1. School districts in Pennsylvania are classified by population into five classes. Philadelphia is the only First Class School District, Pittsburgh is the only First Class A School District, and all other school districts are Second, Third, or Fourth class districts. Philadelphia and Pittsburgh are granted taxing authority specific to them in most cases, while general laws govern the taxing authority of the other classes of school districts.

2. Real estate taxes as a percentage of local tax revenues range from 92.9% to 96.7% in those 20 districts.

3. Philadelphia School District does impose a tax on unearned income which is not authorized for any other district in PA. It is shown in the category 'other' in Table I. See Appendix A for more information on the relative contribution of this tax with a very narrow base.

Table 1: Percentage of Local School District Taxes by Source FY 12-13

Statewide and Five Largest School Districts	Real Estate	Earned Income	Business Taxes	Other	2011-12 Average Daily Membership
Statewide	85.5%	10.5%	1.7%	2.4%	1,755,040
Philadelphia	74.8%	0.0%	21.7%	3.5%	201,695
Pittsburgh	56.7%	40.8%	0.0%	2.5%	28,205
Central Bucks	89.4%	8.7%	0.0%	1.8%	20,261
Allentown City	87.4%	9.8%	0.0%	2.8%	19,282
Reading	56.7%	37.0%	4.0%	2.3%	18,488

Source: "Finances AFR LocalRev 0304-1213.xlsx" accessed at: http://www.portal.state.pa.us/portal/server.pt/community/summaries_of_annual_financial_report_data/7673/af_r_excel_data_files/509047. Categorization and calculations by Temple University Center on Regional Politics.

per student to support educational costs at the local level. Among the five largest districts in Pennsylvania by student count, only one is in the top 10% for either measure. Central Bucks is 36th among the 500 districts in market value and 50th in personal income, making the "top ten" in both categories. Pittsburgh is above the statewide average on both measures. On the other hand, three of the five largest districts are in the bottom 10% when it comes to the ability to raise local funds for education from income or property – Philadelphia, Reading, and Allentown. Reading has the biggest challenge among the Commonwealth's 500 districts when it comes to raising education funds locally.

Taxes imposed on businesses or their customers represent only 1.7% of school districts' local tax revenues on average statewide. Only 99 of Pennsylvania's 500 school districts impose any business taxes. Outside of Philadelphia there has been an erosion of authority over the years to tax business activities or privileges at the local level under the Local Tax Enabling Act (does not apply to Philadelphia or Pittsburgh School Districts). Notably, business gross receipts taxes were frozen as of November 30, 1988 at the levels and subjects of taxation in effect on that date. School districts were also prohibited from levying admissions or amusement taxes after FY 1996-97 in excess of what was collected in that year. Of the 99 districts that utilize taxes on business, only four collect more than 10%

of their tax revenues from businesses or customer transactions. Clairton City School District (SD) collects 30.2% of its local tax revenues from business privilege and mercantile taxes. Altoona Area SD obtains 13.0% of tax revenue from business privilege, mercantile and amusement taxes. Scranton SD collects 11.2% of taxes from its business privilege and mercantile taxes. Philadelphia SD, which has different taxing powers than any other school district, collects 21.7% of its taxes from its separately authorized Business Use and Occupancy Tax and Liquor Tax.

The greater reliance on business taxes in the Philadelphia SD compared to the rest of the state is also reflected in the distribution of property values. Market value of property in the Commonwealth is split 72-28 between residential and non-residential uses. However, in Philadelphia only 56% of taxable property is residential while business property is a robust 44%.

Tax exempt property also presents a significant concern for districts that must rely heavily on property based taxes, yet are hosts to many valuable non-taxable venues including parks, non-profit museums, churches, universities, hospitals, and government offices. No statewide figures are available for the value of tax-exempt properties, and in-lieu-of-tax arrangements differ as far as sharing between municipal and school government are concerned. Only ten

Table 2: 2011 Market Value and Personal Income per 2011-12 WADM

Statewide and Five Largest School Districts	County	MV per WADM	Rank MV per WADM	PI per WADM	Rank PI per WADM
Statewide		\$347,646	219	\$134,551	194
Philadelphia	Philadelphia	\$188,843	430	\$93,674	413
Pittsburgh	Allegheny	\$409,409	137	\$187,994	67
Central Bucks	Bucks	\$618,291	36	\$206,153	50
Allentown City	Lehigh	\$180,471	439	\$67,734	486
Reading	Berks	\$72,254	500	\$46,764	499

Source: "Finances AidRatios 2013-2014 July2013.xlsx" accessed at: http://www.portal.state.pa.us/portal/server.pt/community/financial_data_elements/7672.

school districts in the state received more than \$500,000 in state and local in-lieu-of-tax payments. Federal payments go only to areas with forested property.

Table 3 below displays the percentage of local market value by class of property statewide and in the five largest school districts.

Table 3: 2012 Market Value by Land Use

	Total Residential	% of Total	Commerical	% of Total	Industrial	% of Total
Statewide	\$325,852,865,024	72.0%	\$90,453,457,002	20.0%	\$14,328,780,113	3.2%
Philadelphia	\$6,868,387,701	55.7%	\$4,840,278,982	39.2%	\$628,351,585	5.1%
Pittsburgh	\$7,393,729,701	57.8%	\$5,297,416,835	41.4%	\$94,039,790	0.7%
Central Bucks	\$1,427,846,640	81.8%	\$208,741,640	12.0%	\$35,349,000	2.0%
Allentown City	\$1,094,011,550	68.2%	\$411,114,000	25.6%	\$98,006,750	6.1%
Reading	\$957,902,300	68.4%	\$327,055,000	23.3%	\$115,521,100	8.2%

	Agriculture	% of Total	Other	% of Total	TOTAL
Statewide	\$18,805,948,303	4.2%	\$2,920,296,195	0.6%	\$452,361,346,637
Philadelphia	\$0	0.0%	\$0	0.0%	\$12,337,018,268
Pittsburgh	\$113,500	0.0%	\$464,500	0.0%	\$12,785,764,329
Central Bucks	\$71,447,250	4.1%	\$1,841,350	0.1%	\$1,745,225,880
Allentown City	\$95,050	0.0%	\$992,400	0.1%	\$1,604,219,750
Reading	\$627,000	0.0%	\$0	0.0%	\$1,401,105,400

Source: 2012 Land Use file available at: <http://www.newpa.com/local-government/steb>.

The heavy reliance on property taxes for local support of schools, combined with the large portion of property that is residential in most areas of the state, translates to the burden of local support for schools falling heavily on homeowners. Thus, reform efforts stretching back over 25 years have focused on reducing local reliance on property taxes and limiting the impact of the property tax on homeowners (relative to business property owners).

The most extensive recent reform effort, the Taxpayer Relief Act of 2006, uses gaming tax revenues to provide real property tax relief to homeowners in every school district in Pennsylvania, except Philadelphia. In Philadelphia the tax relief is applied to the City wage tax rather than the property tax. The increased reliance on local revenues to support schools counteracts the effect of changes intended to reduce reliance on property taxes and their impact on homeowners coming, as it has, at a time when state governments have been reducing their share of school funding.

Comparable national statistics over the last five years show that the state portion of state-local support for public schools is declining nationally. Table 4 shows that states' portion of state and local revenue raised for public schools ranged from 49.8% to 53.9% of total school revenues and stood at 50.5% in 2010-11. At the same time, the local

share of state-local school revenues ranged from 46.1% to 50.2% and stood at 49.5% in 2010-11.

Here in Pennsylvania, school districts raised 60.7% of the state-local revenues to support Pennsylvania public schools in 2010-11 compared with the national average of 50.5% coming from local sources—more than ten percentage points **higher** than the national average. The

Commonwealth provided 39.3% of the state-local revenues supporting public schools for the 2010-11 school year compared to the national average of 50.5%—well over ten percentage points **below** the national average.

Philadelphia School District Taxing Authority

The School District of Philadelphia raises about three-quarters of its local revenue from property taxes (see Table 1). Property taxes for schools are authorized under the Public School Code as well as a number of other statutes. Act 131 of 2012 extended authorization for the Homestead Property Exclusion Program to Philadelphia. That program, which had not previously applied to Philadelphia, was originally established by Act 50 of 1998, right after the 1997 approval of a constitutional amendment authorizing a homestead exclusion from property. Act 131 also delayed the implementation of the Actual Value Initiative for property tax assessments in Philadelphia until tax year 2014.

The second largest local revenue source for the School District is the Business Use and Occupancy Tax levied on the privilege of using real estate for commercial and industrial activity. This tax provides just over an eighth of the School District's own revenue. The tax is levied under

the general authority of the “Little Sterling Act” of 1963 which allows the City to authorize the School District to impose taxes on any of the same subjects that the City can tax under the Sterling Act of 1932. The School District also collects a ten percent liquor-by-the-drink tax levied pursuant to the First Class School District Liquor Sales Tax Act of 1971.

The Little Sterling Act was amended in 1967 to authorize the School Income Tax on unearned income and provides for the following exemptions:

- interest on obligations of the US, the Commonwealth and any of its political subdivisions;
- interest and dividends on savings deposits and savings certificates issued by financial institutions;
- and gains on the sale of property held for a period of more than six months.

The tax is imposed only on residents and at the same rate as the resident wage tax.

Additional local revenues provided to the School District come from grants from the City of Philadelphia, a contribution from the Parking Authority, a \$5 million share from the income of the casino located in Philadelphia and income from the sale of property. (See Appendix: Table A.)

Pittsburgh School District Taxing Authority

Pittsburgh School District relies less on property taxes and more on earned income taxes than the statewide average. The School District collects only 56.7% of its tax revenue from property taxes and relies on earned income taxation for 40.8% compared to statewide figures of 85.5% and 10.5% respectively. This reflects the fact that Pittsburgh SD imposes a higher earned income tax rate at 2% than any

other school district in the state. The district is required to share the revenue from .25% of the levy (one-eighth of the revenue) with the City of Pittsburgh. The only other tax the district imposes is the realty transfer tax imposed at 1%.

In previous years the School District had a more diversified tax base that included a mercantile tax and revenue from a personal property tax. The authority to levy the mercantile tax was rescinded effective for 2005. Act 186 of 2004 repealed a provision of the Regional Asset District legislation that had provided the School District with an annual appropriation from the City of Pittsburgh to compensate for the repeal of the personal property tax. Pittsburgh SD exemplifies the dilemma faced by local schools in an environment of reduced state support and rising pension costs. The district is at the maximum statutory non-property tax rates on authorized levies and is located in a distressed municipality that is facing its own challenges handling increasing pension costs.

Second, Third, and Fourth Class School District Taxing Authority

The Public School Code and the Local Tax Enabling Act (LTEA) provide Second, Third, and Fourth class school districts in PA with their taxing authority. Most school non-property taxes were initially authorized under the broad authority granted in the LTEA to local governments and schools to impose taxes on persons, transactions, occupations, privileges, subjects and personal property, and on the transfer of real property - except for a list of specific exclusions. Over the years a variety of amendments eliminated many of the taxes once levied under this Act and its predecessor. Additionally, rates of most taxes are capped and tax bases have been restricted. There is also an overall

Table 4: Revenue for Public Elementary and Secondary Schools by Source of Funds (\$ thousands)

	2006-07	2007-08	2008-09	2009-2010	2010-11
US States and Local	496,702,460	524,587,872	524,136,453	521,488,011	528,751,734
PA State and Local	21,807,423	22,744,114	23,363,552	23,521,767	23,855,258
US States	263,608,741	282,662,805	277,079,518	259,809,768	266,786,402
US States %	53.1%	53.9%	52.9%	49.8%	50.5%
PA State	8,675,316	9,122,496	9,920,340	9,456,502	9,378,294
PA State %	39.8%	40.1%	42.5%	40.2%	39.3%
US Local	233,093,719	241,925,067	247,056,935	261,678,243	261,965,331
US Local %	46.9%	46.1%	47.1%	50.2%	49.5%
PA Local	13,132,108	13,651,618	13,443,213	14,065,265	14,476,964
PA Local %	60.2%	59.9%	57.5%	59.8%	60.7%

Source: U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, Digest of Education Statistics at: http://nces.ed.gov/programs/digest/d13/tables/dt13_235.20.asp.

ceiling on revenues that can be raised from these taxes equal to 12 mills times the market value of the property in the political subdivision levying the tax.

Tax Reform Efforts

Efforts to reduce reliance on the property tax as well as some of the more regressive taxes once imposed under the LTEA such as the Occupational Privilege Tax led to a number of reform efforts. In 1988 the General Assembly passed the Local Tax Reform Act, which would have increased the income taxing powers of school districts and municipalities in order to reduce real estate taxes and replace a number of local taxes on individuals. Counties would have gained authority to utilize sales taxes. These changes were contingent on adoption of the plan by the voters in a statewide referendum. On May 16, 1989 voters defeated the plan, so the majority of changes never went into effect and were eventually repealed. One provision of the act that survived, because it was not dependent on adoption of the referendum, was the prohibition of new or expanded business gross receipts taxes (not to be confused with flat rate business privilege taxes).

After the defeat of the Local Tax Reform referendum, pressure to relieve the regressive impact of the property tax continued and eventually led to the adoption of a constitutional amendment in November 1997 authorizing the use of the homestead exemption to ameliorate the burden of property taxes. A homestead exemption is a flat uniform amount deducted from the assessed value of each eligible homestead before applying the tax rate. The implementing legislation was Act 50 of 1998. Act 50 also included an opportunity for school districts to put a referendum before taxpayers allowing them to adopt an earned income and net profits tax at a rate of 1.0%, 1.25%, or 1.5%. In exchange, school districts would have to eliminate the regressive occupation, occupation privilege, and per capita taxes levied under the LTEA, limit future tax increases, and reduce property taxes first by implementing a homestead exemption, and secondly through reduction of the millage rate. Only four school districts adopted referenda under Act 50.

Other provisions of the Act limited school districts' ability to levy any new or additional amusement taxes, sign privilege taxes, or motor vehicle transfer taxes under the LTEA. Concern on the part of school directors about proposing a tax switch that would limit their ability to increase tax rates in the future may have contributed to the low adoption rate of Act 50 alternatives.

The tax reform effort continued with Act 24 of 2001 which authorized school districts to conduct a referendum au-

thorizing their directors to replace the occupation tax with a revenue neutral increase in the earned income tax. This limited approach proved more successful and the following year similar authority was extended to municipal governments. Act 166 of 2002 aligned the definition of earned income and net profits used for local taxation with the definitions used for state income tax purposes.

Act 32 of 2008 made significant changes in the manner of withholding local earned income and local services taxes. Instead of only requiring employers to withhold taxes for the political subdivision in which they are located, employers were required to withhold for all such taxes imposed under the LTEA. The number of tax collectors was reduced from over 500 statewide to 69 statewide - one per county except for Allegheny County which has four. Philadelphia is not covered by the LTEA.

Taxpayer Relief Act

The Taxpayer Relief Act of 2006 provides real property tax relief to homeowners in every school district in Pennsylvania, except Philadelphia. In Philadelphia the tax relief is applied to the wage tax rather than the property tax.

The tax relief is provided from slot machine and table gaming revenues and is distributed to school districts to fund a homestead exemption within the district. In addition, districts can ask voters to approve increases in local income taxes to implement greater homestead exemptions up to the constitutional limit of half the median assessed value of homestead property. In FY 12-13 the reductions in homeowners' school property tax bills averaged an estimated \$200 per homestead and ranged from \$52 per homestead in Palmyra and Dallas school districts to \$632 per homestead in Chester-Upland school district.

School district tax relief totaled \$615.6 million in FY 12-13 under this program. The majority of the relief, \$508.7 million, funded the property tax reductions for homesteads described above. Philadelphia's share of the funds - \$55.9 million - was dedicated instead to reducing the Philadelphia resident wage tax rate. Another share of the funds provided \$30.4 million for reduction of Philadelphia's non-resident wage tax rate. The remaining tax relief provided to school districts by the Taxpayer Relief Act reimburses districts across the state for credits they provide against their own wage taxes for taxes paid by their residents to Philadelphia.

In FY 12-13, \$20.7 million was used to reimburse non-Philadelphia school districts for these Sterling Act tax credits provided against their local wage taxes. In addition to homestead exemptions and Philadelphia wage tax relief,

the Taxpayer Relief Act increased the income ceilings and maximum rebates available to senior citizens through the Property Tax and Rent Rebate Program administered by the state.

The Act also instituted an index to cap school district tax increases. The index is computed using the statewide average weekly wage, and the federal employment cost index. The base index amount is 2.1% for 2014-15. Adjustments are made to the index based on district specific factors, but tax increases above the adjusted index are not allowed without voter approval except in very limited exceptions. Act 25 of 2011 limited the exceptions to two relating to paying off indebtedness, one relating to special education costs and one to address the situation when the school's required share of retirement payments to the Pennsylvania Public School Employees' Retirement System (PSERS) increases more than the index.

Temporary Tax Exemptions

In 1998 the Commonwealth created twelve Keystone Opportunity Zones (KOZs) and later expanded and extended the program to include Keystone Expansion Zones (KOEZs) and Keystone Improvement Zones (KOIZs). Collectively known as Opportunity Zones, these programs designated underdeveloped and underutilized areas where specific state and local taxes will be eliminated or credits granted for a specific time within the zone in order to encourage economic development and job creation. Local taxes that are eliminated in these districts include real estate taxes, earned income and wage and net profits taxes, business gross receipts and business privilege taxes, and

the Philadelphia specific versions of these taxes as well as the school district's business use and occupancy tax and the City's sales tax. Philadelphia has a number of KOZs. One round of zone benefits expired in December of 2013, but others continue until 2018, 2020, and 2025. The Chester KOZ, which includes the location of the Harrah's Casino and Racetrack, expired at the end of 2013. The casino's estimated \$255 million property will now be entered on the City of Chester and Chester-Upland School District tax rolls.

Other economic development programs that can affect school district revenues are Neighborhood Improvement Zones (NIZ) enacted in 2009, 2011, and 2012 and City Revitalization Improvement Zones (CRIZ) enacted in 2013. The pilot project for the NIZ program is in Allentown. This program diverts existing state and local non-property tax collections from activity within the designated zone to the development authority for payment of bonds used to stimulate economic development projects in the zone. Lancaster and Bethlehem were the only locations approved for CRIZs in the first round of approvals following the pilot program.

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Appendix: Table A

School District of Philadelphia Operating and Grant Revenues FY 10-11 (actual) and FY 13-14 (estimated)

	FY 10-11 (\$)	% of Local	% of Total	FY 13-14 (\$)	% of Local	% of Total
Local Tax Revenue						
- Real Estate Tax	589,272,480	70.5%	19.2%	647,275,000	67.3%	23.3%
- Business U&O Tax	109,272,547	13.1%	3.6%	133,300,000	13.9%	4.8%
- Liquor Sales Tax	43,892,467	5.2%	1.4%	52,600,000	5.5%	1.9%
- School Income Tax	24,010,810	2.9%	0.8%	27,750,000	2.9%	1.0%
- Public Utility Realty Tax	1,114,918	0.1%	0.0%	1,049,000	0.1%	0.0%
TOTAL LOCAL TAX REVENUE	767,563,222	91.8%	25.0%	861,974,000	89.6%	31.0%
Local Non-Tax Revenue						
- Grant from City of Philadelphia	38,600,000	4.6%	1.3%	69,050,000	7.2%	2.5%
- Parking Authority Contribution	7,788,576	0.9%	0.3%	9,914,000	1.0%	0.4%
- Gaming Revenue	5,793,286	0.7%	0.2%	5,000,000	0.5%	0.2%
- Other Non-Tax Revenue	16,525,297	2.0%	0.5%	16,053,000	1.7%	0.6%
TOTAL LOCAL NON-TAX REVENUE	68,707,159	8.2%	2.2%	100,017,000	10.4%	3.6%
TOTAL LOCAL REVENUE	836,270,381	100.0%	27.2%	961,991,000	100.0%	34.6%
State Funding						
State Funding Operating	1,377,621,132		44.8%	1,355,515,000		48.8%
PA Provided Fed. Stimulus Funds/SFSF	121,852,159		4.0%	0		0.0%
State Funding Grants	146,377,148		4.8%	66,188,018		2.4%
TOTAL STATE REVENUE	1,645,850,439		53.5%	1,421,703,018		51.2%
Federal Grants						
Recurring Federal Grants	313,905,712		10.2%	274,453,836		9.9%
Federal Stimulus Funds	163,504,905		5.3%	2,488,188		0.1%
Federal Operating Revenues	6,037,554		0.2%	11,881,000		0.4%
Food Services Fund - Federal Funding	78,104,669		2.5%	86,338,630		3.1%
TOTAL FEDERAL REVENUE	561,552,840		18.3%	375,161,654		13.5%
OTHER GRANTS	3,058,563		0.1%	3,877,049		0.1%
OTHER FINANCING SOURCES	27,305,563		0.9%	15,204,000		0.5%
TOTAL OPERATING AND GRANT REVENUES	3,074,037,786		100.0%	2,777,936,721		100.0%

Source: School District of Philadelphia FY 2012-13 Consolidated Budget; School District of Philadelphia FY 2013-14 Consolidated Budget

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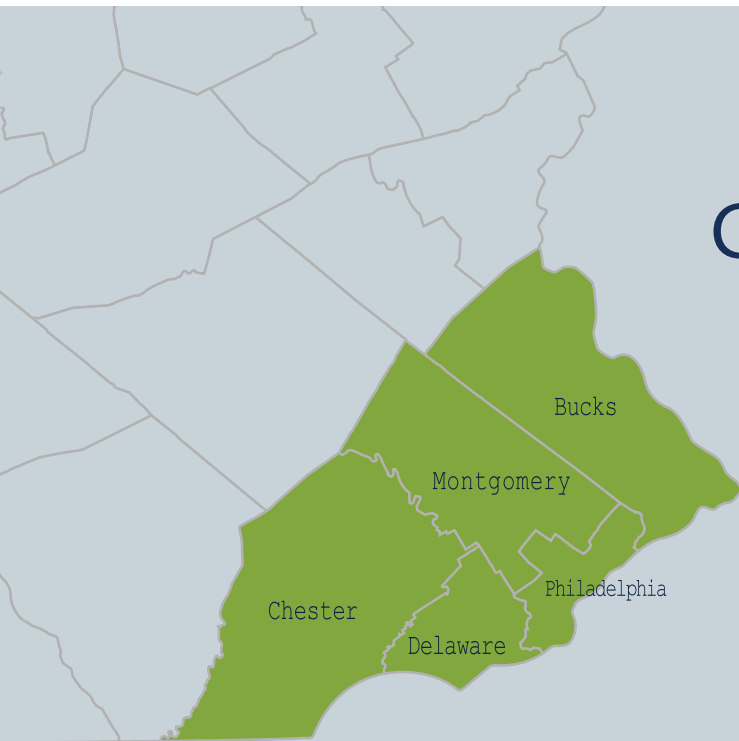
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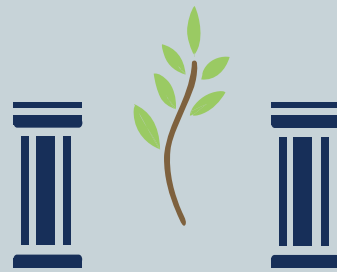
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