Testimony Presented by

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to the

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Good morning, Chairman Benninghoff, Chairwoman Mundy, and members of the House Finance Committee. Thank you for the opportunity to present testimony on behalf of the nearly 21,000 members of the Pennsylvania Institute of Certified Public Accountants. My name is Cheri Freeh, and I am the current president of the PICPA. I am a partner with the firm Hutchinson, Gillahan & Freeh located in Quakertown, Pennsylvania.

Founded m 1897, the PICPA serves nearly 21,000 individual members as the voice of the accounting profession across the Commonwealth of Pennsylvania. Membership is composed of CPAs in public accounting—large firms, regional firms, and sole proprietors—as well as those CPAs working in business and industry, government, and education. PICPA's mission is to further the well-being of its members while upholding the public interest, and articulating positions on professional and public issues where the expertise of CPAs is relevant.

The concept of broadening the sales and use tax and tying it to the reduction or elimination of school property taxes is an idea that has been around in each of the last four legislative sessions. As you know, Pennsylvania's current sales and use tax law is considered "progressive," in that it does not impose a state tax on food, clothing, and professional services such as accounting and legal services, to name a few.

House Bill 1776, Printer's No. 3369, the subject of today's public hearing, proposes to eliminate school property taxes and replace the funding source with an increase in the Personal Income Tax [PIT) rate and an increase in the sales and use tax rate plus an expansion of the items and services subject to the tax,

An expanded sales tax brings with it tremendous enforcemenf and compliance issues, significant cost of compliance, and numerous administrative burdens.

The PICPA also has concerns with the claim that House Bill 1776 would consistently and predictably generate the more than $15 billion in new revenues needed to fund public education in Pennsylvania We urge the committee to examine this issue more carefully to ensure the projections made by proponents are indeed accurate, We have not seen a financial analysis of the plan; therefore we cannot determine the accuracy of these claims.

We do know, however, that a tax on professional accounting services would have a "pyramiding" effect. Fundamentally, accounting services are critical business inputs. The taxation of such services as the mandatory auditing of public companies would effectively impose a "tax on a tax on a tax," Many small and medium-sized businesses have audits, reviews, and other types of examinations performed, sometimes at the request of lenders, other times to assure their investors. These same businesses retain accounting firms to provide advice on how to improve efficiencies, lower costs, and otherwise be more competitive.

Additionally, it is extremely difficult to source where the "sale" of any service occurs. It can be almost impossible to determine where the "sale" of accounting services occurs, creating the likelihood that the same services would be subject to tax in multiple jurisdictions. For example, is the service taxable in the "performed location" or the "benefit location"? If different states chose different imposition choices, does the service get taxed in both places? If this is the case, how will tax offsets be applied? If the tax is imposed on the benefit Location, how would allocation of service costs performed for a large business with division in multiple states be determined? What if the out-of-state service provider does not have nexus in the state and is, therefore, under no obligation to collect the tax? These are only some of the issues associated with "locating' services.

House Bill 1776 will effect taxpayers' decisions, such as how to carry out a particular transaction or whether engaging in transactions should be kept to a minimum. Taxpayers should not be unduly encouraged or discouraged from engaging in certain activities, or taking certain courses of action, because of the effect of the tax law on the activity or action. The primary purpose of a tax is to raise revenue for governmental activities, not to influence business and personal decisions.

Small and emerging businesses are especially disadvantaged under House Bill 1776. These businesses generally purchase services that larger businesses may provide internally. These small businesses not only will have to bear the higher cost of an externally provided service, but also the tax on that service. Further, the additional compliance costs associated with such a tax are proportionally greater for small businesses, and make up a higher percentage of their total purchases. **A** tax on services creates an incentive for larger business not to contract-out services to small businesses or independent contractors because of the additional cost burden of the tax.

Cash flow could be affected as well. For example, suppose I provide a "management consulting service" to a client and the cost of that service is $1,000. After adding 6 percent sales tax, I bill the client $1,060. I remit the $60 as part of my next quarterly sales tax payment to the Commonwealth, but my client doesn't pay me for three months. This requires the taxpayer to float its sales tax payment until payment is actually received, Also, in today's business world the $1,000 invoice is sometimes adjusted after the initial bill is sent. I have already paid the full sales tax due, but the sales tax base is less than the original transaction base.

Another area of concern is what impact House Bill 1776 will have on the nonprofit community? Nonprofit organizations are provided a sales tax exemption for sales tax paid in connection with providing their exempt function. For example, fire companies purchasing firefighting supplies. There is no exemption for fund raising or administrative purchases. Passing this bill now subjects them to taxes they have not had to pay in the past.

Lastly, we remind you that taxing services has been tried before and it failed. In 1991, as part of a deficit reduction plan, a sales tax on computer services was enacted, This tax put Pennsylvania consultants at a competitive disadvantage to those in other states and jobs were lost in the Commonwealth and replaced by those employed in other states. The effect was so obvious and devastating that the tax was repealed quickly but the damage was permanent. In today's global economy, accounting services, like other professional services, are equally portable and a sales tax could predictably have the same impact on jobs in Pennsylvania.

In closing, thank you again for the opportunity to share our thoughts on this important issue. I will be happy to answer your questions.