



January 2008

# EDUCATION LAW WATCH

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## **Act 1 Slot Money, Tax, and Referendum Legislation**

### **Table of Contents**

<b>2008 Exception Process – School District May Not Apply for Exception Unless Preliminary Budget Shows Need.....</b>	<b>1</b>
<b>May a 2007 Exception-Justified Tax Increase Be Rescinded in 2008? .....</b>	<b>2</b>
<b>Multi-Year Financial Planning: Build Reserves! .....</b>	<b>3</b>



**2008 Exception Process –  
School District May Not  
Apply for Exception  
Unless Preliminary Budget  
Shows Need**

PDE has announced an important change for 2008 exception processing.

The starting rule under Act 1 is that a district may not use an Act 1 referendum exception-justified real estate tax increase unless the final budget shows that the exception-justified tax increase over the index is necessary to balance the budget. However, in 2007, PDE approved exceptions even if the preliminary budget did not show a need to use the exceptions. In such cases, PDE approved the exception dollar amount, and also advised of the amount of the tax increase that was permissible based on the preliminary budget submission. If the district concluded before adopting the final budget that all or part of the approved exception dollar amount was needed to balance the budget, the district was permitted, without additional PDE approval, to use the approved exception dollar amount for a tax rate increase over the index. Reporting on use of the exception amount was required in connection with submission of the final budget.

PDE's rule for 2008 is different. PDE will approve an exception dollar amount

only if and to the extent the preliminary budget shows the need to use the exception. In other words, the preliminary budget must reflect a real estate tax increase over the index without any increase in unreserved undesignated general fund balance. The primary reason for this change is to avoid PDE spending time reviewing and approving exception applications that are filed merely as a precaution and ultimately prove unnecessary.

The end result is that school districts must be very conservative in preparing the preliminary budget – ensuring that the projection of revenues and expenses is worst case. If the school district is eligible for one or more exceptions and unsure whether the budget can be balanced by an index real estate tax rate increase, the school district should prepare a preliminary budget reflecting revenue and expenses that require a real estate tax increase based on the index plus use of exception amounts.

The obvious downside is that this approach might unnecessarily alarm taxpayers. However, this approach is necessary to ensure a balanced budget without a need for last minute expenditure cuts that would adversely effect the education program. Of course, the school district can explain to taxpayers that the preliminary budget reflects a worst case scenario, and that the school board is hopeful the projections will

**May a 2007 Exception-  
Justified Tax Increase  
Be Rescinded  
in 2008?**



be revised before final budget adoption, with the possibility of a lower real estate tax rate than projected in the preliminary budget.

Act 1 requires that various exception-justified real estate tax rate increases, particularly those based on debt service, be rescinded at some future date. Because the 2008 index was higher than expected for many districts and PDE has interpreted the required future rescission to be based on the original exception-justified tax rate increase rather than the dollar amount increase, various school districts have asked whether a 2007 exception-justified tax increase may be rescinded now rather than waiting until the future mandatory rescission date.

For example, assume the school district real estate tax rate levied in 2007 was 20 mills and included an index increase plus a .5 mill increase based on the grandfathered debt exception. Assume further that the 2008 index will allow a 1.2 mill tax increase; however, the district can balance its budget with a .5 mill tax increase. May the district rescind the 2007 exception increase amount of .5 mill, restoring the base to 19.5 mills, then add a 1 mill increase based on the 2008 index?

KKAG believes the answer is “yes” – a district may rescind an exception-justified tax rate increase prior to the final mandatory rescission date.

Beyond any question, Act 1, 53 P.S. § 6926.333(f), contemplates that certain

exception-justified tax increases will be rescinded at a later date when no longer needed. For example, this intent is reflected in § 333(f)(2)(iii)(A.1), which relates to grandfathered debt and states as follows: “An increase under this clause shall be rescinded following the final payment of interest and principal.” The obvious legislative rationale for this provision is that the exception-justified tax increase should not be allowed to continue beyond the time when needed to balance the school district budget. In this specific case, the legislature has assumed that the amount is no longer needed to balance the budget when the debt service for which the exception was granted has been eliminated.

There is no provision in Act 1 that states or even suggests a school district must wait for the mandatory rescission date and may not rescind the exception-justified tax increase at an earlier date if no longer needed. Indeed, early rescission fulfills the overarching Act 1 purpose to limit and reduce real estate taxes, and prohibiting early rescission would be inconsistent with this overarching purpose. Early rescission lowers the maximum permissible tax rate in the initial rescission year and all future years consistent with Act 1’s fundamental goal.

This interpretation also follows from the Act 1 language. The Act 1 language states a mandate that the tax increase be rescinded following the final payment of interest and principal. It does not state a prohibition on early rescission.

If a school district wishes to rescind an exception-justified tax increase earlier than the mandatory date, KKAG believes this can be done through appropriate documentation



in the annual tax levy resolution, followed with communication to PDE on the rescission action.

As a cautionary note, we warn that PDE is currently considering this issue and has not announced a final position. It is possible PDE will take a different position from the KKAG interpretation. School districts should consult with PDE and their solicitor before final action on early rescission of an exception-justified real estate tax increase.

## **Multi-Year Financial Planning: Build Reserves!**

Act 1 makes more important than ever before development and implementation of a multi-year financial plan. This is important for all aspects of the school district budget, but particularly important in order to ensure the ability to fund future building construction projects.

A fundamental element of a multi-year financial plan under Act 1 is building reserves. All school districts should focus on building reserves for the future. This should be one component of the school district budget plan for 2008-2009.

One method of building reserves, in addition to maintaining a substantial undesignated unreserved general fund balance, is through designation of fund balance. Designation of fund balance may be changed in the future,

but represents the school board setting aside a part of existing funds for anticipated future needs.

In accordance with the School Accounting Manual, page 19.12, the general requirements for designation of fund balance are:

- The funds are designated for future use for a bona fide purpose.
- The designation represents a planned action (although not a binding commitment).
- The district expects to spend the funds within a reasonable time period.
- The school board takes formal action to designate the fund balance for the intended purpose.

Examples of fund balance designation include:

- Interest rate stabilization fund (for variable rate debt)
- Self-insurance fund reserve (for health, retiree health, workers compensation, or unemployment compensation benefits)
- PSERS reserve (to offset anticipated future increased PSERS cost)

In addition, every school district should have a capital reserve fund, preferably a § 1431 Municipal Code capital reserve fund. Every district should consider augmenting its capital reserve fund in connection with development of the 2008-2009 budget.



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Although there are differing legal opinions on permissible capital reserve fund use, possible uses include:

- Land; building projects; athletic fields or stadiums; parking or paving; and other construction projects
- School furnishings and equipment
- Computers/software/technology equipment/books
- Vans and other vehicles
- Debt service

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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 their solicitors or another 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.