

# Pennsylvania Fiscal Update



CompetePA Retreat

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# Economy, Revenues and Budget

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## Pennsylvania economic growth rates or change

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Real Gross Domestic Product	2.3%	0.6%	2.0%	2.3%
Wages and Salaries	4.1%	1.3%	3.9%	4.3%
Philadelphia CPI-U	-0.1%	0.6%	1.3%	2.3%
Average Net Job Gains (000s)	46.7	52.2	60.4	61.8
Home Price Index	2.5%	4.1%	4.4%	4.0%

## Tax revenues exceed estimate through February (+\$135 million)

- Strong acceleration of estimated income tax payments in Dec-Jan (+33%)
- Mini-casino license auctions strong (+\$90 million), inheritance collections above estimate (+\$30 million)
- Significant revenue uncertainty for remainder of fiscal year

## Longer-term budget outlook remains challenging under current law

- FY 2017-18: modest surplus if \$200 million Joint Underwriter's Association transfer received
- FY 2018-19: potential deficit of \$300 to \$500 million (excludes proposed severance tax)
- Future years: potential deficits likely grow due to aging population, rising interest rates and modest revenue growth

# Impact of Federal Tax Reform on Pennsylvania

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## Anticipate large increase in PA disposable income for FY 2018-19

- US personal income tax cut: \$189 billion (Joint Committee on Taxation)
  - i. PA share is roughly 3.5% or \$6.6 billion
- US corporate income tax cut: \$91 billion (Joint Committee on Taxation)
  - i. Unclear what corporations will do with tax cut
  - ii. Could add another \$1 billion to PA disposable income
- There are ~5.0 million PA households in 2018: ~\$1,500 per household

## Corporate net income tax

- Expansion of state corporate income tax base adds ~\$160 million next year
  - i. Eliminate Section 199 deduction, limit interest deduction
  - ii. Any repatriation impact on tax base?
- Rate cut raises Pennsylvania effective tax rate from 6.5% to 7.9% (see table)

## Sales and use tax

- How quickly does new consumer spending occur?
- Increases revenues by \$60 to \$80 million in FY 2018-19

## Personal income tax

- Higher dividends and capital gains, impact should be immediate
- Smaller impact: wages also increase directly and indirectly

## Miscellaneous issues

- Static vs. dynamic revenue impact
- Most non-financial business activity in Pennsylvania is non-corporate

# Federal 100% Bonus Depreciation

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## Policy has a significant impact on total U.S. tax deductions claimed

- 100% federal bonus depreciation deductions 2011 (C corps only) \$340 billion
- Less: "normal" depreciation deductions that would be claimed -\$56 billion
- Equals: additional depreciation deductions \$284 billion

## IFO revenue impact estimates for FY 2017-18 + FY 2018-19

- Revenue impact of 100% federal bonus depreciation conformity -\$550 million
- Revenue impact of Corporate Tax Bulletin 2017-02 \$200 million

## Overlooked – Section 179 expensing

- Threshold increases from \$500,000 to \$1 million
- Now largely a permanent part of tax code; has bipartisan support
- Number of firms claiming (federal tax form, 2014)

	<u>Section 179</u>	<u>50% Bonus</u>
i. C corporations	244,200	131,600
ii. S corporations	945,900	408,300
iii. Partnerships	296,200	354,900
iv. Sole proprietors, farmers, rental	4,403,000	1,551,700

## Concerns expressed by policymakers

- How do we replace the lost revenues if we conform to federal tax law?
- Will PA be left behind if we don't conform?
- Will investment be routed somewhere else?

# Business Tax Climate and Other Rankings

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**All tax rankings are imperfect because they cannot reflect all aspects of the state tax system**

- Many are subjective and reflect tax policy goals
- A tax-friendly business climate need not translate to economic growth
- Some rankings are incomplete and certain taxes may be omitted: severance tax, gaming taxes

**Tax Foundation: state business tax climate index (see table)**

- Not a computation; subjective index that uses numerous metrics
- States receive highest rank if tax is not levied; severance taxes excluded
- WY, SD and AK rank high due to reliance on severance tax
- Index penalizes progressivity and stability; significant weight on income tax, much less on property

**COST: total effective business tax rate (TEBTR) (not shown)**

- TEBTR: total taxes paid by business / private gross domestic product
- PA ranks 26<sup>th</sup> in TEBTR (4.6%)
- Business taxes only; some very difficult to quantify (e.g., sales)
- Cannot control for tax exporting and tax incidence (bears the true burden of the tax)

**Independent Fiscal Office: state effective tax rate (see table)**

- Total state and local taxes / modified state personal income
- Could also compute on a per capita basis
- Cannot control for tax exporting and tax incidence
- Computation with and without severance tax

## State Corporate Net Income Tax Rates - 2018

	<u>Tax Rate</u>	<u>Rank</u>	<u>Old ETR</u>	<u>New ETR</u>	<u>Diff w/ PA</u>
Iowa	12.00%	1	7.80%	9.48%	1.59%
<b>Pennsylvania</b>	<b>9.99%</b>	<b>2</b>	<b>6.49%</b>	<b>7.89%</b>	<b>0.00%</b>
Minnesota	9.80%	3	6.37%	7.74%	-0.15%
Illinois	9.50%	4	6.18%	7.51%	-0.39%
Alaska	9.40%	5	6.11%	7.43%	-0.47%
New Jersey	9.00%	6	5.85%	7.11%	-0.78%
Maine	8.93%	7	5.80%	7.05%	-0.84%
California	8.84%	8	5.75%	6.98%	-0.91%
Delaware	8.70%	9	5.66%	6.87%	-1.02%
Vermont	8.50%	10	5.53%	6.72%	-1.18%
Connecticut	8.25%	11	5.36%	6.52%	-1.37%
Maryland	8.25%	11	5.36%	6.52%	-1.37%
New Hampshire	8.20%	13	5.33%	6.48%	-1.41%
Louisiana	8.00%	14	5.20%	6.32%	-1.57%
Massachusetts	8.00%	14	5.20%	6.32%	-1.57%
Wisconsin	7.90%	16	5.14%	6.24%	-1.65%
Nebraska	7.81%	17	5.08%	6.17%	-1.72%
Oregon	7.60%	18	4.94%	6.00%	-1.89%
Idaho	7.40%	19	4.81%	5.85%	-2.05%
Kansas	7.00%	20	4.55%	5.53%	-2.36%
Rhode Island	7.00%	20	4.55%	5.53%	-2.36%
Montana	6.75%	22	4.39%	5.33%	-2.56%
Alabama	6.50%	23	4.23%	5.14%	-2.76%
Arkansas	6.50%	23	4.23%	5.14%	-2.76%
New York	6.50%	23	4.23%	5.14%	-2.76%
Tennessee	6.50%	23	4.23%	5.14%	-2.76%
West Virginia	6.50%	23	4.23%	5.14%	-2.76%
Hawaii	6.40%	28	4.16%	5.06%	-2.84%
Indiana	6.25%	29	4.06%	4.94%	-2.95%
Missouri	6.25%	29	4.06%	4.94%	-2.95%
Georgia	6.00%	31	3.90%	4.74%	-3.15%
Kentucky	6.00%	31	3.90%	4.74%	-3.15%
Michigan	6.00%	31	3.90%	4.74%	-3.15%
Oklahoma	6.00%	31	3.90%	4.74%	-3.15%
Virginia	6.00%	31	3.90%	4.74%	-3.15%
New Mexico	5.90%	36	3.84%	4.66%	-3.23%
Florida	5.50%	37	3.58%	4.35%	-3.55%
Mississippi	5.00%	38	3.25%	3.95%	-3.94%
South Carolina	5.00%	38	3.25%	3.95%	-3.94%
Utah	5.00%	38	3.25%	3.95%	-3.94%
Arizona	4.90%	41	3.19%	3.87%	-4.02%
Colorado	4.63%	42	3.01%	3.66%	-4.23%
North Dakota	4.31%	43	2.80%	3.40%	-4.49%
North Carolina	3.00%	44	1.95%	2.37%	-5.52%

Note: Nevada, Ohio, South Dakota, Texas, Washington and Wyoming do not levy a corporate net income tax. ETR is the effective tax rate after allowing for the deductibility of state income tax on federal tax returns.

Source: Tax Foundation, "State Corporate Income Tax Rates and Brackets for 2018" (February 2018).

## 2018 State Business Tax Climate Index Ranks (Tax Foundation)

	<u>Overall</u>	<u>Corp Inc</u>	<u>Indiv Inc</u>	<u>Sales</u>	<u>Unemp Ins</u>	<u>Property</u>
Alabama	35	22	22	49	11	12
Alaska	3	26	1	5	25	38
Arizona	21	13	18	47	15	6
Arkansas	39	39	30	44	32	22
California	48	32	50	41	13	13
Colorado	18	18	15	39	35	14
Connecticut	44	31	37	27	19	49
Delaware	15	50	34	1	3	20
Florida	4	19	1	29	2	10
Georgia	36	10	42	28	38	23
Hawaii	27	14	31	23	27	16
Idaho	20	25	23	26	46	3
Illinois	29	36	16	35	42	45
Indiana	9	23	10	9	10	4
Iowa	40	48	33	19	34	39
Kansas	23	38	19	31	12	19
Kentucky	33	27	29	14	47	36
Louisiana	42	40	27	50	4	30
Maine	28	41	26	8	44	41
Maryland	43	20	46	18	24	42
Massachusetts	22	35	12	12	49	46
Michigan	12	8	14	11	48	21
Minnesota	46	43	45	25	37	28
Mississippi	24	11	20	38	5	35
Missouri	16	5	28	24	7	7
Montana	6	12	21	3	20	9
Nebraska	25	28	24	13	9	40
Nevada	5	33	1	42	45	8
New Hampshire	7	45	9	2	43	44
New Jersey	50	42	48	46	36	50
New Mexico	34	24	35	40	16	1
New York	49	7	49	43	30	47
North Carolina	11	3	13	20	6	32
North Dakota	30	16	36	34	14	2
Ohio	45	47	47	30	8	11
Oklahoma	32	9	38	36	1	15
Oregon	10	34	32	4	31	18
<b>Pennsylvania</b>	<b>26</b>	<b>44</b>	<b>17</b>	<b>21</b>	<b>50</b>	<b>33</b>
Rhode Island	41	30	39	22	23	43
South Carolina	37	15	41	32	29	24
South Dakota	2	1	1	33	39	25
Tennessee	14	21	8	45	22	29
Texas	13	49	6	37	26	37
Utah	8	4	11	17	21	5
Vermont	47	37	44	16	18	48
Virginia	31	6	40	10	41	31
Washington	17	46	6	48	17	27
West Virginia	19	17	25	15	28	17
Wisconsin	38	29	43	7	40	26
Wyoming	1	1	1	6	33	34

Note: A rank of 1 is best, 50 is worst. Rankings do not average to the total. States without a tax rank equally as 1. The report shows tax systems as of July 1, 2017 (FY 2017-18). These data are shown for informational purposes only, and has not been verified by the IFO. Source: Tax Foundation, "2018 State Business Tax Climate Index" (October 2017).



## State and Local Tax Rankings and Effective Tax Rates (IFO)

	<u>Total Taxes</u>		<u>Corporate Net</u>		<u>Personal Income</u>		<u>Sales-Use</u>		<u>Property Tax</u>		<u>Motor Tax</u>		<u>All Other</u>	
	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio
New York	1	15.53%	3	0.98%	1	5.03%	20	2.69%	6	4.63%	48	0.28%	7	1.90%
Hawaii	2	12.83%	43	0.16%	8	3.17%	1	4.74%	41	2.29%	3	0.81%	12	1.66%
Maine	3	12.28%	32	0.26%	15	2.75%	28	2.46%	4	4.83%	11	0.65%	17	1.34%
Vermont	4	12.23%	21	0.34%	26	2.41%	45	1.30%	2	5.33%	27	0.52%	3	2.32%
Minnesota	5	11.98%	9	0.54%	4	3.84%	36	2.09%	20	3.01%	16	0.61%	8	1.89%
Rhode Island	6	11.93%	27	0.29%	27	2.39%	37	2.08%	5	4.78%	49	0.27%	4	2.13%
New Jersey	7	11.37%	13	0.47%	23	2.51%	40	1.93%	3	5.17%	50	0.24%	34	1.05%
Maryland	8	11.29%	19	0.38%	3	4.08%	42	1.57%	26	2.85%	35	0.47%	6	1.94%
Iowa	9	11.08%	23	0.30%	19	2.63%	21	2.68%	16	3.53%	1	0.96%	37	0.98%
Illinois	10	11.07%	6	0.57%	32	2.10%	25	2.52%	9	4.09%	31	0.52%	20	1.27%
California	11	11.06%	12	0.47%	5	3.81%	23	2.58%	29	2.69%	38	0.44%	30	1.07%
West Virginia	12	10.82%	37	0.22%	14	2.76%	34	2.17%	36	2.45%	6	0.74%	2	2.47%
Delaware	13	10.74%	1	3.61%	18	2.65%	48	0.14%	48	1.83%	40	0.42%	5	2.10%
Nebraska	14	10.55%	20	0.35%	24	2.46%	26	2.49%	10	3.93%	17	0.60%	49	0.71%
Connecticut	15	10.53%	24	0.30%	9	3.07%	41	1.64%	8	4.15%	46	0.30%	31	1.07%
Wisconsin	16	10.53%	17	0.38%	13	2.85%	33	2.20%	14	3.55%	18	0.60%	39	0.95%
Mississippi	17	10.48%	5	0.59%	37	1.75%	10	3.28%	27	2.83%	15	0.61%	15	1.42%
Massachusetts	18	10.46%	7	0.55%	6	3.38%	43	1.43%	13	3.60%	45	0.31%	25	1.18%
<b>Pennsylvania</b>	<b>19</b>	<b>10.42%</b>	<b>11</b>	<b>0.48%</b>	<b>17</b>	<b>2.66%</b>	<b>39</b>	<b>1.97%</b>	<b>21</b>	<b>3.00%</b>	<b>13</b>	<b>0.62%</b>	<b>11</b>	<b>1.70%</b>
Ohio	20	10.41%	45	0.11%	20	2.58%	13	3.10%	24	2.92%	23	0.56%	26	1.15%
Oregon	21	10.41%	16	0.40%	2	4.23%	47	0.20%	19	3.11%	14	0.62%	9	1.85%
Arkansas	22	10.40%	14	0.42%	25	2.45%	3	4.01%	47	1.86%	20	0.59%	32	1.07%
Kentucky	23	10.10%	10	0.52%	7	3.32%	32	2.29%	45	2.06%	19	0.59%	18	1.32%
Utah	24	9.75%	28	0.29%	11	2.92%	22	2.61%	34	2.53%	25	0.54%	43	0.87%
North Carolina	25	9.71%	15	0.41%	10	2.94%	29	2.40%	39	2.33%	9	0.70%	41	0.93%
Kansas	26	9.71%	22	0.31%	38	1.67%	9	3.31%	18	3.14%	24	0.54%	47	0.73%
New Mexico	27	9.59%	41	0.18%	35	1.78%	4	3.98%	46	2.03%	12	0.64%	36	0.98%
Michigan	28	9.57%	39	0.21%	30	2.28%	35	2.15%	17	3.20%	32	0.50%	24	1.22%
Indiana	29	9.41%	18	0.38%	29	2.35%	17	2.78%	38	2.36%	28	0.52%	35	1.02%
Georgia	30	9.41%	34	0.25%	21	2.54%	30	2.38%	28	2.82%	29	0.52%	42	0.89%

## State and Local Tax Rankings and Effective Tax Rates (IFO)

	<u>Total Taxes</u>		<u>Corporate Net</u>		<u>Personal Income</u>		<u>Sales-Use</u>		<u>Property Tax</u>		<u>Motor Tax</u>		<u>All Other</u>	
	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio	Rank	Ratio
Washington	31	9.39%	50	0.01%	49	0.00%	2	4.69%	30	2.65%	21	0.58%	14	1.46%
Idaho	32	9.28%	25	0.30%	28	2.36%	27	2.48%	35	2.47%	2	0.83%	44	0.85%
Louisiana	33	9.13%	44	0.14%	39	1.47%	5	3.89%	43	2.09%	42	0.40%	27	1.13%
Virginia	34	9.11%	40	0.19%	12	2.88%	44	1.39%	22	3.00%	43	0.39%	21	1.26%
New Hampshire	35	9.06%	2	1.05%	42	0.12%	50	0.08%	1	5.61%	44	0.37%	10	1.83%
Arizona	36	8.99%	38	0.22%	40	1.45%	6	3.55%	33	2.62%	39	0.43%	48	0.72%
Missouri	37	8.96%	42	0.17%	22	2.52%	24	2.53%	37	2.37%	41	0.41%	38	0.97%
South Carolina	38	8.96%	29	0.28%	33	2.04%	38	2.02%	25	2.91%	36	0.47%	23	1.24%
Colorado	39	8.77%	36	0.23%	31	2.27%	31	2.38%	31	2.64%	37	0.45%	45	0.81%
Montana	40	8.64%	30	0.28%	16	2.67%	49	0.10%	15	3.54%	5	0.78%	19	1.27%
Texas	41	8.61%	49	0.01%	48	0.00%	11	3.27%	12	3.75%	33	0.49%	28	1.09%
South Dakota	42	8.60%	46	0.09%	47	0.00%	8	3.33%	23	2.94%	7	0.73%	13	1.51%
Alabama	43	8.42%	26	0.29%	34	1.97%	15	2.99%	50	1.44%	34	0.48%	22	1.25%
Nevada	44	8.39%	47	0.06%	46	0.00%	18	2.77%	42	2.24%	22	0.56%	1	2.77%
North Dakota	45	8.37%	33	0.26%	41	0.87%	12	3.21%	40	2.29%	4	0.80%	40	0.94%
Wyoming	46	8.28%	48	0.04%	50	0.00%	19	2.76%	7	4.24%	10	0.66%	50	0.58%
Tennessee	47	8.27%	4	0.84%	43	0.12%	7	3.39%	44	2.07%	30	0.52%	16	1.34%
Oklahoma	48	7.87%	35	0.23%	36	1.78%	16	2.82%	49	1.57%	8	0.72%	46	0.75%
Florida	49	7.52%	31	0.27%	45	0.00%	14	3.02%	32	2.62%	26	0.53%	29	1.09%
Alaska	50	6.30%	8	0.55%	44	0.00%	46	0.62%	11	3.79%	47	0.28%	33	1.06%

**U.S. Weighted Avg.**                      **10.28%**                      **0.39%**                      **2.42%**                      **2.58%**                      **3.16%**                      **0.49%**                      **1.25%**

**U.S. Unw. Avg.**                      **9.93%**                      **0.40%**                      **2.16%**                      **2.45%**                      **3.08%**                      **0.54%**                      **1.30%**

Note: Percentages are the ratio of state-local tax revenue to modified state personal income. Total Taxes excludes any severance tax. All Other category includes gaming, liquor, tobacco, inheritance, realty transfer and other miscellaneous taxes. The U.S. weighted average weights each state based on the relative magnitude of total taxes and income. The U.S. unweighted average gives each state the same weight.

Source: State and Local Taxes: A Comparison Across States, IFO (February 2018).