Hearing of the Senate Finance Committee to Discuss
Proposed Changes to the Personal Income Tax and Sales Tax
Testimony
Eileen McNulty, Secretary
Pennsylvania Department of Revenue
June 10, 2015

Chairman Eichelberger, Chairman Blake and distinguished members of the committee, thank you for the opportunity to discuss Governor Wolf's proposed changes to the state personal income tax and sales tax. These changes are part of a comprehensive plan that will provide $3.8 billion in property tax relief while also increasing state participation in funding schools to 50 percent, addressing our pension obligations, closing the structural budget deficit, and revitalizing our business climate.

The Governor's proposal provides greater relief to high-tax, high poverty communities. It will reduce the average homeowner's school property taxes by more than 50 percent and provide an average of more than $1,000 of property tax relief to homeowners. About 270,000 senior households – nearly a third of all senior homeowners – will have their school property taxes eliminated.

Additionally, the Governor has proposed $500 rebates for renters making $50,000 or less in income as defined in the property tax/rent rebate (PTRR) program, in order to provide relief for lower-income renters who will not benefit from the property tax relief. It is estimated that about 877,000 households, or 61 percent of all rental households in the state, would benefit from this proposal.

Governor Wolf proposes increasing the Pennsylvania personal income tax rate from 3.07 percent to 3.7 percent on July 1, 2015, to achieve these unprecedented levels of property tax relief. The proposal also includes Lottery winnings in the tax base and increases personal income tax relief for lower-income families. At 3.7 percent, only two states with a personal income tax, Indiana and North Dakota, will have lower marginal tax rates than Pennsylvania. Our personal income tax rate will still be significantly lower than that of neighboring states, whose top personal income tax rates range from Ohio's 5.39 percent to New Jersey's 8.97 percent.

In addition to the personal income tax rate change, Governor Wolf proposes expanding the Tax Forgiveness program by about 32 percent to extend special poverty tax forgiveness to more residents. Tax relief offered through the current program next fiscal year is estimated at about $270.8 million, and the new Tax Forgiveness program parameters are estimated to provide an additional $90.2 million in personal income tax forgiveness. These changes will result in greater tax forgiveness for almost 426,000 filers, including 205,700 filers that would receive higher tax forgiveness under the proposal than they currently do, and 220,200 filers who would become newly eligible for Tax Forgiveness.

Under the Tax Forgiveness expansion, a family of four earning 150 percent of the poverty level, currently $36,400, would be eligible to have 100 percent of its personal income tax forgiven.

The program expansion increases the allowance per adult from $6,500 to $8,700. The allowance per child continues at $9,500 each.

The Governor's proposal would also extend the personal income tax to Pennsylvania Lottery winnings, which have previously been exempt from the income tax. Making Lottery winnings subject to the personal income tax is estimated to generate $15.7 million for fiscal year 2015-16 and $20.6 million in fiscal year 2016-17.

The combined impact of these changes to the personal income tax will increase revenues by $2.3 billion in fiscal year 2015-16. Under the Governor's proposal, $2.14 billion in new personal income tax revenue generated from this change will be transferred in fiscal year 2015-16 to the Property Tax Relief Fund to create a reserve and manage the cash flow required to provide an unprecedented amount of school property tax relief beginning in October 2016.

Governor Wolf's sales tax proposal will increase the rate from 6 percent to 6.6 percent and broaden the tax base effective Jan. 1, 2016. Broadening the sales tax base to include services like legal, accounting, and personal care acknowledges the growing shift to a service-based economy. Consumer spending on services has grown 38.6 percent faster than spending on goods over the last 20 years. In addition, items such as basic cable television service, amusement and recreation charges, and candy and gum are already taxed in many other states. The sales tax base expansion proposal is similar to the proposal in Senate Bill 76, except that the Governor's plan maintains exemptions for food, clothing, and prescription drugs, and includes real estate services in the services subject to sales tax.

In addition to the exemptions for food, clothing, and prescription drugs, many other exemptions will remain, including:

- Orthopedic equipment
- Physician and dental services
- Hospital services
- Tuition (college, vocational training and instruction)
- Residential utilities including land-line phone, electricity, fuel oil, and natural gas
- Water and sewage services
- Agricultural purchases by farmers

Other items that will be included in the tax base are:

- Personal hygiene products (oral hygiene, disposable diapers, feminine hygiene, toilet paper)
- Newspapers and magazines
- Digital downloads including videos, photos, music, games, software, books, magazines, and apps
- Textbooks
- Non-prescription drugs and vitamins

Some new services that will be incorporated in the tax base include

- Basic cable television service
- Legal and accounting services

- Personal care services such as hair, nail, skin, and makeup services,
- Museums, amusements, and recreational sports such as golf, skiing, and bowling
- Drycleaning; laundry; pet care and boarding; wedding planning; and dating services

Together, the expanded base and rate changes increase state sales tax revenue by $1.6 billion in 2015-16 and $3.95 billion in 2016-17. To ensure that we meet obligations and no longer push debt onto future generations, $1.75 billion of these revenues would be set aside in fiscal year 2015-16 in a restricted fund to pay the statutorily required pension contribution.

The local sales tax of 1 percent in Allegheny County will remain in place, while the 2 percent local sales tax in Philadelphia will be reduced to 1.4 percent, so that the total sales tax in Philadelphia will remain 8 percent. Additional revenue from the expansion of the sales tax base collected at 1.4 percent in Philadelphia will be transferred to the city's Municipal Pension Fund.

By cutting corporate taxes to spur job growth, investing in education to prepare our children for the economy of the future, and reforming tax policy to reduce the burden on middle-class homeowners through historic property tax relief, Governor Wolf's comprehensive tax reform plan is designed to rebuild Pennsylvania's middle class through jobs that pay, schools that teach, and government that works. I thank the committee for the opportunity to offer this testimony, and I look forward to addressing your questions.