

Testimony before the House Appropriations Committee
Dan Hassell, Secretary
Department of Revenue
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Chairman Saylor, Chairman Bradford, and members of the committee, thank you for the opportunity to meet with you today to discuss the budget for the Pennsylvania Department of Revenue. I am Dan Hassell, Secretary for the Department. Joining me today are Amy Gill, Deputy Secretary for Tax Policy, Christin Heidingsfelder, Deputy Secretary for Administration, and Drew Svitko, Executive Director of the Pennsylvania Lottery.

As you know, for more than 90 years the Department of Revenue has been the Commonwealth agency tasked with collecting and distributing all tax monies due to the Commonwealth. We take great pride in the fact that our daily work funds the vital programs and services that are essential to all Pennsylvanians.

The Department also administers the Pennsylvania Lottery, which was established in the early 1970s to generate funding for programs that benefit older Pennsylvanians. Last fiscal year the Lottery sold a record of more than \$4.2 billion in games, from which it paid a record of more than \$2.7 billion in prizes to winners. This great work helped the Lottery generate more than \$1 billion to benefit older Pennsylvanians. It was the seventh consecutive year the Lottery eclipsed this benchmark.

We are proud of this work and are continuing our efforts to find ways to become more efficient and improve services for Pennsylvanians. The Department established several goals in its strategic plan that are designed to improve customer service, enhance our effectiveness in tax compliance and continue boosting sales and net profits for the Lottery.

Setting these goals has greatly helped the Department in its objective to be a leading tax administration and public service agency known for its customer service, integrity, innovation and effectiveness. Please allow me to share with you an overview of several initiatives the Department is working on.

Modernization project

For many years, the Department has been working to update its technology and computer systems to replace several legacy tax systems that have been in use at the Department for many decades.

Late last month, the Department took a big step in its modernization project by successfully launching PATH, which stands for Pennsylvania Tax Hub. This is a new, intuitive online system that will be a great benefit for taxpayers.

As part of this project, the department implemented GenTax, a commercial, off-the-shelf tax administration solution from Fast Enterprises, LLC, which included implementation of Fast's solution for taxpayer self-service over the internet. The Department's version of this portal is myPATH, which launched on Feb. 4 for certain taxpayers.

As part of a first rollout, this system is now available for the International Fuel Tax Agreement (IFTA), Motor Carrier Road Tax (MCRT), Motor Fuel Tax, Alternative Fuels Tax and PA Fuel Transporter. This user-friendly system allows certain taxpayers to register, renew, file returns, pay balances and manage their accounts online in a way that was not possible before. The launch of this system on time and on budget is an important milestone for the Department as we work to update and replace many of our legacy tax systems that have become obsolete.

This first rollout of the taxes paid through the Department's Bureau of Motor and Alternative Fuel Taxes is only the start. Work has begun on a second rollout that will bring the Realty Transfer Tax and the Inheritance Tax to the new online system, improving the customer experience for those taxpayers.

Ultimately, the Department will embark upon a third rollout that will allow Pennsylvanians to use myPATH for their Personal Income Tax returns and Property Tax/Rent Rebate applications. This will be a major benefit for our customers. We will have a better system that will allow them to seamlessly file their tax returns and PTRR applications, receive refunds and rebates faster and access more information online.

Moreover, PATH will increase efficiency, reduce risk of system failure, facilitate improved tax collection, reduce administrative costs and allow the Department to respond more quickly to ever-changing tax laws while improving overall taxpayer service.

Transformation plan and focus on Lean

In addition to the ongoing modernization project, we have also implemented a transformation plan at the Department that focuses on the reorganization of the Department's business tax bureaus to better align our functions and create an improved customer experience for our business taxpayers.

In late November, we informed Department staff that we have identified an initial transformation strategy. It will start with a realignment of the Bureau of Business Trust Fund Taxes (BTFT) and the Bureau of Corporation Taxes (BCT). Those bureaus will become three new bureaus — the Bureau of Business Tax Returns Processing, the Bureau of Business Taxpayer Accounting and the Bureau of Taxation Support. Meanwhile, the Department's Tax Registration Office will be rebranded as the Bureau of Taxpayer Management.

This restructuring will take place over the course of the next several months, with the goal of the new bureaus officially standing up in summer 2019. We shared this plan with staff at a town hall

meeting in early December, and many employees have volunteered to join a focus group that will help the Department's executive staff gather valuable feedback and ideas from those working in our business tax bureaus.

As this work is ongoing, the Department has taken Governor Wolf's direction and made a commitment to embracing the Lean concept, which is designed to help all employees look at how their current work processes can be improved. This concept allows employees to engage with one another and devise strategies for making small and incremental improvements in various aspects of their jobs.

I am pleased to share as of mid-January nearly half of the Department's employees have attended Lean Awareness training, and that several Lean projects are under way throughout the Department. We will continue working to bring this concept to all bureaus within our Department, and we will continue to engage the Governor's Office of Performance Through Excellence to identify new strategies that can help us become more efficient and provide better customer service.

Marketplace Sales legislation/Impact of *South Dakota v. Wayfair*

With the signing of Act 43 of 2017 by Governor Wolf, the Commonwealth became one of a handful of states across the nation to establish requirements for online marketplaces selling products to Pennsylvania consumers. The legislation was intended to improve Sales and Use Tax collection on internet sales. The Department worked with many operators of online marketplaces to help them understand the law, register with the Department and comply with the law's requirements.

I can now report that Act 43-2017 has been very successful in bringing remote sellers into compliance with Pennsylvania sales tax duties, and that it has had a significant impact on collections. The Department estimates the revenue from the marketplace sales requirements in Act 43-2017 to be \$111.5 million from May 2018 through December 2018. We expect collections from this source to approach \$200 million by the end of the fiscal year.

The landscape for online marketplaces also changed further in June 2018 when the U.S. Supreme Court issued an opinion in *South Dakota v. Wayfair*. The opinion overturned the court's previous ruling in *Quill Corp v. North Dakota*, which required a business to have a physical presence in a state in order for the business to be required to collect that state's sales tax.

Read in conjunction with Pennsylvania's Tax Reform Code, the Supreme Court's decision in the *Wayfair* case creates an economic nexus for certain sellers of products in Pennsylvania, where previously, nexus existed only for those with a physical presence in the Commonwealth.

Because Pennsylvania law includes a reference to the federal nexus standard established by the US Supreme Court, the Department issued a tax bulletin outlining the Supreme Court's decision

and explaining that Pennsylvania's sales tax nexus has been expanded to include businesses making at least \$100,000 in annual Pennsylvania gross sales.

The Department plans to work with service providers who are certified under the Streamlined Sales Tax system to offer software and services to aid in the registration, collection, reporting and remittance of Pennsylvania sales tax by July 1, 2019. This will make it easier for certain individuals and businesses selling products on their own websites to Pennsylvania customers to comply with their PA sales tax obligations, and further extend the Department's ability to collect all of the sales tax that is due.

Lottery request for margin relief and success of new products

As noted earlier in my testimony, the Lottery is coming off a record year of sales. It continues to be the only state lottery that designates all of its proceeds to programs that benefit older Pennsylvanians.

To continue meeting this goal and protect the Lottery Fund, the Lottery is seeking to eliminate the profit percentage requirement in Pennsylvania law that requires it to return 25 percent in net profits on games sold at retail. Full relief from the minimum return rate will allow the Lottery to return the maximum amount of profit dollars to the Lottery fund, whereas the current requirement to return an artificial percentage could in fact constrain lottery sales growth.

Many other state lotteries do not have a profit percentage requirement. Having this margin relief here would allow the Pennsylvania Lottery to meet the consumer demand for higher price point games that help us meet our sales and profit goals.

Meanwhile, it should be noted that the Lottery recently launched several new products that were authorized by Act 42-2017 in an effort to remain competitive in a rapidly changing business environment.

Last year the Lottery debuted iLottery, which are games purchased and played online or through a mobile device. More than 90,000 unique players have registered to play iLottery. We anticipate that iLottery will generate \$30 million in profit in the 2018-19 Fiscal Year, which is helping the Lottery remain competitive and fulfill its mission of benefiting older Pennsylvanians every day.

The iLottery games are similar to those offered in other states. Like popular scratch-off games, they offer players within Pennsylvania's borders the chance to win instantly. To promote responsible play, players have the option to set play and deposit limits, set "cool off" periods, and — should they wish — self-exclude from playing for 1 or 5 years.

The Lottery also took a big step forward with the launch last year of monitor-based games, including Keno and Xpress Sports, which are popular in bars, taverns and existing Lottery retailers.

Keno is drawn at random from among the numbers 1 to 80. Players try to match up to 10 numbers (known as SPOTS) per draw. The more SPOTS players match, the more they can win. An animated depiction of the computerized drawing is shown on a monitor, although the game can be played without watching a monitor. Drawings will be held every four minutes.

Xpress Sports are fast-paced games that simulate your favorite sports. Players make their selections using a playslip, then watch the big screen to see an ultra-realistic animated depiction of the random drawing. It's like having a front row seat at a sporting event to enjoy all the action.

We anticipate that monitor-based games will generate about \$9 million in profit in the 2018-19 Fiscal Year.

Governor Wolf budget initiatives

Governor Wolf is proposing to fund the budget with a revenue package that will make Pennsylvania more competitive and level the playing field for taxpayers.

Governor Wolf is proposing a thorough overhaul of the way Pennsylvania taxes corporations. The proposal will dramatically improve the competitiveness of the commonwealth's economy with a lower tax rate. Meanwhile, it will level the playing field for all businesses with combined reporting. Both proposals will help Pennsylvania become a more attractive place to do business.

The Governor's plan will phase down the corporate tax rate from the current 9.99 percent rate, the second highest in the nation. The tax rate will be set at 8.99 percent in 2020, 8.29 percent in 2021, 7.49 percent in 2022 and 6.99 percent in 2023 and 5.99 percent in 2024. This will make it easier to attract business development that is turned away by the "sticker shock" of the current 9.99 percent tax rate.

At the same time, the Governor is proposing that combined reporting be required for taxpayers who are part of a controlled group of corporations. Under current law, each separate corporation reports Pennsylvania tax on its own income, even if it is part of a larger corporate group. This allows certain corporations to shelter income from tax with Delaware holding companies and similar inter-company transactions within the group.

Under combined reporting, corporations in a group will figure their income for the entire group, and each separate company owes tax on a share of the group income. Transactions between members of the group are eliminated, making it harder to shelter corporate income from state taxation.

In closing, I look forward to working with each of you in the weeks ahead. Thank you for the opportunity to provide testimony on behalf of the Department of Revenue and the Pennsylvania Lottery. My colleagues and I look forward to answering your questions.