

House Appropriations Committee
Prepared Statement
Tom Wolf, Secretary
PA Department of Revenue
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Chairman Evans, Chairman Civera and members of the committee. Thank you for giving me the opportunity to submit comments for the Department of Revenue's budget hearing. Joining me today is Dan Hassell, Deputy Secretary for Tax Policy, Stacie Amsler, Director of the Bureau of Fiscal Management and Ed Trees, Executive Director of the Pennsylvania Lottery.

Before I entered public service as Secretary of the Department of Revenue, I spent most of my life building a business in Pennsylvania. I believe that just as a business owner must invest a small amount of money to maintain a piece of machinery before it breaks and requires costly repairs, Pennsylvania also needs to invest now to reduce costs in the long run.

The Governor's fiscally responsible budget does just that – without raising taxes to fund general government operations. The proposed budget includes the latest in a series of targeted tax cuts for Pennsylvania businesses and includes strategic investments that will produce long-term financial savings and benefits for our citizens.

I am happy to report that state revenue collections remain stable so far this fiscal year; however, there are storm clouds in the national economic forecast and we need to act now to ensure residents and businesses we can weather any storm.

One of the components of the Governor's economic stimulus plan is the "Protect Our Progress" rebate. As I explained in my testimony before this committee on February 11, these one-time rebates of up to \$400 per household would be paid automatically to 476,000 lower-income working families who qualify for the Tax Forgiveness credit on their tax year 2007 personal income tax returns.

As you probably know, the Tax Forgiveness credit was enacted by the General Assembly in 1974 and has been endorsed and expanded during both Republican and Democratic administrations since then. By using this well-established program, rebates can be quickly distributed – a key feature of any economic stimulus program. The "Protect Our Progress" rebate would place \$130 million into the hands of hard-working Pennsylvanians. Because these families have limited resources, they are more likely to spend these funds on consumer goods, which will directly stimulate the economy.

This fiscal year's budget also includes 1.5 billion in business tax cuts for 2008-09. Taxpayers will save \$240.4 million from the continued capital stock and franchise tax phase-out in 2008-09.

While cutting business taxes is important, so is making the business tax system fairer and more competitive - which is why I encourage you to enact Governor Rendell's business tax reform proposals. As a former business owner who served on the 2004 Business Tax Reform Commission, I whole-heartedly believe that these tax reform measures are long overdue. Even

though progress has been made on some of the Commission's recommendations, there is still more work to be done. As you may recall, the Commission recommended:

- Reducing the capital stock and foreign franchise tax annually until it is eliminated. That tax is still on schedule to be phased-out completely in 2011.
- Eliminating the annual cap on net operating loss deductions. In tax year 2007, we increased the deduction from \$2 million to the greater of \$3 million or 12.5 percent of net income. The cap is at odds with other state policy and funding initiatives that encourage technology-based and biotech company start-ups.
- Changing the weighting of the sales factor of the corporate net income tax apportionment to 100 percent. A single sales factor would encourage employers to locate or expand in Pennsylvania because they no longer would be penalized through higher taxes for creating jobs and expanding their physical presence in the state. In tax year 2007, we changed the weighting of the sales factor from 60 percent to 70 percent.
- One of the Commission's major recommendations still under your consideration would reduce the corporate net income tax rate from 9.99 percent to 7.90 percent and implement a mandatory unitary combined reporting system for reporting liabilities. Under current law, 71 percent of companies subject to the corporate net income tax pay nothing, therefore creating an inequitable system. PA companies that are not part of a combined group will benefit from rate cuts, sales factor and net operating loss changes.

More than half of Pennsylvania businesses are pass-through entities. Under Pennsylvania law, the owners of these businesses pay taxes at the same rate as workers, 3.07 percent, instead of the much higher corporate net income tax rate of 9.99 percent. At 3.07 percent, the Commonwealth's personal income tax rate is the second lowest in the country and puts many businesses, like the one I previously owned, in strong competitive positions.

Pennsylvania taxes will become even more competitive this year through a historic reduction in property taxes. When all of the slots facilities are fully in place, gaming revenues will allow us to reduce property taxes by about \$1.1 billion each year.

Last year's dramatic expansion of the Property Tax/Rent Rebate program benefited more than 556,000 seniors by reducing property taxes to the tune of \$240 million. Compared to the old rebate program, the state has helped 242,000 more seniors pay their property taxes. These seniors will also receive additional property tax relief from the property tax reduction that all homeowners will receive this summer.

Now that there is enough slots gaming money available to provide property tax relief to all Pennsylvania homeowners this summer, two additional benefits will be added to the Property Tax/Rent Rebate program this year. These "supplemental rebates" will provide a little extra relief to about 187,000 seniors who need it the most: those with high property tax burdens and those living in cities with a high tax burden.

Homeowners in Pittsburgh, Scranton and Philadelphia - where local wage/income tax rates are very high - with eligibility incomes of \$30,000 or less will receive an additional payment equal to 50 percent of their base rebate. Homeowners in the rest of the state, with eligibility incomes

of \$30,000 or less whose property tax bills equal more than 15 percent of their income, will also receive an additional payment equal to 50 percent of their base rebate.

Central to the mission of the Department of Revenue is the administration of the Commonwealth's tax laws in a fair and equitable manner. By making its delinquent tax efforts more efficient, the department achieves maximum revenue collection on behalf of the Commonwealth and increased fairness among taxpayers (i.e., holding everyone equally accountable to the same rules by enforcing payment from everyone). This year's budget request for the department includes money to continue these proven tax enforcement programs.

Specifically, I would like to highlight one of the department's programs for collecting use tax. The number of businesses buying equipment and supplies from out-of-state vendors continues to increase. In many instances, however, out-of-state vendors are not required to collect Pennsylvania sales tax. When this occurs, the purchaser must report and pay use tax directly to the state. The department's program focuses on educating businesses about their responsibility so that voluntary reporting is achieved to collect use tax from businesses. We focus on businesses because they generally owe much more than individuals and have an audit trail of taxable purchases. The department expects to generate \$27 million in revenue this fiscal year from this continued effort.

Over the past five years, under the leadership of Governor Rendell, the Pennsylvania Lottery has been one of the fastest growing lotteries in the nation. Sales have increased by more than \$1.1 billion, or 58 percent. This dramatic growth provided for major expansions of the PACE/PACENET and Property Tax/Rent Rebate programs for seniors.

Over the last several years the Lottery, in response to player demand, focused on enriching the prize structure of its instant games. As a result, lottery sales soared. About 76 percent of the sales growth in the last five years came from instant ticket sales.

The Pennsylvania Lottery now ranks seventh among the 43 U.S. lotteries in annual sales and fourth in annual profits – proving that our lottery is also one of the most efficient in the country.

Lottery sales were expected to grow 2.8 percent this fiscal year; however, sales through the first seven months have been comparatively below last year requiring the Lottery to revise downward its original sales estimate. The drop in sales growth appears to correlate with the well-documented slowdown in the national economy. As one might expect, fuel and food prices continue to rise and discretionary spending continues to decline. The Lottery, just like any other retailer, is not immune to an economic downturn.

Also, Pennsylvania Lottery sales have historically benefited from large Powerball jackpots. The lack of large jackpots in fiscal year 2006-2007 did not provide the sales growth opportunity that was available in the previous fiscal year. Powerball sales were down 11 percent nationwide and \$121 million just in Pennsylvania. Sadly, this fiscal year has not been any better. Lottery sales through the beginning of the fiscal year were strong. Powerball offered a \$300 million jackpot in July and August, but there has not been a jackpot over \$150 million since then.

Key to the Lottery's strategy to increase sales over the last several years was expanding the number of places where consumers could purchase tickets. By concentrating on recruitment and focusing on corporate accounts, the Lottery reversed a 16-year decline in retailer counts, from

1986 to 2002. When Governor Rendell took office in 2003, the PA Lottery retailer network included 7,023 locations. The Lottery has since increased its retail network by more than 21 percent, and today, about 8,500 retailers sell Lottery tickets - a milestone last reached in 1992. As the Lottery has reached an all-time high number of retailers, the number of new retailers the Lottery has added over the past two fiscal years has begun to slow.

Many people have speculated that slots are affecting lottery sales. Let me be clear: We have no reason to believe slots are negatively affecting sales. However, it may still be too soon to tell, as most of the facilities have not been open a year yet. Patronage to the facilities is fluctuating greatly. How much patronage is due to newness or other factors and how that relates to Lottery ticket sales is difficult to determine. However, we do know with a level of certainty, that current economic conditions, especially high gas prices, the lack of high Powerball jackpots, and a slower growing retailer base are negatively affecting Lottery sales.

I can assure you that the Lottery is committed to maximizing revenues to benefit vital programs for older Pennsylvanians through the responsible sale and marketing of its products. In the face of challenging economic conditions and lower than favorable Powerball jackpots, we will continue to focus on what we know works: keeping our games fresh and exciting for players, recruiting new business partners to sell our products and increasing prize payouts to drive sales.

Finally, I would like to close by pointing out the department's request for \$10 million to continue its technology and business processes modernization plan. As the collection arm of state government, this appropriation will enable the department to take the first step in a multi-year plan to improve efficiency of its overall tax collection operations. Ultimately, the department seeks to develop an integrated tax system that will help us better communicate within the department and better serve our taxpayers.

Thank you for the opportunity to submit these comments.