

SEPTEMBER-
OCTOBER 2004



Monthly
REPORT
TO THE
PEOPLE
on the
Fiscal Status
of the
Commonwealth

From the
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APPROPRIATIONS
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Charting the Commonwealth's Surplus

September's revenue collections were \$28 million above official estimates. For the first three months of this fiscal year the surplus is \$56.5 million, or 1.1% above official estimates.

While corporate taxes were a major contributor in September, adding \$19 million to the surplus, it was the PIT which recorded the largest overage, adding another \$23 million. The official sales tax estimate is amazingly close to being right on target as collections are only \$1.6 million, or .1%, below estimates.

**Current Coverage
thru September:
\$56 million**

Continuing the pattern that emerged from the first increase in the cigarette tax rate in 2002 through the latest increase in December of 2003, cigarette tax collections are below estimates every month of the fiscal year. The deficit is now \$16 million, or 7.7%.

The first three months seem to show a random pattern of tax collections: July was \$75 million short of estimate, August was \$103 million above estimate and September came in at \$28 million above estimate. There was, however, a \$74 million posting

delay of sales tax from July to August. If \$74 million is subtracted out of the August surplus and placed in July's collections the monthly surpluses are \$0, \$28 million and \$28 million respectively.

A further adjustment should be made to the July estimated number. The predicted monthly distribution of tax collection is published after the July collections are posted, so July's estimates always look suspiciously like July's actual collections. Last year, the Department of Revenue estimated that July tax collections would be 6.35% of the yearly collections. This year, July's estimate is for 6.5% of yearly tax collections. The dollar difference between these two percentages is about \$35 million. If the July estimate is lowered to last year's expected take of 6.35% and the late posting of sales tax receipts is transferred into July the surplus for July would be \$35 million.

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REPORT TO THE PEOPLE

Spotlight on Commonwealth Revenues: Sales Tax

The sales tax in Pennsylvania is levied on retail sales at 6%. Allegheny and Philadelphia counties have a local sales tax on the state base, which raises the tax to 7% on items purchased within those counties. The sales tax is fairly broad-based, but there are notable exemptions. Food purchased in a grocery store is tax exempt, as are residential utilities, heating and local phone service. Medical care, dry cleaning, personal hygiene products, barbering, and of course clothing and shoes are all nontaxable. The theory is that expenditures for the necessities of life should not be taxable, but purchases of more discretionary items are taxable.

Despite the exemptions, the Pennsylvania tax system is already regressive, meaning poorer people pay a larger share of their income in taxes than wealthier people pay. Any plan that removes the exemptions for necessities would worsen that significantly. Poorer people tend to spend all of the income they receive. If everything is taxed, they would effectively be double taxed on all their earnings – first when the income is earned and then again when they spend it. Under the current system food, clothing and utilities are exempt from the sales tax so the money spent on those items, which is the bulk of their purchases, are free of the sales tax.

Sales taxes are not deductible

for federal income tax purposes, but property and income taxes are. Pennsylvania has a competitive advantage in the non-taxability of clothing and shoes. Many of the border areas have large outlet malls. Those malls bring in customers from New York, New Jersey, Ohio and Maryland because clothes and shoes are not taxable. Any proposal that removes this advantage will cause those outlet malls to suffer.

Whether the House Commonwealth Caucus proposal to eliminate exemptions while reducing the tax rate is adopted or not, the sales tax will undergo substantial changes in future. Sales on the internet are growing and they are making the idea of a sales tax seem antiquated. Taxable items purchased over the internet are still taxable. They fall into the use tax provisions. The use tax requires the purchaser to assess the tax on himself/herself and send the tax to the Department of Revenue. That doesn't happen often. The National Conference of State Legislatures has proposed standardized sales tax definitions and rates for each state so that internet sellers can more easily collect sales tax from all their customers, and then later, collected sales tax will be distributed to the states in some fashion. Pennsylvania is participating in this so called streamlined sales tax project.