

PENNSYLVANIA ILLUSTRATED

A VISUAL GUIDE TO TAXES & THE ECONOMY



Pennsylvania Business
Council Foundation

PENNSYLVANIA ILLUSTRATED

A VISUAL GUIDE TO TAXES & THE ECONOMY

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Introduction

Taxes are complicated. Each state's tax code is a multifaceted system with many moving parts, and Pennsylvania is no exception. This chart book aims to help readers understand Pennsylvania's overall economy and tax system from a broad perspective. It also provides detailed illustrations to each of Pennsylvania's major taxes—individual income taxes, business taxes, sales and excise taxes, and property taxes—to help make the complicated task of understanding the state's tax code a bit easier.

These charts were compiled by Tax Foundation staff and edited by Nicole Kaeding.

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CHAPTER 1

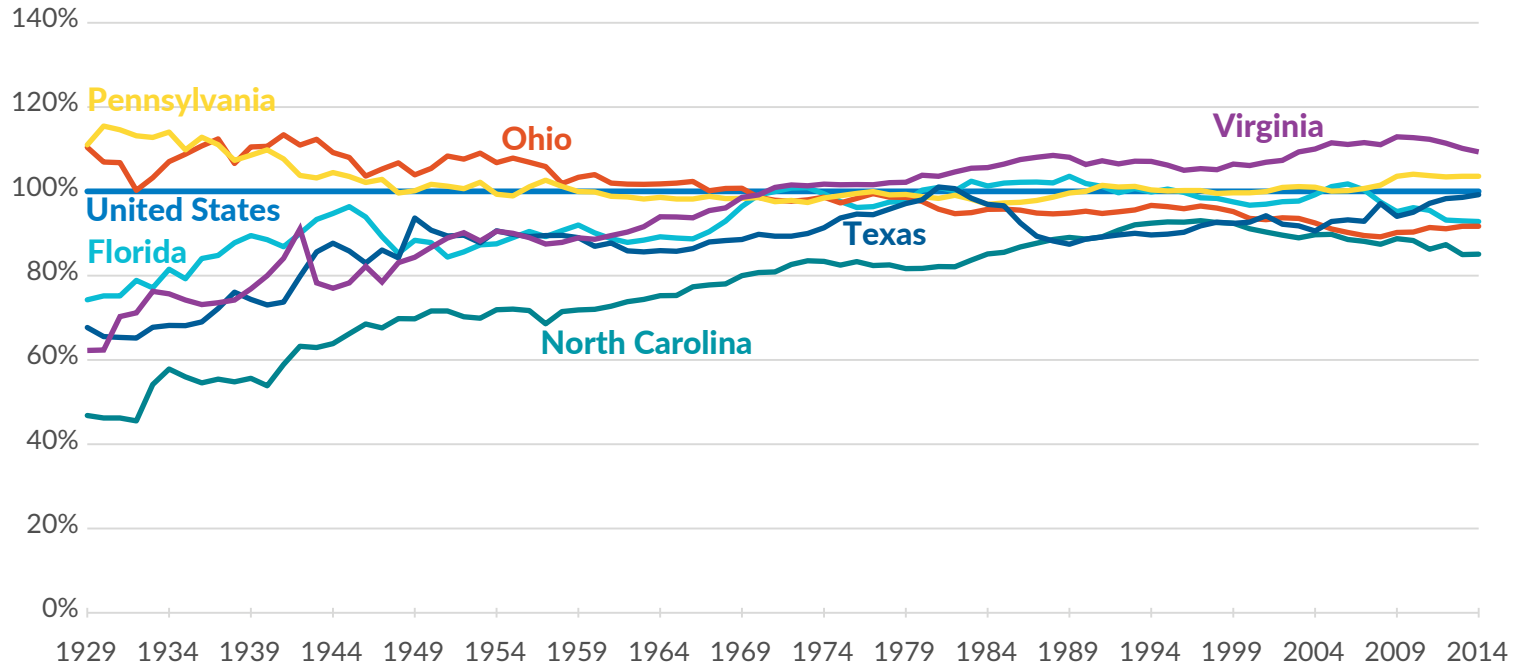
An Overview of the Pennsylvania Economy

The following charts illustrate the current and past performance of Pennsylvania's economy. We show how various economic indicators, such as personal income per capita, state gross domestic product, employment composition, migration, and unemployment, have changed over time. We compare Pennsylvania to five other states—Florida, North Carolina, Ohio, Texas, and Virginia—which compete with Pennsylvania for jobs and opportunity.



Pennsylvania's Income per Person Is Losing Ground to Its Peers

Personal Income per Capita as a Percent of the U.S. Level, Pennsylvania and Selected States (1929-2014)

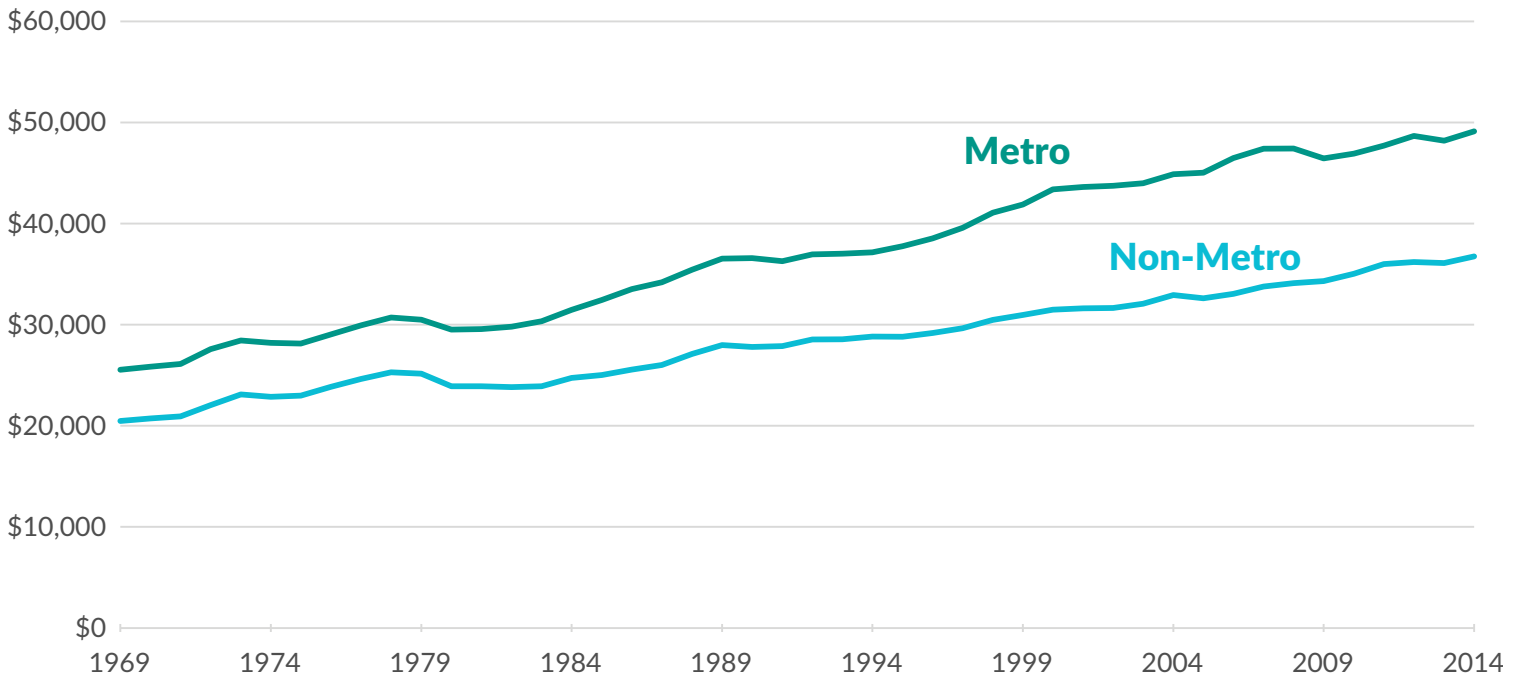


For much of the first half of the 20th Century, Pennsylvania's personal income per capita exceeded the national average. In 1929, Pennsylvania's personal income per capita was 110 percent of the U.S. level. By 1960, however, Pennsylvania lost ground and converged with the national average, staying roughly the same since then. Over the last several decades, many of Pennsylvania's peers have made up ground. For instance, North Carolina has increased its personal income per capita from 47 percent of the national average in 1929 to 85 percent in 2014, and Virginia has surpassed Pennsylvania, achieving personal income per capita at 110 percent of the national average.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Annual State Personal Income and Employment."

Pennsylvania's Metro Income Tends to Be Higher than Non-Metro Income

Personal Income per Capita, Metro and Non-Metro Pennsylvania (1969-2014)



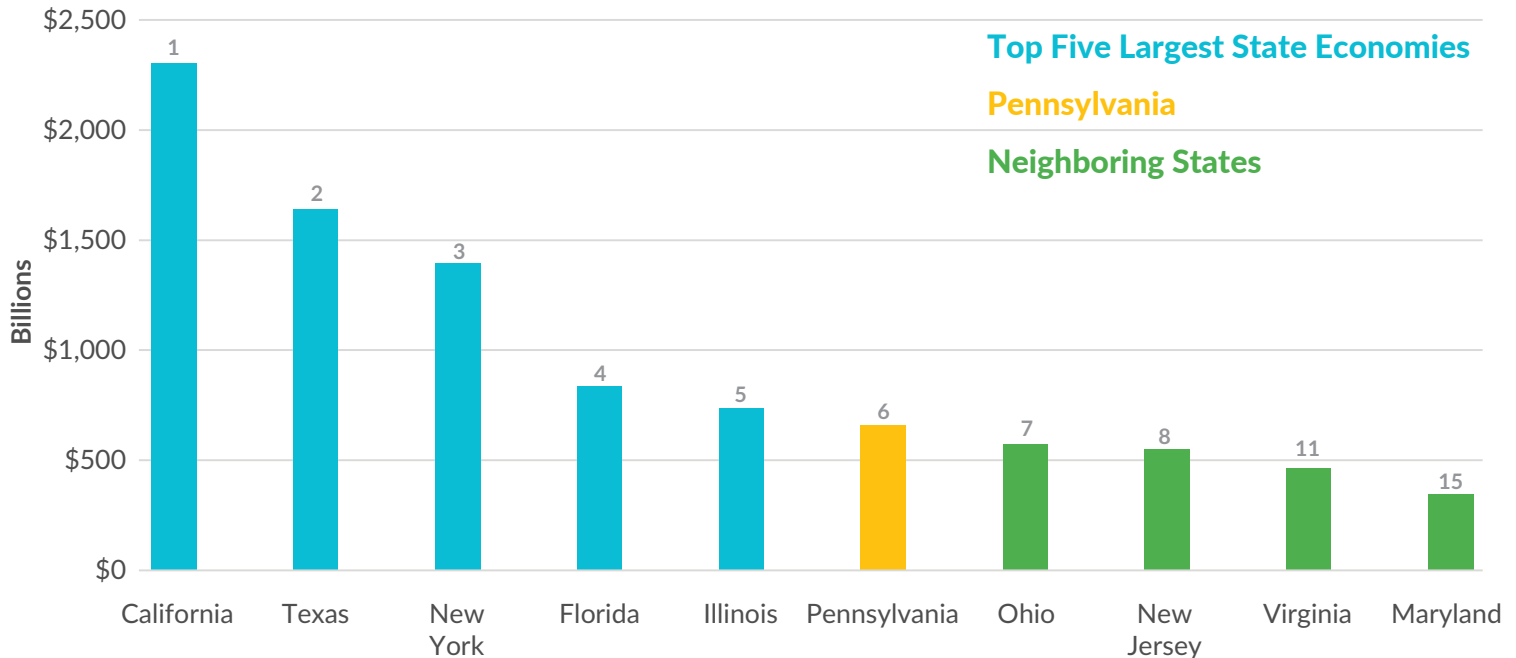
Personal income per capita is not uniform throughout Pennsylvania, with metro areas having consistently higher levels of personal income than non-metro areas. In 1969, personal income per capita in metro areas was \$25,444, compared to \$20,481 in non-metro areas. Since then, income in metro areas has grown at a faster rate than in non-metro areas, reaching \$49,119 in 2014, an increase of 92 percent. In comparison, non-metro-area income grew just 79 percent to \$36,749 in 2014. The disparity is likely a result of the differing industry composition between metro and non-metro Pennsylvania (see page 7).

Note: Counties designated by the Bureau of Economic Analysis as metropolitan are Adams, Allegheny, Armstrong, Beaver, Berks, Blair, Bucks, Butler, Cambria, Carbon, Centre, Chester, Columbia, Cumberland, Dauphin, Delaware, Erie, Fayette, Franklin, Lackawanna, Lancaster, Lebanon, Lehigh, Luzerne, Lycoming, Mercer, Monroe, Montgomery, Montour, Northampton, Perry, Philadelphia, Pike, Washington, Westmoreland, Wyoming, and York.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Local Area Personal Income and Employment."

Pennsylvania Has One of the Largest State Economies in the Nation

State Gross Domestic Product, Selected States (2014)

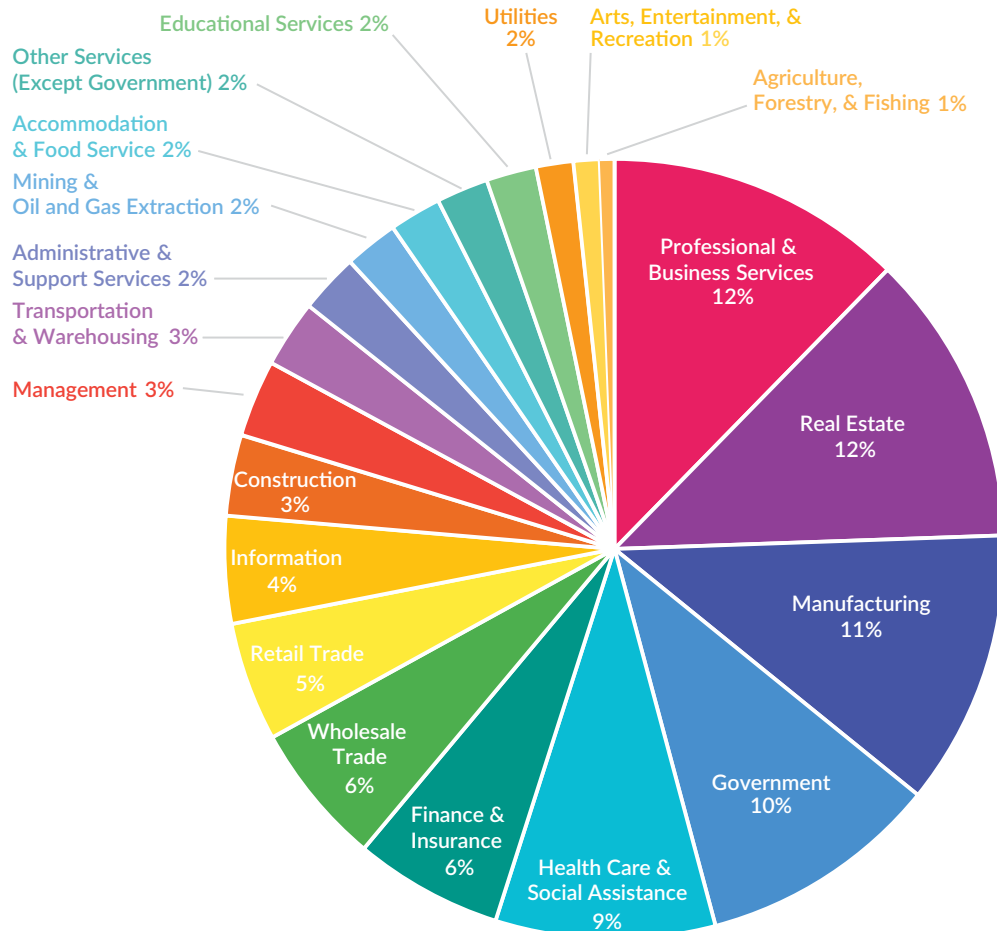


In 2014, Pennsylvania had the sixth largest state economy based on state gross domestic product. It was only outranked by California, Texas, New York, Florida, and Illinois. It is followed closely by neighbors Ohio (7th), New Jersey (8th), Virginia (11th), and Maryland (15th).

Source: Bureau of Economic Analysis, *Regional Economic Analysis*, "Gross Domestic Product (GDP) by State—GDP in current dollars."

Professional and Business Services, Real Estate, and Manufacturing Comprise the Largest Portion of Pennsylvania's Economy

Percent of State GDP by Sector, Pennsylvania Statewide (2014)

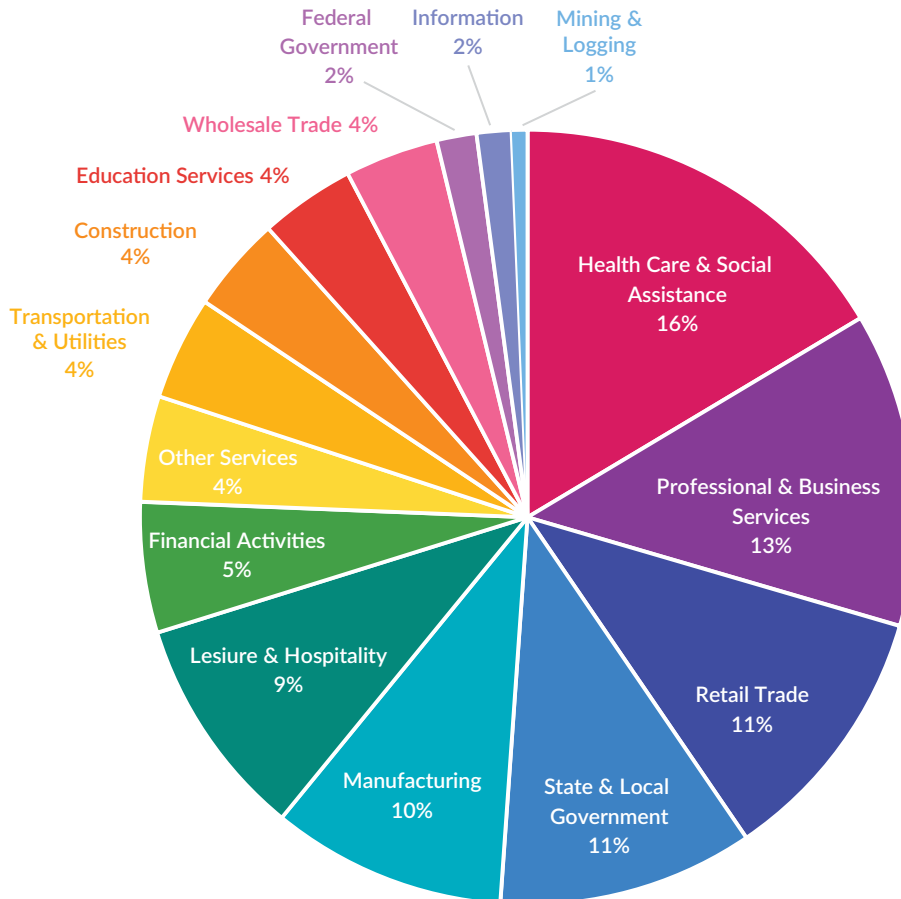


Pennsylvania's economy is dominated by five industries: professional and business services (12 percent), real estate (12 percent), manufacturing (11 percent), government (10 percent), and health care and social assistance (9 percent). In combination, these five industries comprised 54 percent of Pennsylvania's gross domestic product in 2014. Because no one sector is larger than 12 percent, policymakers must be focused on creating a productive environment for all industries.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Gross Domestic Product (GDP) by State—GDP in current dollars."

Health Care, Professional and Business Services, and Government Employ the Most People in Pennsylvania

Percent of Total Nonfarm Employment by Sector, Pennsylvania (2014)

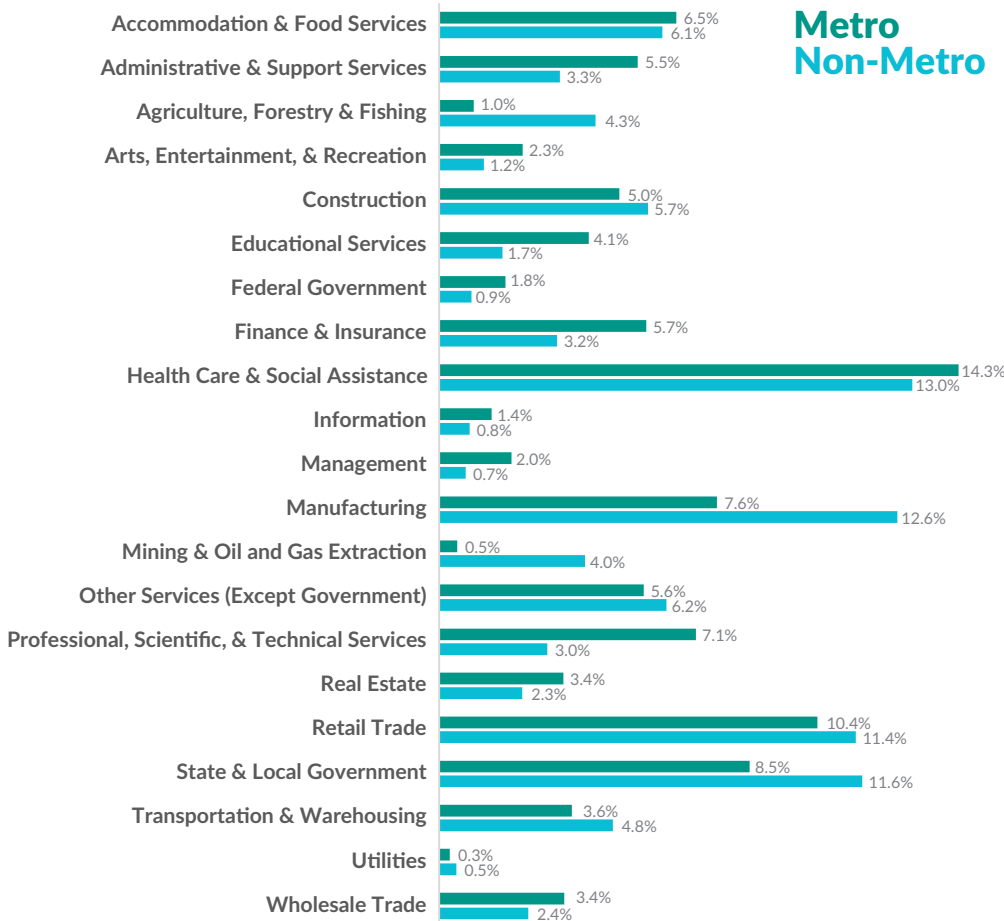


The majority of Pennsylvania employees work in service-providing sectors. Health care and social assistance (16 percent), professional and business services (13 percent), and state and local governments (11 percent) employ the most individuals in Pennsylvania. This measure differs from state GDP produced by sector, due to some industries requiring more labor than others. For instance, health care and social assistance is the fifth largest industry in Pennsylvania, but employs the most people.

Note: Percents may not add to 100 due to rounding.
Source: Bureau of Labor Statistics, *Quarterly Census of Employment and Wages* (Pennsylvania Statewide for All establishment sizes, All Employees, Private Establishments).

Metro-Area Employment in Pennsylvania Varies Greatly from Non-Metro Employment

Industry Employment as a Percent of Total Area Employment, Metro and Non-Metro Pennsylvania (2014)



State economies are diverse; different industries concentrate in different areas of a state. Comparing employment by metro and non-metro areas illustrates this point.

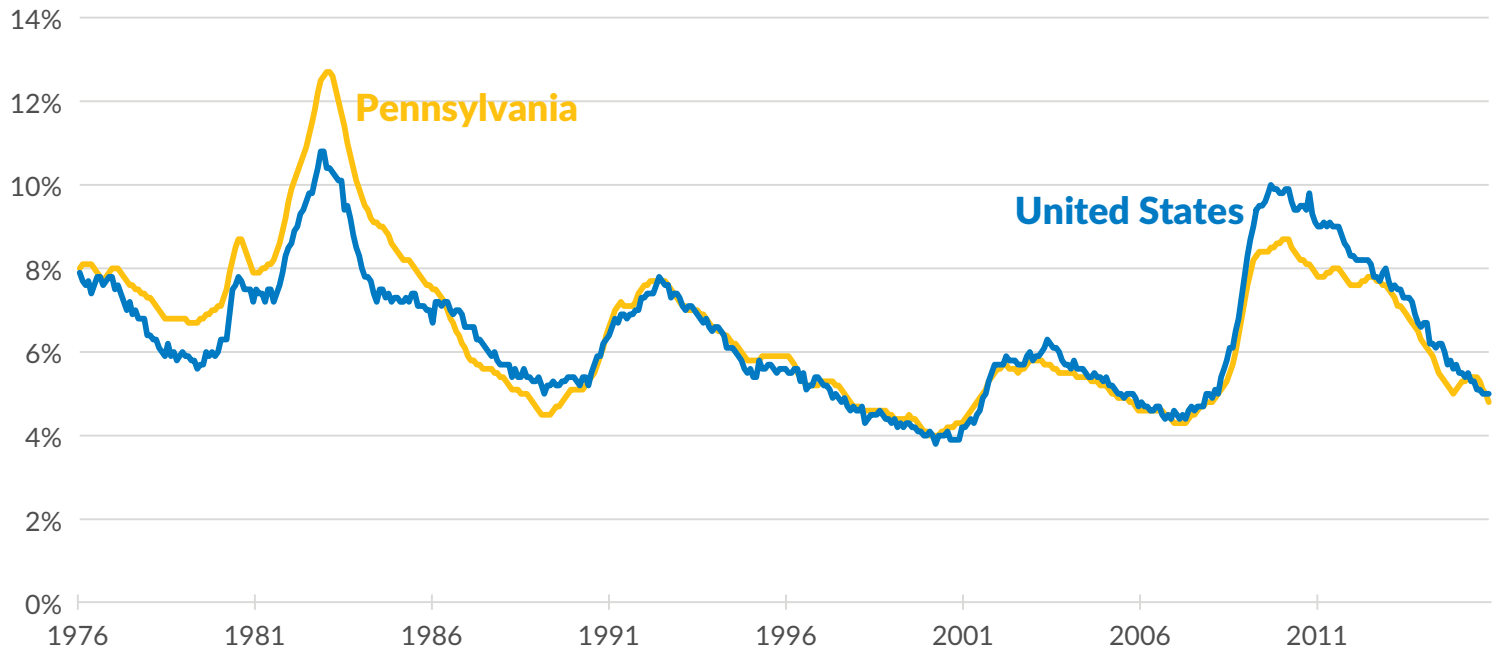
Manufacturing represents 7.6 percent of employment in metro areas, but 12.6 percent of employment in non-metro areas. Mining and oil and gas extraction is 0.5 percent of metro-area employment, compared to 4 percent in non-metro areas. In contrast, finance and insurance is 5.7 percent of metro employment, compared to only 3.2 percent in non-metro areas.

Note: Counties designated by the Bureau of Economic Analysis as metropolitan are Adams, Allegheny, Armstrong, Beaver, Berks, Blair, Bucks, Butler, Cambria, Carbon, Centre, Chester, Columbia, Cumberland, Dauphin, Delaware, Erie, Fayette, Franklin, Lackawanna, Lancaster, Lebanon, Lehigh, Luzerne, Lycoming, Mercer, Monroe, Montgomery, Montour, Northampton, Perry, Philadelphia, Pike, Washington, Westmoreland, Wyoming, and York.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Local Area Personal Income and Employment."

Pennsylvania's Unemployment Rate Fared Better than the National Average during the Great Recession

Monthly Seasonally Adjusted Unemployment Rate, Pennsylvania and the U.S. (1976–2015)

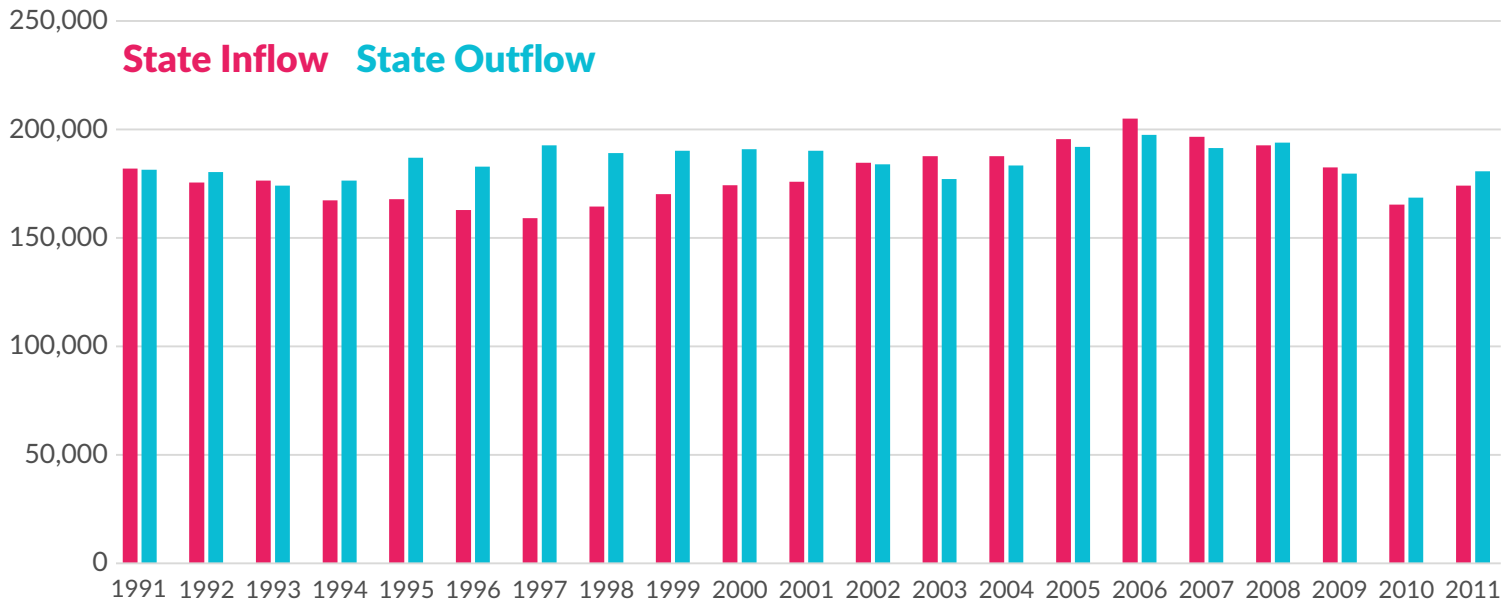


Pennsylvania's recent unemployment rate history can be divided into four distinct periods. From 1976 until 1986, Pennsylvania's unemployment rate was higher than the U.S. average. It peaked at 12.6 percent in 1983, 2 percentage points above the U.S. average. From 1986 to 2009, the Pennsylvania rate tracked closely with the U.S. rate as a whole with little variance between the two rates. During the Great Recession, Pennsylvania's diversified economy insulated the rate from increasing above the national average. Pennsylvania's unemployment rate peaked at 8.7 percent, outperforming the U.S. average of 10 percent. It has since returned to closely tracking the U.S. average unemployment rate.

Source: Bureau of Labor Statistics, *Local Area Unemployment Statistics*.

Pennsylvania Has Struggled with Bouts of Out-Migration

Migration to and from Pennsylvania Based on the Number of Federal Tax Exemptions Claimed (1991-2011)

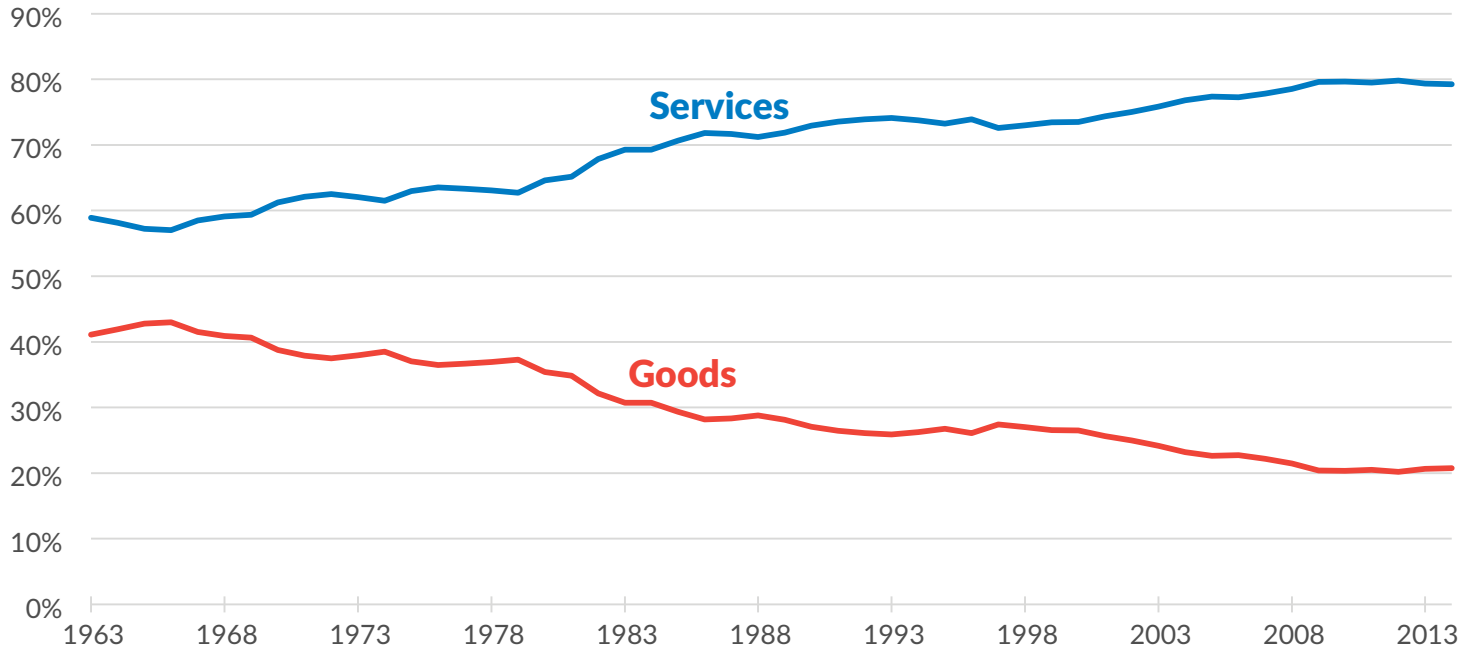


Pennsylvania has experienced net out-migration since the early 1990s. Since 1991, 3,883,137 individuals have left the state of Pennsylvania, compared to 3,747,635 entering the state. On average, Pennsylvania loses 4,208 people each year. Individuals leaving Pennsylvania are disproportionately relocating to Florida, North Carolina, and Virginia, while New York, New Jersey, and Connecticut are statistically overrepresented among individuals moving to Pennsylvania. To some degree, though, the rate of out-migration has slowed in recent years. From 1991 to 2000, the state lost 145,008 individuals, but from 2001 to 2010, it gained 16,093 individuals. In 2010 and 2011, the state did lose more residents than it gained, however, so that trend could be reversing again.

Source: Internal Revenue Service, *Statistics of Income Tax Stats*, "State-to-State Migration Data."

Pennsylvania's Economy Is Transitioning from Goods to Services

Goods and Services as a Percent of Total Private State GDP, Pennsylvania Statewide (1963–2014)



The composition of Pennsylvania's economy has changed dramatically over the past 50 years. The goods-producing sectors of the economy, such as manufacturing, constructing, and mining, have decreased in relative size as economic growth has been concentrated in the services-producing sectors. In 1963, the goods-producing sectors comprised 41 percent of gross domestic product. It fell to just 21 percent in 2014.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Gross Domestic Product (GDP) by State—GDP in current dollars."

CHAPTER 2

Pennsylvania's Tax Code: An Overview

State and local governments in Pennsylvania rely on a variety of taxes to fund operations. Some types are well known, such as the individual income, property, and corporate income taxes. But others are less discussed, such as excise taxes on cell phones and alcohol, and the state's inheritance tax. The state also receives significant revenue transfers from the federal government to help meet the state's health insurance, transportation, and education needs.

In general, Pennsylvania residents face a high state and local tax burden. Residents paid 10.2 percent of their income to state and local taxes in fiscal year 2012, above the national average of 9.9 percent. Tax collections continue to rise, even after adjusting for inflation. Inflation-adjusted collections are up 26 percent over the past 20 years.

Tax rates contribute to a state's competitiveness, but other factors matter as well. Tax bases and tax structures play an essential role in determining the strength of a state's tax climate. Pennsylvania's corporate, property, and unemployment insurance tax structures are not competitive with those of its peer states.



Pennsylvania Taxes at a Glance

This page provides a brief, broad overview of tax rates, tax collections, and other basic structural features of Pennsylvania's tax code.

General Info		Rank	Nat. Avg.
Income per capita	\$47,679	16th	\$46,049
Federal aid as % of gen. revenue	30.42%	29th	30.03%
State debt per capita	\$3,678	20th	\$3,594
Tax Freedom Day	April 22	32nd	April 24

Individual Income Tax

Number of brackets	1
Tax Rate	3.07%
Tax Rate Rank	44th
Collections per capita (2013)	\$1,201
Collections rank (2013)	15th

Corporate Income Tax

Number of brackets	1
Tax rate	9.99%
Tax rate rank	2nd
Collections per capita	\$201
Collections rank	10th

Property Tax

Collections per capita	\$1,376
Collections rank	21st
Effective residential property tax rate	1.47%

Sales Tax

State rate	6.00%
State + average local rate	6.34%
State + average local rank	32nd
Collections per capita	\$778
Collections rank	37th

Excise Taxes

	Rate	Rank
Gasoline taxes and fees	50.4¢ per gallon	1st
Cigarette taxes	\$1.60 per pack	22nd
Spirits taxes	\$7.23 per gallon	18th
Beer taxes	\$0.08 per gallon	45th
Cell phone taxes	14.14%	9th

For all rankings, 1 indicates the highest rank among the 50 states.

Other Taxes

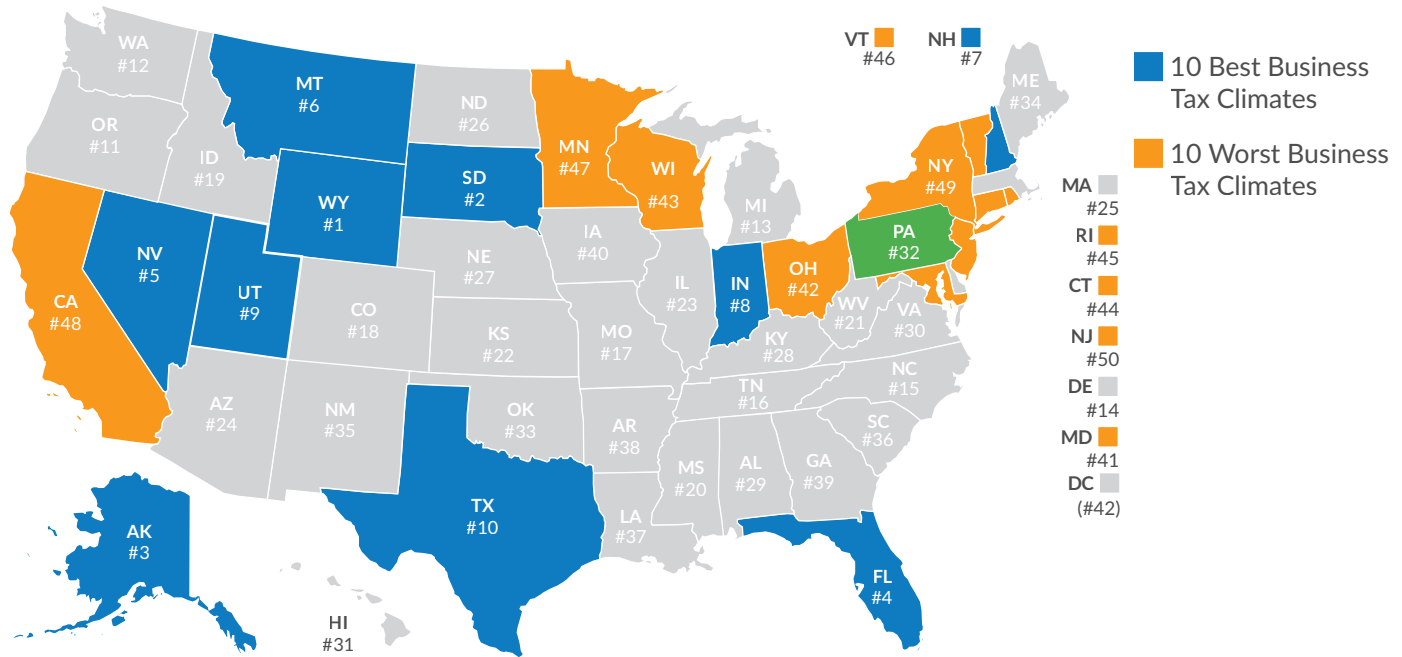
Capital Stock Tax	None
Inheritance Tax	4.5-15%
Estate Tax	None

Note: All collections listed on this page are state and local per capita collections for the 2013 fiscal year. Federal aid and state debt figures are also for the 2013 fiscal year. Income per capita is for the 2014 calendar year. Individual and corporate income tax rates are ranked according to the top rate if the state has a graduated-rate individual or corporate income tax. These rates and ranks are as of January 1, 2016. "State debt" is defined as the outstanding debt at the end of the fiscal year, as calculated by the Census Bureau.

Source: Tax Foundation, *Facts & Figures 2016: How Does Your State Compare?*

Pennsylvania's Tax Climate Has Room to Improve

Pennsylvania Ranks 32nd out of 50 in the *State Business Tax Climate Index (2016)*



The *State Business Tax Climate Index* measures the structure of each state's tax code by reviewing over 100 different variables. States with low rates, broad bases, and simple structures score the best. Pennsylvania's rank suffers from its unusually high corporate income tax rate, inheritance tax, and complex unemployment insurance tax structure, among other things. Pennsylvania currently ranks 32nd in the country on our *Index*.

Note: A rank of 1 indicates the state's tax system is more favorable for business; a rank of 50 indicates the state's tax system is less favorable for business. The snapshot date is July 1, 2015. DC's rank does not affect other states' rankings, but the figure in parenthesis indicates where it would rank if included.

Source: Tax Foundation, 2016 *State Business Tax Climate Index*.

Pennsylvania's Business Tax Climate Trails Its Peers'

State Business Tax Climate Index Rankings, Pennsylvania and Selected States (2016)

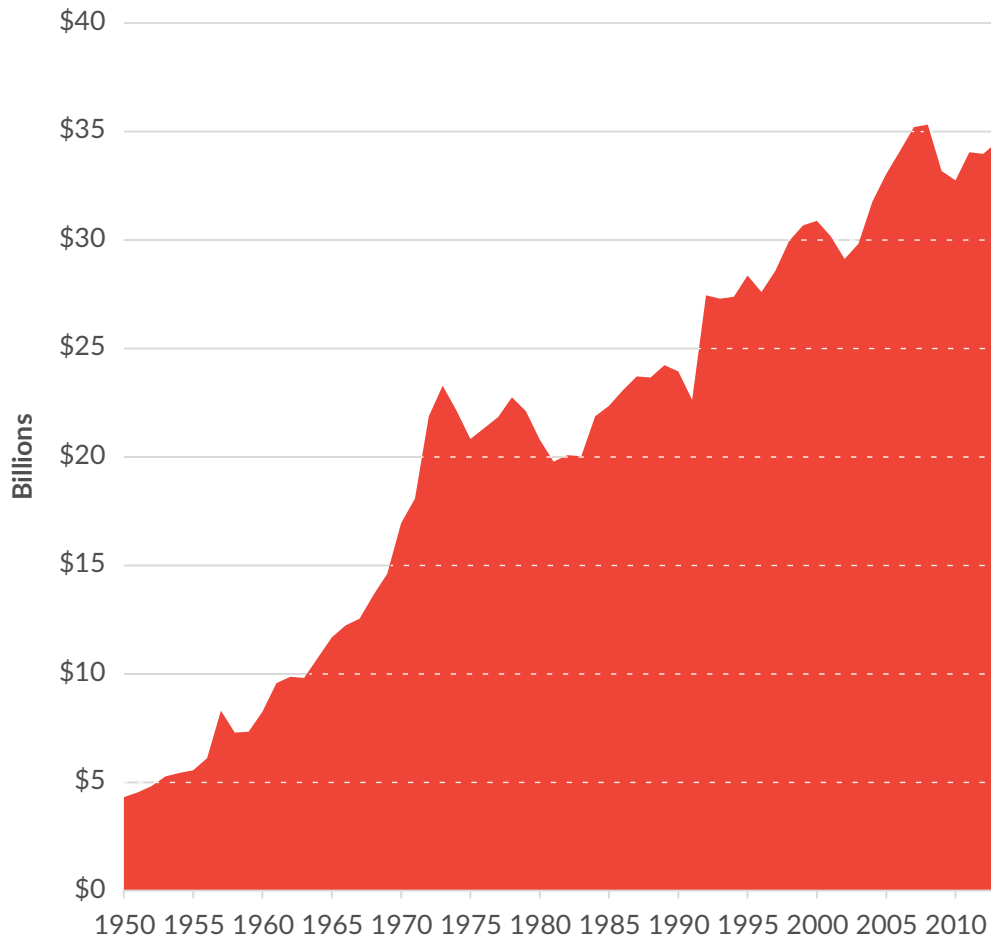
	Overall	Corporate Tax Rank	Individual Income Tax Rank	Sales Tax Rank	Unemployment Insurance Tax Rank	Property Tax Rank
Florida	4	17	1	17	3	20
North Carolina	15	7	14	31	11	32
Ohio	42	26	47	30	6	11
Pennsylvania	32	47	17	25	50	38
Texas	10	41	6	37	15	34
Virginia	30	6	39	6	38	39

With the exception of Ohio, all of Pennsylvania's peer states have better structured tax codes. Florida and Texas do not have individual income taxes. North Carolina dramatically overhauled its tax code in 2013, vaulting ahead of Pennsylvania from 44th to 15th. Virginia ranks well due to its flat corporate income tax and well-structured sales tax. Pennsylvania's structure makes it less competitive than these states.

Note: A rank of 1 indicates the state's tax system is more favorable for business; a rank of 50 indicates the state's tax system is less favorable for business. The snapshot date is July 1, 2015. Component rankings do not average to the overall rank. States without a given tax rank equally as number 1 in that component. Texas does not have an individual income tax, but its Margin Tax affects its individual income tax component ranking. Source: Tax Foundation, 2016 *State Business Tax Climate Index*.

Pennsylvania Tax Collections Continue to Grow

Pennsylvania State Tax Collections (1950–2013, in 2014 Dollars)

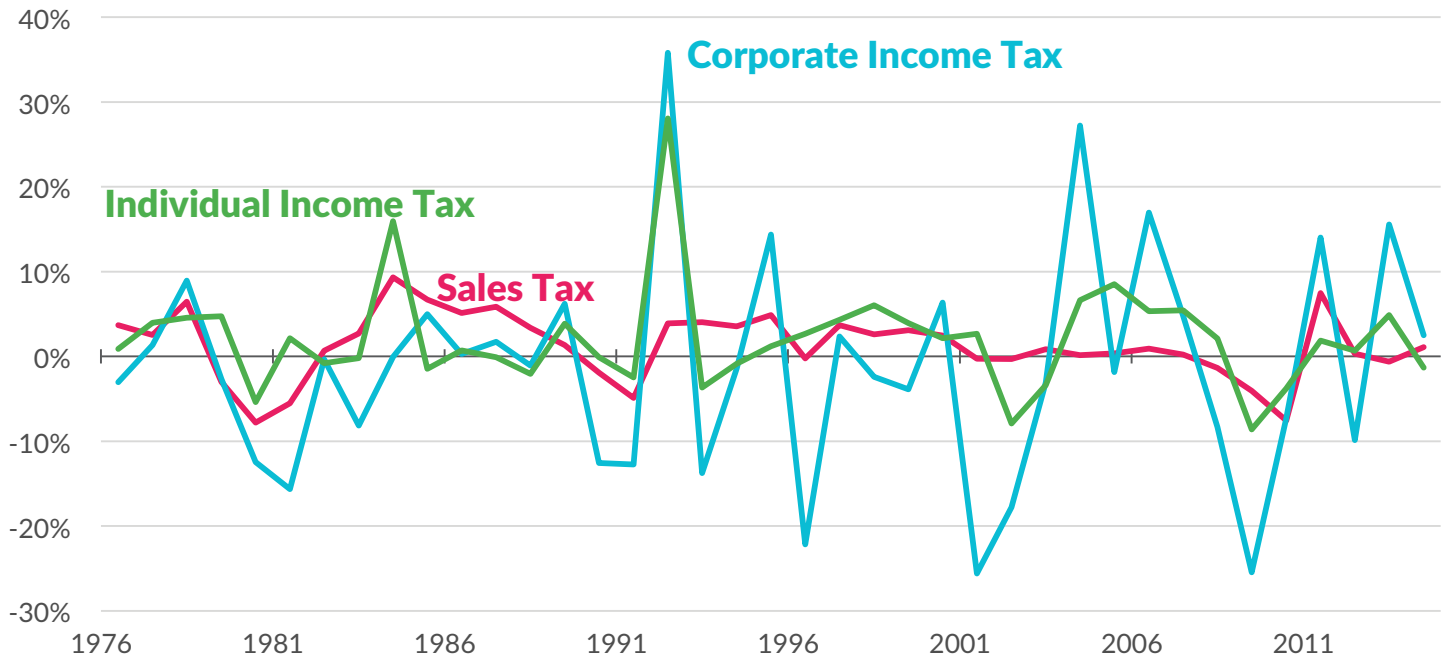


Pennsylvania's state tax collections have grown from \$4.3 billion in 1950 to \$34.5 billion in 2013, after adjusting for inflation. This is an increase of 700 percent over the past 63 years, and a 26 percent increase over the past 20 years. Tax collections did dip during the Great Recession, but have nearly recovered to pre-recession levels.

Note: Dollar amounts are inflation adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2014 base year.
Source: Census Bureau, *State and Local Government Finances*.

Corporate Income Taxes Do Not Provide Stable Revenue

Annual Percent Change in Pennsylvania State Tax Collections by Tax Type (1976–2014)

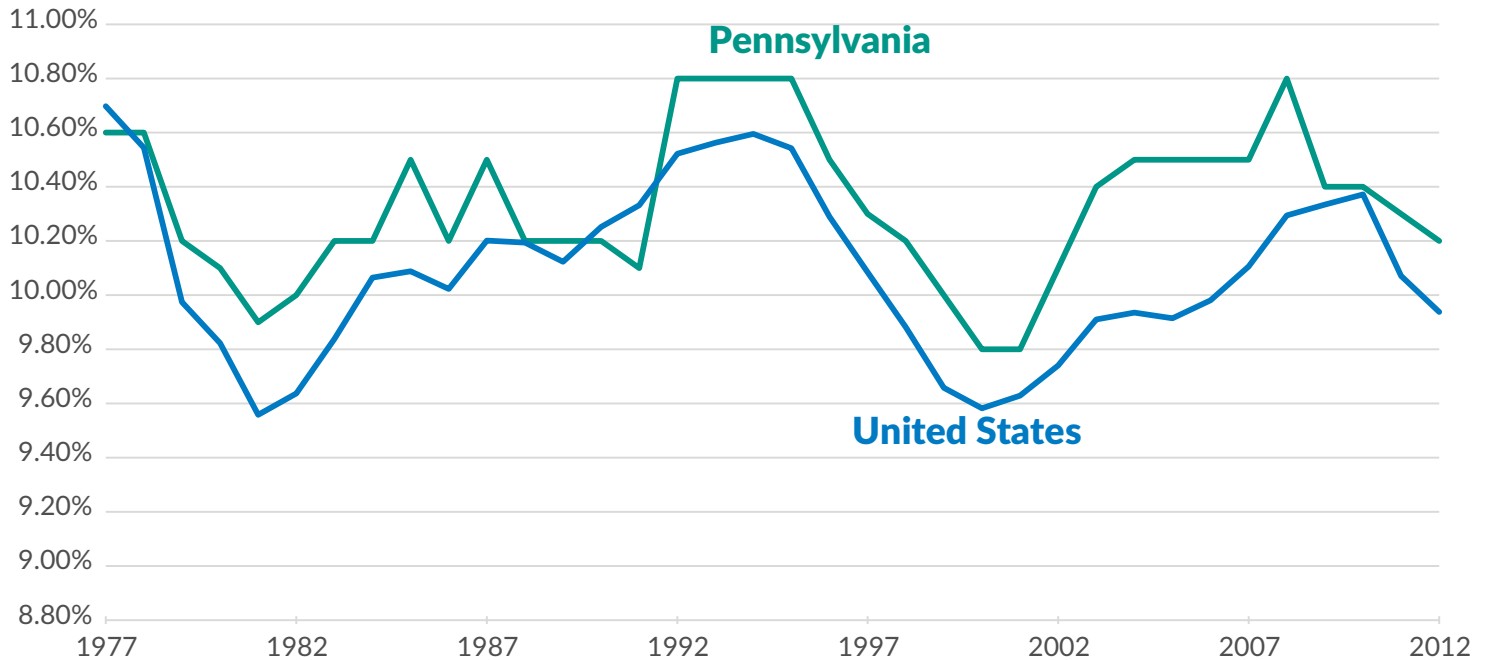


Pennsylvania's tax structure is uniquely susceptible to economic downturns due to its heavy reliance on the corporate income tax. Corporate income tax revenue fluctuates wildly, due to the possibility of corporations' profits being reduced to zero during recessionary years. This makes it difficult for the state to budget during tough economic times, as corporate income tax revenues have swung as much as 36 percent year-over-year. In contrast, sales tax revenue is relatively reliable since consumption continues even during economic downturns.

Source: Census Bureau, *State and Local Government Finances*.

Pennsylvania's Tax Burden Exceeds the National Average

Total State-Local Tax Burden as a Percent of State Income, Pennsylvania and the U.S. Average (FY 2012)

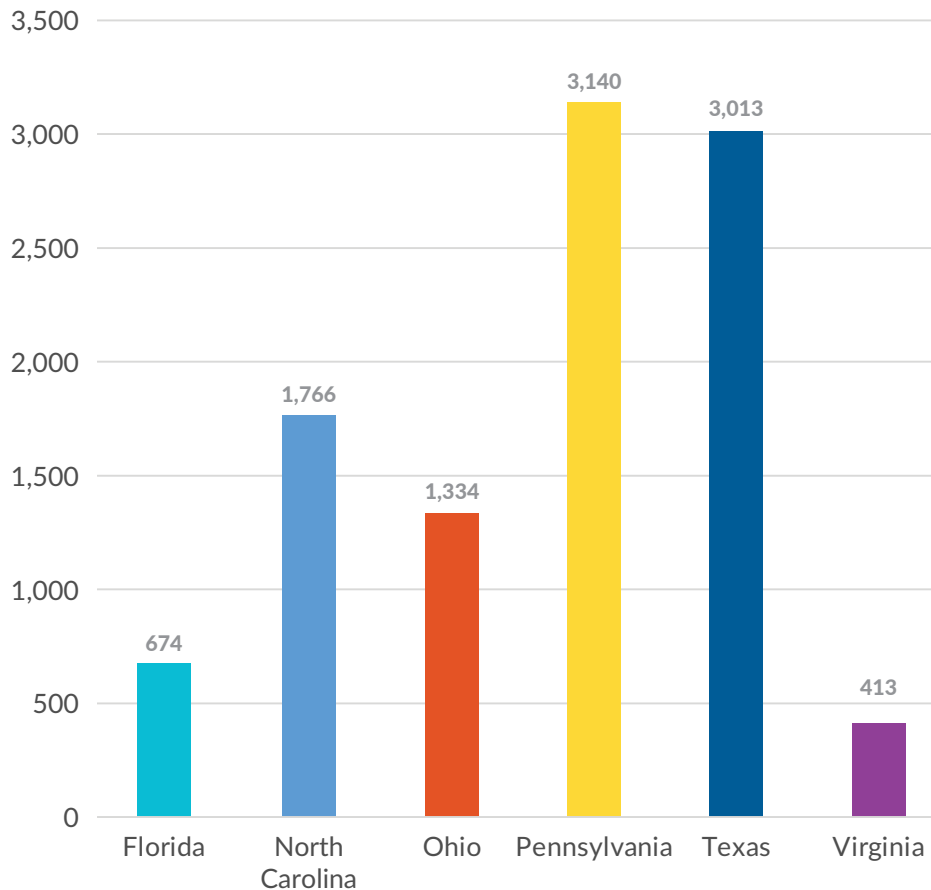


Since 1977, Pennsylvania's tax burden has been consistently larger than the U.S. average. That means that Pennsylvania residents are paying more in state and local taxes than the residents of many other states.

Source: Tax Foundation, *State-Local Tax Burden Rankings FY 2012*.

Pennsylvania's Numerous Tax Authorities Complicate Tax Filings

The Number of Individual Income Tax, Property Tax, and Sales Tax Authorities for Selected States (2016)



A key measure of a state's tax complexity is the number of taxing authorities within that state. Pennsylvania's high number of tax authorities is attributable to its complex local individual income tax structure. While most states forego local income taxes, Pennsylvania allows 500 school districts and more than 2,500 localities the ability to assess an income tax. Pennsylvania's number of total taxing authorities is only close to Texas which has a dramatically larger population, geographic area, and economy.

Note: These totals reflect the number of individual income tax, property tax, and sales tax jurisdictions in the selected states. There exist numerous other taxing authorities in each state.

Source: Author's calculations based on state and local government documents.

CHAPTER 3

Individual Income Taxes

Pennsylvania's flat state income tax is one of the bright spots in its tax system. Of the 41 states that tax wage income, Pennsylvania is one of only eight with a single-rate, rather than a graduated-rate, structure. At 3.07 percent, Pennsylvania's rate is the second lowest for any state with an individual income tax. Only North Dakota, at 2.9 percent, is lower. Because Pennsylvania does not have a standard deduction or personal exemption, it has the broadest income tax base in the country.

The simplicity at the state level, however, is partially undone by the complexity in Pennsylvania's local earned income tax. Municipalities and school districts assess local income taxes, coming together to create more than 3,000 taxing authorities. Employers must review each employee's work and home address to determine withholding, a time-consuming task.

Substantially increasing taxpayers' liabilities, local rates vary from 0.5 percent to Philadelphia's 3.9102 percent, yielding a maximum state-local combined rate of 6.9802 percent.



Pennsylvania's Individual Income Tax Rate is Lower than its Peers

Top Marginal Individual Income Tax Rate and Rank and Numbers of Brackets for Selected States 2016

	Top Marginal Rate	Top Rate Rank	Number of Brackets
Florida	0%	44	--
North Carolina	5.75%	25	1
Ohio	4.997%	34	9
Pennsylvania	3.07%	42	1
Texas	0%	44	--
Virginia	5.75%	25	4

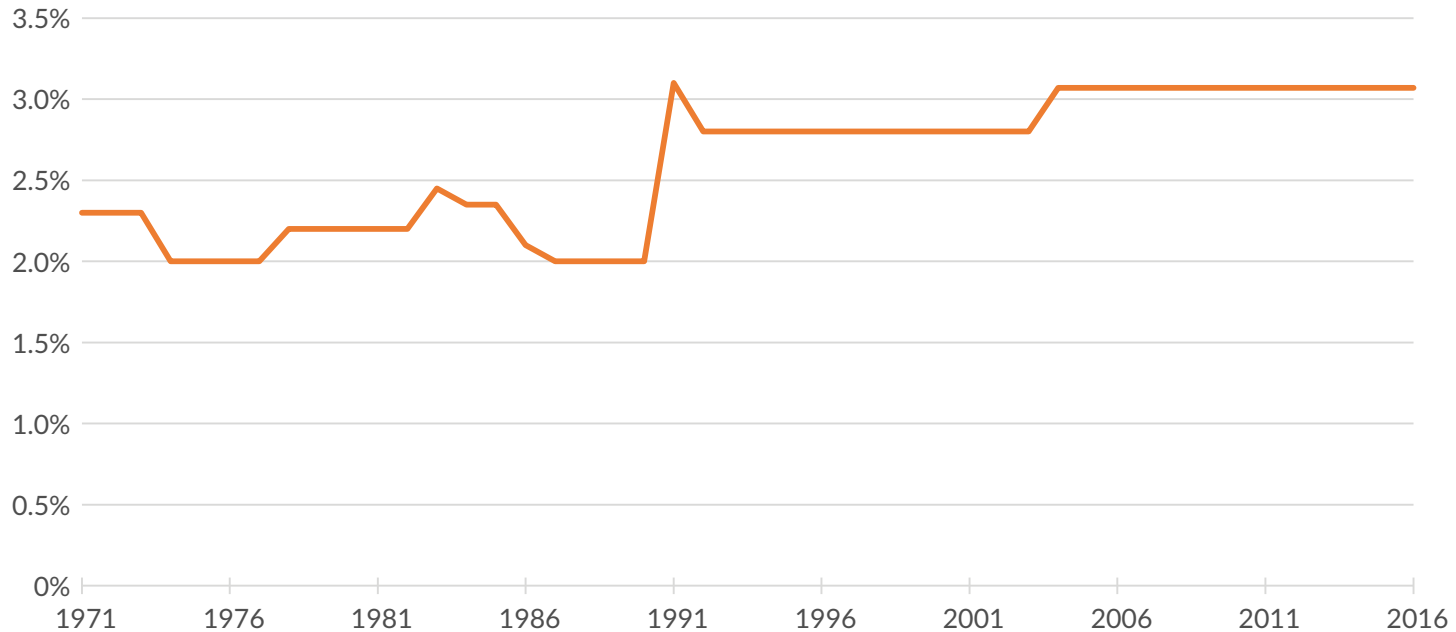
Pennsylvania is one of only eight states that has a flat rate. Of the states that tax individual income, Pennsylvania has the second lowest individual income tax rate in the nation.

Pennsylvania's rate is competitive among states that tax individual income. However, there are seven states, including Florida and Texas, which do not have an income tax. An additional two states only tax interest and dividend income. Pennsylvania is one of only eight states that has a flat rate.

Source: Tax Foundation, "State Individual Income Tax Rates and Brackets for 2016."

Pennsylvania's Individual Income Tax Rate Has Increased over Time

Individual Income Tax Rate, Pennsylvania (1971-2016)

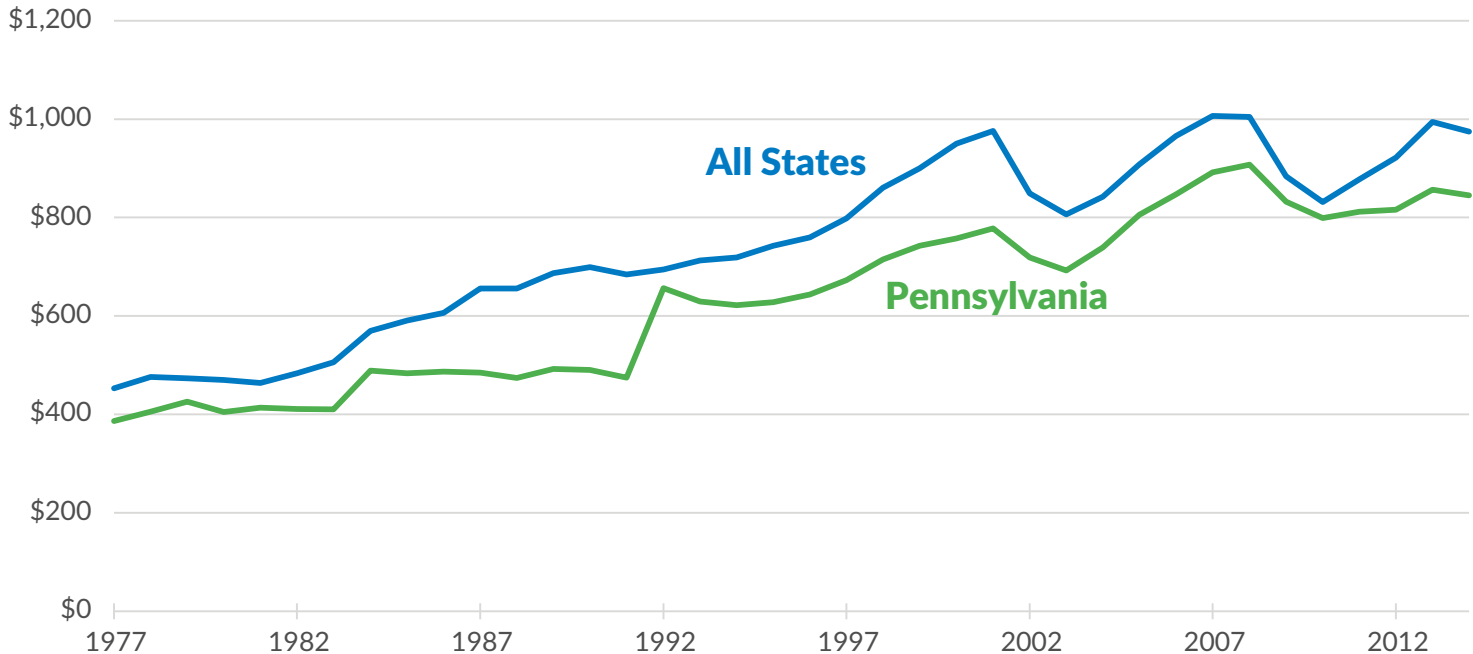


Pennsylvania did not institute its individual income tax until 1971, later than many other states. Since its inception, the rate has never been above 3.1 percent. It began at 2.3 percent in 1971, was lowered to 2.0 percent in 1974, and increased to 2.2 percent in 1978. It inched higher to 2.45 in 1983, and was slowly lowered back to 2 percent. The rate peaked in 1991 at 3.1 percent, it was decreased in 1992 to 2.8 percent and stayed there until 2003. Finally, in 2004, the rate was set at 3.07 percent where it has stayed since. Last year, the Governor proposed a new rate of 3.7 percent (an increase of more than 20 percent), but his proposal was rejected by the legislature.

Source: Pennsylvania Department of Revenue, *The Tax Compendium* (December 2014); Pennsylvania Office of the Budget, *2016-2017 Governor's Executive Budget*.

Pennsylvania Individual Income Tax Collections Continue to Grow

**Total State Individual Tax Collections per Capita, Pennsylvania and the U.S.
(1977–2014, in 2014 Dollars)**



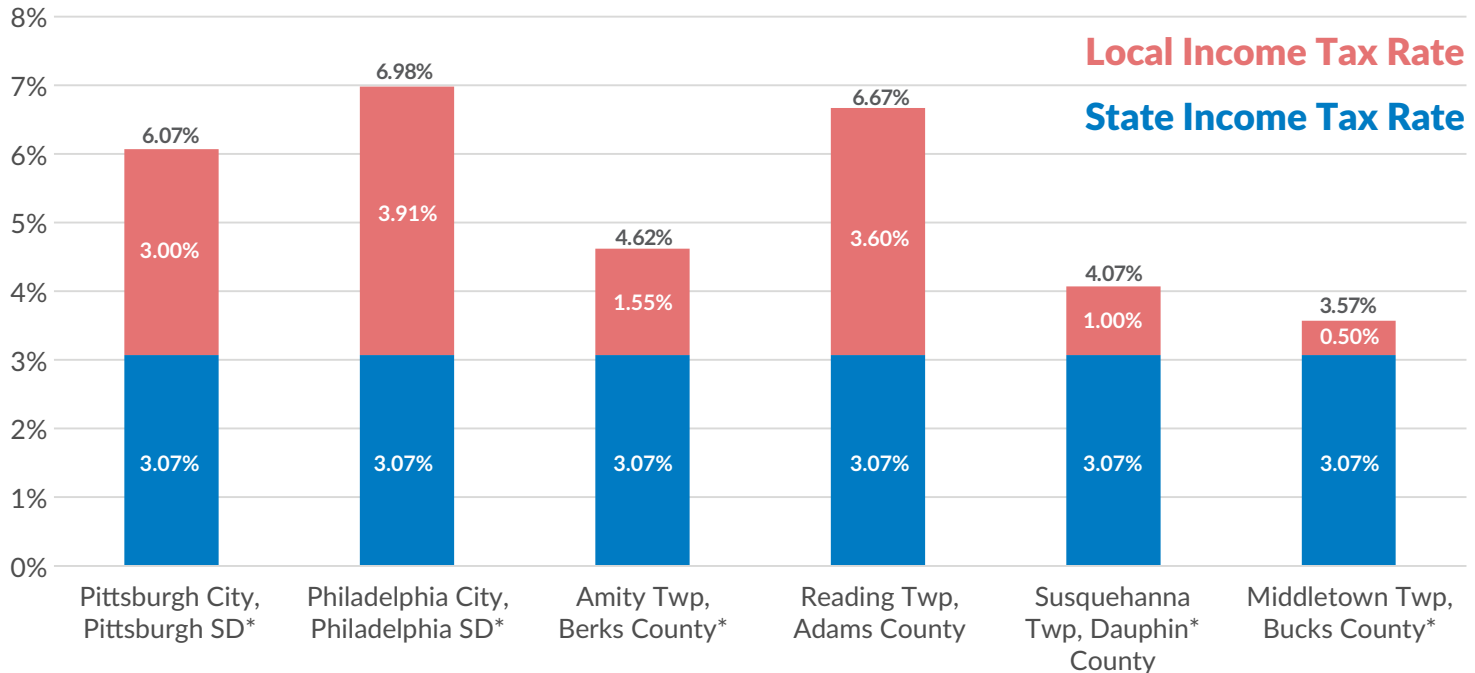
Since 1977, Pennsylvania's inflation-adjusted individual income tax collections have increased 118 percent, tracking closely with the national average of 115 percent. Per capita collections have grown from \$387 in 1977 to \$845 in 2014, in inflation-adjusted terms. While the long-term trend is positive, collections do fluctuate with the business cycle; collections fell quickly in 2002 and 2003 and again in and 2009 and 2010.

Note: Dollar amounts are inflation adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2014 base year.

Source: Census Bureau, *State and Local Government Finances*; Census Bureau, *American Community Survey*; Bureau of Labor Statistics, *Consumer Price Indexes*.

Pennsylvania's Local Taxes Increase Individuals' Tax Burdens

Selected Local Earned Income Tax Rates for Pennsylvania Localities (2016)



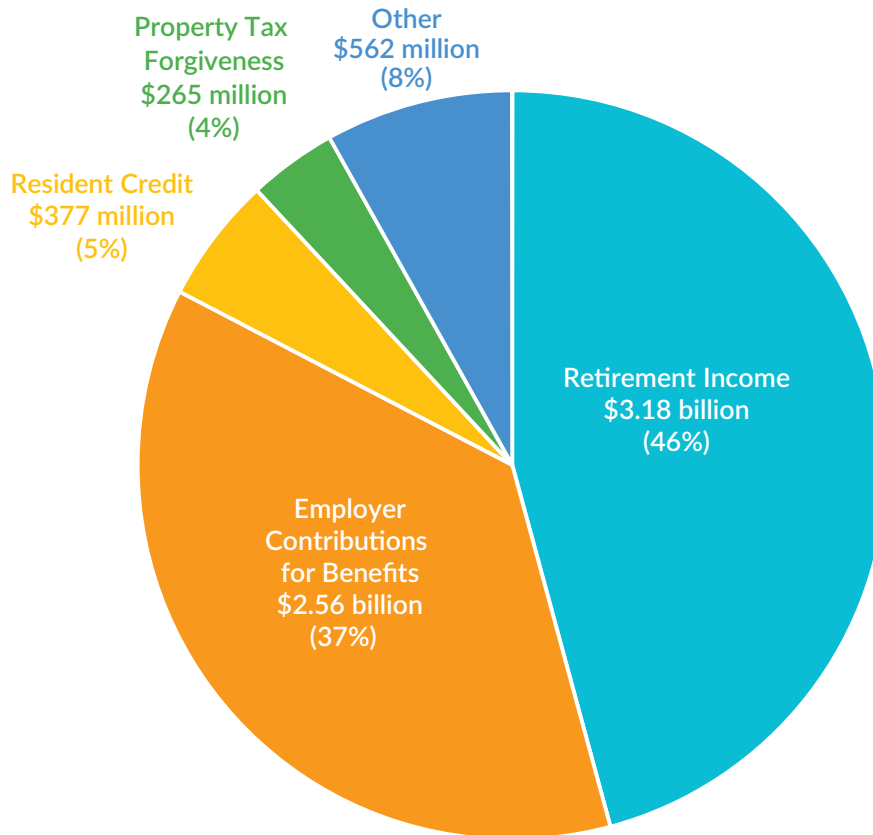
Pennsylvania's state income tax is one of the lowest in the country, but municipalities and school districts in Pennsylvania impose hefty local income taxes. These rates vary from as low as 0.5 percent to Philadelphia's 3.9102 percent. The bulk of localities have rates of 1 percent due to a state statutory limit. To increase the rate above 1 percent, localities must agree to repeal other types of taxes or be given special permission, which is the case in Pittsburgh and Philadelphia.

The funds raised by these local income taxes are split between municipalities and school districts. There are 500 school districts and more than 2,500 municipalities in Pennsylvania.

Note: Residents of the localities flagged by an asterisk are also subject to an annual Local Services Tax of \$52.
Source: Pennsylvania Department of Community and Economic Development, *Municipal Statistics*.

Individual Income Tax Expenditures Total \$7 Billion for Fiscal Year 2017

Individual Income Tax Expenditures, Pennsylvania (FY 2017)



In Pennsylvania, the exclusions for retirement income and employer-provided benefits are the largest individual income tax expenditures. Income from pensions, Social Security, or other retirement benefits are not considered taxable income in Pennsylvania. Similarly, the value of the benefits provided by an employer, like health insurance, are also excluded from taxable income. Pennsylvania also provides tax forgiveness credits for low-income taxpayers.

Source: Pennsylvania Office of the Budget, 2016-2017 Governor's Executive Budget: Tax Expenditures.

CHAPTER 4

Business Taxes

All taxes paid by businesses are ultimately borne by individuals, whether it's in the form of higher prices, lower wages, or smaller returns on investment. In Pennsylvania, businesses paid \$26 billion in total taxes in 2013, primarily on taxes other than the corporate income tax, the most recognized type of business tax.

Pennsylvania's structure has numerous flaws. Its corporate income tax rate is the second highest in the nation at 9.99 percent. The high rate encourages firms to reorganize as "pass-through" businesses. Pass-through businesses pay the much lower individual income tax rate, which can benefit a firm greatly. In fact, the number of pass-throughs in the state is increasing rapidly. In 1991, C corporations—those taxed under the corporate income tax—were the most prevalent business structure. In 2012, they were only the third most common structure.

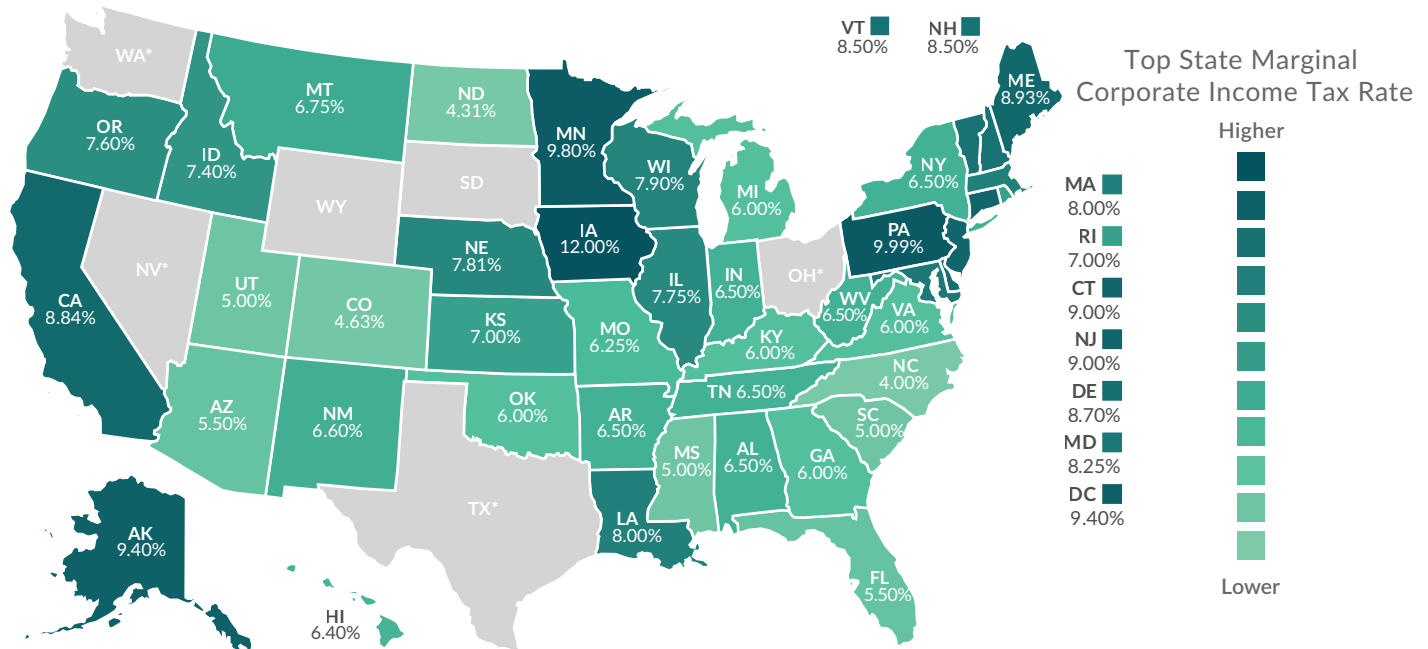
Beyond exposure to corporate income taxes, Pennsylvania businesses struggle with local gross receipts taxes, as they are based on a firm's sales, not its net income.



Citizen Bank park, photo Kevin Ward

Pennsylvania Has an Extremely High Corporate Income Tax Rate

Corporate Income Tax Rates by State (2016)



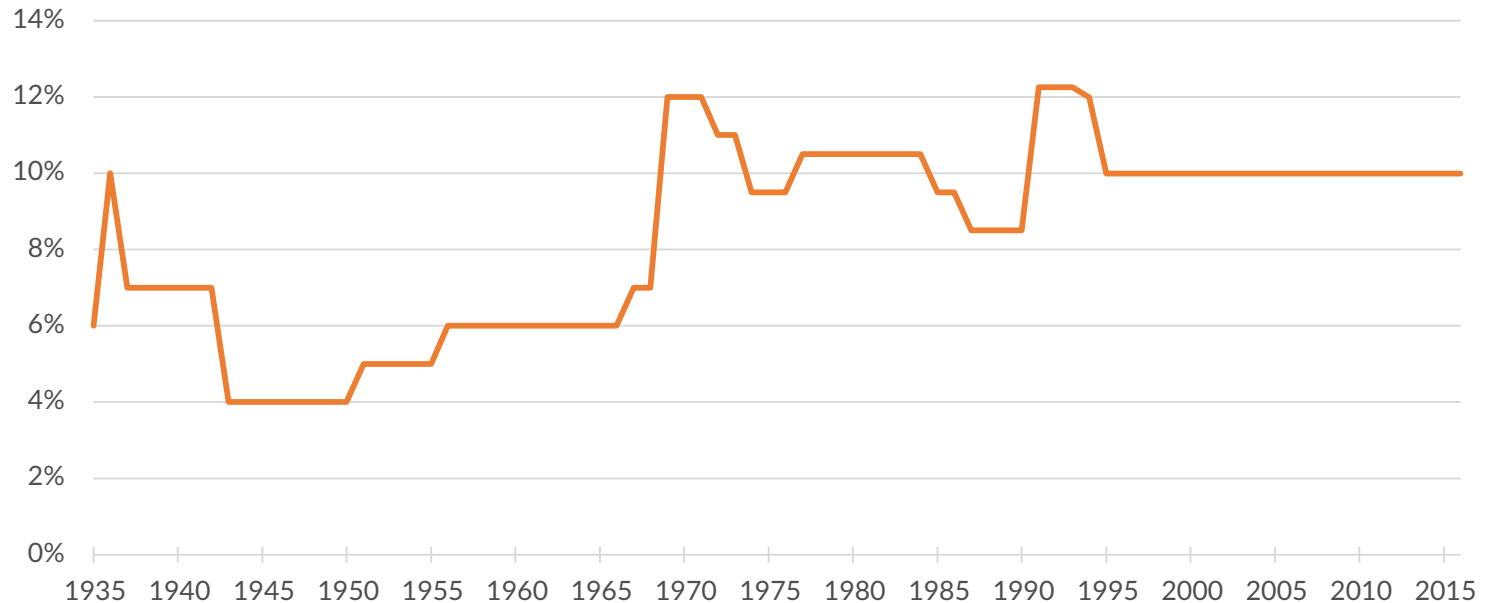
Pennsylvania's state corporate income tax rate of 9.99 percent is the second highest in the nation. The only state with a higher top marginal rate is Iowa, but due to the state's atypical allowance of a deduction for federal taxes paid, the effective rate can be lower than Pennsylvania's. North Carolina, Virginia, and Florida all have corporate taxes far below Pennsylvania's at 4.0, 6.0, and 5.5 percent respectively.

Note: The asterisk (*) indicates states that do not have corporate income taxes but do have gross receipts taxes with rates not strictly comparable to corporate income tax rates.

Source: Tax Foundation, "State Corporate Income Tax Rates and Brackets for 2016."

Pennsylvania Has Historically Had a High Corporate Income Tax Rate

Pennsylvania Corporate Net Income Tax Rate (1935-2016)

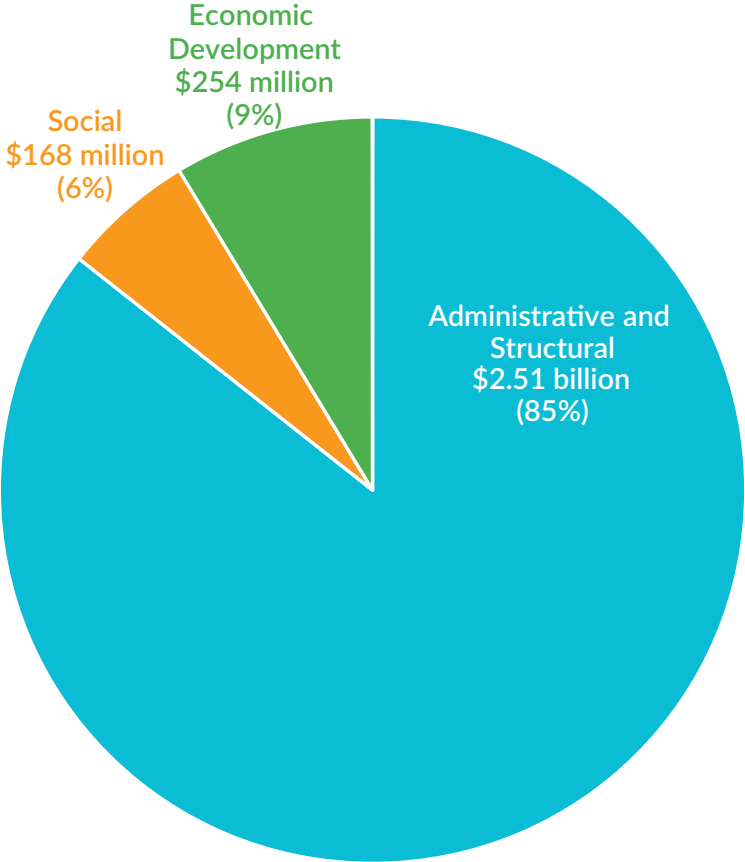


Historically, Pennsylvania's corporate income tax rate has been one of the highest in the country, having been above 8 percent since 1969. The Pennsylvania rate is currently below its peak of 12.25 percent from 1991 to 1993, but has not changed since 1995 and remains well above those of Pennsylvania's peer states.

Source: Pennsylvania Department of Revenue, *The Tax Compendium* (December 2014); Pennsylvania Office of the Budget, *2016-2017 Governor's Executive Budget*.

Tax Credit Programs in Pennsylvania Distort the Tax Base

Corporate Income Tax Credit Programs (FY 2017)

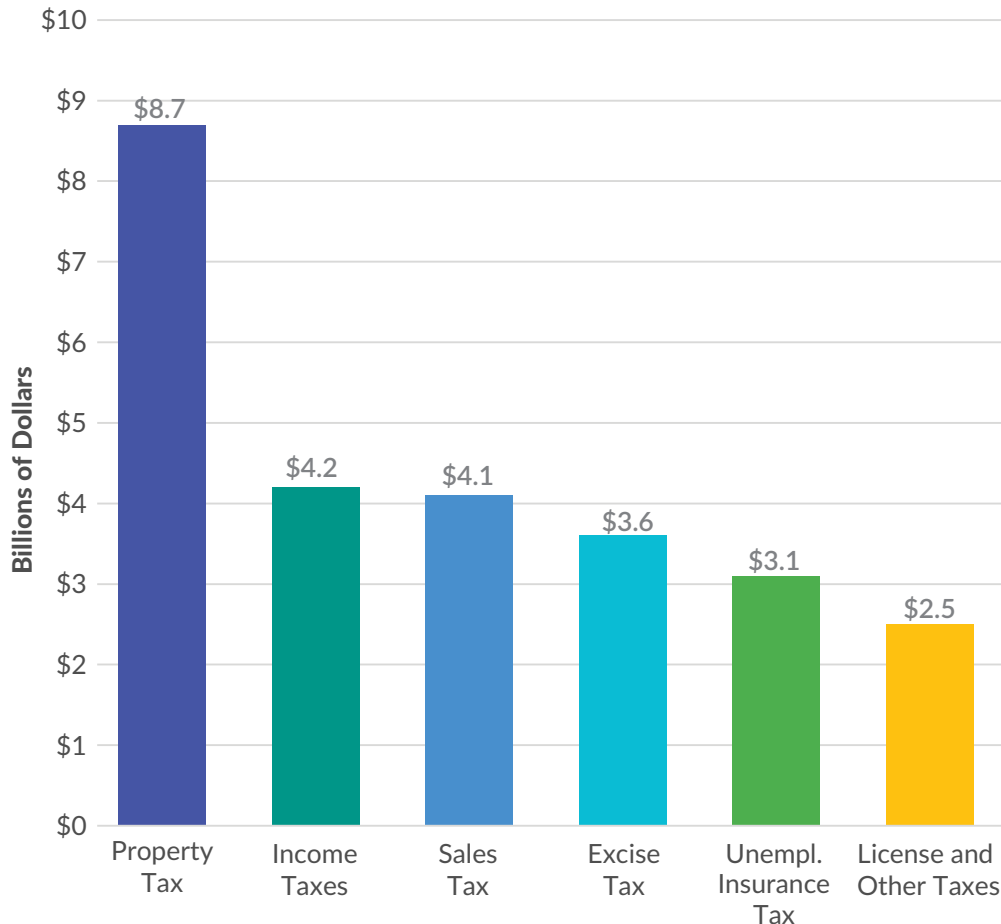


Pennsylvania offers a number of tax credits to corporations in the state. These credits narrow the corporate tax base, create two problems for the state. First, it reduces the amount of revenue that the corporate tax collects, meaning that rates must be higher to collect the same amount of revenue. Second, it distorts decision making by firms. For instance, firms are strongly encouraged, due to the tax credit, to locate in enterprise zones even if the location would not otherwise be ideal. The costs of these tax credits frequently outweigh the benefits.

Source: Pennsylvania Office of the Budget, 2016-2017 Governor's Executive Budget: Tax Expenditures.

Pennsylvania Businesses Pay More than Just Corporate Income Taxes

Pennsylvania Total State and Local Business Tax Liability by Tax Type (FY 2014)



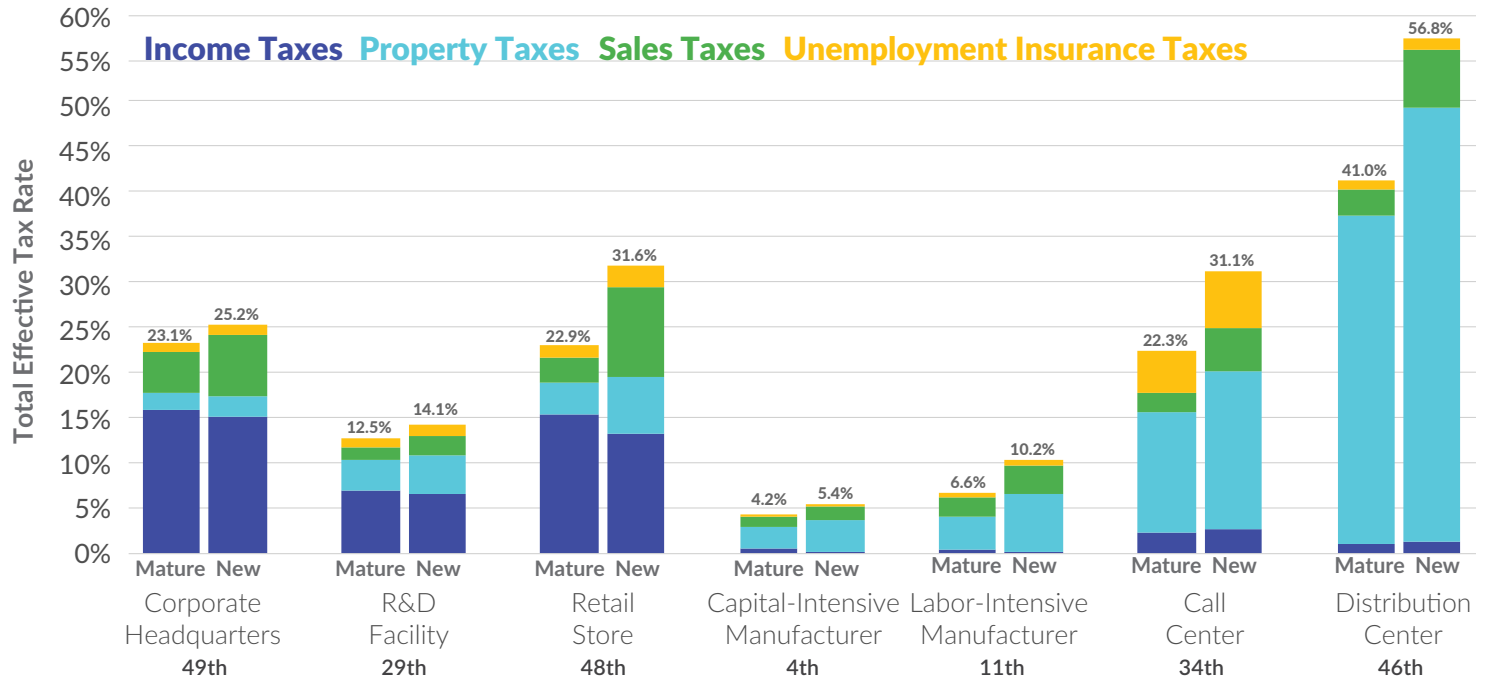
A common misunderstanding is that the corporate income tax is the only tax paid by businesses. In reality, firms pay a variety of taxes. For instance, the land that a firm owns is subject to the property tax, and the goods that it purchases could be subject to the sales tax.

In fiscal year 2014, Pennsylvania firms paid a total of \$26.1 billion in taxes. The property tax made up the largest portion of the total bill at \$8.7 billion. Other large tax categories assessed on businesses are the sales tax (\$4.1 billion) and excise taxes (\$3.6 billion).

Source: Council on State Taxation and Ernst & Young LLP, *Total State and Local Business Taxes* (FY 2014).

Effective Tax Rates Vary by Industry, but Many Exceed National Medians

Total Effective Tax Rates for Select Pennsylvania Business Types, New and Mature Firms (2015)



The Tax Foundation's *Location Matters* study calculates the tax bills for seven firms in different industries in every state, once as a new firm and once as a long-standing, or "mature," firm. Under the Pennsylvania tax code, effective tax rates vary widely by industry. Mature capital-intensive manufacturing operations rank fourth best in the nation. For comparison, mature corporate headquarters, retail stores, and distribution centers rank poorly nationally at 49th, 48th, and 46th respectively.

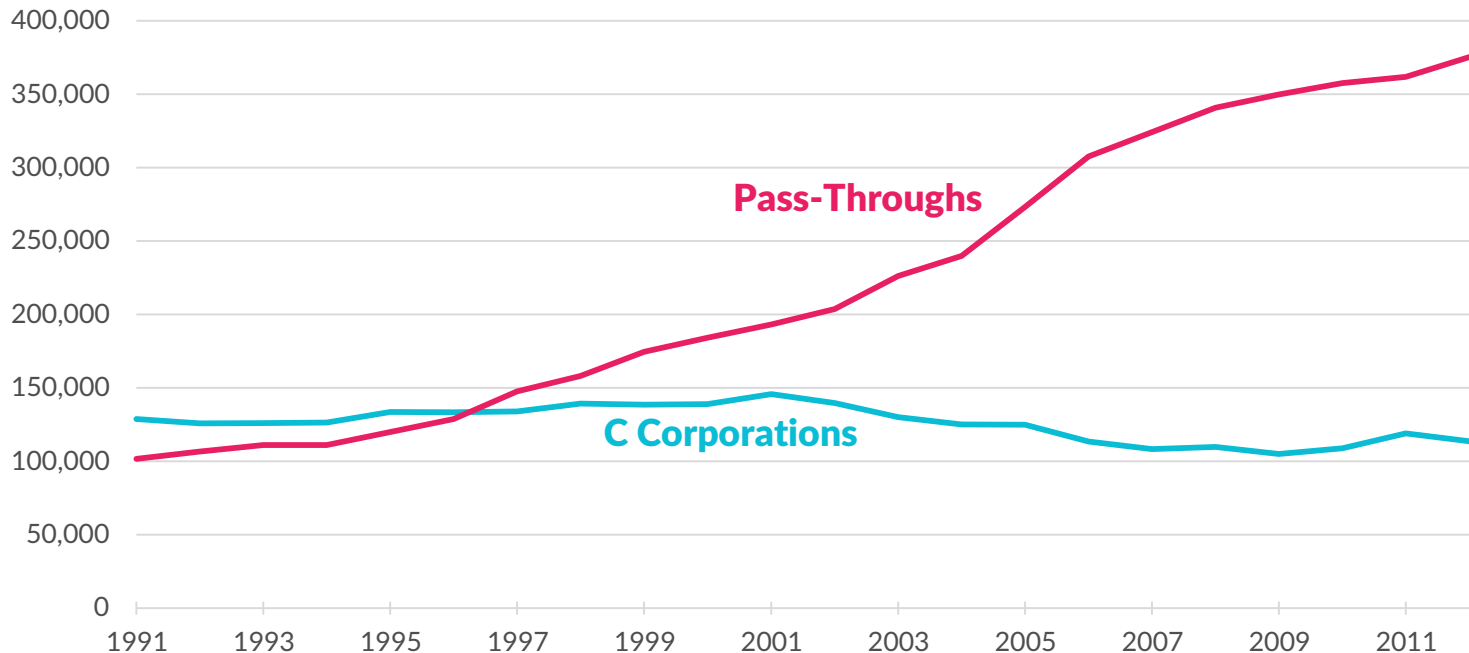
The state offers research and development (R&D) incentives, but they do little to offset the state's high tax burdens. Both new and mature firms consistently experience above-average tax liability.

Note: The total effective tax rate only includes state and local tax liability, not federal tax liability.

Source: Tax Foundation, *Location Matters: The State Tax Costs of Doing Business* (2015).

The Number of Pass-Through Entities Is Growing in Pennsylvania

Number of Business Filers by Organizational Structure by Year (1991–2012)

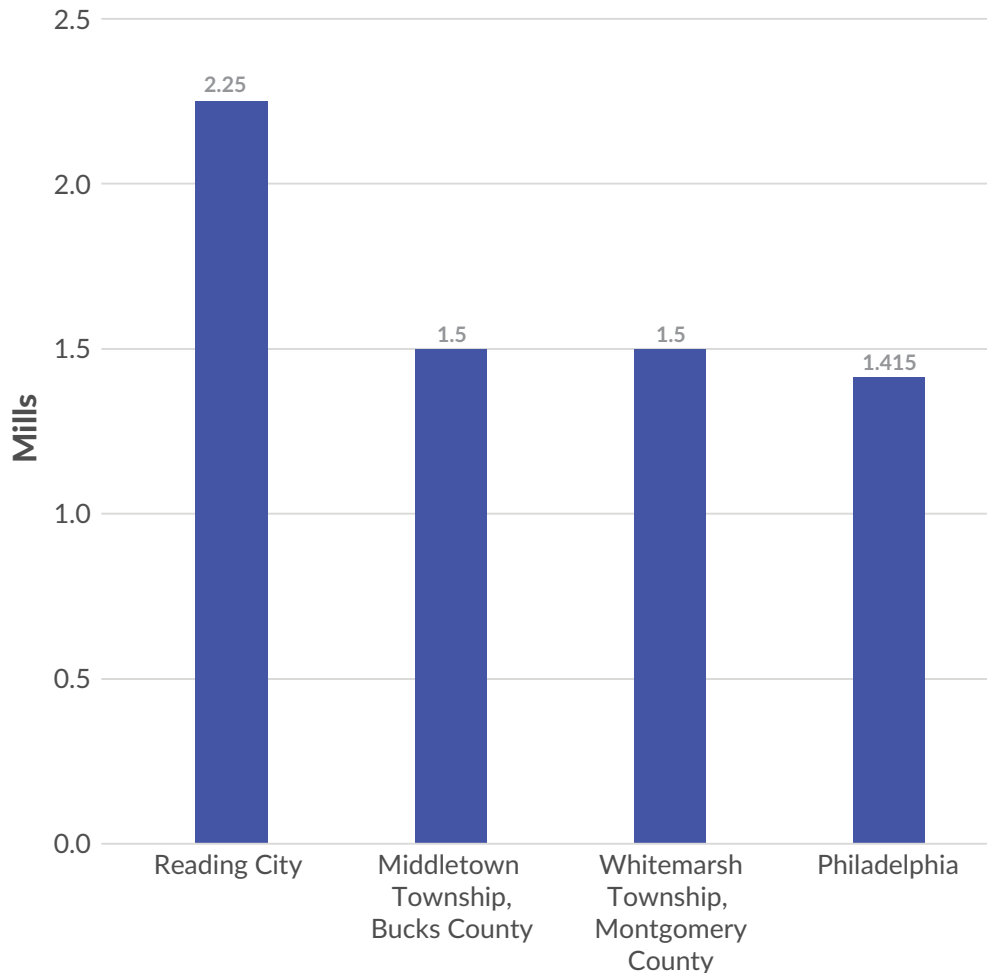


Pass-through businesses, such as S corporations, limited liability corporations, and partnerships, are taxed under the individual income tax code, rather than the corporate income tax code. The disparity between the corporate income and individual income tax rates in Pennsylvania gives firms a large incentive to structure as pass-throughs, instead of as C corporations. Even when adding on local income taxes (which get as high as 3.9102 percent in Philadelphia), the rate on pass-throughs is much lower than 9.99 percent. Over the past 25 years, the number of pass-throughs has increased substantially, growing by 269 percent since 1991.

Note: The number of pass-through businesses includes S corporations, limited liability corporations, and partnerships, and does not include sole proprietorship. Source: Pennsylvania Department of Revenue, *The Statistical Supplement to the Pennsylvania Tax Compendium Fiscal Year 2014-2015* (December 2014); Census Bureau, *County Business Patterns*.

Local Taxes Increase Businesses' Tax Burdens

Selected Local Business Privilege and Mercantile Taxes (2016)



Localities in Pennsylvania assess their own business taxes, called business privilege and mercantile taxes. These taxes are charged on a firm's revenue, not its net profit, and can quickly increase a firm's tax liabilities.

Gross receipts taxes like these are considered one of the most destructive types of taxes by most economists, due to the tax pyramiding that results from them—when taxes are assessed at multiple levels of the production process, final products have several layers of taxation embedded in the price.

Note: A mill equals \$1 in taxes paid for \$1,000 in revenue. Philadelphia's rate of 1.415 mills is not strictly comparable as the city exempts the first \$100,000 in gross receipts, but adds a 6.41 percent net income tax. Localities vary rates by industry. The rates listed above are the maximum assessed rate in each locality.

Source: Local tax forms and statutes.

CHAPTER 5

Sales Tax

Pennsylvania's sales tax consists of two parts. The first is the state rate of 6.0 percent, which is competitive among Pennsylvania's peers. The second is the local rate of 1 percent in Allegheny County and 2 percent in Philadelphia. Pennsylvania's average combined state and local rate is 32nd highest in the country. However, Pennsylvania's proximity to Delaware, which doesn't have a sales tax, encourages residents to engage in cross-border arbitrage, as purchasing goods in Delaware could save Philadelphia residents 8 percent in sales taxes.

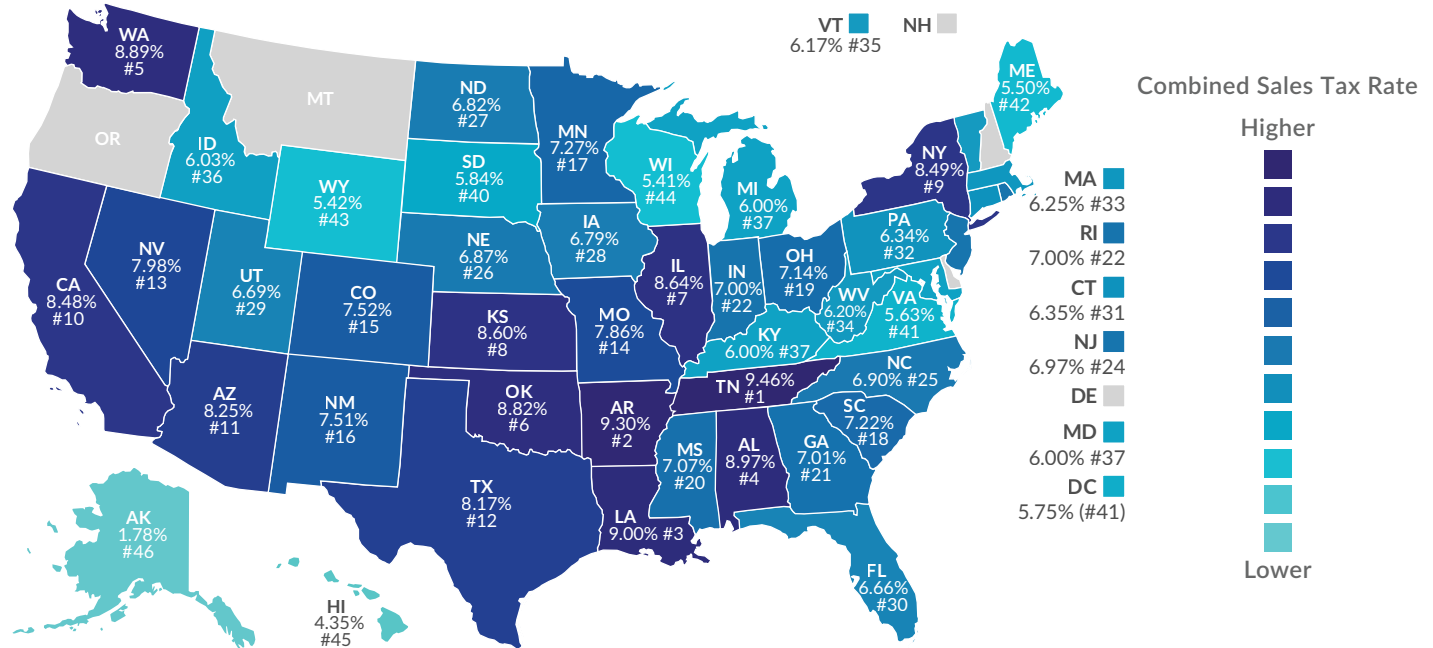
States tend to levy sales taxes on goods, even though the service sector now makes up a much larger share of the economy than when sales tax statutes were written in the 1950s. Over time, the decreasing tax base has contributed to the stagnation of sales tax collections per capita in Pennsylvania even as the rate has increased.



Hammerschlag Hall and the Cathedral of Learning, photo Dllu

Pennsylvania's Combined State and Local Sales Tax is Middle-of-the-Road

Combined State and Average Local Sales Tax Rates, Pennsylvania and Neighbors (as of January 1, 2016)

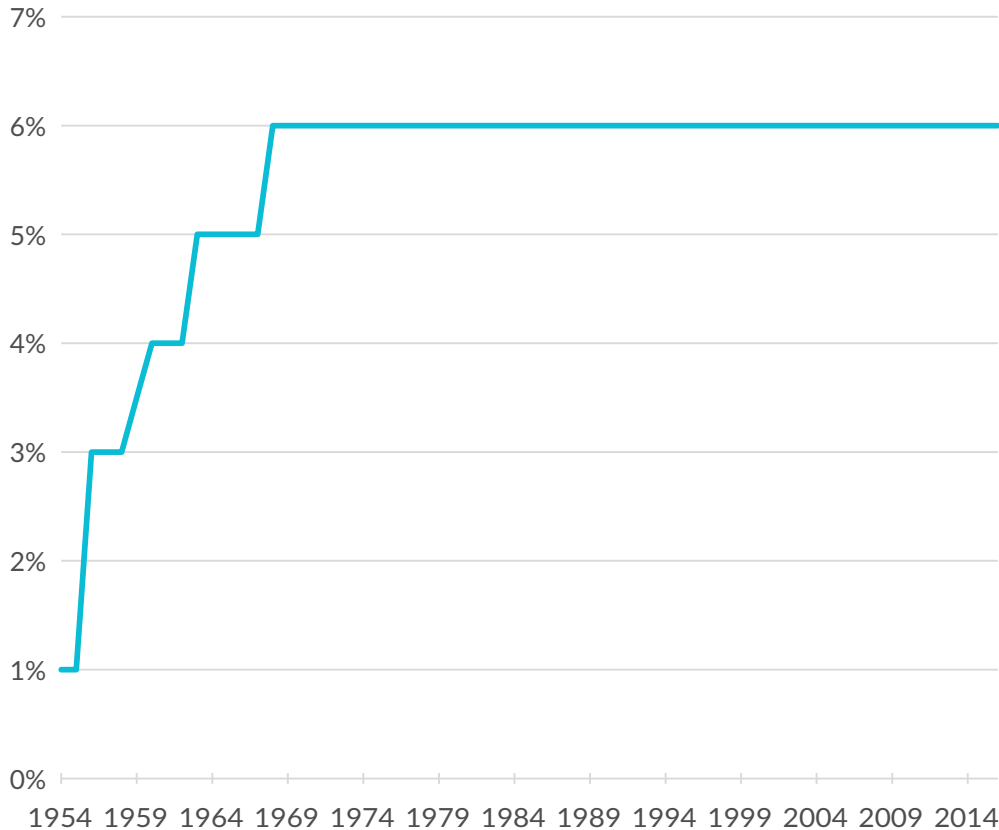


Pennsylvania's combined state-local sales tax rate is middle-of-the-road nationally. It includes a 6 percent state rate and an average local rate of 0.34 percent. The combined rate ranks as the 32nd highest rate in the country. It is lower than neighbors New Jersey (6.97 percent), Ohio (7.14 percent), and New York (8.49 percent). However, Pennsylvania borders Delaware, which has no sales tax. Southeastern Pennsylvania residents can cross the border into Delaware and purchase items tax-free. This presents a challenge to policymakers. They must balance the need for revenue with the strong competition from a no-tax neighbor.

Source: Tax Foundation, "State and Local Sales Tax Rates in 2016."

Pennsylvania's Sales Tax Rate Has Been Steady Since the 1960s

Pennsylvania State Sales Tax Rate (1954-2016)

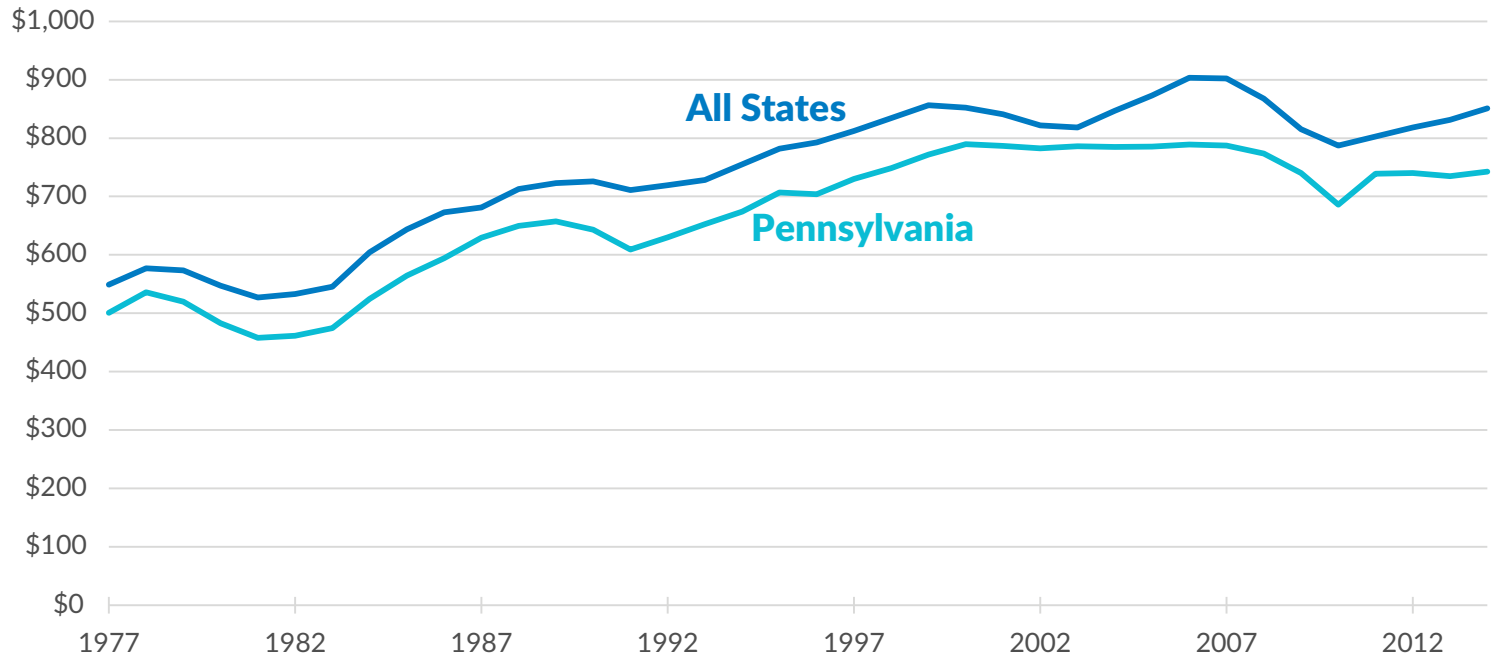


Pennsylvania passed its first state-level sales tax in 1954, setting it at 1 percent. It increased five times, reaching 6.0 percent in 1968. The rate has not changed since then, and it is currently the 16th highest state rate in the country.

Note: These rates do not include local sales tax rates.
Source: Pennsylvania Department of Revenue, *The Tax Compendium* (December 2014).

Sales Tax Collections per Capita Lag other States

State Sales Tax Collections per Capita, Pennsylvania and U.S. (1977-2014, in 2014 Dollars)



Sales tax collections per capita in Pennsylvania have grown since the late 1970s. Since 1977, per capita collections are up 48 percent. The rate of increase lags that of the U.S. as a whole. Nationally, collections have increased 55 percent.

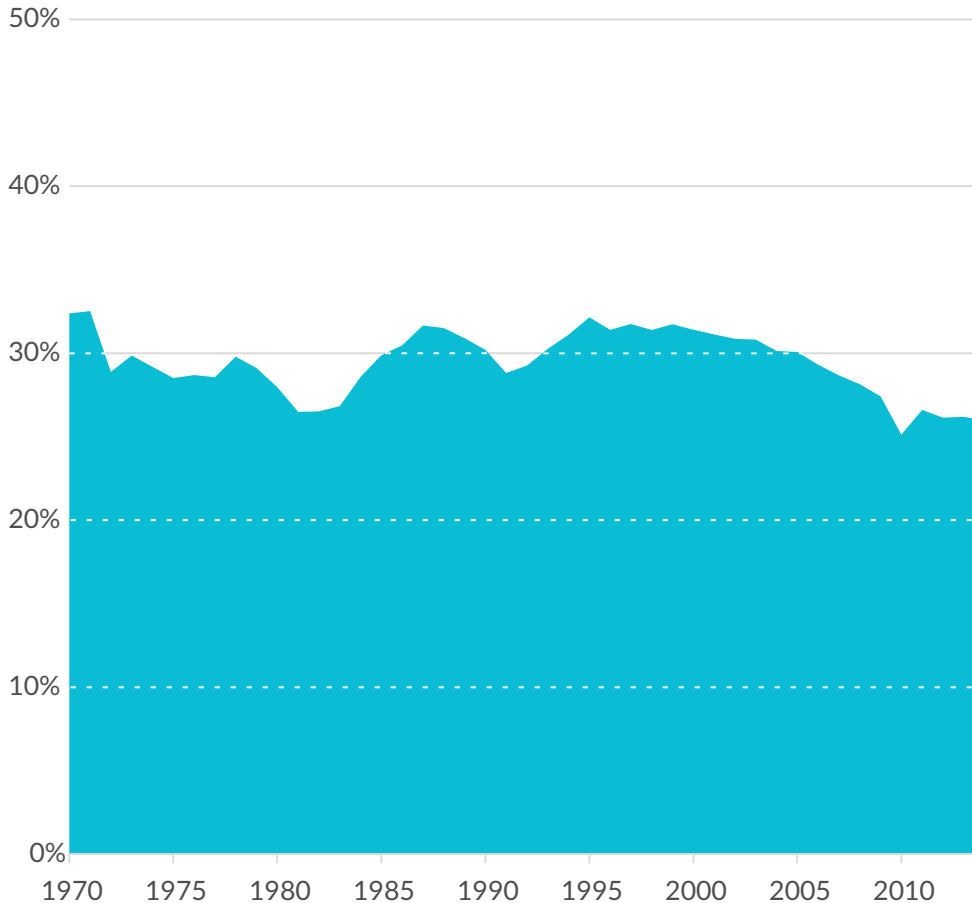
Pennsylvania collections grew quickly until 2000, when they stagnated. Collections fell during the Great Recession and are slowly returning to 2000 levels.

Note: Dollar amounts are inflation adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2014 base year.

Source: Census Bureau, *State and Local Government Finances*; Census Bureau, *American Community Survey*; Bureau of Labor Statistics, *Consumer Price Indexes*.

Pennsylvania's Sales Tax Applies to A Small Portion of the Economy

Pennsylvania Sales Tax Breadth (1970-2013)



An ideal sales tax is one that is levied on all final consumer purchases. By taxing a broad range of transactions, the rate can be kept low and still raise sufficient revenue.

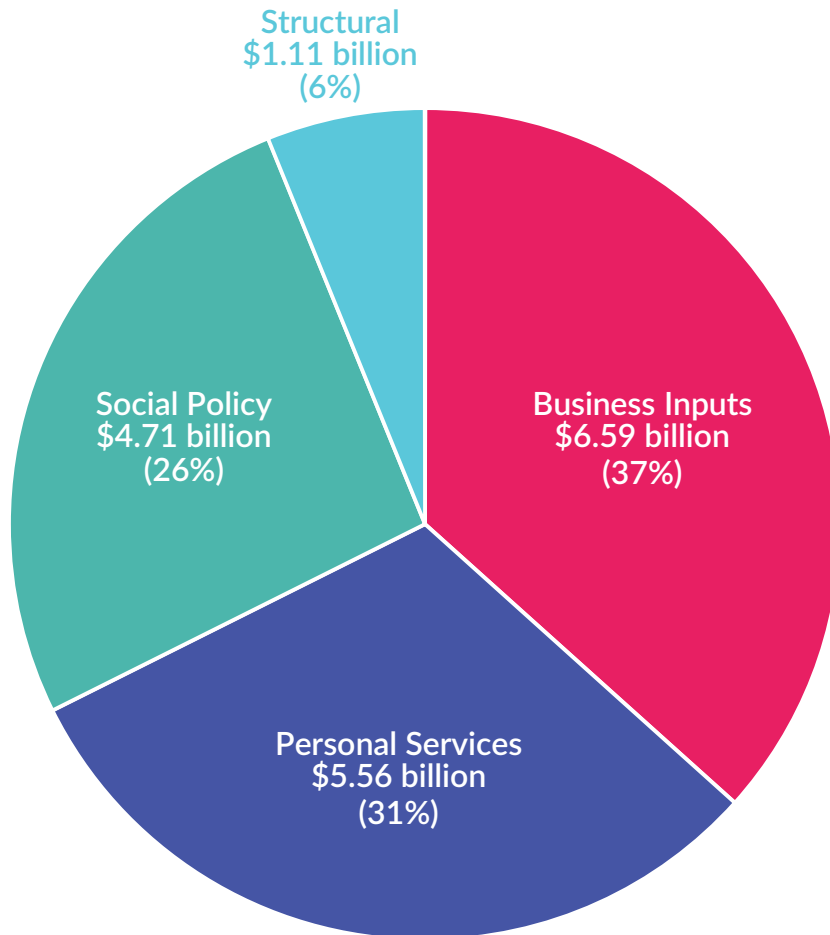
When the first American sales tax was created in Mississippi in 1930, it was levied on tangible goods, which was an overwhelmingly large part of the overall economy. Most other states followed suit with this model. However, the economy has become more service based since then. Pennsylvania's sales tax has represented around 30 percent of its economy since 1970. By failing to tax consumer services, the sales tax inherently favors the services sector over the goods sector and forces the rate to be higher than it would be otherwise.

Note: Sales tax breadth is defined as the ratio of the implicit sales tax base to state personal income.

Source: Professor John Mikesell (Indiana University).

Not All Sales Tax Expenditures Are Equal

Pennsylvania Sales and Use Tax Expenditures, by Type (FY 2017)



When states quantify tax expenditures, they often mistakenly lump structural provisions with other carve-outs when the two should be distinct. The former are tools used to ensure the sales tax is correctly structured, and 37 percent of expenditures fall into this category in Pennsylvania. Other carve-outs represent public policy decisions, such as exempting food and prescription drugs from the sales tax. These total 26 percent in Pennsylvania.

Not taxing personal services also reduces the sales tax base. In Pennsylvania, personal services comprise 31 percent of sales tax expenditure.

Source: Pennsylvania Office of the Budget, 2016-2017 Governor's Executive Budget: Tax Expenditures.

CHAPTER 6

Other Taxes

The previous chapters have covered individual income, corporate income, and sales taxes, but Pennsylvania and its localities assess other taxes too.

The first remaining category of taxes is excise taxes. Excise taxes are taxes on specific products, such as cellphone service, alcohol, cigarettes, gasoline, and natural gas extraction. These taxes differ from sales taxes that broadly apply to all final transactions. Pennsylvania's state and local excise tax collections per capita are 13th highest in the country at \$662 per person.

The second category of taxes is property taxes. In addition to real property taxes, Pennsylvania and localities assess realty transfer taxes when an individual buys or sells property.



Pennsylvania's High Tax on Natural Gas

Natural Gas Severance Taxes, Selected States (2016)



Severance Tax:	7.5%
Impact Fee:	+ 1.1%
Total:	<u>8.5%</u> (Proposed)



TX: 3.9%



OH: 1.1%



WV: 5.0%

Resource-rich states, like Pennsylvania, find ways to tax resource extraction. Pennsylvania, along with 10 other states, taxes natural gas extraction from shale formations. Some states, like West Virginia, tax the value of natural gas produced. Others, like Ohio, assess a flat charge on the amount produced. Pennsylvania does it differently with its impact fee. It assesses a flat fee per well that decreases over time and varies by the market price of gas. In 2015, Pennsylvania's Independent Fiscal Office estimated the impact fee's one-year effective rate at 5.5 percent.

Governor Wolf has proposed changing this to a severance tax of 6.5 percent of the value produced, leading to the highest tax in the nation.

Note: Interstate comparisons of state severance taxes are difficult due to the varied structures. The lifetime effective rates listed above are based on calculations by Pennsylvania's Independent Fiscal Office and allow for easier comparisons. Pennsylvania's rate listed above is based on Governor Wolf's current proposal.

Source: State tax forms and statutes; Pennsylvania Independent Fiscal Office.

Pennsylvania State Excise Taxes on Cigarettes and Alcohol

State Excise Tax Rates on Cigarettes, Spirits, and Beer (as of January 1, 2016)



Cigarette:
\$1.60 per pack,
22nd highest in U.S.



Beer:
\$0.08 per gallon,
45th highest in the U.S.



Spirits:
\$7.23 per gallon,
18th highest in the U.S.

Taxes on cigarettes and different types of alcohol are often referred to as “sin taxes”. While excise taxes on the sale of these specific types of goods can be used to offset the social costs created by the private use—such as the health issues associated with cigarette use—sin taxes should not be used as a means to raise general revenue. The revenues are not sustainable over the long run, and these taxes tend to be regressive.

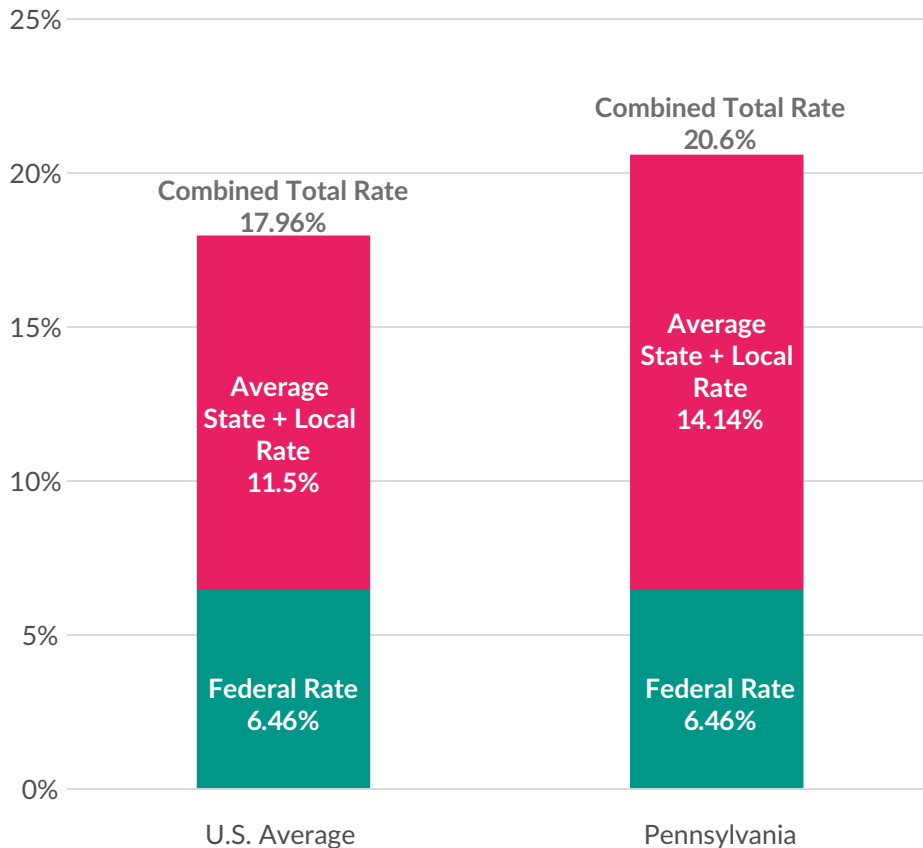
Pennsylvania’s excise taxes are high on spirits and cigarettes, but very low on beer.

Note: Wine is subject to the state’s 6 percent sales tax, not an excise tax. The cigarette tax assumes 20 cigarettes in a pack.

Source: Tax Foundation, *Facts & Figures 2016: How Does Your State Compare?*

Pennsylvania Taxpayers Face High Wireless Taxes

Charges on Wireless Service, Pennsylvania and the U.S. Average (as of July 2015)



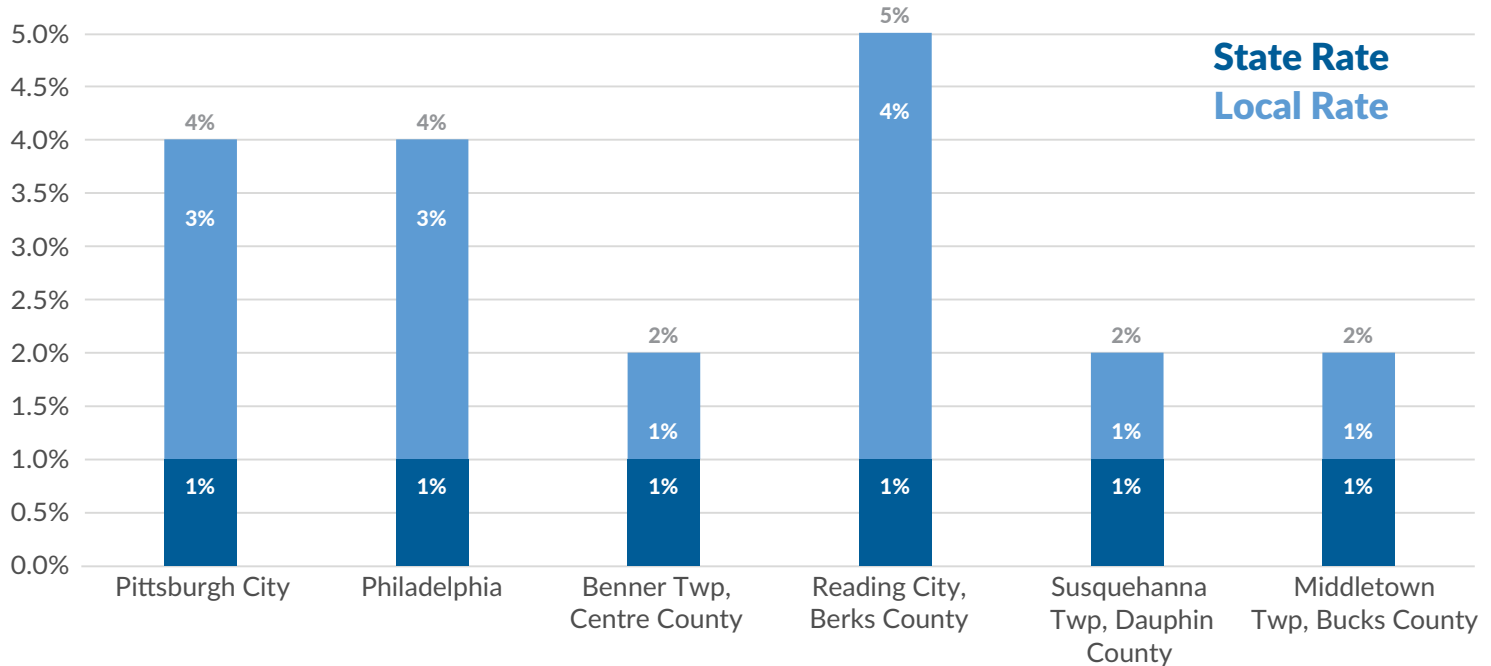
Wireless taxes in Pennsylvania are the ninth highest in the country. When the various federal, state, and local taxes are combined, Pennsylvania residents pay an effective tax rate of 20.60 percent. This is much higher than the U.S. average of 17.96 percent.

These rates are much higher than sales taxes in Pennsylvania. The average state and local sales tax rate is 6.34 percent, or one third of the effective wireless tax rate.

Source: Tax Foundation, "Record High Taxes and Fees on Wireless Consumers in 2015."

Realty Transfer Taxes Add to the Cost of Buying or Selling a Home

Selected Local Realty Transfer Taxes (2016)



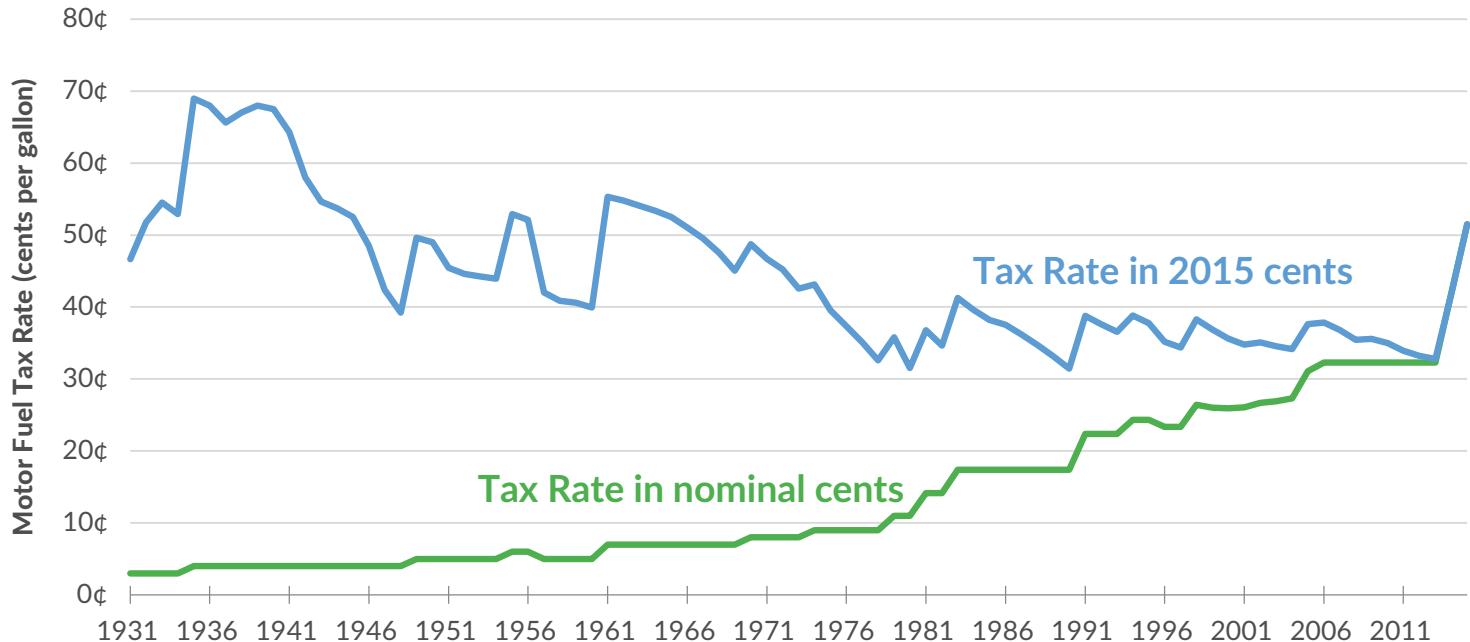
Pennsylvania is one of 36 states that assess a realty transfer tax. A realty transfer tax is assessed when a piece of real property changes ownership. The tax is charged at time of sale. Both sellers and buyers are jointly liable for the state tax of 1 percent, and the cost of the tax is traditionally split between the parties.

Localities assess realty transfer taxes on top of the state rate. The local rates are generally higher than the state rate. The rate is 4 percent in Reading City, which adds considerable costs to the sale of real estate. Local rates are split between municipalities and school districts.

Source: Pennsylvania Department of Community and Economic Development, *Municipal Statistics*; Pennsylvania Department of Revenue, *The Tax Compendium* (December 2014).

The Value of Pennsylvania's Gas Tax Has Returned to Historic Norms

Pennsylvania Gasoline Tax Rate, Nominal and Real (1931-2015)



Pennsylvania's gas tax was first passed in 1931 at 3 cents per gallon and has increased periodically, reaching 51.5 cents per gallon in 2015. The blue line shows each year's tax rate expressed in today's cents. For instance, the 5 cents per gallon rate in 1950 is the equivalent of 49 cents per gallon today.

Past gas tax increases have eroded over time, but the 2014 shift in calculation method has returned the gas tax to its historical norms in inflation-adjusted terms, and the tax will increase tax annually under the new structure.

Note: Amounts of inflation were adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2015 base year. Rates include the state gasoline excise tax, oil company franchise tax, and underground storage fee.

Source: Pennsylvania General Assembly, *Consolidated Statutes*; U.S. Federal Highway Administration, *Highway Statistics*; Bureau of Labor Statistics, *Consumer Price Indexes*.

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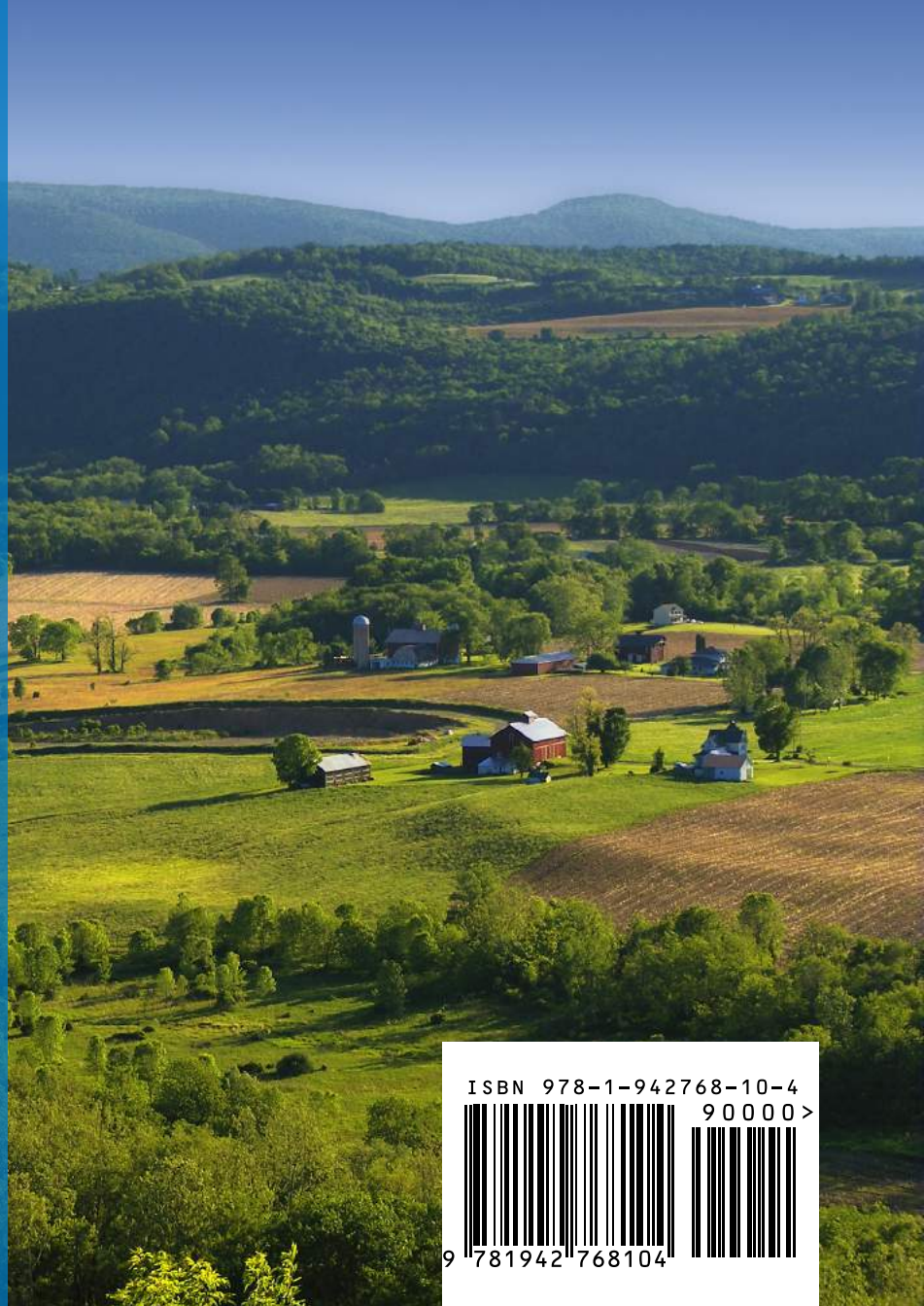
About the Tax Foundation

The Tax Foundation is the nation's leading independent tax policy research organization. Since 1937, our research, analysis, and experts have informed smarter tax policy at the federal, state, and local levels. Our Center for State Tax Policy uses research to foster competition between the states and advises policymakers on how to improve their tax systems.

About the Pennsylvania Business Council Foundation

The Pennsylvania Business Council Foundation, an affiliate of the Pennsylvania Business Council, stimulates and encourages Pennsylvania citizens, and especially business persons, to take a more active part in civic and political affairs. The PBC Foundation commissions research, publishes reports and conducts seminars to disseminate unbiased information on issues of civic affairs. The PBC Foundation does not advocate the adoption of any public policy proposal, or the election or defeat of any candidate. The PBC Foundation works for increased and better informed voter participation. The organization is a charitable organization approved by the IRS under section 501(c)(3) of the Code (EIN 20-0771774). The PBC Foundation is registered with the Commonwealth of Pennsylvania Department of State, Bureau of Charitable Organizations (certificate 36887).

Taxes are complicated. Each state's tax code is a multifaceted system with many moving parts, and Pennsylvania is no exception. This chart book aims to help readers understand Pennsylvania's overall economy and tax system from a broad perspective. It also provides detailed illustrations to each of Pennsylvania's major taxes—individual income taxes, business taxes, sales and excise taxes, and property taxes—to help make the complicated task of understanding the state's tax code a bit easier.



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