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Monthly

REPORT TO THE PEOPLE

on the

Fiscal Status of the Commonwealth

From the
SENATE DEMOCRATIC APPROPRIATIONS COMMITTEE

Vincent J. Fumo
Chairman

Paul S. Dlugolecki
Executive Director

717.787.5662

❑ Charting the Commonwealth's Surplus

Through the end of February, tax collections are $204 million above official estimates, an overage of 1.5%. February collections were disappointing, coming in $57 million below estimate.

Twenty million dollars in state liquor store profits were not transferred in February as they should have been. That revenue is not lost, only delayed, and the state will receive it in March. The remaining shortage, however, is a different story. Sales tax collections were $17 million below estimates and licenses, fees and miscellaneous income was $14.7 million short of projections. Other than the liquor store profits and perhaps the sales tax receipts, the losses might never be fully recouped.

On the positive side, business taxes were $6.5 million above estimate and PIT and realty transfer tax collections were above estimate by $4.9 million and $5.5 million respectively. As usual, cigarette tax and inheritance tax collections were below estimate. Because it is never wise to panic after one bad month, the Senate Democratic Appropriations Committee estimate of a year-ending surplus of $500 million remains unchanged.

Revenue Surplus thru end of February:
$204 million
Estimated Final Surplus:
$500 million
Governor's Estimate :
$290 million

Governor's Business Tax Proposal

The Governor proposed sweeping tax changes to the Commonwealth's business taxes. The changes are based on the recommendations developed by the Business Tax Reform Commission. The goal is to revamp the Commonwealth's business taxes to increase the state's competitiveness and to modernize business taxes from the days of the industrial revolution.

The major components of the proposal are:

1. *Lower the corporate net income tax from its current rate of 9.99% to 7.99%.*
2. *Remove the $2 million limit on annual usage of the net operating loss.*
3. *Increase the sales factor in the apportionment formula to 100%. This will change the way that*

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business taxes are split among states for multi-state corporations. The determining factor would become the percentage of a company's sales that occur in Pennsylvania. This will place more tax burden on corporations that only sell products in Pennsylvania and provide a reduction to corporations that have plants and employees in Pennsylvania.

4. *To make the Governor's proposal revenue neutral, the Commonwealth would require multi-state corporations to file consolidated returns. Consolidated returns include all of a corporation's United States activities on their Pennsylvania return, not just the Pennsylvania-located income. This does not mean that they will be taxed on activities that are clearly outside of Pennsylvania, but it is intended to close the Delaware holding corporation loophole and other loopholes that have resulted in significant losses in tax revenue that should have been collected by the Commonwealth.*

The Governor will also recommend that businesses or individuals who have licenses to do business in the Commonwealth will not be allowed to renew those licenses if they owe back taxes to the Commonwealth.

The proposal corrects the two most glaring shortcomings of Pennsylvania's business tax system. The high stated rate of the CNI is, at 9.99%, the third-highest rate in the nation. While taxes are only one component of the businesses' location decision, the high rate has for 15 years kept Pennsylvania off many corporations' list of possible locations. A rate of 7.99% will place Pennsylvania at the 20th-highest CNI rate. A very impressive jump. It is not vital to have the lowest tax rate, but it is important to be in the pack and this change would clearly place Pennsylvania there.

Equally important is the change to the apportionment factor. This will lower the tax bill to corporations that are committed to producing and employing people in Pennsylvania.

Requiring consolidated reports may be the necessary evil of the plan. Certainly it allows for the proposal to be revenue neutral and it will provide a mechanism to get corporations that have an economic profit to pay taxes on their true net income. But it will require some Pennsylvania corporations to pay more in taxes. Whether it is their fair share or not, they won't be happy about it.

The argument has been made that corporations approach any state with consolidated reporting very gingerly, and that such a change may offset the competitive advantage accruing from the rate change. Those arguments seem unpersuasive given the positive changes that are contained in the rest of the proposal.