

Testimony before the House Appropriations Committee
Dan Hassell, Secretary
Department of Revenue
Tuesday, February 20, 2018

Chairman Saylor, Chairman Markosek, and members of the committee, thank you for the opportunity to meet with you today to discuss the budget for the Pennsylvania Department of Revenue. I am Dan Hassell, Secretary for the Department. Joining me are Amy Gill, Deputy Secretary for Tax Policy, Christin Heidingsfelder, Deputy Secretary for Administration, and Drew Svitko, Executive Director of the Pennsylvania Lottery.

The Department of Revenue is continuously working to find ways to become more efficient and improve services for individual and business taxpayers in Pennsylvania. Recently, as the Department revised its strategic plan in an effort to evaluate our strengths and weaknesses as an organization, we identified a series of goals aimed at building public trust and pursuing more equitable tax collection. These goals include: improving customer service, enhancing our effectiveness of tax compliance, increasing sales and net profits at the Pennsylvania Lottery and continually working to instill public confidence in the work that we do.

Setting these goals will help the Department fulfill its ultimate mission of fairly, efficiently and accurately administering the tax laws and other revenue programs of the Commonwealth of Pennsylvania. With that said, I would like to provide you with an overview of several initiatives the Department is working on.

Modernization initiative

The Department of Revenue is moving forward with the final phase of a multi-year modernization in several tax systems.

The project will enable the Department to modernize the system it utilizes for individual taxes, including personal income tax (PIT), inheritance tax, realty transfer tax, pass through entity processing, property tax/rent rebates, taxes related to the international fuel tax agreement (IFTA) and motor fuel and liquid fuel taxes. This phase of our modernization project will impact approximately 6.7 million taxpayers, or 52 percent of Pennsylvania's population.

The project will also revolutionize the system the Department uses to process personal income tax returns and property tax/rent rebate applications. By the end of the project, we will have the capability to process property tax/rent rebate applications electronically. That will be a huge boost for older and disabled Pennsylvanians, who last year received more than \$259 million in property tax and rent rebates. Those rebates were sent to more than 542,000 homeowners and renters across the commonwealth for property tax and rent paid in 2016.

The ultimate goal of this modernization project is to provide taxpayers with a better system to file their tax returns, receive refunds faster and access more information online. The project also is necessary because many of the information systems in use at the Department are more than 20 years old and address only specific tax types, rather than providing a holistic view of a taxpayer's account.

Furthermore, the project will increase efficiency, reduce risk of system failure, facilitate improved tax collection, reduce administrative costs and allow the Department to respond more quickly to ever-changing tax laws while improving overall taxpayer service.

iLottery and monitor-based games

A major modernization initiative now underway at the Pennsylvania Lottery is intended to help stabilize and protect the Lottery Fund, which supports benefit programs for older adults. While Lottery revenues again totaled more than \$4 billion last fiscal year, the Lottery must position itself to remain relevant and competitive in a rapidly changing business environment.

This spring, the Lottery plans to introduce two new types of gaming: iLottery, which are games purchased and played online or through a mobile device, and monitor-based games including virtual sports and Keno. Together, iLottery and monitor-based games are projected to generate \$75 million in the 2018-19 fiscal year. These new gaming initiatives are also estimated to generate up to \$561 million in new revenues through the 2022-23 fiscal year.

Pennsylvania's initial iLottery games will be similar to those offered in other states. Like popular scratch-off games, they will offer players within Pennsylvania's borders the chance to win instantly. To promote responsible play, iLottery will not accept credit cards. Players will be able to set play and deposit limits, set "cool off" periods, and — should they wish — self-exclude from playing for up to five years.

The Lottery is now recruiting retailers to offer virtual sports & Keno. Virtual sports games do not show actual sporting events, but are an animated simulation of an event — the outcome of which is determined by a random drawing.

Keno is drawn at random from among the numbers 1 to 80. Players try to match up to 10 numbers (known as SPOTS) per draw. The more SPOTS players match, the more they can win. An animated depiction of the computerized drawing is shown on a monitor, although the game can be played without watching a monitor. Drawings will be held every four minutes. The game will be offered from just before 6 a.m. to shortly after 1:30 a.m. each day.

We expect virtual sports games and Keno will be popular with bars and taverns, although some existing Lottery retailers will also offer them.

Marketplace Sales legislation

With the signing of Act 43 of 2017 by Governor Wolf, the Commonwealth became one of a handful of states across the nation to establish marketplace sales tax collection, notice and reporting requirements. To implement these new requirements, the Department of Revenue recently issued procedural and technical guidance on its website.

The legislation clarifies current law to improve sales tax collections and compliance for online sales of items that are already taxable. This change results in a more efficient system for certain individuals and businesses using online marketplaces to sell and purchase products. The ultimate goal is to help brick-and-mortar stores compete on an even playing field with online sellers.

The Marketplace Sales legislation requires certain marketplace facilitators, remote sellers and referrers facilitating, making or referring sales to Pennsylvania customers to make an election to either: (1) register to collect and remit sales tax; or (2) comply with tax notification and reporting requirements. The deadline for this election is March 1, 2018.

In addition, beginning April 1, 2018, Pennsylvania customers will begin receiving information notices from businesses that have elected not to collect sales tax. The information notice will list the purchases and purchase price of products for which sales tax was not collected by the seller.

Pennsylvania customers will also receive annual notices detailing their purchases of products for which sales tax was not collected and similar information will be reported by the business to the Department of Revenue. Pennsylvania individuals and businesses who purchase taxable items without paying Pennsylvania sales tax are required to remit use tax.

The Department of Revenue has developed a frequently asked questions web page to help those affected by the Marketplace Sales legislation understand their obligations.

Overall, the requirements of the Marketplace Sales legislation will help improve sales and use tax collection on internet sales.

Recent cost savings

I would also like to share with you other recent work the Department has done to improve customer service, reduce costs and generate savings for the commonwealth:

- The Department recently completed the administration of a Tax Amnesty program that generated \$130.4 million in net revenue for the commonwealth, which exceeded the net revenue estimate of \$100 million. Act 84 of 2016 authorized the Tax Amnesty program to run for 60 days, between April 21 and June 19, and allowed eligible individuals and businesses to pay past-due state taxes while having all the penalties and half of the interest waived.

- The Department has continued the important work of urging taxpayers, their tax preparers and software vendors to utilize electronic filing options. As administrative costs to process paper increases each year, it has become more important for the Department to make electronic filing options accessible and efficient. Processing electronic tax returns reduces processing time and costs, as well as the rate of returns with calculation errors. During the 2016 tax year, the department received 5.2 million electronic returns, which was 2 percent higher than the prior year. The total number of returns received for the year was approximately 6.5 million.
- The Department's Bureau of Individual Tax generated a net savings of \$97.4 million from the examination of personal income tax returns in 2017, compared to \$70.8 million in 2016, which is a 38 percent increase. BIT also generated a net savings of \$241,000 from the rejection of Property Tax/Rent Rebate claims, which is a 3 percent increase from last year.
- As part of Governor Wolf's GO-TIME initiative, the Department saved taxpayers approximately \$29.3 million in the last fiscal year by improving the process it uses to prevent the issuance of fraudulent and erroneous tax refunds. An estimated \$80.5 million will be saved over four years. The Department achieved the savings in part by renegotiating a software contract that helps identify and prevent fraudulent and erroneous tax returns. The new contract also allowed the department to expand its reviews to more types of tax returns while reducing the cost of the system it utilizes to prevent fraudulent and erroneous refunds.
- The Department hosted two free seminars for new business owners to provide them with information on state tax obligations and help them achieve success in managing their new businesses. The seminars, held in Pittsburgh and Harrisburg, were designed as a way to connect the Department's seasoned tax experts with people who are just starting out in the business community.
- The Department partnered with other state agencies to launch the new PA Business One-Stop Shop, which serves as a sole source to guide entrepreneurs and small businesses through all stages of development, from planning and startup to operation and expansion. The PA Business One-Stop Shop also offers resources for registration and permitting, hiring employees, receiving funding and technical assistance and more. It also prevents a small business owner or entrepreneur from seeking out information from several state agencies and organizations to get a business up and running, as was the case in the past.
- The Department's Taxpayer Service and Information Center completed its third year of the property tax/rent rebate automated call project, which involves notifying claimants of the status of their PTRR claims. More than 291,000 calls were made notifying claimants that the Department received their applications. We estimate that more than 252,000, or 86

percent, of claimants received the communication. In addition, more than 319,000 of the 404,000, or 79 percent, of claimants whose applications were scheduled to be paid starting July 3 were called.

Governor Wolf budget initiatives

Governor Wolf this year is proposing to fund the budget with a revenue package that will make Pennsylvania more competitive and level the playing field for taxpayers. One of the focal points of Governor Wolf's proposal is a commonsense tax on natural gas extraction in Pennsylvania. The proposal comes at a time when Pennsylvania is the second largest producer of natural gas, but is the only major gas-producing state without a severance tax.

The severance tax will add significant revenue to the General Fund, while hewing closely to the form of existing severance taxes in other major fossil fuel-producing states across the nation. The tax would raise \$248.7 million in its initial year, climbing to nearly \$400 million in the 2022-23 fiscal year. These estimates are based on IHS Global Insight historical and forecast price data, as well as actual well and production data from the Pennsylvania Department of Environmental Protection.

Governor Wolf is also proposing a thorough overhaul of the way Pennsylvania taxes corporations. The proposal will dramatically improve the competitiveness of the commonwealths' economy with a lower tax rate. Meanwhile, it will level the playing field for all businesses with combined reporting. Both proposals will help Pennsylvania become a more attractive place to do business.

The Governor's plan will phase down the corporate tax rate from the current 9.99 percent rate, the second highest in the nation. The tax rate will be set at 9.49 percent in 2020, 8.99 percent in 2021, 8.49 percent in 2022 and 7.99 percent in 2023. This will make it easier to attract business development that is turned away by the "sticker shock" of the current 9.99 percent tax rate.

At the same time, the Governor is proposing that combined reporting be required for taxpayers who are part of a controlled group of corporations. Under current law, each separate corporation reports Pennsylvania tax on its own income, even if it is part of a larger corporate group. This allows certain corporations to shelter income from tax with Delaware holding companies and similar inter-company transactions within the group.

Under combined reporting, corporations in a group will figure their income for the entire group, and each separate company owes tax on a share of the group income. Transactions between members of the group are eliminated, making it harder to shelter corporate income from state taxation.

In closing, I look forward to working with each of you in the weeks ahead. Thank you for the opportunity to provide testimony on behalf of the Department and Revenue. My colleagues and I look forward to answering your questions.