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**Testimony to the  
Pennsylvania General Assembly  
Senate Finance Committee**

**Concerns with Tax Burden Shifting Proposals**

**Fred Nicely  
Senior Tax Counsel  
June 10, 2015**

Chairman Eichelberger, Minority Chair Blake, and Members of the Finance Committee, thank you for the opportunity to provide written testimony today on behalf of the Council On State Taxation (COST) regarding legislative proposals to reduce school district property taxes in Pennsylvania by increasing the State’s personal income tax and sales/use taxes. COST is concerned with tax changes that merely shift tax burdens without accounting for sound tax policy considerations and fail to improve the overall administration of those taxes. While COST is not opposed to Pennsylvania changing its tax structure, significant tax changes must be studied to ensure the changes do not increase economic burdens for businesses conducting their operations in Pennsylvania. Further, Pennsylvania should also improve its administrative practices for both its property taxes and sales/use taxes.

**About COST**

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 600 major corporations engaged in interstate and international business. COST’s objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. Nearly all COST members conduct business in Pennsylvania and are impacted by changes to the Commonwealth’s tax structure.

**Proposed Sales/Use Tax Base Expansion**

If designed properly, sales taxes imposed by states would fall entirely on consumer end-user consumption. The COST Board of Directors has adopted a formal policy statement on sales taxation of business inputs. COST’s policy position is:

*Imposing sales taxes on business inputs violates several tax policy principles and causes significant economic distortions. Taxing business inputs raises production costs and places businesses within a State at a competitive disadvantage to businesses not burdened by such*

*taxes. Taxes on business inputs, including taxes on services purchased by businesses, must be avoided.<sup>1</sup>*

While Governor Wolf's proposed expansion of the Commonwealth's sales/use tax base attempts to exclude certain business-to-business transactions to mitigate pyramiding of the tax, it still fails to cover all the enumerated services in his proposal. The tax base can be expanded in a way that minimizes the detrimental effects to business. A preferred example of this is a broad-based exemption for all services provided to business. Even with an effective business inputs exemption, businesses looking to locate or expand operations in Pennsylvania may be concerned with an expansion of the sales tax base to services. When revenues are down, it creates tremendous pressure to undo the business-to-business exemptions and improperly tax certain services, such as accounting and legal services. Businesses will naturally seek to minimize costs, and imposing a 7% sales/use tax on business-to-business transactions would create a disincentive for business to retain or expand their operations in the Commonwealth.

### **Any Sales/Use Tax Rate Increase Compounds Tax on Business-to-Business Transactions**

Unfortunately, the states' sales/use taxes are imposed on numerous business-to-business transactions. Currently, approximately 39% of Pennsylvania's sales/use tax revenue is derived from business-to-business transactions.<sup>2</sup> Any general rate increase in Pennsylvania's sales/use tax compounds the cost of businesses conducting their activities in the Commonwealth. Further increases in the Commonwealth's sales/use tax rate, without eliminating some of the tax already imposed on business inputs, will not make Pennsylvania a more attractive environment for businesses to locate. Importantly, such taxes would likely be borne disproportionately by small businesses, since larger businesses would be incentivized to provide these services in-house to avoid the tax – a strategy that small businesses typically cannot afford.

### **Simplify Sales/Use Tax Collection for Remote Seller Collection Authority**

Legislation has been introduced for at least the past six sessions of Congress to grant the states remote seller collection authority to curb the revenue loss resulting from noncollection by remote sellers without a physical presence. The COST Board of Directors has adopted a formal policy statement on sales tax simplification and collection. COST's policy position is:

*A sales, use or similar transaction tax should be easily administered, easily understood by consumers, and nondiscriminatory between similarly situated vendors, purchasers, and goods. The Congress is encouraged to enact legislation that: 1) establishes precise standards and a governance mechanism by which the States would simplify and reform the sales, use or similar transaction tax system for all vendors and purchasers; and 2) remove existing limitations on the authority of States to compel remote vendors to collect and remit taxes for those States that simplify their sales, use or similar transaction tax systems. Under a simplified system, the amount*

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<sup>1</sup> COST policy statement on taxation of business inputs is available at: [http://www.cost.org/uploadedFiles/About\\_COST/Policy\\_Statement/Sales%20Taxation%20of%20Business%20Inputs.pdf](http://www.cost.org/uploadedFiles/About_COST/Policy_Statement/Sales%20Taxation%20of%20Business%20Inputs.pdf).

<sup>2</sup> Robert Cline, Andrew Phillips, and Tom Neubig, "What's Wrong with Taxing Business Services," Ernst & Young in conjunction with COST, April, 2013.

*of tax collected on taxable transactions should not differ based on the vendor's nexus status.<sup>3</sup>*

One of the impediments to enacting federal legislation has been the lack of additional states becoming full members of the Streamlined Sales and Use Tax Agreement (SSUTA). The Commonwealth should become an SSUTA state. The addition of Pennsylvania, as the sixth most populous state in the Union, would greatly assist with this effort to give those states that have simplified their sales/use tax laws remote sales collection authority.<sup>4</sup> Membership in the SSUTA would show that Pennsylvania is committed to: 1) assisting remote sellers with collecting the Commonwealth's tax; 2) assisting Pennsylvania-based sellers to collect and remit other SSUTA states' sales/use taxes; 3) leveling the playing field and making it easier for the states to collect the tax due on purchases made by its residents from remote sellers; and 4) participating in a forum for the SSUTA states and the business community to work together to continuously improve the states' sales/use tax administrative practices.

### **Fixing Poor Property Tax Administration Practices Should be a Priority**

Pennsylvania deserves recognition for improving from a "D" grade in COST's 2010 Administrative Practices Scorecard to one of the top states with an "A-" in COST's 2013 Scorecard.<sup>5</sup> One of the major changes made by the General Assembly was ensuring independence within the Board of Finance and Review, which also must issue written decisions available to the public. Unfortunately, the same cannot be said about Pennsylvania's decentralized property tax administration practices. COST, in collaboration with the International Property Tax Institute, issued its second Property Tax Administration Scorecard last year, and Pennsylvania ranked as the worst U.S. State with a "D" grade.<sup>6</sup> The core problem with Pennsylvania's property tax administration is that it lacks a central location to provide taxpayers with information, does not have central oversight and control over the local assessors, and lacks equal assessment and a statewide uniform appraisal cycle that the assessors must follow. The COST Board of Directors has adopted a formal policy statement on fair and equitable property tax systems. COST's policy position is:

*State and local property tax systems must be fairly administered and tax burdens equitably distributed among taxpayers. A property tax system that is inefficient or that disproportionately falls upon business is not equitable and will negatively impact a state's business tax climate.*

COST strongly encourages the General Assembly to fix deficits in Pennsylvania's property tax administration before, or along with, addressing the burden of the school district property taxes.

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<sup>3</sup> COST policy statement on the simplification of the sales/use tax system is available at: [http://www.cost.org/uploadedFiles/About\\_COST/Policy\\_Statement/Simplification%20of%20the%20Sales%20and%20Use%20and%20Similar%20Transaction%20Tax%20System%202026%2013%20adopted%20\(2\).pdf](http://www.cost.org/uploadedFiles/About_COST/Policy_Statement/Simplification%20of%20the%20Sales%20and%20Use%20and%20Similar%20Transaction%20Tax%20System%202026%2013%20adopted%20(2).pdf).

<sup>4</sup> There are 23 full member SSUTA states; Ohio (7), Georgia (8), Michigan (9), and North Carolina (10) are presently the most populous SSUTA states.

<sup>5</sup> Douglas Lindholm, Ferdinand Hogroian, and Fredrick Nicely, "The Best and Worst of State Tax Administration – COST Scorecard on Tax Appeal & Procedural Requirements," December, 2013; available at: <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=85976>.

<sup>6</sup> Fredrick Nicely, Catherine Oryl, et. al, "The Best and Worst of International Property Tax Administration – COST-IPTI Scorecard on State and International Property Tax Administrative Practices," September, 2014; available at: <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=88125>.

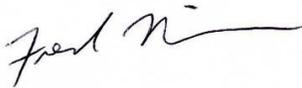
### **Tax Shifting Creates Winners and Losers**

While COST is not opposed to reducing school district property taxes, we are concerned when the revenue from such cuts is funded by mechanisms such as further levying sales taxes on business investment. This will certainly drive some businesses to invest elsewhere. Further, COST is not aware of any research that suggests swapping a reduction in school district property taxes in Pennsylvania for increased sales/use taxes and personal income tax will make Pennsylvania a better place to do business. That research is critical before this Legislature initiates such changes.

### **Conclusion**

COST appreciates the opportunity to provide comments on proposed tax restructuring in Pennsylvania. COST encourages the General Assembly to further study the potential impact before undertaking a tax swap for a reduced school district property tax by increasing the Commonwealth's personal income tax and sales/use tax rates. Such a study is needed to verify the proposed changes will ultimately improve Pennsylvania's economy and create jobs in Pennsylvania. In addition, Pennsylvania should work on improving its property tax administration practices and should improve its sales tax administration by becoming an SSUTA member state.

Sincerely



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COST Board