2017/18
BUDGET BRIEFING
Report on Key Issues
HOUSE APPROPRIATIONS COMMITTEE (D)
JOE MARKOSEK, DEMOCRATIC CHAIRMAN

# 2017/18 Tax Code Summary
## House Bill 542 Printer's Number 2259

We have worked hard to address the structural deficit over the past several years. Instead, missed opportunities and "kicking the can down the road" have exacerbated the problem, and we have reached a breaking point: raise revenues or dig ourselves into a deeper hole with credit downgrades.

This revenue proposal would rely, mostly, on a new gross receipts tax on natural gas consumption, increased gross receipts taxes on electric and telephone, a new severance tax, and a large amount of borrowing to be paid back over up to 30 years. Expanded gaming is also assumed but not contained in this bill.

The 2016/17 fiscal year ended with a $1.5 billion deficit; required expenditures continue to outpace projected revenues. Act 1A of 2017 became law July 11, 2017, and contained preferred General Fund Appropriations of $31.38 billion. This spending package, along with non-preferred appropriations bills (yet to be enacted), would leave a deficit of about $2.48 billion in 2017/18. House Bill 542 is triggered by the chronic structural deficit problem and the need for recurring revenue sources.

House Bill 542 proposes an estimated $520.2 million in net recurring revenue, as well as base revenues increasing by $40 million and authorization for Tobacco Settlement Fund bond securitization of up to $1.3 billion. The Governor's Budget Office would consider a bond issuance of about $1.255 billion.

Recurring revenues are necessary to balance the 2017/18 and the 2018/19 budgets. The new revenues in this bill would generate $630.4 million in 2018/19, which is necessary just to keep the lights on (funding-only mandated increases), according to estimates by the Governor's Budget Office.

In addition to this Tax Code bill, new revenue from expanded gaming would need to be enacted and realized for the budget to balance for the current and following years: $225 million in 2017/18 and $140 million in 2018/19 would be necessary.

### Gross Receipts Tax

- The return of the gross receipts tax on natural gas supply and distribution companies would be imposed at a rate of 57 mills (equivalent to 5.7 percent). A GRT on natural gas previously existed, but was exempted in 1999 with the deregulation of the natural gas industry. This GRT would generate $305.1 million in 2017/18.
- The GRT on telephone and transportation companies would be increased from 50 mills to 60 mills (equivalent to 6 percent).
- The GRT on electric distribution companies would increase from 59 mills to 65 mills (equivalent to 6.5 percent). The revenue increase from the GRT increase on electric, telecom and other is $140.7 million in 2017/18.

- Natural Gas Optimization Fund
    - This bill would establish a new fund that would provide an additional $20 million annually to the Low Income Home Energy Assistance Program, or LIHEAP, as authorized under the Human Services Code.
    - A new program would also provide $20 million annually for natural gas infrastructure improvements and expand access to natural gas in residential areas.

## Severance Tax and Environmental Regulations

- The tax code bill would establish a "volume differential tax" to which each producer subject to the current impact fee would be liable. The tax rates are listed in the table below and are levied per thousand cubic feet of gas (Mcf). For purposes of computing the tax, natural gas would be measured at the wellhead meter. For 2017/18, a $0.02/Mcf volume tax is assumed. For 2018/19, the tax is projected to be $0.025/Mcf.

| **Average Annual Price** | **Surcharge/Tax Rate - per Mcf** |
|---|---|
| $0-$2.25 | $0.015 |
| $2.26-$2.99 | $0.02 |
| $3.00-$4.99 | $0.025 |
| $5.00-$5.99 | $0.03 |
| $6.00- | $0.035 |

- This severance tax would be in addition to the current impact fee. If the impact fee results in less than $200 million in revenue, revenue from the severance tax would be deposited into the Unconventional Gas Well Fund to ensure at least $200 million is distributed the same way the impact fee is distributed. Remaining revenues would be deposited into the General Fund.
- An unconventional oil or gas well permit application that has not been denied by DEP within the applicable time period established for review would be deemed to be approved. If the review period is extended for cause, DEP would have to refund the application fee to the applicant.
- The Tax Code would create an Air Quality Permit Advisory Committee to review and approve (or disapprove) currently pending forms of permits for air quality plans for gas well operations.
- This proposal would also tie the validity of these two new requirements to the validity of the new severance tax though the use of a non-severability provision.
- Within one year, DEP is directed to contract with third-party licensed professionals to administer a permit review program which is to be partially funded by the application fees collected for the permit applications under review.

## Sales Tax

- Marketplace Providers – Would require websites that facilitate third party sales to collect and remit sales and use tax as if they were the vendor. This would affect online companies like eBay, Etsy and Amazon Marketplace. Estimated revenue is $43.5 million in 2017/18.

## Corporate Net Income Tax

- Net Operating Loss –The Net Operating Loss deduction today is 30 percent, or $5 million. A pending court case questions the uniformity of the two-part rate, and an appropriate fix is to eliminate the "or $5 million" option of the tax rate. This bill proposes a deduction of 35 percent for tax year 2018 and 40 percent for tax year 2019.

- This language would be dependent upon the outcome of the commonwealth's appeal to the case. Estimated revenue would be dependent upon the court ruling. If these changes go into effect, the revenue increase will be $52.6 million in 2017/18.

## Fireworks Tax

- This bill proposes a new 12 percent tax on consumer fireworks purchases. This new levy would be in addition to existing sales and use taxes. This tax would not apply to purchases of professional fireworks or fireworks for agricultural purposes. Estimated revenue is $2.8 million in 2017/18.
  - In addition to the proposed tax, numerous regulations and licensing requirements (with the Department of Agriculture) would be added that would affect businesses selling consumer fireworks and professional pyrotechnic display companies. Regulations would be added requiring municipalities to use professional, licensed operators for public fireworks displays.

## Electric Grid Virtual Transaction Tax

- This would be a new tax on the gross amount of virtual financial transactions in electricity markets and would apply to transactions at an electric grid regional transmission organization, PJM, which is based in Pennsylvania, in the day-ahead energy market. The tax would be imposed on the entity initiating the financial transaction at a rate of 5 percent of the gross transaction amount.
  - The Department of Revenue expects no new revenue resulting from this proposal based on estimates showing the tax would eliminate the profitability of such transactions and cause them to cease.

## Revenue Maximization

- This bill contains various methods proposed by the Department of Revenue to enhance and maximize revenue collections from current taxes. This is expected to generate approximately $40 million in 2017/18.

## Tobacco Revenue Bond Debt Service Account

- Orders the Commonwealth Financing Authority, if approved, to issue revenue bonds with a term not to exceed 30 years. This proposal is expected to raise $1.3 billion in net proceeds for the General Fund (amount can be increased with approval of CFA and budget secretary).
- Would stipulate that these bonds would only be paid by authorized revenues (tobacco settlement payments or other revenues earmarked for this purpose) and that they would not backed by the full faith and credit of the commonwealth and would not count against the CFA's debt limit.
- Tobacco Settlement payments and other general revenues, as authorized, would be deposited in a debt service account for payment of principal and interest on any bonds issued under this section. Tobacco payments deposited in the account would not be available to support the health-related programs that annually receive funding in accordance with appropriation percentages set forth in the Fiscal Code.
- The CFA could issue refunding bonds for the debt.

## Film Tax Credit

- This bill would allow the Department of Community and Economic Development to establish up to two film production tax credit districts. Districts must be at least 55 acres, located on a deteriorated property, and be occupied by a qualified business that would make a capital investment of at least $400 million within five years and contain at least one qualified production facility and six sound stages.
  - This new tax credit is in addition to the current cap of $65 million. A cap on the new credits is not established by the bill. The new credits take effect in 2019/20 and continue thereafter.

## Concert Rehearsal and Tour Tax Credit

- This bill would move the concert tour tax credit from Title 12 and return it to the Tax Code where it was originally established.

## Manufacturing Innovation and Reinvestment Deduction

- This would be a newly created deduction that would allow qualifying businesses to deduct five percent of their capital investment from their corporate net income tax liability if they invest at least $100 million in building or refurbishing a manufacturing facility. The deduction would be available to each qualifying business for five years and would not exceed 50 percent of the tax liability.

## Special Tax Zone Changes

- City Revitalization and Improvement Zones, or CRIZ, would allow excess funds in a pilot zone to be used for administrative costs.
    - Also would make changes to allow for the transfer of real estate parcels into or out of a CRIZ.
- Neighborhood Improvement Zone, or NIZ, would make changes to the appointment of board members. Three members would be appointed by the Senate Pro Tempore, three by the House member whose district includes a majority of the zone; and three by the mayor of the city where the zone is located.
    - Also would make changes to allow for the transfer of a real estate parcel out of a zone and replaced with a parcel the same size or smaller.

## Miscellaneous Provisions

- Help desk support would be excluded from the sales tax to clarify the digital download sales tax enacted in 2016.
- Beer kegs would be excluded from sales tax as part of the wrapping and packaging of supplies.
- PA ABLE account earnings and distributions would be exempt from all state and local tax.
- Would exempt veterans' service organizations chartered by Congress from the realty transfer tax.
- Inheritance tax clarification for the definition of timely filed returns.
- Would provide a prorated fee for partial day car sharing services as a clarification to the current vehicle rental fee.