**House Appropriations Committee**
**Testimony**
**Eileen McNulty, Acting Secretary**
**Pennsylvania Department of Revenue**
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Chairman Adolph, Chairman Markosek and members of the committee, thank you for the opportunity to submit remarks for the Department of Revenue's budget hearing. Joining me today are Dan Hassell, Deputy Secretary for Tax Policy; Christin Heidingsfelder, Deputy Secretary for Administration and Drew Svitko, Acting Executive Director of the Pennsylvania Lottery.

The department's transition to an integrated tax system (ITS) is a critical investment, allowing us to replace decades-old data silos at risk of failure with an integrated system that allows the department to view its tax records from the perspective of the taxpayer and coordinate records from all of its tax systems that touch a particular taxpayer. This modernization is critical to future efficiencies and cost savings. However, the integration of corporation taxes and more recently trust fund taxes, like sales tax and employer withholding, has not been without its challenges. Inadequate testing and problems with data conversion have led to processing delays, difficulties with account detail visibility, electronic filing system interruptions and the need to move staffing from collection activities to processing, in order to address backlogs. I recently restructured executive management within the department to consolidate supervision of tax processing, information technology and collections functions under Executive Deputy Secretary Bob Coyne, to provide better coordination of processing priorities and focusing of IT resources to improve efficiency of review and assessment of returns. The resolution of these challenges and elimination of backlogs is one of our top operating priorities.

Another priority is improved communication with taxpayers and the practitioner community. Taxpayers were frustrated when the department issued assessments on unreimbursed employee business expenses before giving them opportunity to provide documentation substantiating the expenses. Practitioners, who could have partnered with the department in explaining to their clients the kinds of documents they should be prepared to provide, were also frustrated by the unannounced changes in procedure. Corporate taxpayers have had difficulties as well in obtaining account statements that explain the application of funds. Our tax collection system is dependent on citizens' voluntary compliance with tax laws. Most taxpayers comply willingly when given the appropriate communication and information to understand what is expected of them. We need to provide that communication and direction as we move forward and work together with tax practitioners to make the process of paying taxes as easy and understandable as possible.

From a policy perspective, improving the competitiveness of the commonwealth's economy is one of Governor Wolf's highest priorities. The Governor will cut the corporate income tax rate by 40 percent – from 9.99 percent, the second-highest in the nation, to 5.99 percent on January 1, 2016 – thereby making it easier to attract business development currently discouraged by the "sticker shock" of the 9.99 percent tax rate. The corporate tax rate will be further reduced to 5.49 percent in 2017 and 4.99 percent in 2018.

Governor Wolf will finally put an end to the capital stock and franchise tax after 17 years of on-again, off-again phasing down of the tax rate. He will make it harder for corporations to shelter income from state taxation and ensure all corporations pay their fair share by requiring combined reporting. Combined reporting is used in more than 60 percent of states with a traditional tax on corporate net income. The rate reduction, along with combined reporting, will level the playing field for local Pennsylvania corporations that currently pay the 9.99 percent rate but have little opportunity to employ the sophisticated tax planning available to multi-state corporations. By contrast, corporate conglomerates that are able to shelter income will no longer be able to do so as easily, but will also benefit from the lower rate. The proposal includes capping net operating loss deductions at the greater of $3 million or 12.5 percent of taxable income to ensure that the benefits of combined reporting are spread across all corporate taxpayers.

To further encourage business growth and job creation, Governor Wolf proposed the Made In Pennsylvania Job Credit Program, which would eliminate unutilized tax credits and invest $5 million in tax credits to manufacturing companies that create good paying middle-class jobs. The credit would provide up to 5 percent of new taxable payroll to manufacturing companies that increase their annual taxable payroll by at least $1 million over a four-quarter period. The jobs must be full-time and offer health benefits and average wages at or above the local average county wage, and the company must maintain the jobs for five years.

Another policy priority of Governor Wolf is relieving the burden of school property taxes. The Governor's proposal will reduce the average homeowner's school property taxes by more than 50 percent and eliminate school property taxes entirely for 30 percent of senior households. This budget will deliver $3.8 billion in school property tax relief – the largest property tax relief package in Pennsylvania's history. This plan makes common purpose with legislative supporters of Senate Bill 76 and similar proposals that fund property tax relief using a combination of personal income tax and sales tax increases. Our personal income tax proposal increases the tax rate from 3.07 percent to 3.7 percent, which will be the third-lowest rate of all states with a personal income tax and remains significantly lower than all of our neighboring states. Personal income tax revenues will be transferred to the Property Tax Relief Fund to create a reserve and manage the cash flow required to provide the school property tax relief in October 2016. The personal income tax proposal also extends special poverty tax forgiveness to more struggling families. Under the tax forgiveness expansion, a family of four making up to $36,400, or about 150 percent of the poverty level, will pay no state personal income tax. Pennsylvania will continue to provide one of the highest thresholds on which state personal income tax is imposed on a family of four, as reported by the Center on Budget and Policy Priorities.

In addition to the comprehensive property tax relief, the budget appropriately shifts school funding responsibility back to a shared responsibility between state government and school districts by increasing state funding to 50 percent of the cost of education. Governor Wolf has proposed a natural gas severance tax to increase education funding. Pennsylvania is the only state in the U.S. that is home to abundant natural gas resources but doesn't impose a tax on those resources. Governor Wolf's proposal – a tax of 5 percent on the value of the gas, plus 4.7 cents per thousand cubic feet of gas extracted – was modelled after the severance tax in West Virginia, a state that has proved a reasonable severance tax and a thriving natural gas industry can coexist. This tax would raise over $1 million annually while preserving funding currently delivered through the impact fee, protecting property owners who lease their land to gas developers, and ensuring appropriate environmental protections. But most importantly, the Education Reinvestment Act would dedicate the majority of revenue from the severance tax to Pennsylvania's schools and an education system that has suffered long enough from cuts that increased class sizes, shrank teaching staffs and forced schools to eliminate programming critical to our children's development. Governor Wolf's severance tax is a common sense approach that capitalizes on Pennsylvania's fortune in sitting atop one of the largest natural gas deposits in the world and transforms that abundant resource into better educations for our children, another resource on which Pennsylvania's future will depend.

Sales tax changes to fund significant and sweeping property tax reform include increasing the state tax rate from 6 percent to 6.6 percent and broadening the tax base. Importantly, Governor Wolf's proposal retains sales tax exemptions for food, clothing and prescription drugs, to protect our most vulnerable residents. Many of the items that would become subject to sales tax under this proposal – such as basic television, amusement and recreation, and candy and gum – are already taxed in other states. Further, the imposition of sales tax on services like legal, accounting, and personal care acknowledges the growing shift to a services-based economy. A portion of sales tax revenues will be transferred to a restricted receipt account to pay the actuarial required contribution to the Public School Employees Retirement System, putting the commonwealth on a trajectory to consistently meet its obligation to school district employees, instead of kicking the can down the road while a large unfunded liability grows.

Governor Wolf's budget focuses on three priorities that will help rebuild the middle class and set the stage for Pennsylvania's economic renaissance: jobs that pay, schools that teach and government that works. The tax and revenue proposals within the budget serve each of these important goals, and I look forward to working with legislators in the weeks and months ahead to achieve a budget that will enable new solutions for longstanding challenges to Pennsylvania's progress. I thank the committee for the opportunity to offer this testimony, and my colleagues and I look forward to addressing your questions.