



**Earned Income Tax Consolidated Collection
Presented to the Pennsylvania House of Representatives House Finance Committee March 2,
2010**

Dr. David Davare, Director of Research Services

Good morning, Chairmen Levdansky and Rohrer and members of the House Finance Committee. Thank you for allowing the Pennsylvania School Boards Association (PSBA) to offer its testimony on the important issue of earned income tax (EIT) consolidated collection implementation. My name is David Davare and I am the Director of Research Services at PSBA.

Now, more than ever, school districts in the Commonwealth have to carefully scrutinize each budget expenditure, forcing them to make difficult decisions regarding cuts to programs. Facing employer contribution rate increases to the Pennsylvania School Employees Retirement System (PSERS) by more than 700% between the current school year and 2014-2015 and a future of economic uncertainty requires school districts to have the flexibility to lower their costs. From our perspective, earned income tax collection consolidation was and is an attainable goal to lower the administrative costs to school districts.

Although the consolidated EIT collection system has the potential to be complicated, we think those fears are unwarranted. We believe a consolidated regional collection system will offer more uniformity, oversight, efficiency, accountability and access to technology such as electronic transfer of funds for our smaller and more rural school districts. Toward that goal, PSBA worked diligently with legislative staff and others to ensure that the legislation (Act 32 of 2008) was crafted to ensure shorter lag times between receipt of wage taxes by the collector and their transfer to the school district, school districts have a fair voice in the management of the system, and the costs of the system were proportionally shared. We were successful in some of those agenda items, but not all.

We supported provisions that aligned the collection districts along county boundaries and allowed those split county school districts to be included in the tax collection district with the greatest share of the district's population. Additionally, allowing an extended and phased transition period for implementation allowed our form a regional joint tax collection committee thereby recognizing additional cost savings. Along that line, our proposed language was included to require DCED to conduct a study of the existing methods and practices for the purpose of identifying strategies to reduce

risk, best practices and procedures, and promote loss prevention. This study allowed the development of standards and the creation of models and templates and other resources so that not every tax collection committee was burdened with starting from scratch.

We also supported limiting the members of the tax collection committee from “opting out of the consolidated collection.” Ultimately language was included to permit this option; however, PSBA’s language was inserted to ensure that a municipality or district would have a steep ladder to climb if it sought to remove itself from the consolidated collection committee. Finally, PSBA’s language was accepted into the law that ensured it would not be a conflict of interest for a delegate or his alternative to participate in discussions and voting of the tax collection committee relating to the appointment of a tax officer, solely on the basis that the delegate or alternative also is an employee or member of the governing body of an existing tax bureau or other public tax collection entity under consideration for appointment as the tax officer.

Although, we supported the public policy concept in general and some of our proposals were captured into Act 32, ultimately several major issues caused PSBA to oppose the bill. In particular, we raised concerns repeatedly about the costs of start-up, the weighted voting rights, the turnaround time from collection to distribution to the taxing authority, changing the tax base, and the cost sharing construct in the act. Details of our rationale for opposition are as follows.

Inadequate or uncertain underwriting of start-up costs.

Senate Bill 1063 as introduced and as later enacted as Act 32 did not make provisions for any reimbursement for the start-up costs of the tax collection committees. Although the Department of Economic Development made promises to prioritize its shared services grant monies, PSBA was extremely concerned about the very real possibility that there would be insufficient monies after the budget process to fully reimburse for their costs. Our concern, unfortunately, has proven legitimate as evidenced by DCED’s recent opening of a tax collection committee expense grant program. According to DCED’s website, the tax collection committee expense grant program is to underwrite initial expenses associated with implementing Act 32 of 2008. The maximum grant amount is limited to just \$5,000. Not only is a local match is required, but in-kind services are not to be considered. The program also further caps reimbursement of legal fees to \$3,500, far below what any reasonable person would anticipate those costs to be.

This micro grant program is particularly troublesome to those districts that have had no experience working voluntarily with other school districts and municipalities to collect their earned income taxes and likely will require more meetings. Larger counties like Allegheny County with 40

plus school districts and over 130 municipalities, even though it is divided into 4 collection committees, will incur additional costs that other smaller areas will not recognize. Additionally, since some municipalities do not have paid staff that can manage this project, school districts with experienced and professionally paid staff will likely bear the burden and costs of handling the initial staffing of these committees unfairly.

Weighted voting of the committee

PSBA also voiced concerns about the governance and voting rights outlined in Senate Bill 1063. As originally introduced, the bill provided that each political subdivision with a tax collection district to appoint one voting delegate and one or more alternates to the committee by September 15, 2009. The original bill also proportioned voting rights based on population. Specifically, the language stated, "Votes shall be based upon the proportional population of each political subdivision in proportion to the population of each tax collection district as determined by the most recent Federal decennial census data." This language was not only different from the original proposal circulated by DCED, it differed from the House version of the bill. PSBA argued that this voting construct will likely result in tie votes on the tax collection committee. We also found the language particularly troublesome because it failed to weight votes favorably toward those political subdivisions that have the greatest revenues at risk – in many cases school districts.

PSBA also countered that weighted voting based on revenue collected was the standard to enact. We argued that the entities with the greatest say in operating the system should be given to the entities with the greatest interest in balancing efficiency, loss prevention, and economy. Separating out those concepts presents a greater risk that those things will not be appropriately balanced, or worse yet, that the interests of economy will be placed above the interests of fiscal safeguards and the time-value of funds. PSBA suggested that revenue-based weighting allows annual adjustment based on financial reports, rather than the census which locks in rights for 10 years.

Subsequently, the Senate amended the bill to provide that for the first meeting of the tax collection committee, actions of the committee are determined by a majority vote of the delegates present under a weighted voting schedule. The votes were weighted as follows: 50% shall be allocated according to the proportional population of each political subdivision and 50% shall be weighted in direct proportion to income tax revenues collected in each political subdivision based on each political subdivision's most recent annual financial report. The voting rights are recalculated each year only based on the financial revenues. Although school districts by statute must submit annual financial reports to the Pennsylvania Department of Education or risk financial penalties, local

municipalities have no such constraints. Accordingly, there is not only a mismatch between the local governments and school districts' fiscal years, the type of accounting being used may differ (accrual), but there also is a disparity in the most recent fiscal year report being used between the political subdivisions.

Lengthy Turnaround Time and Phase-In Add up to Negative Impact on Revenue Flows.

This bill had the potential of a severe impact on local cash flow due to the bill's elimination of the present ability of employers to voluntarily remit withholding directly to the non-resident tax collector, as some do now, and instead force all withholdings of non-resident tax through an additional layer. The law also requires that distribution of income taxes from a tax officer to the political subdivisions within the tax collection district must occur within 60 days of the receipt or the deadline for payment unless it is otherwise agreed to by the committee for income taxes received from employers prior to April 1, 2013. Tax collection officers also got an additional 60 days to distribute taxes to other tax officers in other tax districts. The phase-in coupled with the fact that employers may remit only quarterly, a 60-day period could mean cash flow delays as long as 7 months from the time the tax was withheld. PSBA suggested that the deadline should be 30 days from the beginning so that non-resident taxes will be in the hands of a non-resident taxing authority no later than 60 days after employer remittance. As a compromise, the final Act mandates that income taxes received from employers on or after April 1, 2013 must be distributed within 30 days of the later of receipt.

Cost sharing is shifted to school districts

PSBA also took exception to Act 32's provision that failed to align the collection costs with voting rights or the producer of the costs. We suggested repeatedly that this was a recipe to allow local municipal governments to not only control the tax committee voting, but also to assess the majority of the taxing committee's costs to school districts who collect the most revenues. As everyone knows, the costs of collection are not driven by revenues. The truth of the matter is that a tax collector who issues a \$500 check to a municipality does not incur a higher fee by issuing a check to a school district for \$5,000. Additionally, processing the return of a higher-earning taxpayer does not take longer than processing a return of a lower-earning taxpayer. The costs arise when increasing the volume of clients, i.e. when adding 2600 plus municipalities to the mix. PSBA also objected to the language because it did not allow locally elected officials the authority to choose a different allocation of their costs "after the first meeting." The weighted voting rights made this accommodation to local governments, but not to the allocation of costs.

PSBA made two suggestions. First, it offered language that the cost allocation be shared among and paid by all political subdivisions within the tax collection committee in the same manner as the weighted vote of each political subdivision. In the alternative, PSBA suggested the fixed expenses of collection and operation of the tax collection committee be divided equally among and paid by all political subdivisions within the committee and that the variable expenses be allocated to and paid by each political subdivision in proportion to its fair share of the variable cost. We unsuccessfully argued that either proposal would have ensured that the costs were not divorced or allocated unfairly.

Implementation

We understand that the EIT consolidated collection has some local municipalities grumbling. It is our experience that there is not much in the way of mechanical issues under the language of the act that was tripping anybody up as far as implementation. Where implementation problems exist, they have more to do with the same age-old reasons, instead of focusing on getting done what the act requires. We have heard of instances of difficulties in getting quorums because of some municipalities not attending meetings and others refusing to pay their TCC expense share. Overall, however, it seems that most committees are moving forward and trying to meet the statutory deadlines.

Conclusion

Despite our opposition to components to the legislation, PSBA continues to work to train its members about the law during this transition period. We have posted frequently asked questions on our website and have joined with other local government associations and DCED in a variety of ways to expand our members' knowledge.

We appreciate the efforts of this Committee to keep tabs on the implementation phase of Act 32. Although some very material problems may arise, PSBA suggests it is premature to open up this legislation. The implementation issues currently causing friction seem to be ones that were already debated several times over, compromised and dealt with when Act 32 was enacted, not new ones that were not foreseen. Moreover, changing the rules or targets in the middle of the implementation process could cause delays and confusion that would be costly to all the players as well as taxpayers. Thank you for your time and consideration of our comments. I can take any questions that you may have for me.