



## INDEPENDENT FISCAL OFFICE

September 30, 2019

The Honorable Francis X. Ryan  
Pennsylvania House of Representatives  
149A East Wing, Main Capitol Building  
Harrisburg, PA 17120

Dear Representative Ryan:

Thank you for your July 9<sup>th</sup> letter that requests the Independent Fiscal Office (IFO) to provide additional estimates related to House Bill 13. The IFO provides the enclosed table in response to that request. Please note the following:

- The estimates utilize the latest revenue forecast released by the IFO (June 21, 2019 and updated to reflect statutory changes that were enacted with the fiscal year 2019-20 state budget). They should be viewed as approximations only. The estimates do not incorporate effective dates or a compliance phase-in. In addition, the estimates are not reduced for administrative costs, which would likely be significant under this proposal.
- The estimates include the impact of changes in behavior and compliance at full implementation for each of the proposed tax rates.
- Your letter indicates that the additional sales and use tax (SUT) would be imposed at the local level, similar to the existing local SUT in Philadelphia and Allegheny counties. Unlike the state tax which is imposed at the point of use, the local taxes are imposed at the point of sale and only apply to purchases originating in those counties. Local tax is not collected on sales shipped into those counties by out of state (or out of county) sellers. Imposing the tax with the same local situs could materially reduce collections (5-10 percent). The projections included in the enclosed table assume the new SUT (including that imposed on food and clothing) is imposed at the state level.
- The SUT estimates assume that any increase in the SUT rate would coincide with a revenue neutral adjustment to the SUT transfers for public transportation. In other words, public transportation would not receive a funding windfall from an increase in the tax rate.
- The SUT estimates for clothing and food assume that the new 2% tax is only imposed on those items not subject to the current 6% tax.
- Your letter indicates that the additional personal income tax (PIT) would be collected at the local level, similar to the existing local earned income tax (EIT). The Department of Revenue devotes significant resources to ensuring compliance with PIT laws, including the matching of

state returns with federal tax data. Since local collectors lack these resources, imposing the tax at the local level would likely produce reduced collections. The PIT estimates included in the enclosed table are calculated using the current state tax base and assume that the tax would be collected at the state level.

- Under current Pennsylvania law, employee contributions to qualified retirement accounts are subject to PIT, but qualified distributions from those accounts (including employer contributions and earnings) are exempt from tax. If Pennsylvania were to impose PIT on retirement income (excluding Social Security), employee contributions already subject to tax under prior law would be deductible. Assuming that under the proposal, contributions to retirement accounts would now be exempt and distributions would be taxable (consistent with federal tax law), Pennsylvania would immediately lose the PIT paid on new employee contributions (tax is now delayed until retirement). These transition issues are incorporated into the Retirement Income forecast (see table) and will resolve slowly over the next 30-40 years.
- The value of the Retirement Exemption reflects the “pick-up” (in addition to the estimates under Retirement Income) if Pennsylvania adopted a hybrid approach to the imposition of tax on Retirement Income. That is, employee contributions would not qualify for exemption and distributions (net of employee contributions) would be subject to tax upon distribution at retirement. No other state imposes tax using this hybrid approach and most states follow federal law (contributions are deductible and distributions are subject to tax).

If you have any questions regarding the table or estimates provided, please do not hesitate to contact my office (717-230-8293). Per the policy of the IFO, this letter will be posted to the office website three days after transmittal to your office.

Sincerely,



Matthew Knittel  
Director, Independent Fiscal Office

### Options to Fund School District Property Tax Elimination

		2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
<b>Additional SUT<sup>1</sup></b>	1.50%	\$2,764	\$2,875	\$2,956	\$3,039	\$3,123	\$3,210
	2.00%	3,667	3,814	3,921	4,031	4,143	4,258
Food <sup>2</sup>	2.00%	580	590	599	611	623	636
Clothing <sup>3</sup>	2.00%	303	308	313	319	325	332
<b>Additional PIT<sup>4</sup></b>	1.85%	7,931	8,200	8,626	8,911	9,268	9,620
<b>Retirement Income<sup>5</sup></b>	4.92%	1,223	1,305	1,390	1,480	1,573	1,668
<i>State Share</i>	3.07%	763	814	868	923	982	1,041
<i>Local Share</i>	1.85%	460	491	523	556	592	627
<b>Retirement Exemption<sup>6</sup></b>	4.92%	723	726	729	732	736	739
<i>State Share</i>	3.07%	451	453	455	457	459	461
<i>Local Share</i>	1.85%	272	273	274	275	277	278

Note: in millions of dollars. Estimates are long-term and assume an effective date prior to FY 2018-19.

<sup>1</sup> New statewide SUT rates would be 7.5% or 8.0% respectively. The new rates for Philadelphia would be 9.5% or 10.0%. The new rates for Allegheny County would be 8.5% or 9.0%. Estimates are calculated using the current state SUT base. The existing local SUTs are point of sale taxes and are only imposed on sales originating in those counties. If the new tax is imposed with the same situs, tax collections will be materially lower (approximately 5-10 percent) because tax would not be collected on e-commerce purchases from out of state sellers. Estimates assume that all transfers from SUT are adjusted to a revenue neutral rate, i.e., special funds do not receive a windfall from the increased tax rate and are not reduced for Department of Revenue administrative costs.

<sup>2</sup> Excludes food purchased with Supplemental Nutrition Assistance Program (SNAP) and Women, Infants and Children (WIC) benefits. Assumes foods already subject to the 6% state tax are excluded.

<sup>3</sup> Assumes clothing and footwear already subject to the 6% state tax are excluded.

<sup>4</sup> New PIT tax of 1.85 percent calculated using the existing state PIT base. The Department of Revenue devotes significant resources to ensuring taxpayer compliance, including the matching of state returns with federal tax data. Since local collectors lack these resources, actual collections would likely be lower than the provided estimates by an unknown amount.

<sup>5</sup> Retirement income tax of 4.92 percent (3.07 percent state tax and 1.85 percent local) net of previously taxed employee contributions and excluding Social Security. Moving forward, assumes that all retirement income will be taxed upon distribution.

<sup>6</sup> Represents the "pick-up" (to the estimates under Retirement Income) if Pennsylvania adopts a hybrid approach to the imposition of tax on retirement income. No other state imposes tax on retirement income in this manner.