



**Testimony Presented by**

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**and**

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**to**

**Pennsylvania House Finance Committee**

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Good morning Chairman O’Neill, Chairman Wheatley, and members of the House Finance Committee. My name is David Caplan. I am a CPA, member of the Pennsylvania Institute of Certified Public Accountants (PICPA), and chair of the PICPA Committee on State Taxation’s Act 32 task force. I am a sole practitioner with a firm in Lafayette Hill, Pa., and personally file well over 500 individual and business state tax returns each year. Joining me this morning is Jim Newhard.

Good morning. My name is Jim Newhard. I, too, am a CPA and a sole practitioner in Paoli, Pa. I am a member of the PICPA, past president of the PICPA Greater Philadelphia Chapter, and a member of multiple PICPA committees. Like David, I file 150 individual and business tax returns annually.

On behalf of the PICPA, thank you for the opportunity to discuss with you the Philadelphia nonresident wage tax credit/net profits tax credit, commonly referred to as the “super credit.” We understand that there is legislation pending before this committee that seeks to change the current application of the super credit. PICPA will not be taking a position on this legislation at this time; our role here today is to provide you with a technical understanding of the law and how it is currently applied.

The PICPA was founded in 1897 and is the fourth-largest CPA organization in the country. The PICPA represents more than 22,000 members from across the Pennsylvania, and membership is composed of CPAs in public accounting, business and industry, government, and education. Our members are trusted advisors to thousands of Pennsylvania’s leading businesses and industries, as well as individual taxpayers.

Let me start with some background. Local income taxes in Pennsylvania are variously termed earned income taxes, wage taxes, net profits taxes, or a combination of these terms. Local income taxes were first authorized in 1932 by the Sterling Act for the City of Philadelphia. The Local Tax Enabling Act – known as Act 511 – authorizes local earned income taxes (EIT) for all other municipalities and school districts covering the remainder of Pennsylvania. The tax is levied on the wages, salaries, commissions, net profits, or other compensation of persons subject to the jurisdiction of the taxing body.

Under the Sterling Act, Philadelphia may not levy or collect a tax on any subject preempted by a state tax or license fee, but otherwise there are no limits on the kinds of taxes Philadelphia can impose, no limits on the rates of those taxes, and no limits on the aggregate amount of revenue that can be raised. The income tax imposed by the city applies not only to residents of the city wherever they may work, but also to nonresidents earning income within the city. Additionally, the Pennsylvania Intergovernmental Cooperation Authority Act requires all employers across Pennsylvania to withhold the Philadelphia wage tax from any employee who is a Philadelphia resident.

Under Act 511, local taxing jurisdictions are authorized to levy the earned income tax on nonresidents earning income within their jurisdiction. However, Act 511 requires the

jurisdiction of employment to remit to the employee's resident Act 511 jurisdiction any earned income tax levied, up to that jurisdiction's resident rate. In a majority of local taxing jurisdictions, there is an EIT at the place of residence. All communities in Pennsylvania outside of Philadelphia – those covered by Act 511 – share their earned income tax revenues with each other based on this procedure.

The exception to the priority given to the place of residence is persons subject to the Philadelphia wage tax. This is the "super credit." Act 511 requires taxing jurisdictions to credit their residents for taxes paid to Philadelphia on income earned within the city. This credit, like the other credits provided in Section 14 of Act 511, is a direct reduction against the liability for tax owed by the taxpayer. The credit is limited to the total EIT liability of the taxpayer, and not just to the liability on the Philadelphia earned income subject to double-taxation. If the taxpayer had additional EIT withheld on non-Philadelphia income, this could produce a refund for the taxpayer.

The local taxing body must also allow a credit against the taxpayer's EIT liability for the amount of tax paid to nonreciprocal states (such as New York and Delaware). The same dollar of the out-of-state tax cannot be claimed as credit against liability for both state and local taxes in Pennsylvania, but the credit can be divided and apportioned against Pennsylvania state and local tax liability. Tax payments made voluntarily to another state do not qualify for the credit; there must be evidence the taxpayer was legally liable for the out-of-state taxes. Credit for taxes paid to other states is limited to the amount payable to the Pennsylvania political subdivision on that portion of the taxpayer's income which was subject to taxation by the other state (that portion being double-taxed).

The following are examples of current Act 511 crediting practices. Reference to Act 32 of 2008 equates to the act amending withholding applications of Act 511 earned income taxes.

**Example 1** - A resident of Warwick Township, Chester County, PA, works in Allentown City, Lehigh County, PA. His home EIT rate is 1.25 percent, his nonresident rate where he works is 1.28 percent. Act 32 requires that the higher of the two rates is withheld from his pay. He earns \$100,000, so he has \$1,280 in earned income tax withheld from his pay. At the end of the year he files his annual earned income tax return with Keystone Tax Collectors. His total tax is \$1,250, and according to the instructions for line 12 of the return he can claim a credit for \$1,250, does not owe anything additional, and does not get a refund. Allentown City gets to keep the remaining \$30 of extra tax withheld.

**Example 2** - A resident of Whitehall Township, Lehigh County, PA, works in Allentown City, Lehigh County, PA. His home EIT rate is 1.5 percent; his nonresident rate where he works is 1.28 percent. Act 32 requires that the higher of the two rates is withheld from his pay. He earns \$100,000, so he has \$1,500 in earned income tax withheld from his pay. At the end of the year he files his annual earned income tax return with Berkheimer. His total resident earned income tax is \$1,500, and according to the instructions for line 12 of the Berkheimer return he can claim a credit for \$1,500, does not owe anything additional, and does not get a refund.

**Example 3** - A resident of Marysville Borough, Perry County, PA, works in the City of Reading, Berks County, PA. His home EIT rate is 1.8 percent, his nonresident rate where he works is 1.3 percent. Act 32 requires that the higher of the two rates is withheld from his pay. He earns \$100,000 and has \$1,800 in earned income tax withheld from his pay. At the end of the year he files his annual earned income tax return with Capital Tax Bureau. His total resident earned income tax is \$1,800, and according to the Capital Tax Bureau tax form he receives credit for the amount in Box 19 of his W-2, which is \$1,800. He does not owe anything with his tax return.

**Example 4** - A resident of Monroe Township, Cumberland County, PA, works in the City of Reading, Berks County, PA. His home EIT rate is 1.1 percent, his nonresident rate where he works is 1.3 percent. Act 32 requires that the higher of the two rates is withheld from his pay. He earns \$100,000 and has \$1,300 in earned income tax withheld from his pay. At the end of the year he files his annual earned income tax return with Cumberland County Tax Bureau. His total tax is \$1,100, and according to the Cumberland County Tax Bureau tax form he receives credit for the amount in Box 19 of his W-2, which is \$1,300, but limited to \$1,100. He does not get a refund. The City of Reading gets to keep the remaining \$200 of extra tax withheld.

Here's how the Philadelphia super credit works.

Jane Doe lives in ABC Township, which imposes a 1 percent EIT on all income earned by residents of the township. Jane has a full-time job in Philadelphia and a small business in her township. During the 2015 tax year, Jane earned \$100,000, with \$75,000 of her wages earned in Philadelphia and the rest (\$25,000) was earned in her township.

Jane's employer in Philadelphia correctly withholds Philadelphia wage tax at the nonresident rate (mid-year rate change blends to a rate of 3.48715 percent x \$75,000 = \$2,615), while no tax is withheld on her small business net income earned in her township.

With the super credit, Jane will offset all of her earned income tax liability in the example above with the Philadelphia super credit (\$1,000 balance due and \$2,615 withheld), with no additional dollars due to the township. It should be noted, the super credit could not create a refund of tax.

Now I will turn it over to Jim.

Thank you and good morning.

For the purposes of this discussion, each area which is covered by a distinct law shall be called a legal jurisdiction (LJ). Let's consider the following nine legal jurisdictions:

- a. Act 511 PA local taxing jurisdictions (except Philadelphia)
- b. Sterling Act (Philadelphia only)

- c. New York
- d. New York City, NY
- e. Yonkers, NY
- f. Delaware
- g. Wilmington, DE
- h. New Jersey
- i. Maryland

Tax policies within each legal jurisdiction, but not necessarily between each legal jurisdiction, are consistent. For example, if you work in Wilmington but don't live there, you are still subject to its tax; if you work in Yonkers and don't live there, you pay a nonresident tax after allowable exemption that is earnings-based; and if you work in NYC and do not live there, you do not pay any NYC tax. The sharing of revenue among all communities within Act 511 is consistent policy, but it does not mean that Philadelphia, which is in a different legal jurisdiction, needs to comply to be consistent. For purposes of terminology, New York and Delaware (and possibly New Jersey starting in 2017) are known as nonreciprocal states. This means that they don't recognize Pennsylvania's crediting procedures, and they are not required by law to remit taxes paid by Pennsylvania residents back to Pennsylvania or its local jurisdictions. In a similar vein, Philadelphia, under the Sterling Act, is a nonreciprocal city, in that its law does not require remittance to Pennsylvania local jurisdictions covered by Act 511.

Further, Wilmington city and Yonkers city are likewise non-reciprocal. They do not remit any taxes to a taxpayer's resident taxing jurisdiction. And finally, while Maryland is reciprocal to Pennsylvania at the state income tax level, its counties (Maryland counties assess a local income tax at the county level that is applicable to both residents and non-residents) is also non-reciprocal to Pennsylvania localities (whether that locality is Philadelphia or an Act 511 jurisdiction).

Another example is the New Jersey, who has been a party of a reciprocal agreement with Pennsylvania at the state income tax level for over 40 years, allows a credit against New Jersey state income tax for taxes paid to Philadelphia by its residents who work in Philadelphia. Philadelphia and New Jersey are likewise non-reciprocal, and thus Philadelphia does not remit any funds to New Jersey for the crediting it permits to its residents subject to Philadelphia tax.

We will be happy to answer any questions.