COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE
HARRISBURG, PENNSYLVANIA
17128-1100

THE SECRETARY (717) 783-3680

February 25, 2019

Honorable Stan Saylor
Majority Appropriations Chairman
House of Representatives
245 Main Capitol
Harrisburg, PA 17120

Honorable Matthew Bradford
Minority Appropriations Chairman
House of Representatives
512E Main Capitol
Harrisburg, PA 17120

Dear Chairmen:

Thank you for the opportunity to testify before the House Appropriations Committee on Monday, February 11, 2019. During the course of the hearing, a number of questions were raised by committee members requiring follow-up after our testimony. This letter is in response to those questions.

Representative Donna Bullock requested further information regarding the department's diversity in the workforce. According to the U.S. Census Bureau Quick Facts Pennsylvania (https://www.census.gov/quickfacts/fact/table/PA/RHI125216#viewtop), our statewide non-minority population is 82.1%, which means 17.9% of our commonwealth citizens are minorities. According to the Governor's Annual Workforce Report (http://www.oabis.state.pa.us/SGWS/2019/SGWS_MAIN.html), 14.8% of the employees under the Governor's jurisdiction are minorities, up from 14.5%, and the Department of Revenue's workforce includes 22.3% minorities, up from 21.8%. A further breakdown of the department's diversity numbers are in the chart below. Rep. Bullock also requested diversity information for the Pennsylvania Lottery. We do not have data for the PA Lottery because its employees are part of the Department of Revenue and the diversity data is broken out by agency.

Department of Revenue Diversity Information		
	Agency Percentage	**Number of Employees**
Minority female	14.7%	262
Minority male	7.6%	135
Total female	49.2%	879

Although in total, our percentage of women and minorities exceeds the averages across the Governor's jurisdiction, we are implementing initiatives to be intentional with respect to leadership development programs to better position this segment of our workforce for higher level advancement opportunities within the department.

Additionally, Rep. Bullock inquired about House Bill 50 (Wheatley), the legalization of recreational marijuana, and if the department has reviewed the legislation for a fiscal impact. The department is currently analyzing the proposal and can share revenue estimates once our review is complete.

Representative Jesse Topper requested further information regarding our modernization contract including costs, how payments are made to our vendor, FAST Enterprises LLC, and a general timeline of implementation. The Department of Revenue's contract for modernization officially began on February 14, 2018 with the first phase rollout for motor fuels taxes completed on January 28, 2019, which was on schedule and on budget. The timeline for phases 2 and 3 are as follows, October 2019 will be the go-live date for Realty Transfer Tax and Inheritance Tax, and November 2020 will be the go-live for Personal Income Tax and Property Tax/Rent Rebate. Our modernization contract is structured to pay for services rendered after each rollout, upon acceptance, and includes a 20% holdback for ninety days following a rollout (see charts below). The full contract is publically available on the PA Treasury's website at http://contracts.patreasury.gov/View.aspx?ContractID=443455 and an amendment to the original contract at http://contracts.patreasury.gov/View.aspx?ContractID=456461.

Fast Contract

	Contracted (years 1-5)	Paid as of 2/12/19
Services	$ 29,900,000.00	$ -
License Fee	$ 6,000,000.00	$ 6,000,000.00
Maintenance	$ 4,300,000.00	$ 400,000.00
Support **	$ 4,000,000.00	$ -
Total (without hosting)	$ 44,200,000.00	$ 6,400,000.00
Hosting Services *	$ 1,050,000.00	$ 250,000.00
Total (with hosting)	$ 45,250,000.00	$ 6,650,000.00

Notes

* Hosting services costs above represent years 1 and 2 only; additional hosting costs will accrue in future years however actual cost is under negotiation. Amendment 1 to the contract added these services.

** Support costs will not begin until after final rollout (2020-21). The department will then determine which support level will be needed. Associated costs will continue yearly thereafter and are not included in this amount for future years.

Milestone	DOR Estimated Invoice Date	Amount
GenTax Installation - License Fee	May 30, 2018	$6,000,000
Rollout 1 - IFTA and MAFT		
Rollout 1 - Production Rollout/Acceptance	February 15, 2019	$8,252,400
Rollout 1 - Holdback Payment	May 15, 2019	$2,063,100
Rollout 2 - RTT and Inheritance Tax		
Rollout 2 - Production Rollout/Acceptance	October 15, 2019	$5,621,200
Rollout 2 Holdback Payment	January 15, 2020	$1,405,300
Rollout 3 - PIT PTBO PTRR		
Rollout 3 - Production Rollout/Acceptance	November 27, 2020	$10,046,400
Rollout 3 - Holdback Payment	February 28, 2021	$2,511,600
	License Fee	$6,000,000
	Services	$29,900,000
	Total Services and License fee	$35,900,000

Payments for services are due at time of acceptance for each rollout. 20% of each payment is held for 90 days following each rollout.

Representative John Lawrence asked if the department can provide copies of the delinquent tax collection report. This report is available publically and published annually on our website through the department's Statistical Supplement report. These reports can be found via the following link, https://www.revenue.pa.gov/GeneralTaxInformation/News%20and%20Statistics/ReportsStats/TaxCompendium/StatSupplement/Pages/default.aspx. Below are the relevant charts from the most recent statistical report related to delinquent tax collections.

General Fund Delinquent Tax Collections
Three Year History
($ millions)

	2015-16	2016-17	2017-18
General Fund Total	**621.5**	**694.8**	**739.0**
Corporation Taxes	135.3	196.6	193.7
Sales and Use Tax	163.3	154.2	191.1
Employer Tax	16.5	17.1	15.6
Personal Income Tax	179.4	189.5	194.2
Miscellaneous [1]	127.0	137.5	144.3

[1] *Miscellaneous includes collection of delinquent Inheritance Tax, Realty Transfer Tax, and miscellaneous collections.*

Motor License Fund Delinquent Tax Collections
Five Year History
($ millions)

	2013-14	2014-15	2015-16	2016-17	2017-18
Motor License Fund Total	**3.8**	**4.7**	**7.6**	**2.9**	**4.4**
Liquid Fuels	1.3	2.1	3.8	1.2	0.8
Motor Carriers	2.5	2.6	3.8	1.7	3.6

Rep. Lawrence also asked for the delinquent tax collections that are over 10 years old. There could be several factors why the department would collect a debt that is over 10 years old. Appeals may last several years before finally settled, particularly larger tax questions argued before Commonwealth Court. If a taxpayer files for bankruptcy, all collections must stop and cannot resume until the bankruptcy is completed, which can take several years. Collection may be a result of a lien that was filed several years before and now the property is being sold. Additionally, the department has new collections programs such as the out of state lien enforcement program which are geared towards older, out of state liabilities. Finally, taxpayers may not have the financial wherewithal to pay when the initial liability was due, but over time the taxpayer's financial situation improves and the taxpayer wants to resolve the liability. Below are our delinquent collections by tax type from the last three fiscal years which were 10+ years old when paid.

DELINQUENT COLLECTIONS
TEN OR MORE YEARS FROM THE DUE DATE

FY	TAX TYPE	AMOUNT ($)	FY	TAX TYPE	AMOUNT ($)
2015-16	CORPORATION	12,544,043	2017-18	CORPORATION	34,921,099
	EMPLOYER	788,869		EMPLOYER	1,023,484
	INHERITANCE	6,273,059		INHERITANCE	8,444,693
	OTHER	319,339		OTHER	473,389
	PIT	14,997,859		PIT	8,239,689
	SUT	2,179,525		SUT	2,262,092
	TOTAL	37,102,694		TOTAL	55,364,447
2016-17	CORPORATION	12,810,141			
	EMPLOYER	870,599			
	INHERITANCE	8,078,919			
	OTHER	57,222			
	PIT	7,231,791			
	SUT	2,510,429			
	TOTAL	31,559,102			

NOTES:
1/ Does not include amnesty payments.
2/ Data not available for Motor Fuels and Realty Transfer taxes.

Additionally, the department included a breakdown of all our delinquent collections made in FY2017-18, by tax type in the chart below.

FY 2017-18 DELINQUENT COLLECTIONS
TAX YEAR BREAKDOWN
($M)

			TAX YEAR			
TAX TYPE	**2018**	**2017**	**2016**	**2015**	**2014**	**< 2014**
CORPORATION	1.1	4.7	18.9	20.6	20.4	128.0
EMPLOYER	1.0	5.9	3.1	1.5	1.1	3.1
INHERITANCE	0.0	56.5	50.4	9.2	4.3	14.3
PIT	0.1	0.3	75.5	49.9	21.8	46.6
SUT	21.6	62.2	13.7	7.3	18.1	68.2
OTHER	1.3	1.8	0.1	0.0	0.0	1.0
TOTAL	25.1	131.4	161.7	88.5	65.7	261.3

NOTES:
1/ Data not available for Motor Fuels and Realty Transfer taxes.
2/ Inheritance tax years represent year of death.

Representative Greg Rothman inquired further about the mechanics of a minimum wage increase and employer deductions. Wages paid to employees are deductible expenses for the employer. If the Governor's proposed minimum wage were adopted, business owners paying Pennsylvania Personal Income Tax (PIT) will see an increase in their deductible wage expenses and a decrease in net taxable income. However, the reduction in business income does not fully offset the increase in taxable wages for several reasons.

Not all employees work for businesses that pay PIT. The portion of the additional wages attributable to business owners paying PA PIT was determined using U.S. Census data on business firm size for Pennsylvania. Businesses with fewer than 250 employees are assumed to be small businesses that would ultimately pay PA PIT. Of the $4.4B increase in employees' wages, 69% is offset by the decrease in business income.

This 69% offset could be adjusted even further for the fact that businesses often have negative income (business losses) and pay no tax regardless of a change in deductions. If this effect were considered, the 69% would likely decrease and the PIT effect would increase. No adjustment for this factor was included in the calculation.

The effect on CNIT was not included because many minimum wage employees work for pass-through businesses and the impact on corporate taxpayers is not as direct. Taxable income for a corporation is determined on a nation-wide basis and "apportioned" based on sales to get to a Pennsylvania taxable income figure. Expenses for some corporations would go up with minimum wage increases, but revenue may increase, too, depending on what the corporation sells. Additionally, it is difficult to model the effect that increased deductions for increasing pay for some workers, but not others would have when apportionment and net operating losses are considered. Finally, 70% of C corporations run a loss each year and would not see a tax reduction from increased deductions. In total, there were too many factors to make a reasonable estimate.

Finally, it should be noted that all businesses will benefit to the extent that Pennsylvania wage earners have more money to spend on goods and services.

Representative Maria Donatucci asked the department to provide further information on the sales and use tax gap from unremitted marketplace sales. While the department anecdotally believes Act 43 of 2017 significantly helped to reduce the tax gap from marketplace sales, further study is needed to formulate a specific number by using April tax returns. The gap is of interest to the department and we will continue to review. To help illustrate this further, a Marketplace Pulse report indicates in 2018 that Amazon has an online retail sales market share of 48%. The other major online-only marketplaces include eBay with 7.2%, Walmart.com with 4% and Etsy and Wish at less than 1%. The department has accounted for their collections in the revenue forecast. Source: https://www.marketplacepulse.com/articles/amazon-marketplace-is-the-largest-online-retailer

It is also anticipated the gap will further shrink due to the *Wayfair* decision and the department's issuance of guidance, effective July 1st, which follows the *Wayfair* decision. Act 43 allows for either an election to notify a taxpayer of their obligation to pay use tax or a seller can select to collect and remit sales tax. Our bulletin follows *Wayfair* to require marketplace facilitators and sellers who made over $100,000 in Pennsylvania sales to register for a sales tax license and collect, report, and remit sales tax on sales into the Commonwealth and further decrease the sales tax gap.

Representative Rosemary Brown inquired about Act 109 of 2018 (HB 1511, M. Quinn), which requires booking agents to collect the Commonwealth's 6% Hotel Occupancy Tax (HOT) on the accommodation fee, and the related local HOT tax collection responsibility of the booking agents. The Department of Revenue is not tasked with the collection of local taxes, which is left to the local counties and municipalities. To assist local governments and successfully implement Act 109, the department has placed guidance on our website, sent letters to identified booking agents, and worked with the County Commissioner's Association of Pennsylvania (CCAP) and the Pennsylvania Restaurant and Lodging Association (PRLA) on the issue. As part of our collaboration with CCPA and PRLA, the department has linked on our website a CCAP document which lists the various county HOT rates and best county contact for local registration by a booking agent to better fulfill their local HOT collection obligation. Furthermore, as part of the implementation process of Act 109, booking agents must also register with the department for a booking agent license. Booking agent license data is part of the public record and will be available on the commonwealth's "Open Data Pennsylvania" site, http://data.pa.gov, similar to other Department of Revenue licensing information. This information can assist local governments in tracking booking agents.

During our exchange with Representative Clint Owlett regarding the Governor's minimum wage proposal, the department cited several academic studies that found no evidence of job losses due to increasing the minimum wage. The citations for the studies are below and the studies are enclosed with this letter. We have also cited and enclosed two Economic Policy Institute reports that helped point us to the other studies.

- Sylvia Allegretto, Anna Godoey, Carl Nadler and Michael Reich. *The New Wave of Local Minimum Wage Policies: Evidence from Six Cities*. Center on Wage and Employment Dynamics, Institute for Research on Labor and Employment, University of California, Berkley. September 6, 2018. http://irle.berkeley.edu/files/2018/09/The-New-Wave-of-Local-Minimum-Wage-Policies.pdf.

- Doruk Cengiz, Arindrajit Dube, Attila Lindner, and Ben Zipperer. *The Effect of Minimum Wages on Low-Wage Jobs: Evidence from the United States Using a Bunching Estimator*. CEP Discussion Paper No. 1531. Centre for Economic Performance. February 2018. http://cep.lse.ac.uk/pubs/download/dp1531.pdf.

- Dale Belman and Paul J. Wolfson. *What Does The Minimum Wage Do?* Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, Chapter 4, 2014. (See enclosure, chapter 4 from "What Does the Minimum Wage Do?")

- Sylvia Allegretto and David Cooper. *Twenty-three Years and Still Waiting for Change: Why It's Time to Give Tipped Workers the Regular Minimum Wage.* EPI-CWED Briefing Paper # 379. Economic Policy Institute. July 2014. https://www.epi.org/publication/waiting-for-change-tipped-minimum-wage/.

- David Cooper. *Raising the federal minimum wage to $15 by 2024 would lift pay for nearly 40 million workers.* Economic Policy Institute. February 2019. https://www.epi.org/publication/raising-the-federal-minimum-wage-to-15-by-2024-would-lift-pay-for-nearly-40-million-workers/.

Representative Dunbar requested clarification on the revenue impact of combined reporting. Below are two tables, the first table represents the Governor's proposal which includes combined reporting and a Corporate Net Income Tax rate decrease and the second table shows the revenue gain from strictly combined reporting and no rate decrease.

Governor Wolf's Combined Reporting and CNIT Rate Decrease Proposal ($ millions)						
Fiscal Year	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**2023-24**
Revenue Impact	$0	-$7.2	$549.6	$319.9	-$149.3	-$526.8
Rate Decrease by Tax Year						
Tax Year	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
CNIT Rate (%)	9.99	8.99	8.29	7.49	6.99	5.99

Impact of Combined Reporting by Fiscal Year without a CNIT Rate Decrease ($ millions)	
Fiscal Year	**Combined Reporting Impact**
2018-2019	$0.00
2019-2020	$0.00
2020-2021	$960.9
2021-2022	$1,408.0
2022-2023	$1,125.2
2023-2024	$1,167.8

Additionally, Rep. Dunbar asked for a further description of the difference between the Independent Fiscal Office's (IFO) combined reporting numbers versus the department. From the information we have, it appears the figures being compared are the IFO figures produced last year for the combined reporting estimate in that year's executive budget, and a breakdown of this year's proposal provided by the Department of Revenue. For last year's proposal, the IFO reported that the increase from combined reporting at the current rate of 9.99% would generate revenue between $340 million and $360 million. By contrast, the department estimates the increase from combined reporting at 9.99% to generate approximately $1.1 billion.

The department has performed a study using tax returns from corporations operating in both Minnesota (which has combined reporting) and Pennsylvania. The combined income and apportionment denominators reported in Minnesota were the starting point for our calculations, while Pennsylvania sales and net operating losses from returns filed in Pennsylvania were used to complete the calculation. Using that data, at the current NOL cap (40% of taxable income) and the rate of 9.99%, it is estimated the CNIT base would increase approximately 31%.

The IFO estimate is from a 2013 IFO report which used research from states that have implemented combined reporting during the previous decade to examine the revenue impact from that filing method. The report found that combined reporting could increase revenues by roughly 9% to 13%.

One important consideration is the current law of each state prior to the enactment of combined reporting. Pennsylvania has one of the narrowest tax bases in the country coupled with a high rate – this invites extensive tax planning. By contrast, some of the other states considered by the IFO may have already had a broad addback provisions or similar legislation to address tax avoidance behavior, making their base increase smaller than Pennsylvania's would be.

Finally, the IFO report notes that Rhode Island, which made the switch to combined reporting in 2014, saw its base increase by 20%.

Representative Martina White asked the department if we could provide a general estimate of uncollected taxes related to the energy used for charging electric vehicles, which is subject to the Alternative Fuels Tax. Currently, there are no systems in place that are dedicated to measuring the kilowatt hours (KWH) of energy placed into a plugin electric vehicle (PEV). In 2017, there were approximately 9,100 PEVs in the Commonwealth, according to a study by Plug In America. Less than 1% of that number remitted the Alternative Fuels Tax in 2017. The department estimates that non-reporting PEVs could have remitted approximately $412,000 in 2017.

Rep. White also inquired as to why tax revenues are decreasing in the Motor License Fund. The low compliance of electric vehicle owners is not the main cause for the decline this fiscal year. Rather it is the tax rate of gasoline and diesel fuels. The first 6 months of fiscal year 2017-18 had a higher tax rate than the first 6 months of fiscal year 2018-19 (58.2 cents per gallon of gasoline and 74.7 cents per gallon diesel versus 57.6 cents per gallon of gasoline and 74.1 cents per gallon of diesel). In addition, motor fuel consumption has slowed. Compared to the prior year, fuel consumption is down by -1% for gasoline and -1% for diesel through November. The increase in vehicle fuel efficiency is the most likely factor that is impacting overall fuel consumption growth.

Representative Steve Samuelson inquired about the Property Tax/Rent Rebate (PTRR) program and how many taxpayers benefitted from the program and why the number of people benefitting is decreasing. For the 2016 claim year, approximately 548,000 taxpayers qualified for the PTRR program and received a rebate. The number of taxpayers benefitting has been decreasing due to "bracket creep", which is taxpayers' incomes rising over time and resulting in their earnings being too high to qualify for the program. The overall income limits in the PTRR program have not been changed since Act 1 of 2006. There have been small changes to the program which help expand qualification such as a cost of living adjustment that expired in 2017, the exclusion of veterans' disability payments and state veterans' benefits, and an exclusion of the Civil Service Retirement System income. However, those changes are not enough to offset the effect of bracket creep.

Additionally, Rep. Samuelson asked for clarification on the department's PTRR claim form and instruction booklet (PA-1000) mailing to previous program applicants. In an effort to use taxpayer dollars efficiently and reduce paper waste, the department only mails PA-1000s to taxpayers who filed their own paper return in the prior year. If a rent rebate taxpayer utilized a third party preparer or computer software, the taxpayer does not receive the PA-1000 but instead receives two copies of the Rent Certificate to be submitted with the computer software prepared form for their rent rebate application.

I hope that you find this information helpful. If you or any of the committee members have questions or need additional information, please feel free to contact Andrew Moser in our Legislative office at 717-783-4024.

Sincerely,

C. Daniel Hassell

C. Daniel Hassell
Secretary of Revenue

Enclosure