Testimony before the Select Subcommittee on Tax Modernization and Reform
Dan Hassell, Secretary, and Amy Gill, Deputy Secretary for Tax Policy
Department of Revenue
Wednesday, November 15, 2017

Chairman Evankovich and members of the committee, my name is Dan Hassell, and I serve as Secretary for the Pennsylvania Department of Revenue. Joining me today is Amy Gill, the Department's Deputy Secretary for Tax Policy. We appreciate the opportunity to provide you with an overview of the Department of Revenue.

The Department, which originated in 1927 and began operating in 1929, is charged with a mission to fairly, efficiently and accurately administer the tax laws and other revenue programs of the commonwealth to fund necessary government services. The Department employs about 1,650 people who serve in more than two dozen bureaus and offices across Pennsylvania.

To give you a general summary, the Department is responsible for the following functions:

- Collecting more than $30 billion a year in state taxes that account for 96 to 98 percent of General Fund revenue, plus collecting an additional $2.8 billion annually for the Motor License Fund;
- Annually processing more than 10 million business and individual tax reports and payments;
- Researching and developing revenue projections for the state budget and analyzing the effect on revenues of proposed changes in either the laws or the tax structure of the commonwealth;
- Administering the Property Tax/Rent Rebate Program (PTRR);
- Managing the Pennsylvania Lottery.

The Department continues to look for ways to become more efficient and effective to build public trust and pursue more equitable tax collection. As part of this effort, the Department recently completed the process of revising its strategic plan. Our goal was to evaluate our strengths and weaknesses as an organization, and to identify strategic and actionable initiatives to support our goals. Now that the strategic plan has been updated, our staff has established a clear path forward in which we will work to improve customer service, enhance effectiveness of tax compliance and continually improve the public's confidence in the Department.

The Department also is moving forward with the final phase of a multi-year modernization in several tax systems. After modernizing the computer system for business taxes, the Department issued a request for proposals to modernize the system it utilizes for individual taxes, including personal income tax (PIT), inheritance tax, realty transfer tax, pass through entity processing, property tax/rent rebates, taxes concerning the international fuel tax agreement (IFTA) and motor

fuel and liquid fuel taxes. The goal is to provide taxpayers with a better system to file their tax returns, get refunds faster and access more information online.

The Revenue Modernization Project was necessary because many of the information systems in use at the Department were more than 20 years old and addressed only specific tax types, rather than providing a holistic view of taxpayers. The project also will improve efficiency, reduce risk of system failure, facilitate improved tax collection, reduce administrative costs and allow the Department to respond more quickly to ever-changing tax laws while improving overall taxpayer service.

Regarding revenue projections, the Department of Revenue is responsible for forecasting and reporting tax collections, evaluating the fiscal and departmental impact of legislative proposals and monitoring changes in economic conditions. The Department's Bureau of Research follows economic trends to determine revenue projections for years to come so that the Governor can propose a balanced state budget each year. Our projections also help the Governor prepare for and address revenue shortfalls and develop a plan for recovery. Our researchers also investigate tax cuts, tax credits, tax increases and tax changes proposed by the legislature to determine what kind of revenue impact those proposals would have, should they become law.

The Department also is responsible for authoring the Pennsylvania Tax Compendium, a general guide to Pennsylvania's taxes. This resource, available on the Department's website, describes the basis, rate and history of state taxes.

Another key function of the Department is administering a program with which I'm sure many of you are familiar — the Property Tax/Rent Rebate (PTRR) program, which benefits older Pennsylvanians and residents with disabilities. As of this month, more than $250 million in property tax and rent rebates have been sent to more than 500,000 homeowners and renters across the state for taxes and rent paid in 2016. The maximum standard rebate is $650, but supplemental rebates for qualifying homeowners with particularly high property tax burdens can boost rebates to $975. Claimants must reapply for rebates every year because rebates are based on annual income and property taxes or rent paid each year. The deadline to apply to the PTRR program has been extended until Dec. 31, 2017.

The PTRR program is funded, in part, by the Pennsylvania Lottery, which has a mission of providing funding for programs benefiting older Pennsylvanians. The Pennsylvania Lottery is a $4-billion-a-year retail sales and marketing operation and remains the only state lottery that designates all its proceeds to programs that benefit older residents. Since its first ticket was sold in 1972, the Pennsylvania Lottery has contributed nearly $28 billion to senior programs.

The Lottery is responsible for licensing and servicing more than 9,100 retailers statewide; promoting the sale of scratch-off, Fast Play and Draw games, including the multi-state games Powerball and Mega Millions; conducting mid-day and evening drawings; validating winning Lottery tickets and paying prizes; recruiting new retailers and providing customer service

through seven area offices across Pennsylvania. As of the end of fiscal year 2015-16, the Pennsylvania Lottery was ranked the sixth-largest lottery in the country in traditional lottery sales, but ranked fifth with regard to profits generated.

With that background in mind, we would like to draw your attention to the following supporting information that provides a synopsis of tax revenue in Pennsylvania.

Overall Share of Total Revenues by Tax

- Please see Chart #1, titled General Fund Tax Revenues – Share of Tax Revenue Total. This chart shows how the contribution of the major tax revenue sources has changed over the last 20 years.
- Over this 20 year period, total General Fund Tax Revenue grew from $17.0 billion to $30.8 billion. While collections grew by over 80% during this period, the composition of taxes has shifted.
- Sales tax revenue is a smaller share of the General Fund. In 1996-97, 36% of the General Fund tax revenues was from sales and use tax. By 2016-17 that fell to 33%.
- Meanwhile, PIT revenue has grown as a share of the General Fund. Personal Income Tax collections were 34% of General Fund tax collections in 1996-97. By 2016-17 that had increased to 41%.
- In addition, revenue from the Corporation Taxes has fallen significantly during this period. The major corporate taxes (Corporate Net Income Tax, Capital Stock and Foreign Franchise Tax, and Gross Receipts Tax) were 20% of General Fund collections twenty years ago. For 2016-17 these taxes were 13% of the total – primarily due to the elimination of the Capital Stock and Franchise Tax.
- Overall, 74% of General Fund Tax collections are from two taxes – the Personal Income Tax and the Sales and Use Tax. This figure is up from 70% 20 years ago.

Growing and Declining Revenue Sources

- Please see Chart #2, titled Cumulative 10-Year Growth in Major General Fund Revenue Sources. This chart shows the change in revenue from the six largest taxes over a ten year period. The chart allows you to see which sources are growing and which are declining.
- Cumulative growth for General Fund tax revenues from 2006-07 to 2016-17 was about $4 billion or 15%.
- The largest source of revenue growth has been the Personal Income Tax which grew a total of $2.4 billion during this period. Meanwhile Sales Tax revenue grew by $1.4 billion.
- While Cigarette Tax has increased almost $500 million in the last ten years, that is entirely due to two rate increases and the elimination of a fund transfer. The rate was $1.35 per pack in 2006-07 and is currently $2.60 per pack. If we adjust for the tax rate changes, the cigarette tax base is now about 30% smaller than it was 10 years ago.

- Corporate Net Income Tax (CNIT) revenue grew by $259 million during these ten years. For most of these years, CNIT revenues were below the FY 2006-07 level, and only recently showed a small amount of revenue growth.
- Gross Receipts Tax (GRT) revenue has been stagnant during these years, with only slight increases and decreases from one year to the next. FY 16-17 revenue was $63 million lower than ten years ago. GRT revenue from electricity has had little growth, while the tax on telecommunications has been in decline. One primary reason for that decline is a shift in receipts from phone service to data usage, since access to the Internet is not taxable under federal law.
- Offsetting much of the growth in other revenues, Capital Stock and Franchise Tax has been phased down gradually to zero, from almost a billion dollars ten years ago, due to the elimination of the tax.

Growth of Specific Taxes Compared to Economic Growth

- Next, we will take you through a set of charts showing how the indexed growth of taxes compares to several economic variables.
- Indexing both sets of figures allows the taxes and economic variables to begin at the same starting point (in this case fiscal year 1997-98) and the lines show the growth from that point forward.
- Please see Chart #3, titled Total Tax Revenue vs. PA Personal Income. This chart shows that total tax revenue is a declining share of Pennsylvania personal income. There have been variations over time, with higher revenue during strong economic times and drop-offs during recession periods. In FY 16-17, General Fund tax revenue was at its lowest share of personal income during this 20-year period.
- Next, please see Chart #4, titled PIT Revenue vs. PA Personal Income. This chart shows that Personal Income Tax revenue has closely tracked Pennsylvania Personal Income over time. There are some years when the growth in PIT revenue runs over or under the growth of personal income.
- Most of these variations can be attributed to fluctuations in capital gains income. Capital gains income is very volatile and has a significant effect on PIT revenue, but is not included in the measurement of personal income. Aside from this factor, PIT revenue follows personal income very closely.
- The 2004 increase in the PIT tax rate from 2.8% to 3.07% is also a factor raising PIT revenue during this time period.
- Turning to Chart #5, titled SUT Revenue vs. Personal Consumption Expenditures, we see a different pattern for Sales Tax. Sales Tax revenue lags PA personal consumption growth. This is partly due to the shifting pattern in personal consumption, as the growth in spending on services, which is generally not taxable, has outpaced that of spending on goods.
- In order show the effect of the growth of services, the chart also shows a dotted line for personal consumption of goods, which is growing more slowly. However, Sales Tax revenue growth is also falling short of this measure. We believe this is attributable in

large measure to the growth of Internet commerce which escapes Sales Tax to some degree.

- If Sales Tax had tracked the personal consumption of goods for these 20 years, Sales Tax revenue would have been $1.2 billion higher last fiscal year.
- Finally, please turn to Chart #6, titled "CNIT Revenue vs. Corporate Profits." Corporate profits are very volatile, growing strongly during good economic times and falling dramatically during recessions. The chart makes it clear that CNIT revenue has not kept pace with national corporate profits. Growth began to lag during the early 2000's and has never recovered.
- Indeed, if CNIT revenue had grown at the same rate as before-tax corporate profits, the Department would have collected an additional $1.6 billion in CNIT in 2016-17.
- The reasons for lagging CNIT revenue include tax cuts enacted several times during this period which increased the cap on the net operating loss (NOL) deduction and increased the weight on the sales factor.
    - For Fiscal Year 2006-07 the amount of tax foregone for those two expenditures was 15% of collections. By Fiscal Year 2016-17 that had increased to 38%.
    - The NOL deduction was increased from a cap of $2 million in 2006 to the greater of $5 million or 30% of income in 2017. This increase benefits a few hundred large corporations each year.
    - The Sales Factor weight for apportionment was increased from 60% to 100% over the same time period.
    - The estimated tax foregone for these two expenditures in 2016-17 was more than $1 billion.
    - I would also note that legislation reducing business taxes has been enacted with bipartisan support across several administrations, including that of Gov. Wolf, to reduce the business tax burden and increase the competitiveness of the Commonwealth. We raise these issues simply to help explain the slow growth of General Fund revenues over a long period of time, and that they have had a significant budgetary cost.
- The rapid growth in the availability of tax credits is also a factor in lower CNIT revenue. In 2015-16, there was a total of 16 tax credit programs with awards of more than $383 million. Most of these awards will eventually lower CNIT payments. Further, there are an additional 13 tax credit programs that were not awarded in 2015-16, but have begun to be awarded since then.
- 17% of the General Fund tax collections are imposed on tax bases that are stagnant or even declining–Cigarette Tax, Gross Receipts Tax, and Corporate Net Income Tax. In addition, Sales and Use Tax receipts, which make up 33% of General Fund tax collections, are not keeping up with personal consumption due to shifting purchase patterns.

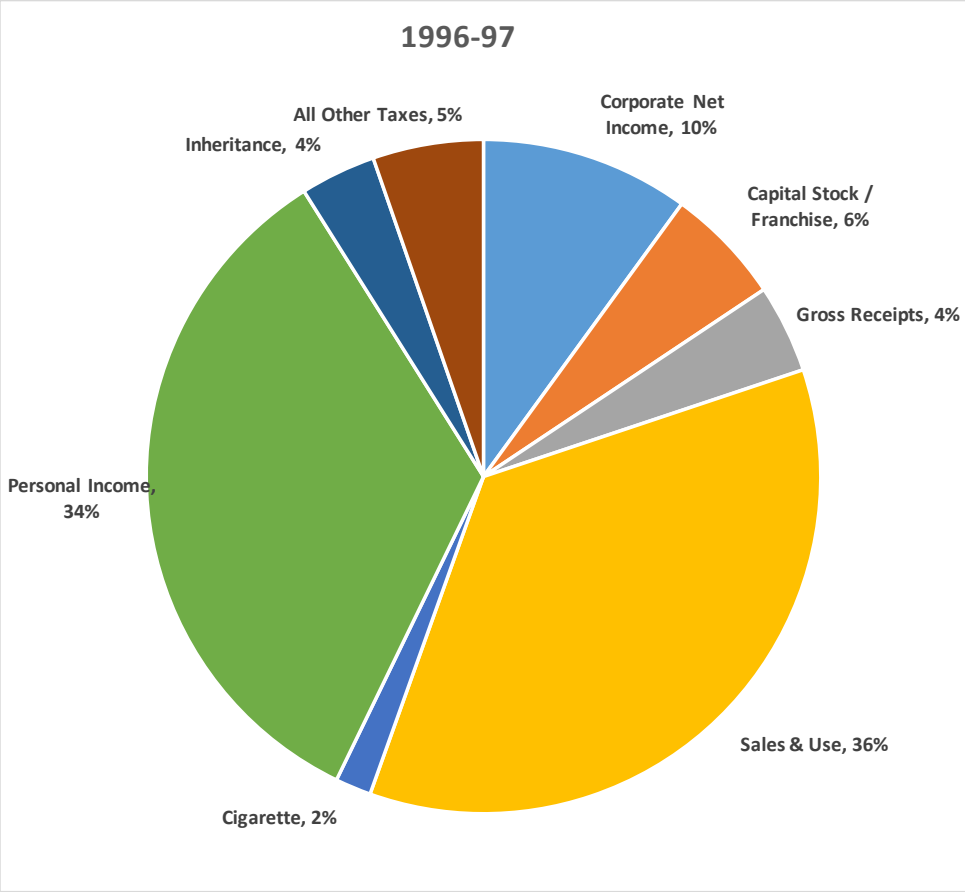
Summary

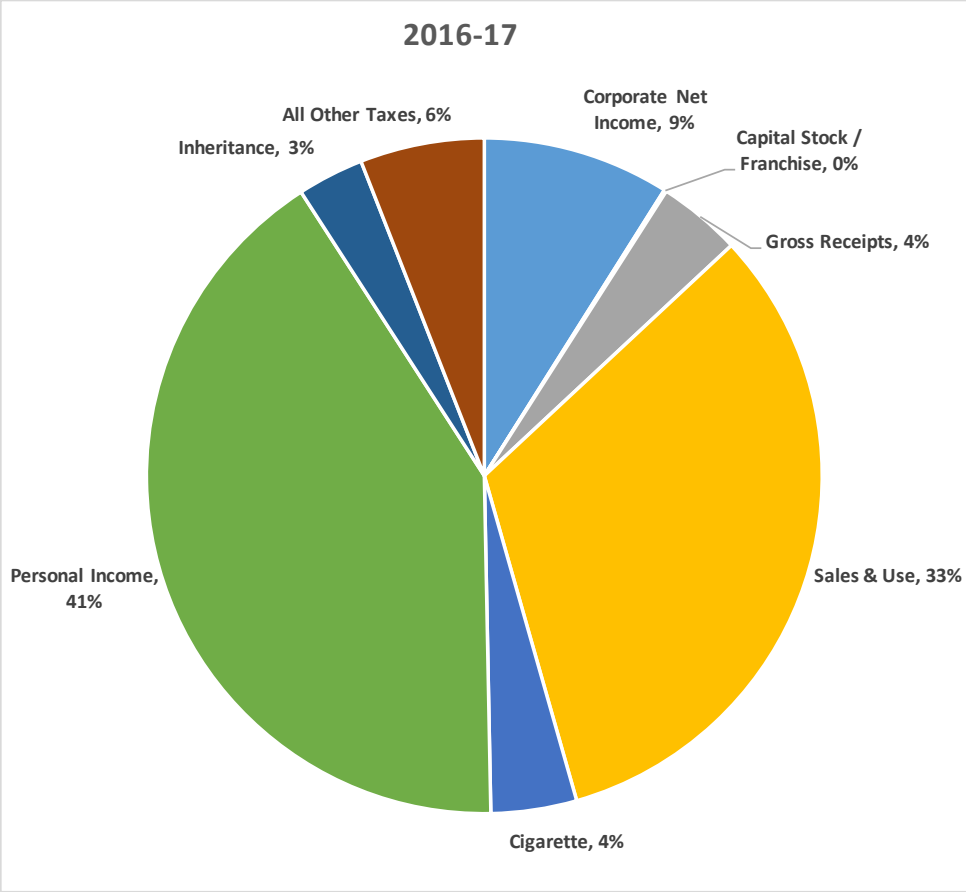
- 74% of General Fund Tax Collections are from two taxes – the Personal Income Tax and the Sales and Use Tax, up from 70% in FY 1996-97.
- The strongest source of revenue growth is from the Personal Income Tax, which tracks the growth of PA personal income closely.
- Personal Consumption is increasing faster for Services, limiting Sales and Use Tax growth.
- The expansion of Internet commerce has also had an impact on Sales and Use Tax revenue.
- Legislative changes to the Corporate Net Income Tax reduced revenue by an estimated $1 billion in 2016-17.
- Tax credit and zone programs have also been expanded rapidly, much of which is used to offset CNIT revenue.
- The phase out of the Capital Stock and Franchise Tax has offset other sources of revenue growth by almost $1 billion.
- The changes to Capital Stock and Franchise Tax and Corporate Net Income Tax have reduced business share of General Fund tax revenues from 16% in 1996-97 to 9% in 2016-17, significantly reducing the overall tax burden on business in Pennsylvania.
- 17% of the General Fund tax collections are imposed on tax bases that are stagnant or even declining –Cigarette Tax, Gross Receipts Tax, and Corporate Net Income Tax. In addition, Sales and Use Tax receipts, which make up 33% of General Fund tax collections, are not keeping up with personal consumption due to shifting purchase patterns.

Thank you for the opportunity to provide this information and an overview of the Department of Revenue.

Chart #1:

GENERAL FUND TAX REVENUES - SHARE OF TAX REVENUE TOTAL





Total FY 1996-97 Tax Revenue = $17 Billion

Total FY 2016-17 Tax Revenue = $30.8 Billion

Chart #2:

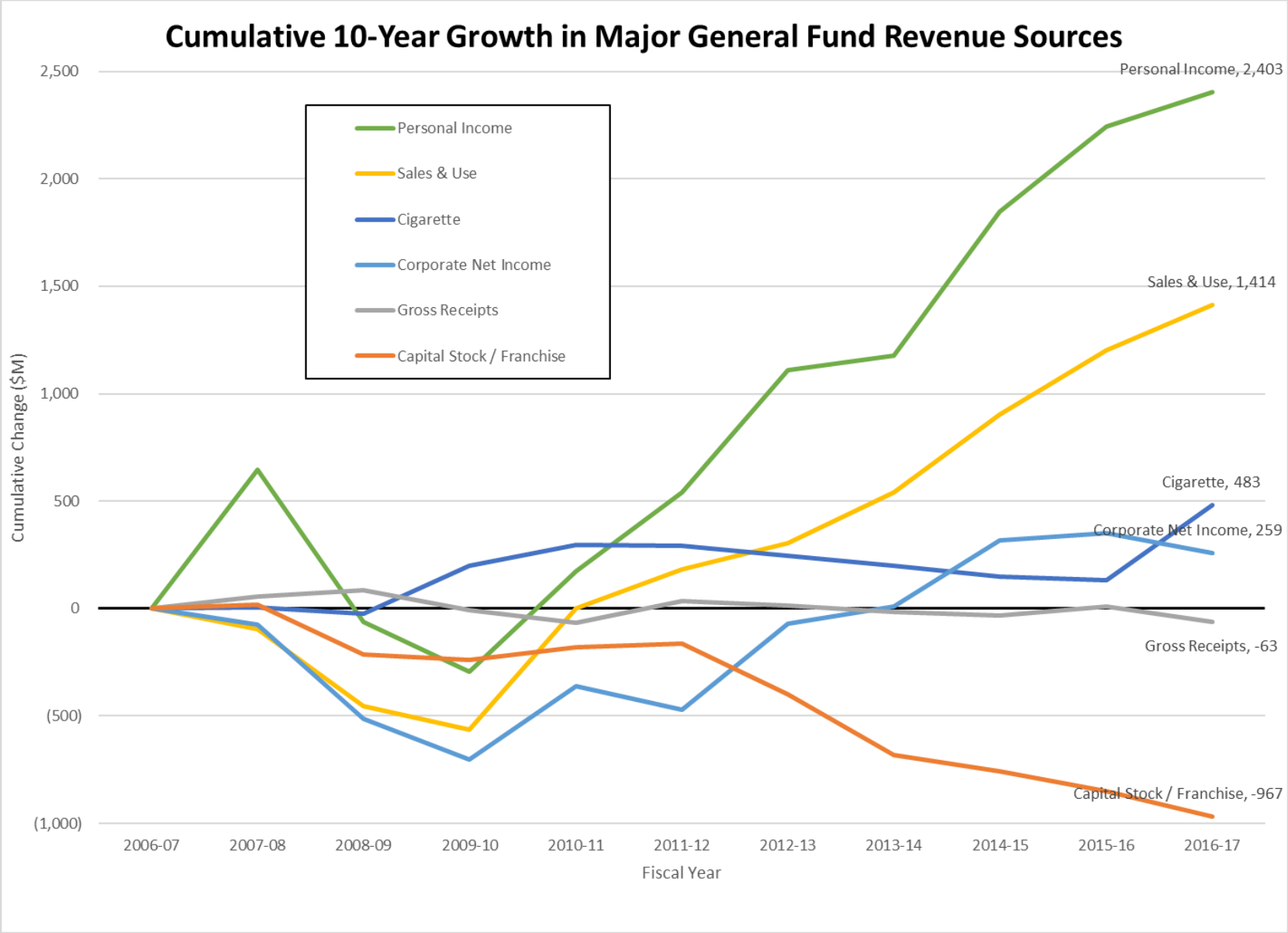

Cumulative 10-Year Growth in Major General Fund Revenue Sources
Personal Income
Sales & Use
Cigarette
Corporate Net Income
Gross Receipts
Capital Stock / Franchise
Personal Income, 2,403
Sales & Use, 1,414
Cigarette, 483
Corporate Net Income, 259
Gross Receipts, -63
Capital Stock / Franchise, -967
2,500
2,000
1,500
1,000
500
0
(500)
(1,000)
Cumulative Change ($M)
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
Fiscal Year

Chart #3:

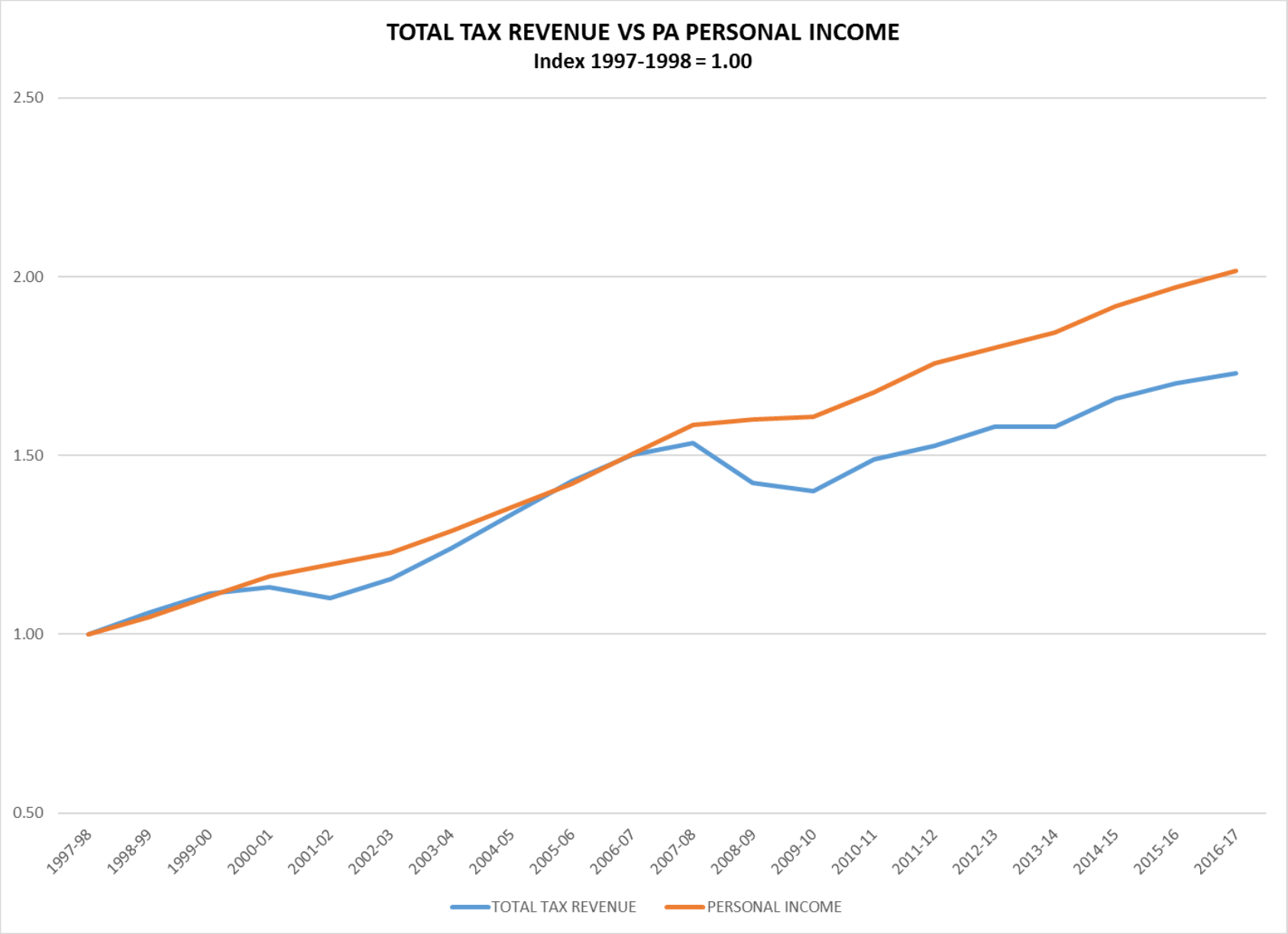

TOTAL TAX REVENUE VS PA PERSONAL INCOME
Index 1997-1998 = 1.00
2.50
2.00
1.50
1.00
0.50
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
TOTAL TAX REVENUE
PERSONAL INCOME

Chart #4:

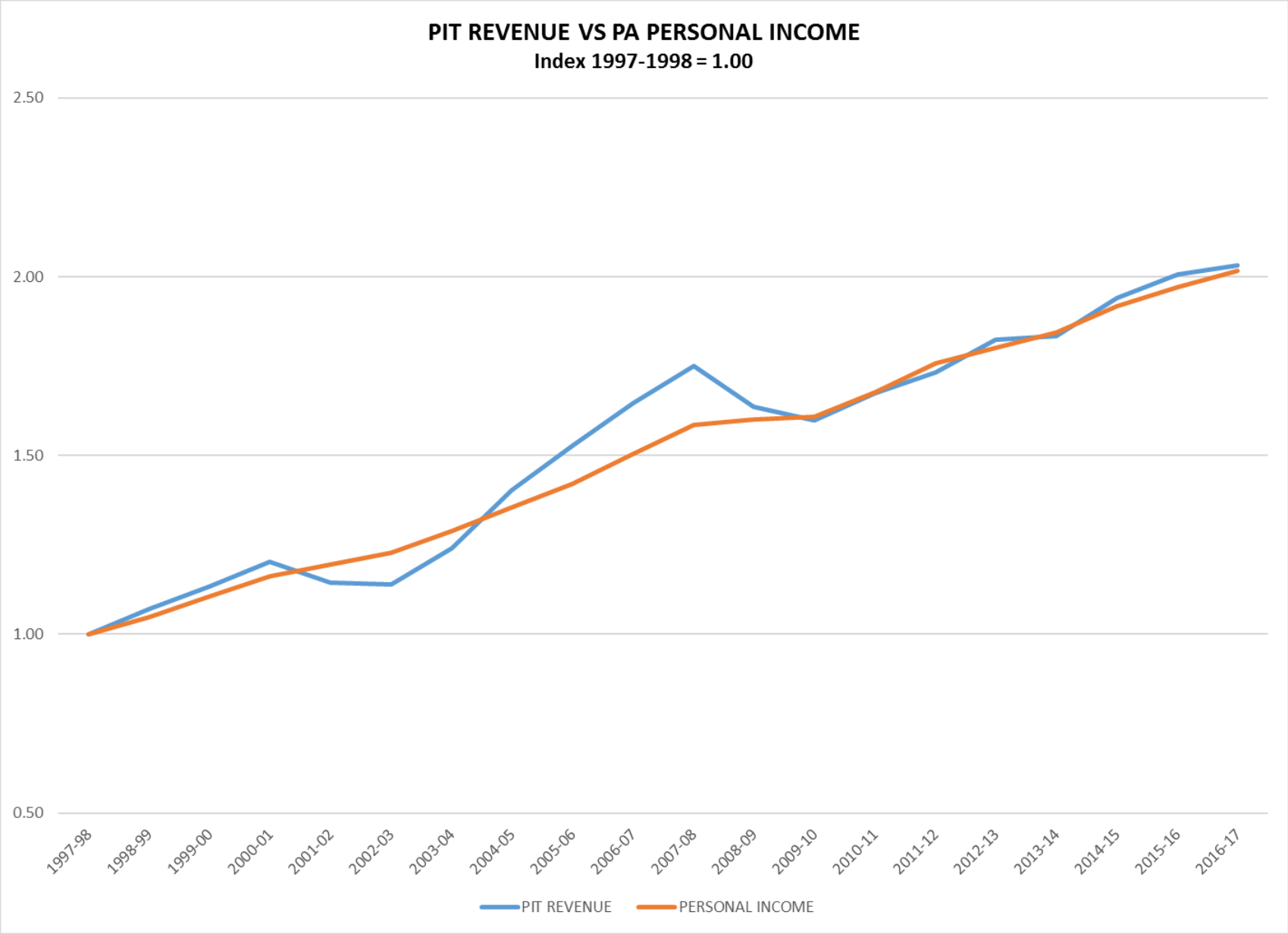

PIT REVENUE VS PA PERSONAL INCOME
Index 1997-1998 = 1.00
2.50
2.00
1.50
1.00
0.50
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
PIT REVENUE
PERSONAL INCOME

Chart #5:

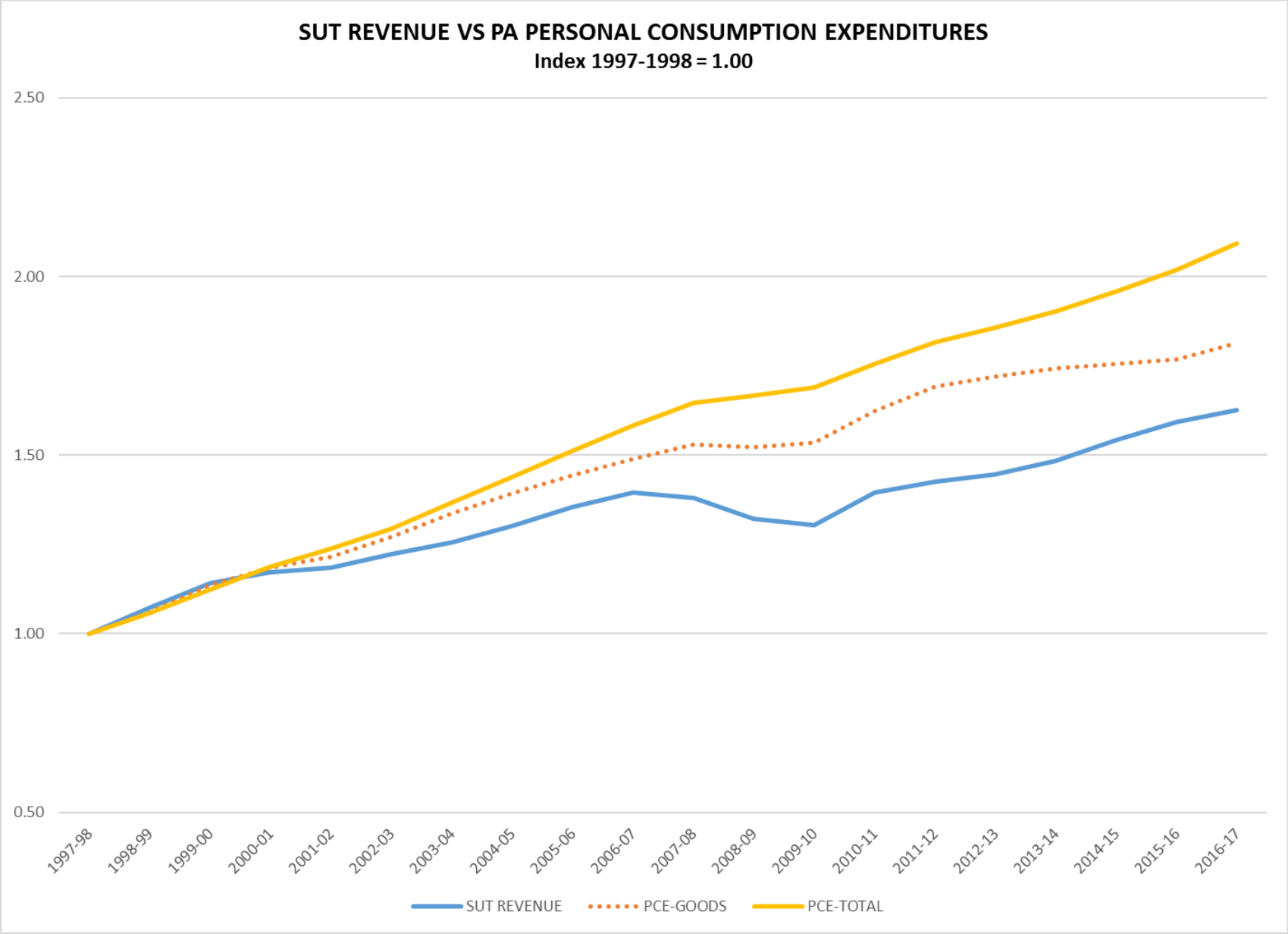

SUT REVENUE VS PA PERSONAL CONSUMPTION EXPENDITURES
Index 1997-1998 = 1.00
2.50
2.00
1.50
1.00
0.50
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
SUT REVENUE
PCE-GOODS
PCE-TOTAL

Chart #6:

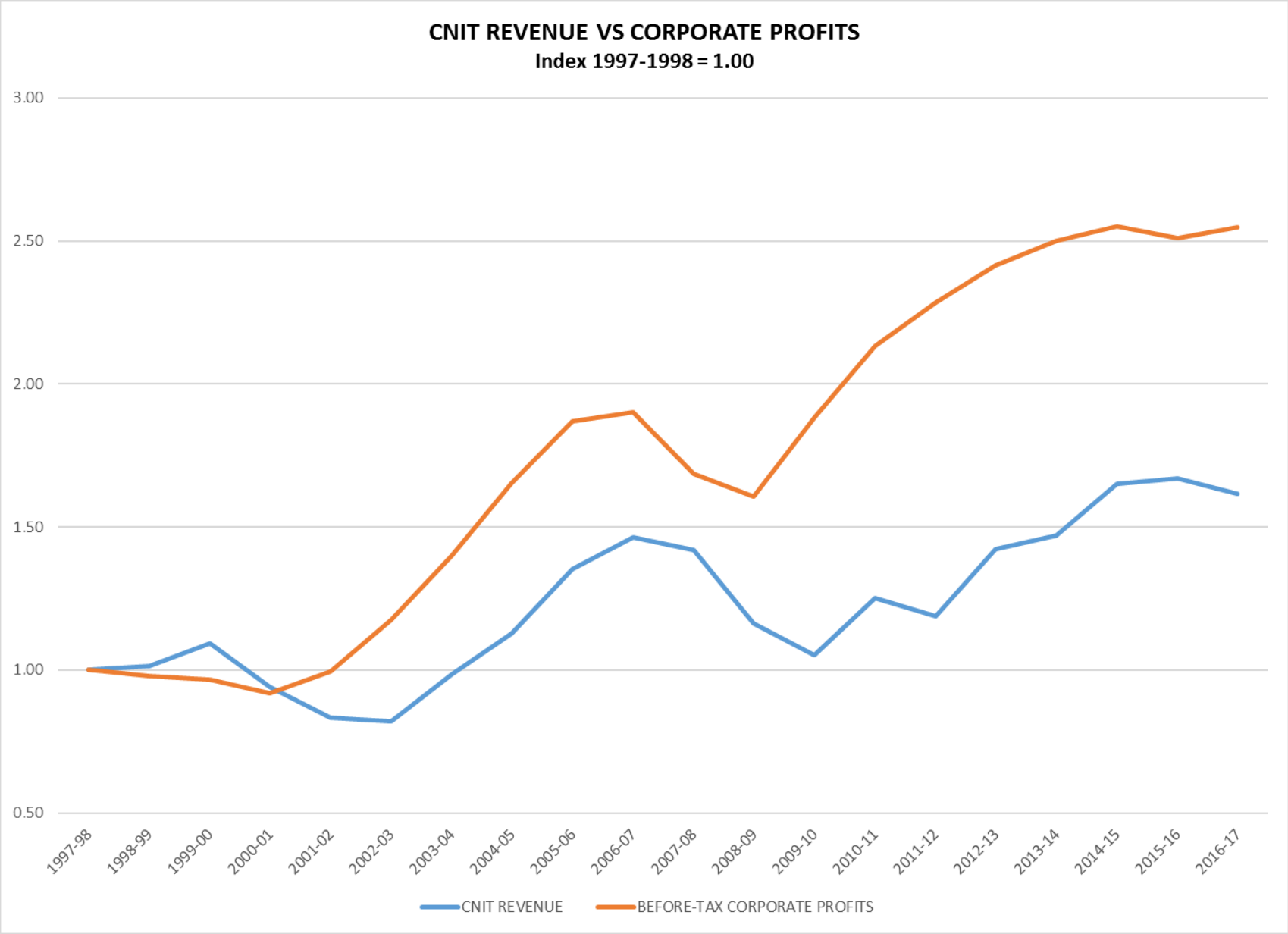
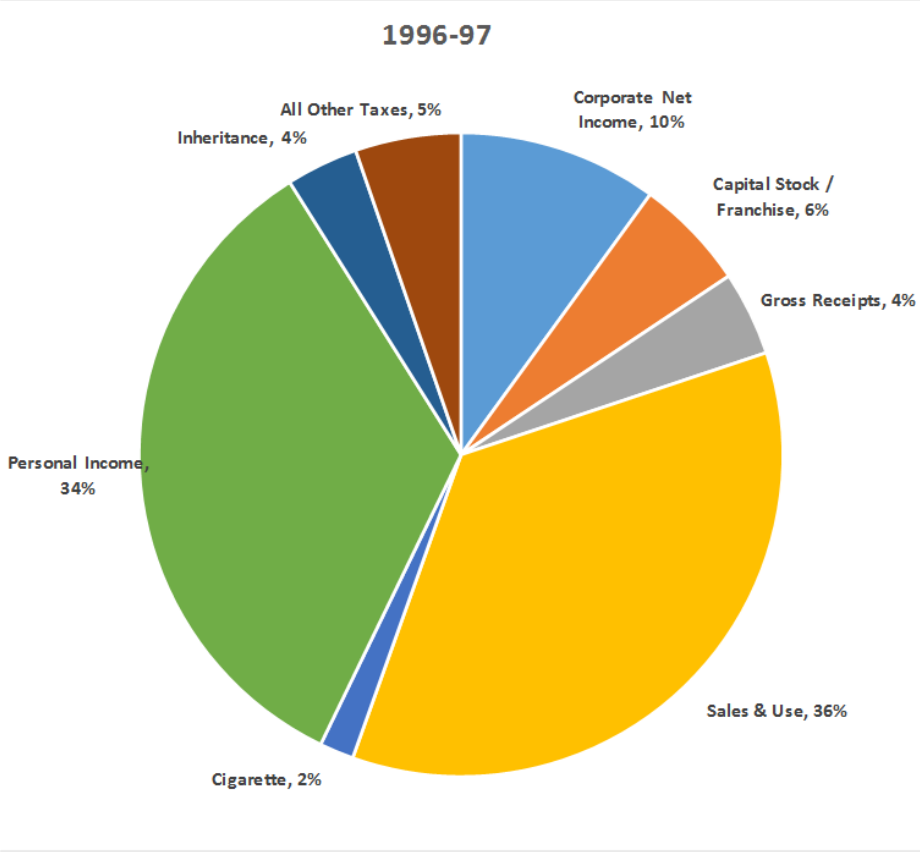
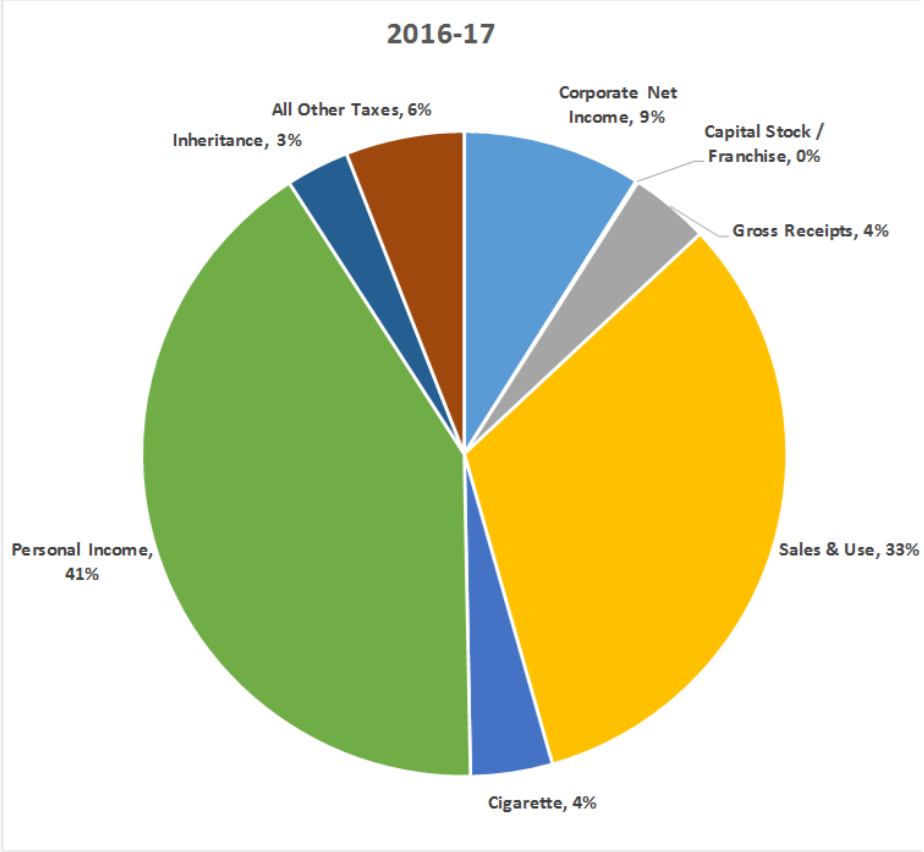

CNIT REVENUE VS CORPORATE PROFITS
Index 1997-1998 = 1.00
3.00
2.50
2.00
1.50
1.00
0.50
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
CNIT REVENUE
BEFORE-TAX CORPORATE PROFITS

Chart #1

GENERAL FUND TAX REVENUES - SHARE OF TAX REVENUE TOTAL



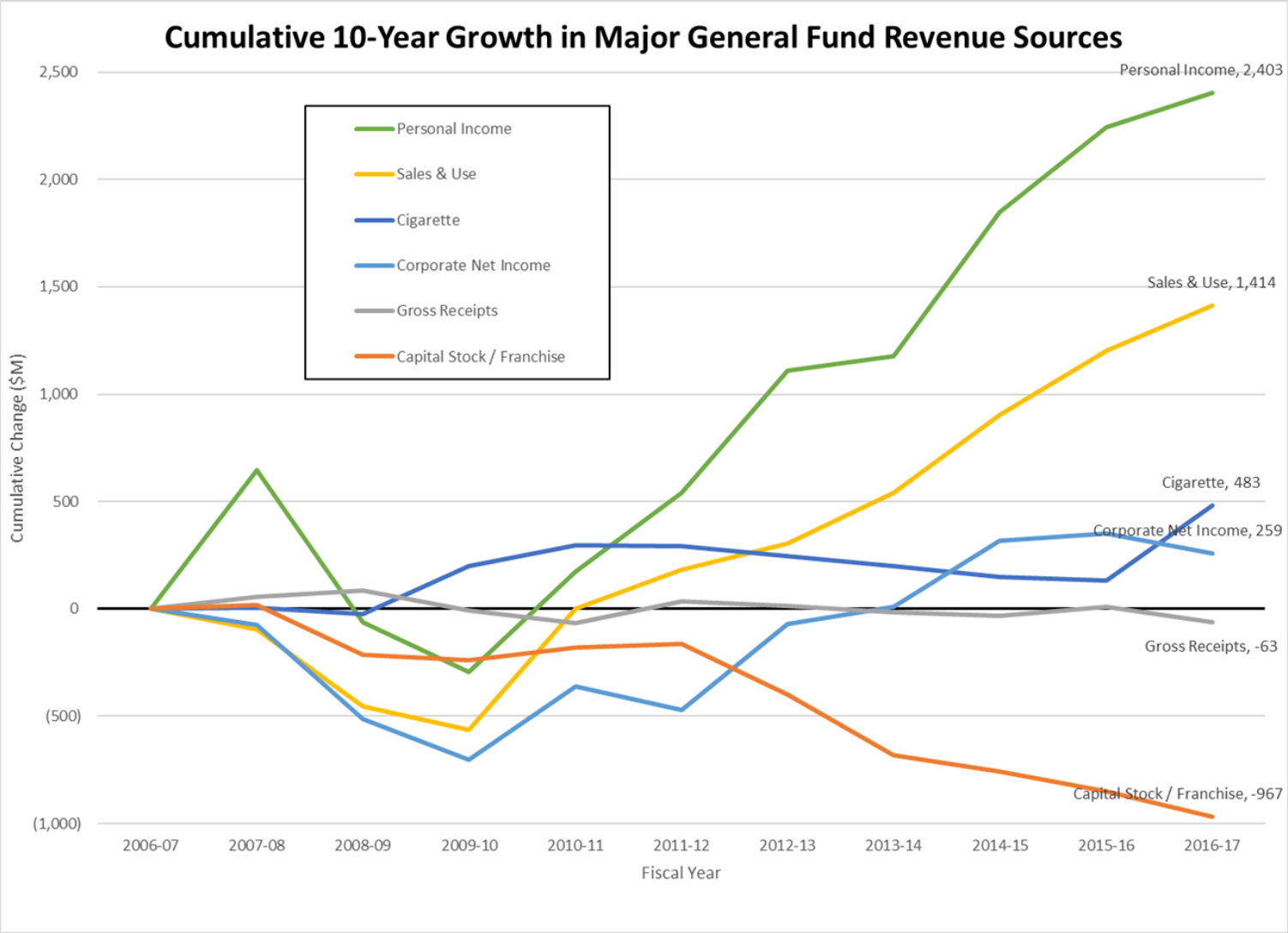


Total FY 1996-97 Tax Revenue = $17 Billion

Total FY 2016-17 Tax Revenue = $30.8 Billion

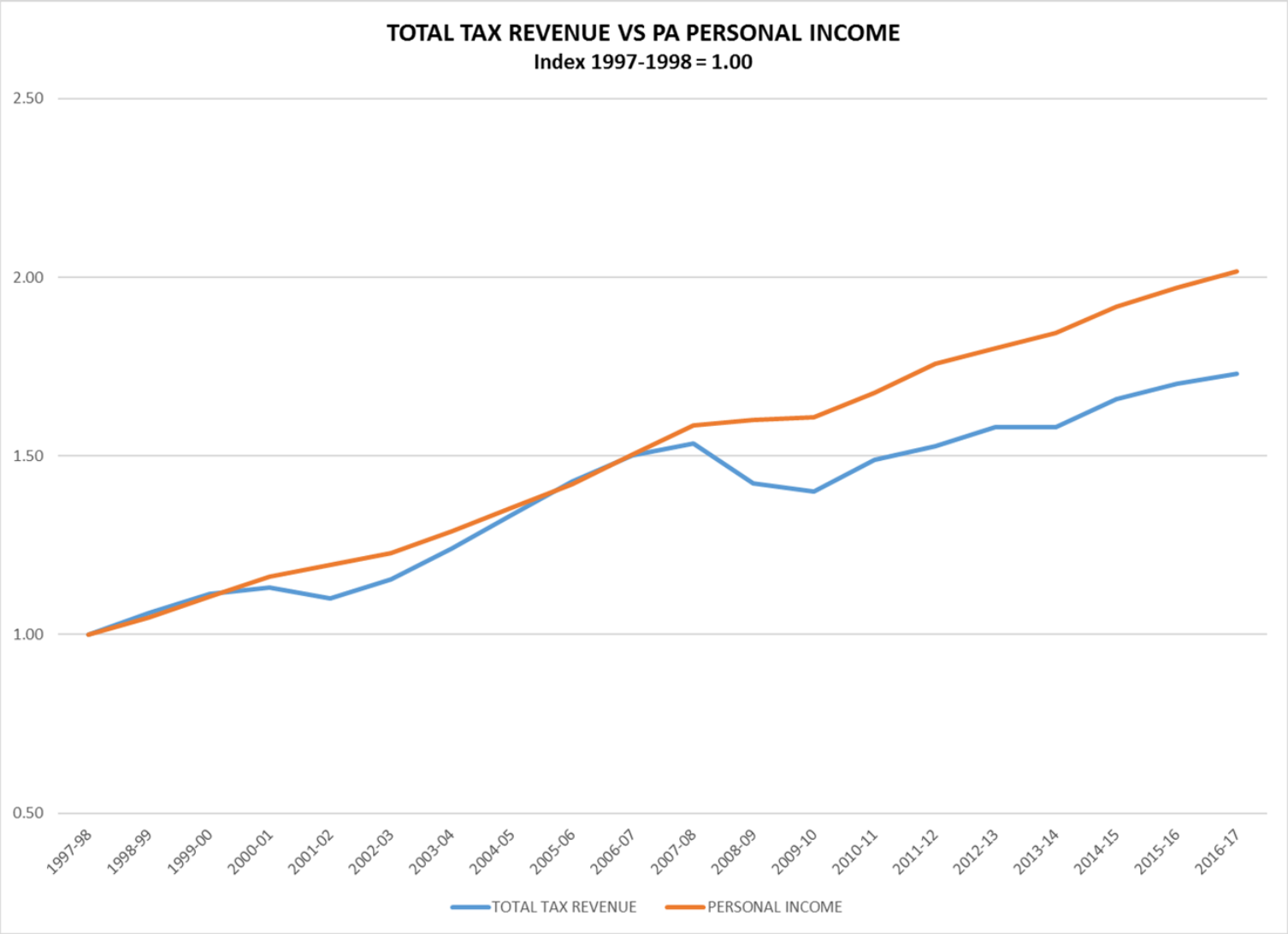
pennsylvania
DEPARTMENT OF REVENUE

Chart #2



pennsylvania
DEPARTMENT OF REVENUE

Chart #3



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DEPARTMENT OF REVENUE

Chart #4

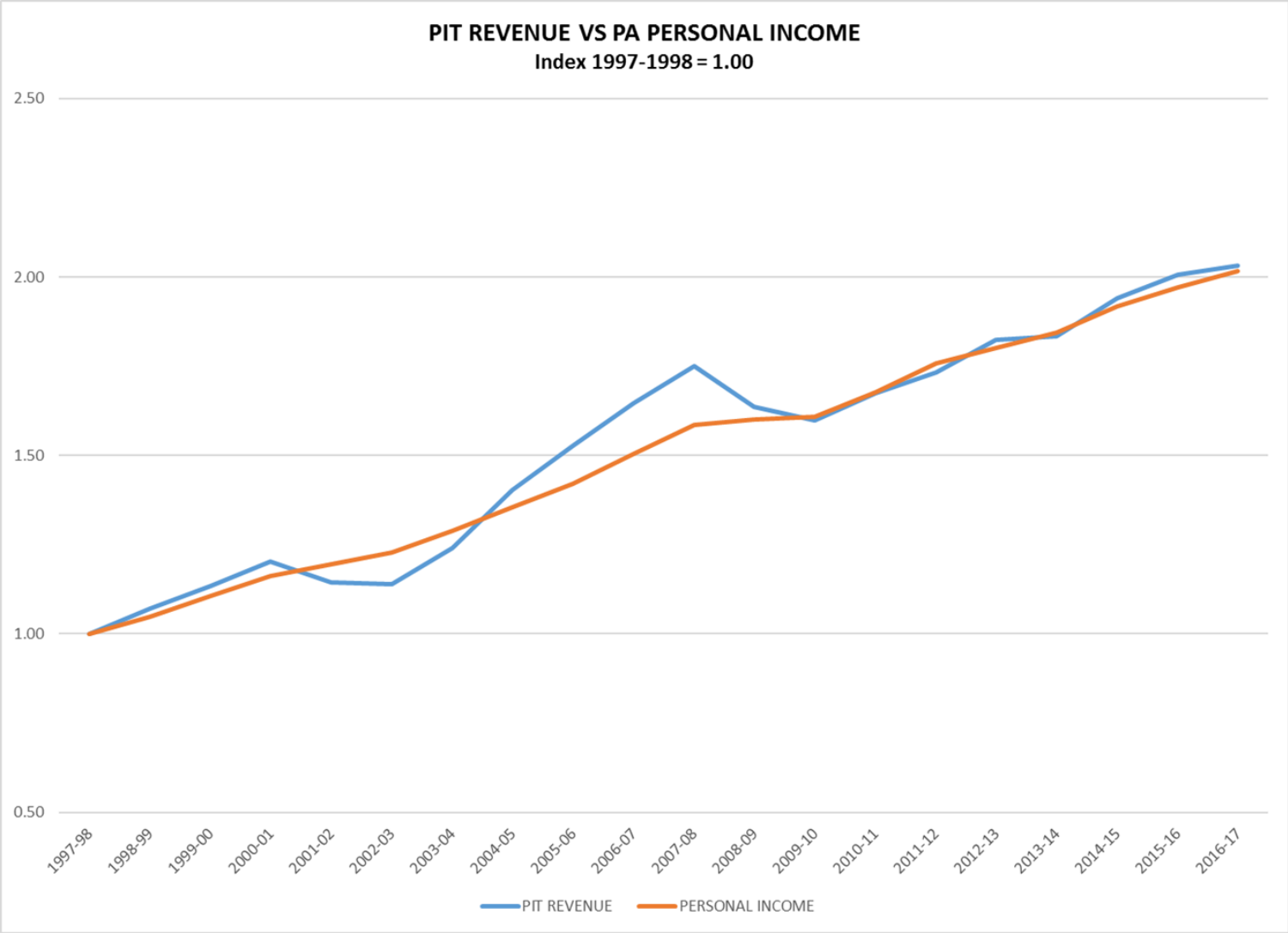

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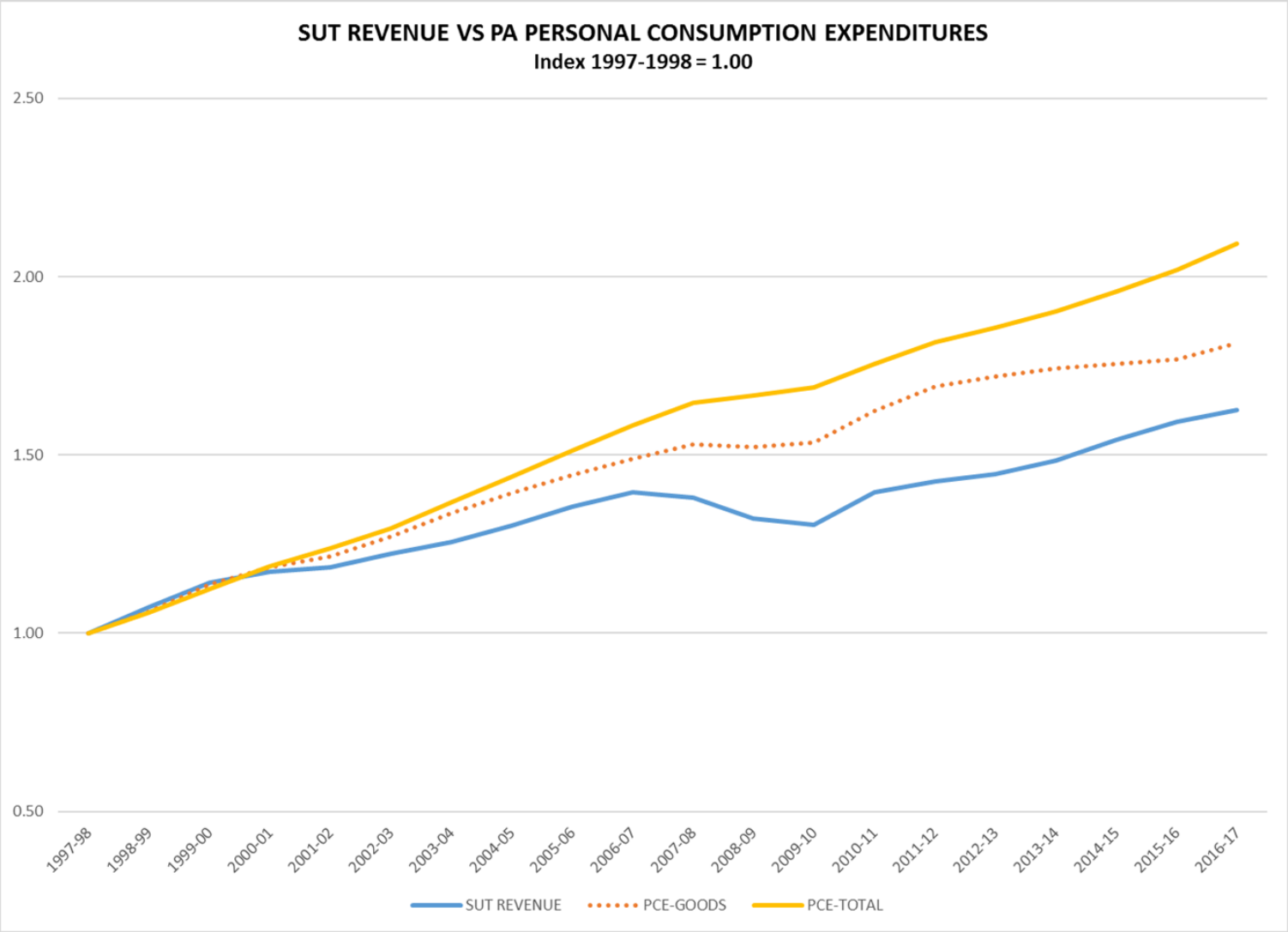
Chart #5



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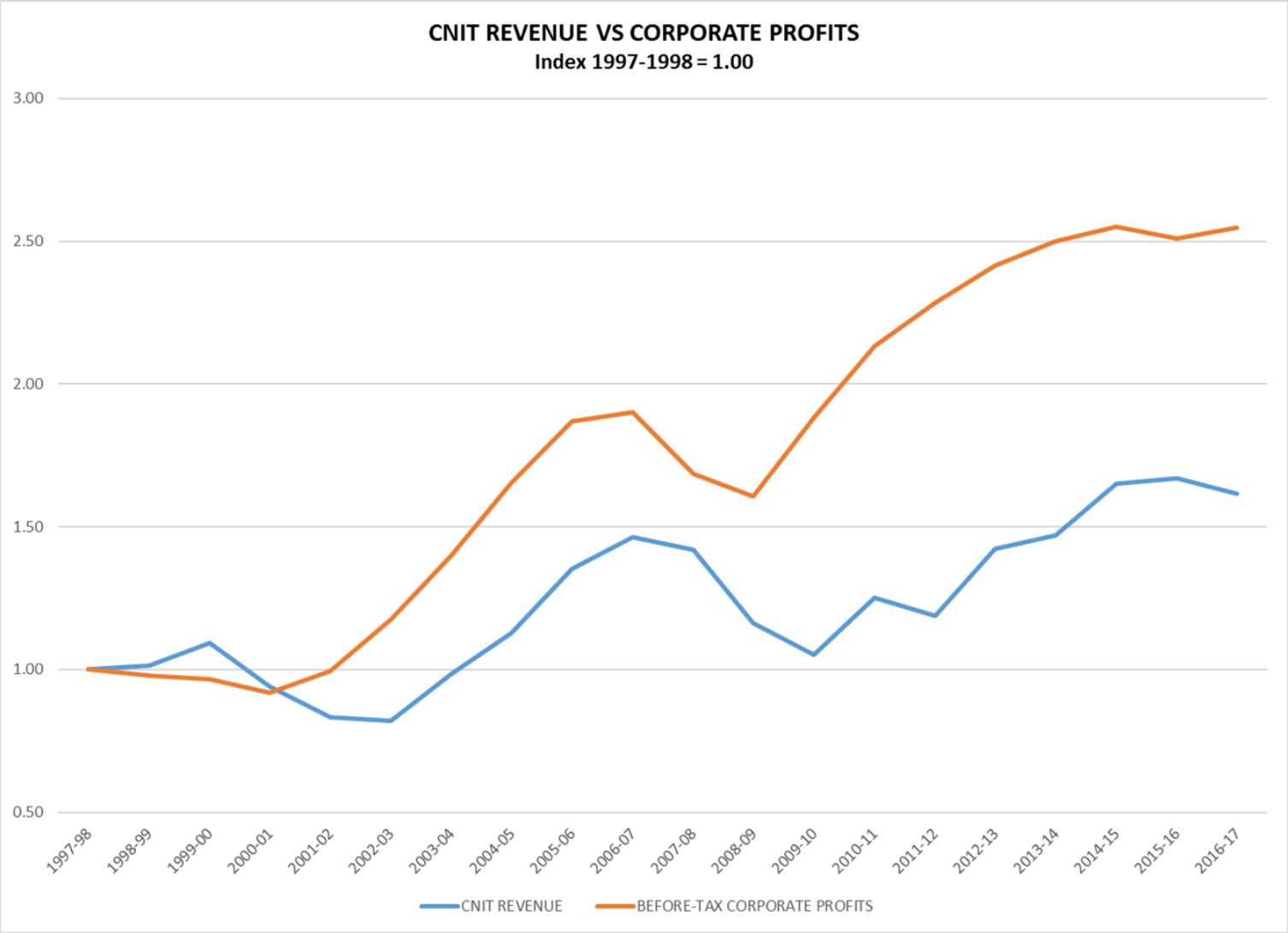
DEPARTMENT OF REVENUE

Chart #6



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