

**Unionville-Chadds Ford  
School District**

**Local Tax Study Commission  
Report and Recommendation**

**December 11, 2006**

## EXECUTIVE SUMMARY

The Unionville-Chadds Ford School District (“School District”) Tax Study Commission (“Commission”) was appointed by the Unionville-Chadds Ford School Board (“Board”) pursuant to Act 1 of Special Session 2006 (“Act 1”) for the purpose of studying the School District tax structure and to evaluate the shift of a part of School District funding from the current real estate tax to a new income based tax. Following eight meetings and one public hearing over a three month period, the Commission recommends as follows:

- The Commission concludes tax shifting is undesirable, and the tax and funding policies and operations of the School District would not be improved by implementation of an Earned Income Tax (“EIT”) or Personal Income Tax (“PIT”).
- Since the Board is obligated to place a question on the ballot, the Commission recommends the ballot question include a proposal for an EIT at the lowest permissible rate, currently estimated at 1.0%.

## BACKGROUND

Act 1, the Taxpayer Relief Act, was signed into law on June 27, 2006 by Governor Rendell. The law required each school district, except Philadelphia, appoint a local tax study commission by September 14, 2006. The local tax study commission must consist of taxpayers and/or resident individuals who reflect the socioeconomic, age, and occupational diversity of each school district.

On September 11, 2006, the Board appointed the nine (9) member Commission representing: six townships; homeowners and renters; those whose source of income is derived from work in Philadelphia, work out-of-state, self-employment, farming, investment income, and pensions; and income levels that span low, middle and high income brackets. One of the Commission members is also a Board member. The Commission became effective on September 14, 2006.

The purpose of the Commission is to study the School District’s tax structure and evaluate shifting part of the School District funding from the current real estate tax to a new income based tax. The study was required to include the following four items:

- 1) Historic and current revenue from current School District taxes
- 2) Percentage of total School District revenue provided by current taxes
- 3) Age, income, employment and property characteristics of the existing tax base
- 4) Projected School District revenue from current taxes and from the possible new Act 1 EIT or PIT.

The Commission is charged to make a non-binding recommendation to the Board within 90 days of formation. This recommendation should include endorsing either an EIT or PIT, and an associated tax rate within state-established parameters.

Since its inception, the Commission has held eight (8) meetings, open to the public in accordance with the Sunshine Law, and one (1) public hearing. The purpose of these meetings was to weigh and evaluate the impact of the possible shift in tax policies on the School District and its taxpayers. The Commission was provided with the required School District revenue, community socio-economic and demographic data, as well as additional other data requested.

After the Commission makes its non-binding recommendation, the law requires the Board to place a referendum question on the May 2007 primary election ballot regarding a new income tax (either EIT or PIT) and tax rate. If approved by the voters, the funds from the new income tax will be used to fund a reduction in real estate taxes via homestead and farmstead exclusions for those properties that have been approved by the County Assessment office.

### DISCUSSION & COMMENTARY

The Commission would like to acknowledge that, uniquely among the 501 school districts in Pennsylvania, Unionville-Chadds Ford School District has the highest per household income and consistently ranks among the highest achieving districts (the top district in 2006) according to Standard & Poor's while ranking 46 out of 501 in spending per student. Among the 12 school districts in Chester County, the School District ranks 5 out of 12 in spending per student.

The role of the Commission was significantly limited by the constraints of Act 1, with few possible outcome choices, listed below:

- 1) A recommendation to the board to adopt an income tax to fund property tax reductions via homestead and farmstead exclusions:
  - EIT to be levied on wages only or
  - PIT to be levied on wages plus unearned income (dividends, interest, etc.)
- 2) A recommendation on income based tax rate, within state-prescribed parameters
  - EIT between 1.0% and 2.0%
  - PIT between 0.8% and 1.6%
- 3) No recommendation
- 4) A finding that a tax shift was not in the best interests of the School District combined with a recommendation for the required ballot question.

The overwhelming consensus of the Commission was that a tax shift was not in the best interest of the School District and implementation of an EIT or PIT was not advisable. It is not the Commission's desire to upset, or in any way interfere with student achievement by substantially altering the School District's funding structure. Nor is it the Commission's desire to migrate from a property based taxation system to an income tax based system. After in-depth deliberations, the Commission believes that the School District would be best served to not implement such a tax shift and to retain the present property tax system.

One alternative would have been to "opt-out" of making a recommendation (#3 above). However, the Commission recognized the importance of providing the Board guidance on the issue of the required ballot question, and accordingly, spent significant time studying the pros and cons of EIT vs. PIT. At the conclusion, the Commission determined that an EIT would be preferable and, as such, recommends the ballot question include a proposal for an EIT.

#### Impact on Taxpayers: Near Term

Adopting any form of an income tax under Act 1 would result in winners and losers in our School District. The law essentially provides a mechanism for shifting some portion of school funding from property taxes to income taxes, however, the impact varies depending upon the circumstances of the individual tax payer. The Commission has concluded that up to 70% of our resident taxpayers could see a net reduction in school taxes of \$1 to \$1,200, at least in the initial period following enactment, while the remaining 30% will likely see an increase in the total taxes paid to the School District.

Concerning individual taxpayers, the Commission determined that the new Act 1 income tax would generally benefit tax payers who are homeowners and:

- 1) qualify for farmstead exclusion and have taxable household earnings of less than \$240,000
- 2) work in Philadelphia
- 3) qualify for homestead exclusion and have taxable household earnings of less than \$120,000

However, it would generally result in increased total taxes for:

- 1) Renters
- 2) Dependents with earnings (e.g. high school and college students)
- 3) Homeowners with taxable household earnings greater than \$120,000
- 4) Homeowners and farm owners who do not qualify for or have not applied for the homestead/farmstead exclusion

#### Impact on Taxpayers: Longer Term

Though the tax shift initially provides definitive property tax relief for some taxpayers, over time it provides a diminishing benefit as the number of qualified properties increases and household incomes increase. The number of benefiting taxpayers decreases from the initial 70% range.

#### Impact On School District

1. Although a shift to a new income tax will be revenue neutral to the School District, adding a new type of tax increases the School District's administrative burden and costs, including the cost for hiring a collection agent.
2. Real estate taxes are primarily collected in the first four months of the school fiscal year, whereas income taxes would be collected quarterly or annually, much later into the school year. This change will result in reduced interest income for the School District.
3. Real estate tax base is a more stable and predictable tax base than and income tax base for planning and budgeting purposes.
4. Act 1 limits the School District's ability to raise future tax rates for both real estate and income taxes. However, as taxpayers' earnings increase over time an income tax would provide an added source of revenue for the School District while the portion of the income tax allocated for property tax reduction is fixed after the second year.

#### Earned Income vs. Personal Income

This was one area of great discussion and differences of opinion among the Commission members. The aggregate nature of the empirical data available made sufficient detailed analysis impossible.

Unanswerable questions include:

1. The top 21.73% of tax returns represent 80.69% of the unearned income and 70.00% of the earned income in the School District. Would the disproportionate impact of adopting a PIT encourage a change in the nature and make-up of the School District population?
2. Although renters are negatively impacted either way, are they overall impacted more negatively by an EIT or a PIT?
3. What is the impact of and EIT vs. PIT on retirees?
4. What is the collection rate, ease of collection and predictability of collections of EIT vs. PIT?
5. What will be the billing and collection issue unique to local PIT?
6. What is the comfort and familiarity of people with EIT as some townships currently have?

CONCLUSION

The members of the Commission recognize that the process of finalizing the ballot question is a complex and important undertaking, and may be critical in determining the outcome of the referendum. Accordingly, since the members of the Commission have spent many hours familiarizing themselves with Act 1 and its impact, they offer their continued assistance to the Board in developing the language for both the ballot question and the required non-legal description that must accompany the ballot.

December 11, 2006

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