



PENNSYLVANIA LEGISLATURE CONSIDERS FIX TO TAX COLLECTION ISSUE

Earlier this year, the Commonwealth Court decided *Pennsylvania Land Title v. East Stroudsburg Area School District* and threw a wrench into the application of the Municipal Claim and Tax Lien Act and the Real Estate Tax Sale Law to the collection of delinquent real estate taxes by school districts and municipalities. The Commonwealth Court held that school districts and municipalities who choose to collect delinquent real estate taxes themselves or through contractors were nevertheless required to remit a 5% fee to the local County Tax Claim Bureau. As a result of this case, it has become less financially advantageous for districts and municipalities to undertake their own delinquent tax collections. The Pennsylvania Supreme Court declined to review the Commonwealth Court's decision.

The Pennsylvania legislature is presently considering a bill which would amend the Municipal Claim and Tax Lien Law and remove this requirement, thus freeing the School Districts and Municipalities from paying the additional 5% fee. On November 20, 2007, Senate Bill 777 was approved by the Pennsylvania State Senate and as of the printing of this newsletter, was to go before the State House for consideration and, hopefully, passage. This legislation is of great interest to school districts to maximize the possible benefits of delinquent real estate tax collection. We will provide updates regarding the status of this legislation, both through a future edition of this newsletter and via our firm's website, www.mbm-law.net.

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Built on Integrity,
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SUPREME COURT ADDRESSES FIRST AMENDMENT RIGHTS OF STUDENTS

In an opinion announced at the end of the 2006-2007 term, the U.S. Supreme Court decided a case concerning student free speech rights and the ability of a school district to discipline students who advocate illegal drug use. The case is an interesting step in the evolution of free speech rights and may have application to your district's day-to-day administration of student discipline.

In *Morse v. Frederick*, the Court reviewed the action of a high school principal in Juneau, Alaska in suspend-

ing a high school student. In June of 2002, the Olympic torch relay was proceeding through Juneau on its way to the site of the winter games in Salt Lake City, Utah. The administration of the Juneau-Douglas High School decided that the student and staff populace could choose to leave class and observe the relay from either side of the street in front of the school, although the students would continue to be under school supervision.

Joseph Frederick, a high school senior, stood on the street with several friends to watch the procession. When the Olympic torch bearers crossed in front of the group, Frederick and his friends unrolled a banner 14 feet long on which was written "BONG HITS 4 JESUS." The banner could be read by the people on the other side of the street, including the high school principal, who immediately crossed the street and instructed the students to take it down. All of the students except for Frederick agreed to her request. In response to his refusal, the principal issued him a 10-day suspension on the grounds that the banner promoted or encouraged illegal drug use, in violation of school policy.

The superintendent reduced the suspension to eight (8) days, and Frederick further appealed the suspension to the School Board, which upheld the suspension. From there, Frederick filed a federal suit against the district and the principal alleging that his free speech rights had been infringed when he received the suspension. The lower court granted the school district's motion for summary judgment, ruling there had been no infringement of the student's First Amendment rights and finding that the banner promoted illegal drug use in violation of school board policies.

Supreme Court permits schools to restrict speech that encourages illegal drug use.

On appeal, the Ninth Circuit Court of Appeals reversed and held that, under the landmark Supreme Court decision of *Tinker v. Des Moines Independent Community School District*, the school district did not establish there was a substantial risk of disruption to the educational process by Frederick unfurling the banner. For many years, the Supreme Court's decision of *Tinker v. Des Moines* has been the landmark case regarding the free speech rights of students, and its holding is codified in the student rights portion of the Pennsylvania Code at 22 Pa. Code 12.9(b). The *Tinker* Court held that students retain some First Amendment rights and that a school district could not punish student free speech unless it created a substantial risk of disrupting school operations and the educational process. Applying that test, the Ninth Circuit decided that the BONG HITS 4 JESUS banner did not constitute a substantial disruption to the educational process and could not be the cause of student discipline.

In an opinion written by Chief Justice John Roberts, by a 5-4 vote, the Supreme

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Court reversed the Ninth Circuit and held the school was permitted to suspend the student and did not violate his First Amendment rights. The Court held that schools may take steps to restrict speech that encourages illegal drug use, and thus the school principal acted properly in confiscating the pro-drug banner and suspending the student. The Court rejected the student's argument that it was not a school-sponsored event by noting that it occurred during normal school hours and was approved by the administration as a social event where the district's conduct rules were expressly applicable, and students were supervised by staff. Further because other students were subjected to the message Frederick intended to convey with the banner, his speech had the effect of promoting illegal drug use to other members of the school populace.

Turning to *Tinker*, the Supreme Court drew a distinction between that standard and the standard employed by the Court in *Bethel School District No. 403 v. Fraser*, an earlier case where the Court upheld the suspension of a student who made a speech at a school assembly which contained a graphic and explicit sexual metaphor. Because the *Fraser* court held that a school district could lawfully impose sanctions concerning lewd or indecent speech, even without showing a substantial risk of disruption in the educational process, the Court noted that a school district has an important interest in deterring drug use by students, and that on that basis a school is free to impose penalties under its code of conduct for speech which promotes illegal drug use. The Court held that the special characteristics of the school environment and the governmental interest in deterring student drug abuse justified the district's action. The Court also noted that the principal at issue was entitled to certain deference as a result of being required to act quickly to address the matter of the student's expression at a public event.

Turning to facts and circumstances which may be presented in your school district, the Supreme Court's holding in *Morse v. Frederick* demonstrates that there are other bases to regulate student speech other than the "substantial disruption to the educational process" test set forth in the *Tinker* case. However, districts should be careful to narrowly draw and enforce speech codes to ensure that they are deterring or punishing offending speech within similar circumstances.

GASB 45 – IT'S YOUR TURN NOW

Public School Districts with annual revenues between \$10 million and \$100 million dollars must comply with the requirements of GASB 45 in the 2008-2009 fiscal year. With the early onset of budget preparation requirements under Act 1 of 2006, preparations for GASB 45 compliance cannot be further delayed. School Districts with annual revenues less than \$10 million have a short reprieve as compliance for these School Districts will not be until the 2009-2010 fiscal year.

The Governmental Accounting Standards Board

("GASB") is the international accounting standards board established to set the standards of financial accounting and reporting for state and local governmental entities, including public School Districts. In June 2004, GASB issued Statement Number 45, Accounting and Financial Reporting by Employers for Post-Employment Benefits other than Pensions. Other post-employment benefits ("OPEB") generally take the form of health insurance, including dental, vision, prescription or other healthcare benefits, provided to eligible retirees, and in some cases their beneficiaries. OPEB may also include some types of life insurance, legal services and other benefits. Prior to GASB 45, public entities typically followed the "pay as you go" accounting approach in which the cost of benefits was not reported on financial statements until after employees retired. However, this accounting approach significantly underreports the real costs of OPEB to a School District. GASB 45 requires Districts to report expenses and specific information about OPEB on its financial statements and footnotes. In order to comply with GASB 45, Districts with 100 or more plan participants must retain a qualified actuary to form an actuarial valuation of the District's actual OPEB liability.

GASB 45 compliance could significantly impact a School District's budget preparation, collective bargaining negotiations, credit rating and bond financing disclosures. Regarding budget preparation, for those School Districts who offer OPEB to their retirees, the financial impact on the District's budget could be significant. The severity of the impact depends on the required vesting periods, if any, and the level of retiree benefits. For example, if the District has few restrictions on the vesting period to obtain full retiree benefits and provides lifetime health benefits to those retirees who meet the eligibility requirement, the District should not be surprised when the actuary reports a significant OPEB liability. Actuaries have conservatively estimated that Districts should expect their annual OPEB cost to be three to ten times their "pay as you go" amount. GASB 45 does not require funding of the OPEB liability, but only establishes the standards for accounting and financial reporting. The majority of governmental entities, including School Districts, have not pre-funded their OPEB liabilities, which may have severe budget consequences.

Once the actuarial cost of the OPEB liability is established, the School Districts should evaluate their position with respect to offering ongoing OPEB in collective bargaining negotiations. The ever increasing cost of medical care coverage for retirees may compel School Districts to make significant revisions to the OPEB which they continue to offer their employees or, in fact, whether OPEB will be offered at all.

Regarding a School District's credit rating, all the major rating agencies have indicated that they view OPEB liabilities similar to pension obligations and will factor them into their assessment of a District's credit

rating. Therefore, although GASB 45 does not require pre-funding of the OPEB liability, a District's management of its OPEB liability might have a bearing on its credit rating. Further, School Districts with a GASB 45 liability which issue bonds for public financing of school projects must carefully review their disclosures to ensure that they properly include the District's OPEB liability.

The most important recommendation which our firm can provide at this time is that Districts immediately retain the services of a certified actuary to complete a GASB 45 compliant actuarial valuation to properly measure the District's OPEB liability. Not only is this information required for completion of a District's financial statements for the 2008-2009 fiscal year, but once the District is armed with the information, it will be able to evaluate the potential advantages, if any, to the District in pre-funding or placing funds to be held in a trust to satisfy its OPEB obligations. Districts may have several trust options, including an Internal Revenue Code ("IRC") Section 401(h) trust, Voluntary Employee Benefit Association ("VEBA") trusts, and IRC Section 115 trusts. Depending on the needs of the District, there are several advantages and disadvantages of each of the trusts. It is strongly recommended that each School District discuss the options with a tax consultant to determine which trust vehicle is the most appropriate under its circumstances.

RECENT TAX LAW CHANGES AFFECT TEACHER COMPENSATION

Recently, the Internal Revenue Service announced a change in the way it will interpret tax laws relating to deferred compensation which will have an impact on the way professional employees are paid by school districts. In general, Internal Revenue Code Section 409A addresses how income taxes will be imposed on compensation a person has earned, but is yet to be paid. Section 409A applies to anyone who has a legally binding right, during a taxable year, to compensation that **is or may be** payable in a future year. This has relevance to teachers, who work until the end of a school year but are sometimes paid after the year is over for work already performed. An election to defer compensation under Section 409A may include either an affirmative election by the teacher or a deferral condition inherent in the terms of a collective bargaining agreement. If a school district allows a teacher the choice of receiving all compensation during the school year or to spread payments over a twelve month period, then under the recent change announced in Internal Revenue Bulletin T.D. 9321, the teacher is deemed to have deferred compensation and is now subject to an additional 20% tax on the deferred portion. The application of this provision of Section 409A will affect teachers who elect to defer any portion of their compensation beginning in the 2008-2009 school year.

With proper planning, Section 409A sets forth requirements and deadlines in order to defer compensation over 12 months without a tax penalty. The new regulation pro-

vides: "With respect to recurring part-year compensation, an election to defer to all or a portion of the compensation to be earned during a particular period of service may be made at any time before the period of service begins, provided that no amounts are deferred under the election to a date after the last day of the 13th month following the performance period." By way of example, if the school year runs from August 25 through June 15, 2009, a teacher may make an election regarding deferral of compensation any time prior to August 25, 2008. For such an election to comply, 409A requires that before the first day of the period of service:

- a teacher must provide a written or electronic election notifying the district that the salary should be spread over twelve months
- the election must be made before the first day of the work period (i.e., the first day of the school year);
- the election must be irrevocable; and
- the election must state how the compensation is going to be paid (i.e., over the school year or the calendar year).

The election need not be in any particular format. Rules governing this procedure can be provided in an employee handbook, in school board policies or in a collective bargaining agreement.

Whether or not your school district needs to act in response to the tax law change depends on whether your current collective bargaining agreement or practice provides such an election. If your current agreement or practice does not permit teachers to elect whether to be paid over a school year or calendar year basis, no action is required, and you are not required to offer any such election. However, if teachers are currently permitted to elect the deferral of payment, action must be taken. You should schedule a meeting with the union to determine how the parties will comply with this regulation. The matter can be resolved by pursuing several different options, namely:

- (a) requiring that all professional employees collect their salary over the period of time during which school is in session;
- (b) requiring that all professional employees collect their salary over a twelve-month period; or
- (c) providing an election under the circumstances approved by the IRS.

To make a valid election, under (c) above, the teacher must notify the district in writing, before the beginning of the 2008-2009 school year, that the election is irrevocable and sets forth how the teacher's compensation will be paid in order to avoid the additional tax obligation. Whichever measure you and the union agree upon should be put in place so that employees can properly make any necessary election prior to the start of the 2008-2009 school year. On September 10, 2007, the I.R.S. extended the document compliance period to December 31, 2008, but any necessary action should still be taken prior to the start of the 2008-2009 school year.

In the event you have additional questions regarding this tax law change and its impact on your district, you should consult your Solicitor or contact an attorney in our school law group.

Act now to avoid 20% tax penalty on teacher deferred compensation over 12 month period.