Pennsylvania Senate
Appropriations Committee
Senator Pat Browne
Chairman

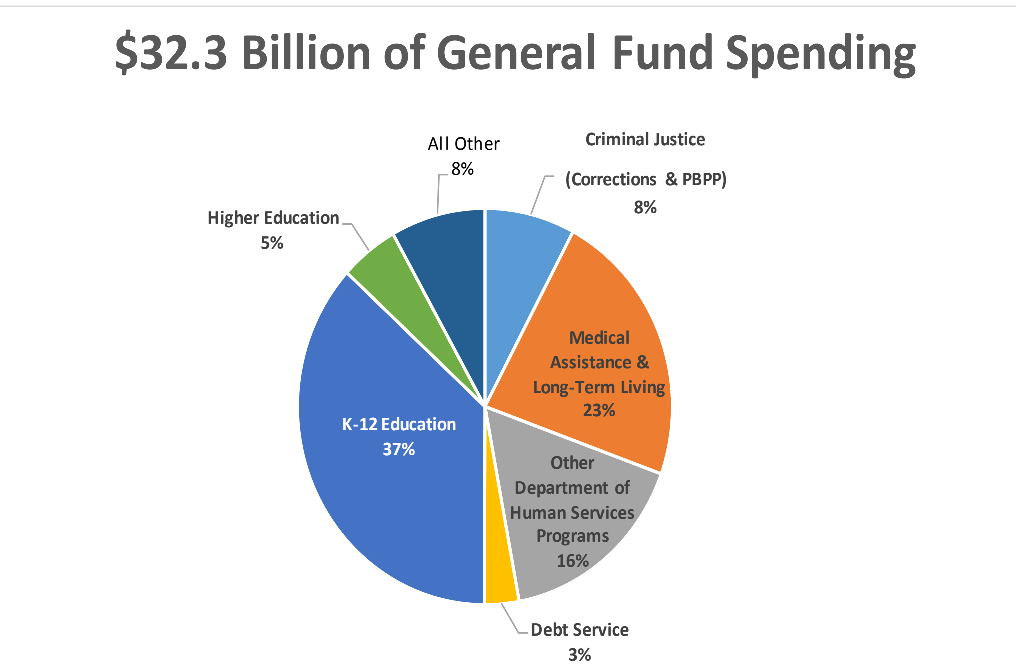
March 2017

Monthly Report

Governor Wolf Announces 2017-18 State Budget

Late last year Governor Wolf announced that he would not recommend broad-based tax increases to solve a then undisclosed budgetary gap. At the time, we were projecting the two-year budget gap to be approximately $3 billion.

On February 7th, Governor Wolf, in his budget documentation, affirmed that we were correct in our estimate of the shortfall. His budget proposal recommends more than $1 billion in tax increases and about $2.1 billion in cuts, savings initiatives and one-time financial maneuvers to bring his budget into balance. He proposes total spending of $32.3 billion which is an increase of $571.5 million or, 1.8%, above the revised available budget. The Governor's recommended budget includes $234 million in targeted spending initiatives, most of which is K-12 education related.



Inside This Issue

Where We Are In The Annual Budget Process

Governor Wolf presented his budget on February 7th. From February 21st through March 9th, the Appropriations Committee held three weeks of in-depth hearings designed to learn more about the Governor's budget proposal.

Senate Appropriations Staff

Greg Jordan, Director
John Guyer, Assistant Director
Kristi Houtz, Committee Secretary
Faith Bender (Environment/Labor)
Tom Diehl (Human Services)
Tom Horan (Revenue/DCED)
Russ Miller (Education/Agriculture)
Bill Witmer (Criminal Justice/Capital)

Senate Appropriations Committee
281 Main Capitol Building
Harrisburg, PA 17120
Phone: 717-787-1349
Fax: 717-772-3458
http://appropriations.pasenategop.com/

Senator Browne's District Office
702 W. Hamilton Street, Suite 101
Allentown, PA 18101
Phone: 610-821-8468
Fax: 610-821-6798
www.senatorbrowne.com

Governor's 2017-18 State Budget Continued

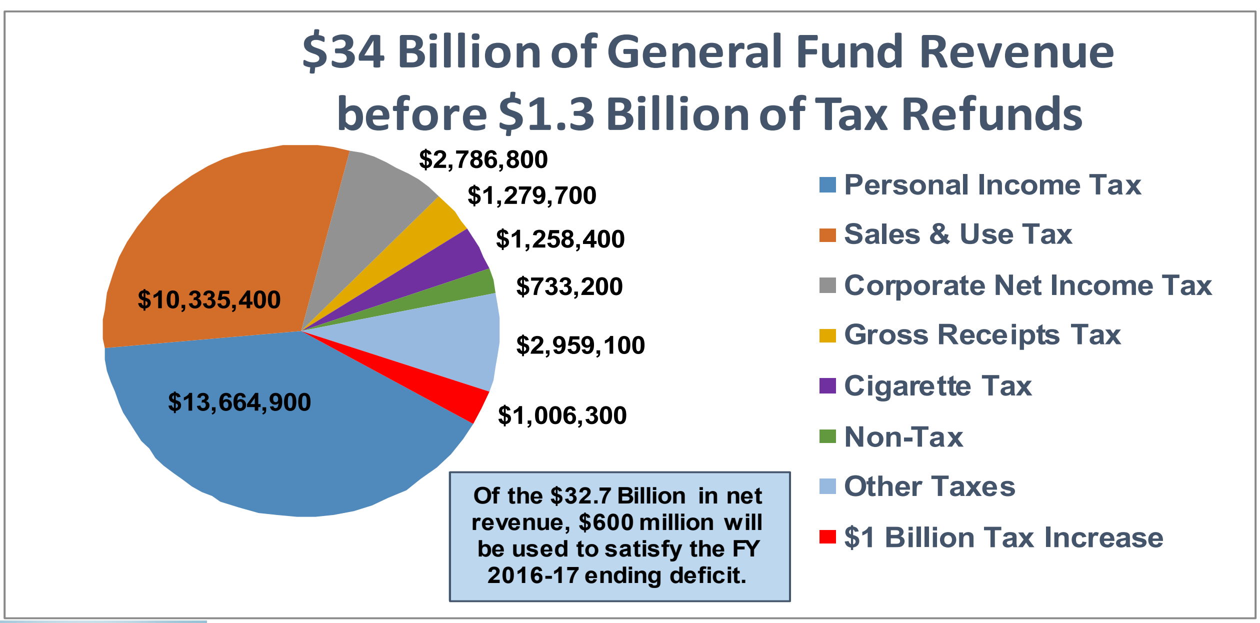
The Governor's balance sheet shows a budget with a modest positive ending balance at June 30, 2018. As noted in the table below, the budget contains several non-recurring budget-balancing options and is premised on more than $850 million of revenue that is questionable.

Non-Recurring Funding Options		Financial Risks to the Plan	
Farm Show Lease Leaseback	$ 200.0	Gaming Expansion	$ 250.0
Prior-Year Lapse Estimates	200.0	JUA Loan	200.0
Worker's Comp. Security Loan	165.0	Early SUT Effective Date	135.0
Bond Financing Grant Programs	110.0	Lottery Fund Revenues	100.0
Debt Service - Refinancing	28.0	Minimum Wage	95.0
Sale of State Property	10.0	Gaming Licenses	74.8
	$ 713.0		**$ 854.8**

Among the non-recurring options, the Governor proposes to monetize the Farm Show Complex. In this lease leaseback deal, the Commonwealth would receive $200 million from a private firm in exchange for a 29-year stream of payments. In addition, the Governor proposes to bond fund several grant programs for the next three years. This would free up $110 million each year to support the General Fund. The Governor's proposal includes a $165 million loan from the Worker's Compensation Security Fund to the General Fund and assumes $95 million of additional revenue collections from increasing the minimum wage to $12.00 per hour.

The Governor is also proposing a 30-and-out early retirement incentive for executive branch employees. Savings are pegged at $25 million. Under the retirement window, employees with 30 years of service could retire before attaining superannuation without penalty. As with all early retirement windows, this has the potential to increase the SERS unfunded actuarial liability. It will be necessary for the Independent Fiscal Office (IFO) to provide an actuarial note for this proposal.

Finally, the Governor is proposing that all tax credit programs would be block granted in order to save $100 million. The Governor would issue credits on his own volition, and it is safe to say certain credits would be reduced or eliminated.

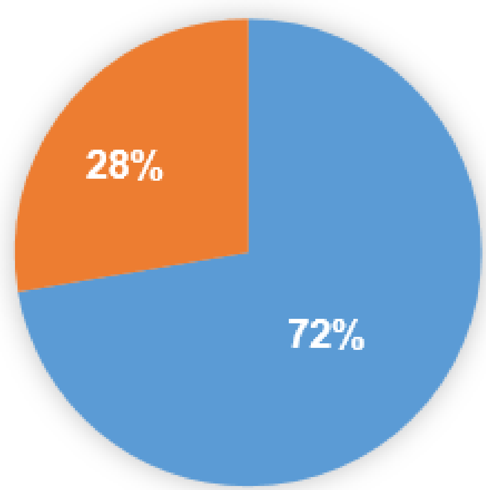


Major Initiatives in the Governor's Budget Proposal

- The Basic Education Funding allocation is proposed at $5.995 billion, an increase of $100 million, or 1.7%.
- Includes $212.3 million for Pre-K Counts, a $65 million, or 44.1%, increase.
- Recommends $59.2 million for Head Start Supplemental Assistance, a $10 million, or 20.3%, increase.
- Proposes $1.122 billion for Special Education Funding, an increase of $25 million, or 2.3%.
- Provides $453.1 million for PASSHE, an increase of $8.9 million, or 2%.
- Includes funding for the Manufacturing PA Initiative, a $12 million partnership with the Commonwealth's research universities and Industrial Resource Centers to accelerate manufacturing technology advancement and adoption, foster manufacturing innovation and commercialization, and build a 21st century workforce.
- Provides $10 million to expand access to naloxone for first responders and $3.4 million to implement and expand drug courts and expedite the accreditation process.
- Recommends $21.2 million to serve 1,470 additional individuals with physical disabilities in the Services to Persons with Disabilities Waivers.
- Expands services to individuals with disabilities by providing $8.6 million to create a new program for family caregivers to ensure 1,000 individuals currently on the waiting list can continue to live at home.
- Recommends $15.4 million to create a new program for family caregivers to ensure 1,000 individuals currently on the Community Living Waiver waiting list can continue to live at home.
- In addition, the budget proposes to consolidate the Departments of Aging, Drug and Alcohol Programs, Health, and Human Services into a Department of Health and Human Services.

The 15 Largest General Fund Appropriations Comprise 72% of General Fund Spending

Basic Education: $6.0 Billion
Capitation: $3.7 Billion
School Employees' Retirement: $2.3 Billion
State Correctional Institutions: $2.0 Billion
Intellectual Disabilities Waiver: $1.5 Billion
County Child Welfare: $1.2 Billion
Long-Term Care: $1.2 Billion
Special Education: $1.1 Billion
Treasury Debt Service: $1.0 Billion
Mental Health Services: $0.8 Billion
Federal Government - Part D: $0.8 Billion
School Employees' Social Security: $0.5 Billion
Pupil Transportation: $0.5 Billion
Fee for Service: $0.5 Billion
State System of Higher Education: $0.5 Billion



Governor Proposes Combined Reporting as part of His Budget Proposal

Governor Wolf's FY 2017-18 Budget proposes to implement mandatory combined reporting for the corporate net income tax (CNIT), effective January 1, 2019. Advocates of combined reporting maintain that the goal is to level the playing field for all businesses subject to the CNIT. Supporters believe that combined reporting is the most effective way to combat corporate tax minimization maneuvers such as the "Delaware Holding Company Strategy." Beginning in 2019, the CNIT rate is proposed to be reduced from 9.99% to 8.99%. The CNIT rate is proposed to be further reduced to 7.99% in 2020; 6.99% in 2021; and 6.49% in 2022 and thereafter.

The Pennsylvania corporate net income tax is an annual excise tax measured by net income that is imposed on domestic and non-Pennsylvania corporations doing business in state. The tax is imposed at the rate of 9.99%, which is the second-highest rate in the nation. The CNIT tax base is federal taxable income as calculated pursuant to the Internal Revenue Code and reported on the corporation's federal tax return, before net operating loss and special deductions and modified by certain additions and subtractions.

Allocation and Apportionment

For corporations whose entire business is not transacted in Pennsylvania, the income base may be allocated and apportioned to determine income subject to taxation in Pennsylvania. Most taxpayers having income from business activities taxed both within and without Pennsylvania apportion their income based on the value of sales sourced to Pennsylvania.

Separate Company Reporting (Current Law)

Pennsylvania requires corporations to file tax reports on a separate company basis. Corporations that are part of an affiliated group (e.g. parent and subsidiaries) for federal purposes are required to file separate company Pennsylvania CNIT returns even though their income may have been reported to the federal government in a consolidated report of affiliated corporations. The taxable income is computed on a stand-alone basis even though the corporation participates in a consolidated filing for federal income tax purposes.

Combined Reporting (Governor Wolf's Proposal)

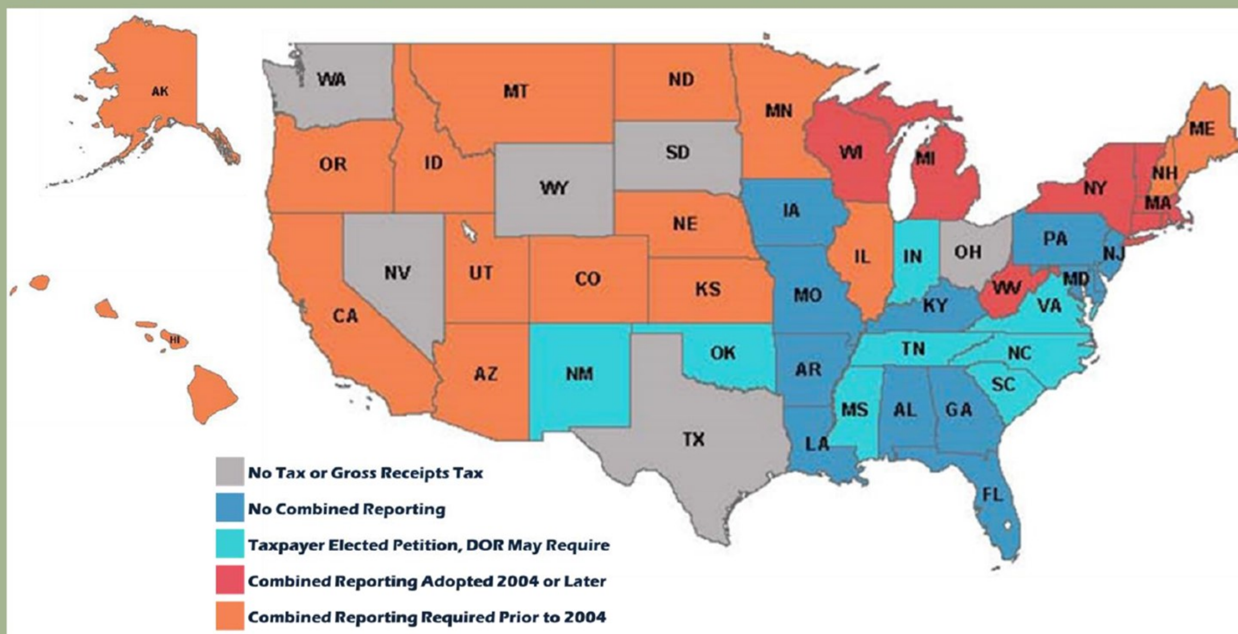
A combined report is an accounting document used to prepare a tax return for a group of corporations engaged in a unitary business. In combined reporting, the unitary group is treated as a single entity. The business income and apportionment factors of each member of the group are combined, intercompany transactions are eliminated and the resulting income is apportioned using the combined apportionment factors, as modified by the elimination of intercompany transactions. Even members of the group that are not taxable by the state may be included in the combined report if they are part of the same unitary business.

Previously introduced legislation in Pennsylvania defined a unitary business as consisting of two or more affiliated corporations with at least one corporation not doing all of its business in Pennsylvania. A unitary business is a single economic enterprise made up of: (1) separate parts of a single corporation; or (2) a commonly controlled group of corporations that are sufficiently related by their activities and that mutually benefits all members through a sharing of a significant flow of value among the separate entities.

Despite the uncertainty surrounding combined reporting, Governor Wolf has proposed combined reporting legislation as part of his FY 2017-18 Budget. Combined reporting does not increase taxes on all businesses that are affected by its adoption. Although the overall revenue impact is presumed to be a gain

Combined reporting began in California in the 1930s. Figure 7 displays the variation in combined reporting across the states. Currently 24 states require combined reporting. Eight of these states have adopted combined reporting since 2004.

Figure 7. Combined Reporting Status in States, as of January 1, 2016



Source: Office of Fiscal and Management Analysis Indiana Legislative Services Agency, October 1, 2016

(i.e. tax increase), there are many corporations whose tax liabilities would be decreased. Corporations that have profitable businesses paying corporate net income tax in Pennsylvania could see a tax reduction by bringing less profitable affiliates into the combined group. Furthermore, including corporations from other states in the combined group has a diluting effect on the Pennsylvania apportionment percentage, which is used to measure the amount of income that is taxable in Pennsylvania.

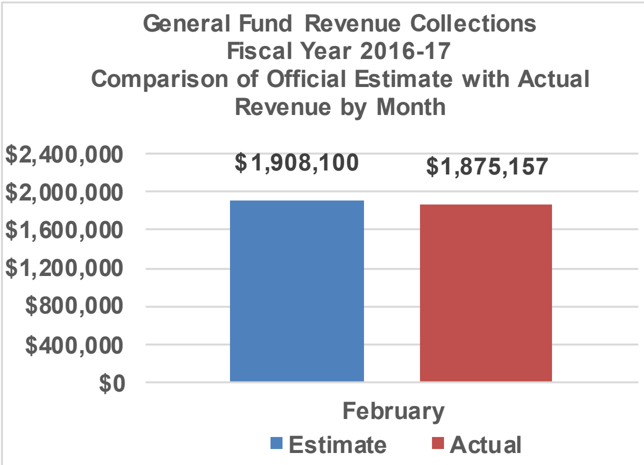
On March 4, 2013, the Independent Fiscal Office (IFO) issued a report entitled *Corporate Tax Base Erosion: Analysis of Policy Options*. The IFO concluded in its analysis that combined reporting could increase |corporate net income tax revenues by nine-to-thirteen percent.

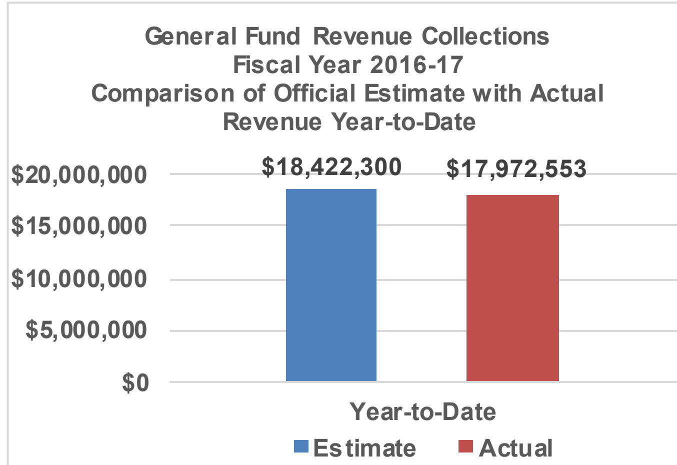
<u>Winners and Losers</u>

A change from separate company reporting to combined reporting would result in an unknown number of winners and losers. Those corporations whose tax liabilities would be reduced (i.e. "winners") are likely to immediately take advantage of the change and file their CNIT returns under combined reporting without contest. However, the "losers" would be less inclined to accept increased tax liabilities without appeal, resulting in costly litigation and potential delay in tax payments. Because of this, any revenue gain, especially in the early years of the change, may not materialize to the extent anticipated.

Like many tax policy decisions, the issue of separate company reporting versus combined reporting for state corporate income tax is not without controversy. Proponents of combined reporting argue that it levels the playing field by closing tax "loopholes." Critics suggest that combined reporting unfairly taxes profits not earned within a given state and increases the cost of doing business, thereby making the state less attractive for growth and investment.

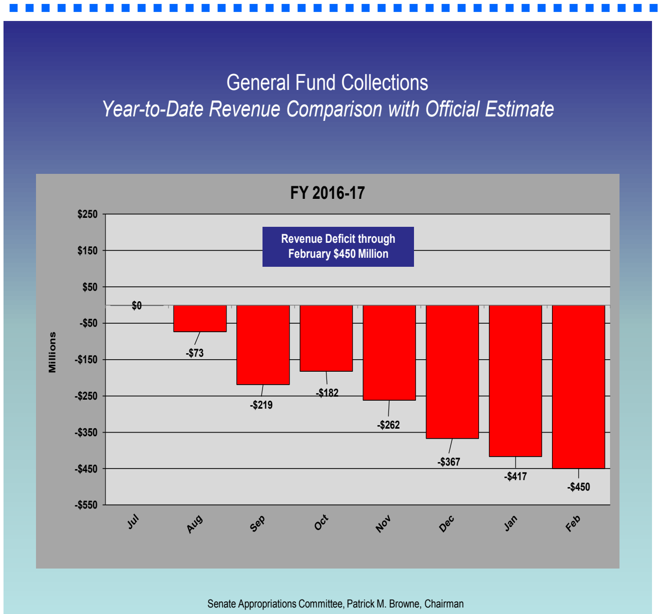
Revenues Come Up Short of Projections Again for Month of February

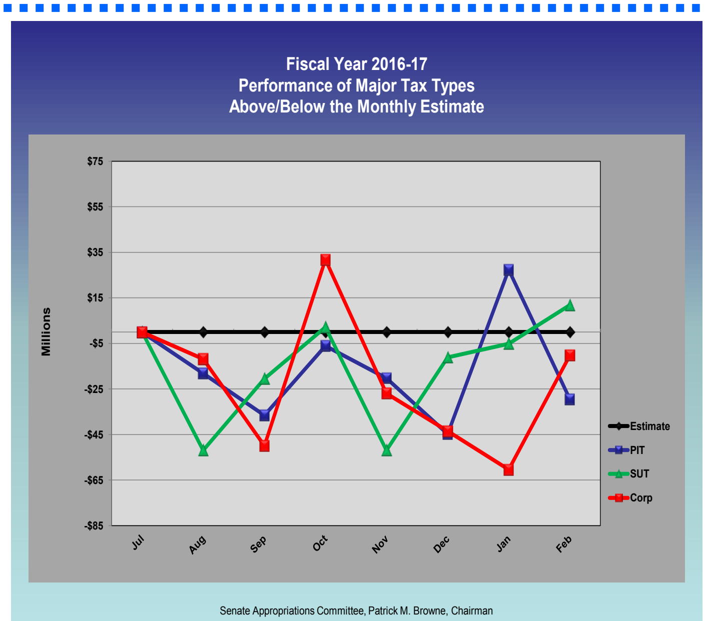




General Fund revenue collections for the month ended February 2017 totaled **$1.88 billion**, which was **$32.9 million**, or **1.7%**, **below estimate for the month**. **Fiscal year-to-date collections totaled $18 billion**, which is **$449.7 million**, or **2.4%**, below estimate for the year.

**In Thousands	February 2017 Estimate	February 2017 Actual	Over/Under Estimate	Fiscal Year-to-Date Estimate	Fiscal Year-to-Date Actual	Over/Under Estimate
Corporation Tax	$84,700	$74,525	$10.2 million or 12.1%	$1,624,000	$1,452,889	$171.1 million or 10.5%
Sales & Use Tax (SUT)	$690,100	$701,940	$11.8 million or 1.7%	$6,722,700	$6,596,182	$126. 5 million or 1.9%
Personal Income Tax (PIT)	$829,000	$799,424	$29.6 million or 3.6%	$7,650,900	$7,522,755	$128.1 million or 1.7%
Cigarette Tax	$97,000	$87,064	$9.9 million or 10.2%	$856,200	$814,900	$41.3 million or 4.8%
Other Tobacco Products	$6,900	$9,071	$2.2 million or 31.5%	$34,500	$44,571	$10.1 million or 29.6%
Liquor Tax	$27,900	$25,986	$1.9 million or 0.7%	$250,300	$244,246	$6.1 million or 2.4%
Realty Transfer Tax (RTT)	$33,600	$27,802	$5.8 million or 17.3%	$360,100	$309,746	$50.4 million or 14.0%
Inheritance Tax	$82,500	$68,383	$14.1 million or 17.1%	$621,600	$598,489	$23.1 million or 3.7%
Non-Tax Revenues	$44,800	$72,329	$27.5 million or 61.4%	$219,300	$292,755	$73.5 million or 33.5%





General and Motor License Fund Revenue Detail

Fiscal Year 2016-17

Senate Appropriations Committee Monthly Revenue Report

($ thousands)

REVENUE SOURCES	YTD FY 2015-16	February 2017 Actual	February 2017 Estimated	Surplus/ (Deficit)	YTD Actual	YTD Estimated	Surplus/ (Deficit)
TOTAL - GENERAL FUND	**17,754,202**	**1,875,157**	**1,908,100**	**(32,943)**	**17,972,553**	**18,422,300**	**(449,747)**
TOTAL - NON-TAX REVENUE	**245,991**	**72,329**	**44,800**	**27,529**	**292,755**	**219,300**	**73,455**
TOTAL - TAX REVENUE	**17,508,212**	**1,802,829**	**1,863,300**	**(60,471)**	**17,679,799**	**18,203,000**	**(523,201)**
TOTAL - Corporation Taxes	**1,656,410**	**74,525**	**84,700**	**(10,175)**	**1,452,889**	**1,624,000**	**(171,111)**
Accelerated Deposits	189	(148)	0	(148)	1,726	0	1,726
Corp. Net Income	1,417,016	37,244	52,200	(14,956)	1,280,678	1,490,600	(209,922)
Cap. Stock & Franchise	105,878	1,944	500	1,444	34,953	16,900	18,053
Gross Receipts	43,666	4,251	6,500	(2,249)	47,319	37,900	9,419
PURTA	2,773	30	0	30	2,344	2,800	(456)
Insurance Premiums	48,660	30,025	22,200	7,825	62,950	47,700	15,250
Financial Institutions	36,029	1,180	3,300	(2,120)	22,920	28,100	(5,180)
Other Selective Bus. Taxes	2,199	$0	$0	$0	$0	$0	$0
TOTAL - Consumption Taxes	**7,345,459**	**825,848**	**823,700**	**2,148**	**7,716,362**	**7,879,800**	**(163,438)**
Sales and Use	6,498,167	701,940	690,100	11,840	6,596,182	6,722,700	(126,518)
General (net of transfers)	5,626,181	610,750	594,100	16,650	5,712,498	5,812,800	(100,302)
Motor Vehicle Sales	871,986	91,190	96,000	(4,810)	883,684	909,900	(26,216)
Cigarette Tax	594,993	87,064	97,000	(9,936)	814,900	856,200	(41,300)
Other Tobacco Products		9,071	6,900	2,171	44,571	34,500	10,071
Malt Beverage	16,606	1,787	1,800	(13)	16,463	16,100	363
Liquor	235,692	25,986	27,900	(1,914)	244,246	250,300	(6,054)
TOTAL - Other Taxes	**8,506,342**	**902,455**	**954,900**	**(52,445)**	**8,510,548**	**8,699,200**	**(188,652)**
Personal Income	7,487,245	799,424	829,000	(29,576)	7,522,755	7,650,900	(128,145)
Withholding	6,155,734	757,566	780,400	(22,834)	6,253,268	6,333,400	(80,132)
Non-Withholding	1,331,511	41,858	48,600	(6,742)	1,269,488	1,317,500	(48,012)
Realty Transfer	325,095	27,802	33,600	(5,798)	309,746	360,100	(50,354)
Inheritance & Estate	604,853	68,383	82,500	(14,117)	598,489	621,600	(23,111)
Minor & Repealed	22,629	(2,076)	400	(2,476)	2,248	(11,800)	14,048
Table Games	66,521	8,921	9,400	(479)	77,309	78,400	(1,091)
TOTAL - MOTOR LICENSE FUND	**1,669,515**	**225,749**	**232,200**	**(6,451)**	**1,720,452**	**1,738,520**	**(18,068)**
TOTAL - Liquid Fuels Taxes	**1,108,983**	**158,663**	**159,900**	**(1,237)**	**1,147,167**	**1,144,400**	**2,767**
Liquid Fuels	(854)	1	0	1	58	0	58
Fuels	38	0	0	0	0	0	0
Motor Carriers/IFTA	67,633	18,107	20,800	(2,693)	69,189	69,900	(711)
Alternative Fuels	6,289	928	900	28	6,866	7,200	(334)
Oil Company Franchise	1,035,876	139,627	138,200	1,427	1,071,053	1,067,300	3,753
TOTAL - Licenses, Fees & Other	**560,531**	**67,086**	**72,300**	**(5,214)**	**573,286**	**594,120**	**(20,834)**
Licenses and Fees	544,836	64,125	70,300	(6,175)	562,667	579,700	(17,033)
Other Motor Receipts	15,695	2,962	2,000	962	10,618	14,420	(3,802)