



August 2006 (revised August 24, 2006)

EDUCATION LAW WATCH

Act 1 Slot Money, Tax, and Referendum Legislation

Act 1 Open Issues – Interpretation of 1% EIT Minimum

Act 1 contains many ambiguous provisions that require interpretation and present school districts with unknowns. One of the more important open legal issues is whether a district is required to propose a 2007 EIT rate *increase* of at least 1% – or whether alternatively the district is required simply to have or propose a *total district EIT* rate of at least 1%.

KKAG believes Act 1 requires only a total district EIT rate of at least 1%, and does not require districts to propose a 1% EIT increase. This conclusion results primarily because the similar 1% PIT minimum clearly and without question applies to the total district rate. In addition, applying the 1% minimum just to the increase would cause 18 school districts to have combined school/municipal tax rates equal to or above the 3% Pittsburgh rate the legislature determined excessively high. However, the Act 1 wording is unclear, PDE has issued a letter stating the alternative interpretation, and this 1% EIT minimum interpretation could possibly lead to a taxpayer legal challenge. Proposing an increase of 1% or more will avoid potential legal risk of a taxpayer challenge. The tax study commission and school board should review and consider options reflecting the numbers impact of both alternate interpretations, and should rely on the advice of legal counsel in deciding the appropriate option for the school district.



Act 1 language. Section 331.2(a) states that a school board shall submit at the May 2007 primary election a referendum question asking voters to decide on a new or increased earned income tax (EIT) or new personal income tax (PIT). Section 331.2(b) requires the school board to adopt a resolution authorizing the referendum question. Section 331.2(c) states that the board shall establish the tax rate to be included in the resolution. It then states three separate requirements for determining the minimum permissible referendum tax rate, as follows:

“The rate ... shall not be less than the rate required to provide an exclusion for homestead and farmstead property equal to 50% of the maximum homestead exclusion [the “50% minimum”],

provided that a school district shall not be required to propose an earned income and net profits tax under this section that is greater than 1% [the “1% EIT minimum”]

or a personal income tax that is greater than the equivalent of an earned income and net profits tax of 1% [the “1% PIT minimum”].”

The question – Does the 1% EIT minimum apply to the total EIT rate? Or the new or increased EIT rate? There is a question concerning what is meant by the second requirement – the 1% EIT minimum. There are two possible

interpretations. The first interpretation is that a school district is not required to propose a *total district EIT* that is greater than 1%. The second interpretation is that Act 1 language means the school district must propose a *new or additional EIT* at least 1% over and above whatever EIT is currently in place. It is important to note that a district may satisfy any one of the three requirements. The 1% EIT minimum is important if it produces a more desirable result than the 50% minimum.

Statutory construction rules. Relevant statutory construction rules include the following: (a) When statutory words are clear and free from ambiguity, the clear words control. However, when there is ambiguity, the statute will be interpreted to fulfill the legislative intent if legislative intent can be ascertained. 1 Pa. C.S.A. § 1921. (b) In ascertaining legislative intent, it is presumed the legislature does not intend an unreasonable result. 1 Pa. C.S.A. § 1922(1). (c) Parts of statutes are *in pari materia* when they relate to the same things. 1 Pa. C.S.A. § 1932(a). When parts of a statute are *in pari materia*, they are to be interpreted in the same manner. *First Union Nat’l Bank v. Estate of Shevlin*, 897 A.2d 1241, 1246 (Pa. Super. 2006) (holding that a definition in 53 P.S. § 7293(c) is *in pari materia* with the rest of § 7293 and that the two provisions must be read together). *Commonwealth v. Hall*, 744 A.2d 1287, 1290 (Pa. Commw. 1998) (holding that two subsections of 73 Pa. C.S. 3754 are *in pari materia* and thus must be construed together as a single provision). *J.C. v. Dep’t. of Public Welfare*, 720 A.2d 193,



196 (Pa. Commw. 1998) (since 23 Pa. C.S. 6341(a), (b) and (c) are part of the same statute and are *in pari materia*, they must be construed together).

The unambiguous wording of the 1% PIT minimum compels interpretation of the 1% EIT minimum as applying to the total EIT rate.

KKAG believes the starting point for determining the correct interpretation of the 1% EIT minimum requires reference to the 1% PIT minimum. If a district converts from an EIT to a PIT, § 331.2(e) requires a PIT ballot question as follows:

“Do you favor converting the school district’s current earned income tax to a personal income tax at ___%? The revenue generated from the personal income tax will be used to reduce taxes on qualified residential property by \$_____ and to replace the revenue from the school district’s current earned income tax. The current earned income tax rate is ___%.”

In conversion to a PIT, the EIT is completely eliminated and replaced by a PIT, together with an additional amount of PIT used to fund property tax reduction. Under this ballot question that involves elimination of the PIT, there is no question the tax rate inserted in the ballot question is the total district PIT rate, including the portion of the PIT that replaces the prior EIT and also the portion used for property tax reduction. Section 331.2(e)(5) states that after voters have approved a

referendum question, the % rate stated in the referendum question becomes the effective tax rate on the next July 1. Section 331.2(e)(1) states that the % rate specified in the referendum question shall be the total rate, including both the portion replacing the current EIT and the portion used for property tax reduction. Section 331.2(c) then states that a district is not required to propose in the ballot question a PIT rate greater than the equivalent of a 1% EIT. With this background, it cannot be questioned that the 1% PIT minimum refers to the total district tax rate, not just the amount that represents new revenue.

Since the 1% PIT minimum clearly applies to the total district rate, there is no logical reason why the 1% EIT minimum would not similarly apply to the total rate, and would instead apply to the increase only. To apply the 1% EIT minimum only to the increase and apply the 1% PIT minimum to the total tax rate would result in a significantly higher tax on exactly the same individuals in exactly the same school district if the EIT is retained than if the EIT is replaced by a PIT. Similarly, this would result in significantly higher total district income tax revenues if the EIT is retained than if replaced by a PIT. There is no logical justification for these differing results depending solely on whether a PIT is proposed rather than an EIT. Thus, this interpretation of the statute clearly produces an unreasonable result.

As to the 1% EIT minimum, the Act 1 language is ambiguous, requiring that we seek to determine legislative intent and in doing so assume the legislature did not



intend an unreasonable result. Since it would make no sense to interpret the 1% EIT minimum in a manner different from the 1% PIT minimum, and the 1% PIT minimum clearly applies to the total district rate, the statutory construction rule against unreasonable results mandates interpreting the 1% EIT minimum as applying to the total district rate, not just the rate increase.

This conclusion is also supported by the *in pari materia* statutory construction rule. Since the 1% PIT minimum clearly applies to the total district rate and relates to the same thing as the 1% EIT minimum – setting the lowest permissible tax rate for the 2007 referendum – the *in pari materia* rule also mandates interpreting the 1% EIT minimum as applying to the total district rate, not just the rate increase.

Applying the 1% minimum just to the increase would produce substantially different EIT rates for different categories of school districts. There is yet another reason why applying the 1% minimum just to the increase would produce an unreasonable result and therefore be an improper interpretation under statutory construction rules – the minimum rate would be different for Act 50 districts, Act 24 districts, and districts with no current EIT, compared to each other and also compared to all other districts.

The EIT rate currently imposed by the vast majority of districts is .5%. However, there are more than fifty Act 50 and Act 24 districts that already have higher EIT rates,

in varying amounts and in some cases already above 1% because of prior tax shifting from other taxes to EIT. In addition, 38 school districts currently have no EIT. If the EIT minimum were applied just to the increase and not to the total district EIT rate, the minimum EIT rate for districts with no current EIT would be 1%, for districts at the norm would be 1.5%, and for Act 50 and Act 24 districts would be varying substantially higher amounts, in some cases well above 2%. This result of a different minimum rate for all of these districts would be illogical, particularly when the legislative reason for providing an alternate minimum other than the 50% minimum was to ensure against mandating an EIT that is so high as to constitute an undue taxpayer burden and economic development disincentive. There is no reason why the measure of what is deemed an undue tax burden and an economic development disincentive would be different among all of these districts.

Legislative concern about high rates indicated by special treatment of Philadelphia, Pittsburgh and Scranton.

Aside from the structure of the statute and the logic explained above, there are also other indications that interpreting the 1% minimum as applying to the total rate reflects legislative intent. Pittsburgh, Scranton, and Philadelphia already have high EIT rates – 3%, 3.4%, and 4.3% respectively, combined school/ municipal rates applicable to residents. The legislature was concerned that the EIT rates in these 3 cities are already too high, resulting in unfairness to individuals living or working in such areas, and that



these high EIT rates create impediments to economic development. For this reason, Act 1 does not allow further EIT increases in these cities.

In addition, Act 1 provides more favorable supplemental senior citizen tax rebates for residents of Philadelphia, Pittsburgh, and Scranton compared to senior citizens living in other parts of the state.

While considering Act 72 options in 2005, many school districts similarly concluded that raising the EIT rate to the amount that would meet the 50% minimum would produce an excessively high and undesirable EIT rate. Accordingly, the legislature wanted to establish a lower referendum question EIT floor for such school districts through the alternate 1% floor. Interpreting the EIT floor as referring to the total district rate, not just the increase, produces a lower minimum rate consistent with this intent, whereas applying the 1% floor just to the increase would in some districts produce a combined school/municipal rate perilously close to, and in many cases exceeding, the Philadelphia, Pittsburgh and Scranton rates deemed excessive.

In fact, based on review of the Department of Community and Economic Development Local Tax Register, increasing the current EIT rate by 1% would result in a total combined school/municipal rate in 18 school districts equal to or above the 3% Pittsburgh rate, and in 5 school districts equal to or above the 3.4% Scranton rate. Moreover, a total of 83 school districts

would have a combined school/municipal rate equal to or above 2.5%.

The statutory words. The actual statutory words of the 1% EIT minimum provision are ambiguous and could be interpreted as applying the 1% EIT minimum either to the total rate or to just the increase. Reading the words of this provision standing alone, either interpretation is equally plausible. Assuming the 1% EIT minimum applies to the total rate, the words “under this section” modify the words “required to propose” and simply mean that the referendum question relating to the increase is proposed “under this section.” This is an equally plausible reading of the words as interpreting “under this section” to apply to the amount of the tax rate increase proposed “under this section.” The ambiguity of the words of this provision require according to statutory construction rules that it be interpreted in the context of the rest of the statute, and particularly with reference to the 1% PIT minimum.

Arguments for applying 1% minimum just to increase. Arguments for interpreting the 1% minimum as applying just to the increase are:

1. The alternate interpretation requires the assumption that the legislature intended to add the word “total” before the reference to “earned income tax.”
2. Under the alternate interpretation, forty-eight Act 50 or Act 24 districts that already have EIT rates of 1%



or higher will not be required to pose a referendum question, whereas the mandate that school boards submit a voter referendum question does not expressly state any exceptions.

3. As to the different minimum rates that would be applicable among most districts, Act 50 districts, Act 24 districts, and districts with no current EIT, there is no indication such discrepancies were a legislative concern. On the contrary, the legislature wanted to provide property tax reduction, and might have wanted to ensure that all districts offer voters a referendum on a minimum amount of tax shifting, without concern for the current EIT rate. The legislature was more concerned with the amount of tax shifting than the ultimate EIT rate.

4. The House/Senate Conference Committee Report refers to a minimum 1% increase.

5. PDE has issued a letter stating that Act 1 should be interpreted to require a minimum 1% increase.

The answers to these arguments are:

1. Implying the word “total” before the reference to “earned income tax” is the most logical interpretation in the context of the entirety of § 331.2 and Act 1.

2. As to the possibility of no referendum in 48 districts, the § 331.2(a) mandate for school boards to submit a referendum question simply refers to “a

board of school directors,” it does not expressly mandate that *all school boards* submit a referendum question. Essentially, the statute creates a mandate, then says that it does not apply in circumstances where the EIT rate is already at a high level. This statutory structure of establishing a general rule and exceptions is very common.

3. As to different minimum rates among districts, there is no basis to assume the legislature was more greatly concerned with the minimum amount of tax shifting than with the ultimate EIT rate level. On the contrary, the legislative exclusion of Philadelphia, Pittsburgh and Scranton entirely from the tax shifting scheme, as well as the legislature creating an alternate floor to the 50% minimum, contradict this assumption and underline a fundamental legislative concern against pushing EIT rates too high.

4. As to the House/Senate Conference Committee Report, the language of the conference bill as finally introduced and approved contradicts the report.

5. As to the PDE letter, this is discussed in the next section.

KKAG has discussed interpretation of the 1% EIT minimum with many different lawyers and other individuals. Very importantly, although some individuals have suggested that applying the 1% minimum just to the increase is an appropriate interpretation, KKAG has not heard anyone answer the primary reason



for concluding that this is the incorrect interpretation – namely, that the unambiguous wording of the 1% PIT minimum compels interpretation of the 1% EIT minimum as applying to the total EIT rate.

PDE Letter. On August 18, Secretary of Education Zahorchak issued a letter to superintendents stating the interpretation that the 1% minimum applies just to the increase, not to the total district EIT rate. The letter provides zero explanation, and does not even set forth the statutory words.

The PDE letter states that both the 1% EIT minimum and the 1% PIT minimum apply to the tax increase amount, and does not address any of the interpretation issues set forth above. Clearly, the letter is wrong as to the 1% PIT minimum. KKAG believes the interpretation is also wrong as to the 1% EIT minimum.

Unfortunately, this PDE letter is of little help given the total absence of analysis or explanation, and the obvious error as to the 1% PIT minimum. We assume this letter was sent at the Governor's direction in order to set forth the Governor's wishes concerning interpretation of the ambiguous statutory language. This would follow the PDE practice started under Act 72 of issuing "political interpretations" of statutory provisions seeking to promote a particular interpretation, in many cases clearly contrary to the statutory language – similar to what PDE did under Act 72 on the requirement for certifying first year EIT tax receipts. Of course, the Governor's

wishes concerning interpretation and political positions are irrelevant to the extent contradicted by the statutory language – unless legislative history supports the interpretation.

This kind of bold (and in some cases clearly wrong) statement regrettably undermines PDE's credibility and effectiveness in dealing with difficult issues under this important new legislation. It would be more helpful to school districts if PDE issued an interpretation acknowledging the difficulty of this issue, including thoughtful explanation and analysis related to the statutory language. Moreover, if the Governor wishes an interpretation at variance with the statutory language, the Governor should request the legislature to adopt clarifying legislation.

Legislative history. KKAG has reviewed the legislative journals as to debate at the multiple times Act 1 was considered by the House and Senate. The journals do not provide any helpful information indicating a legislative intent for either of the two possible interpretations. However, it is important to note that two of the journals (the House journals for June 13 and June 14) have not yet been printed. KKAG will review these journals when available.

As explained in the following paragraphs, there are two arguably relevant aspects from the legislative history; however, the impact of these aspects is contradictory and inconclusive.



This legislation followed the unfortunately frequent and constitutionally questionable path of the legislature starting and passing a simple unrelated bill, then (using the words of Representative Gabig in the House Journal of February 14, 2006) substituting a “gut and replace bill” after the constitutionally required legislative approvals. House Bill 39 started in the House on November 14, 2005, as a 1-page bill taking away school district authority to levy so-called “nuisance taxes” under the Local Tax Enabling Act. This bill was approved three times in the House and twice in the Senate, then at the time of the Senate’s third consideration on February 6, 2006, entirely new 89-page comprehensive school slot money, tax, and budget provisions were inserted as the new Printer’s No. 91 HB 39.

Printer’s No. 91 HB 39 included the 1% EIT minimum, but not the 1% PIT minimum.

On February 14, 2006, the House rejected Printer’s No. 91 HB 39, and thereafter in March the House and Senate appointed a joint conference committee.

On May 2, 2006, the conference committee presented a 2-page Conference Committee Report briefly summarizing the committee results. This report includes a statement that “... a school district will not be required to propose to increase the rate by more than the equivalent of a 1.0% increase in the EIT.” It is important to note that this statement would support the interpretation

that the 1% EIT minimum applies just to the increase, not the total district tax rate.

However, on the same day, Printer’s No. 93 HB 39 was introduced in the Senate, now adding the 1% PIT minimum that clearly referred to the total district rate. This new version referring to the total district rate was approved by the Senate May 2, 2006, and by the House June 14, 2006 – and became Act 1 when signed by the Governor on June 27, 2006.

Thus, the Conference Committee Report suggests the 1% minimum rate applies just to the increase; however, the actual language of Act 1 as later adopted with reference to the PIT directly contradicts this statement – leading to the conclusion that legislative intent cannot be discerned by reference to legislative history, and must instead be determined through statutory construction rules.

Conclusion. KKAG believes the correct interpretation is that the 1% EIT minimum applies to the total district rate, not just to the increase – primarily because the similar 1% PIT minimum clearly and without question applies to the total district rate. To date, KKAG has heard no one answer the conclusion that the unambiguous wording of the 1% PIT minimum compels interpretation of the 1% EIT minimum as applying to the total district rate.

In addition, applying the 1% minimum just to the increase would cause 18 school districts to have combined school/municipal tax rates equal to or



above the 3% Pittsburgh rate the legislature determined excessively high.

However, the Act 1 language on the 1% EIT minimum is ambiguous, the Conference Committee Report suggests and PDE has announced an alternate interpretation, and there can be no certainty as to the correct interpretation unless and until the courts rule or the legislature adopts clarifying legislation.

Given the uncertainty, there is some risk in proposing a rate increase less than 1%, or declining to propose a referendum question if the district EIT rate is already 1% or higher. It is possible a taxpayer might challenge such action and seek an injunction forcing a higher referendum tax rate.

The tax study commission and school board should review and consider scenarios reflecting the numbers impact of both alternate interpretations. This open legal issue presents no problem for a tax study commission or school board that wishes to propose an earned income tax rate increase of 1% or more. If the tax study commission or board believes an increase of 1% or more would result in a tax rate that is too high, district options are: (a) Nevertheless, propose a tax rate increase of 1% - in order to avoid the possible legal risk of a taxpayer challenge. (b) Follow the legal interpretation that Act 1 does not require proposing a total district tax rate above 1% - and defend this interpretation if challenged by legal proceedings. (c) Initiate a declaratory

judgment legal proceeding, seeking a court interpretation. School districts should request advice from the district solicitor or Act 1 legal counsel in deciding the option appropriate for the school district.

Study Commission Critical Dates

09/14/06 – Board appoint Commission to recommend ballot question

Sept/Oct/Nov/Dec 2006 – Commission meetings/study/public hearing/
recommendation

12/13/06 (or earlier) – Deadline for Commission to recommend ballot question

Jan 2007 – Deadline for Board preliminary approval of ballot question/
begin advertising

03/13/07 – Deadline for Board public hearing and final approval of ballot question

5/15/07 – Primary election day: voters vote on ballot question

7/1/07 – Act 1 tax effective if approved by voters



We hope you find this issue of KKAG's Education Law Watch helpful and informative. Please understand that the Law Watch is designed to provide information about current developments and required actions. It does not constitute legal advice, and school districts should consult a lawyer knowledgeable in this area of the law prior to taking specific actions on the issues addressed.

If you have any questions regarding any education law matter, including the issues discussed in this newsletter, please do not hesitate to contact us at 717/392-1100, or e-mail us at the following addresses:

KEGEL KELIN ALMY & GRIMM LLP
Education Law Group
(717) 392-1100

Clarence C. Kegel, Jr.	kegel@kkaglaw.com
Howard L. Kelin	kelin@kkaglaw.com
Jeffrey D. Litts	litts@kkaglaw.com
Eric N. Athey	athey@kkaglaw.com
Rhonda F. Lord	lord@kkaglaw.com
Kay Mercein Mann	mann@kkaglaw.com
Elizabeth A. Reister	reister@kkaglaw.com
Amy G. Macinanti	macinanti@kkaglaw.com
John S. Lawler	lawler@kkaglaw.com

KKAG is solicitor and general counsel to 13 school districts, career and technology centers, and other school entities, and bond counsel or special counsel to many others in Central and Eastern Pennsylvania. In addition to ongoing work as solicitor and bond counsel, KKAG is frequently retained to resolve challenging problems, projects, and litigation. Together with our education law practice, we also have a substantial labor and employment law practice, including labor negotiations and all other areas of labor and employment law.