

House Appropriations Committee budget hearing with Revenue

2/21/17, 1:00 p.m., 140 Main Capitol Building

The committee held a budget hearing with the Department of Revenue.

Eileen McNulty, Secretary of the Department of Revenue, offered a brief overview of her written statement. She told committee members, "Governor Wolf is proposing a budget that cuts bureaucracy and eliminates waste, protects seniors and education, and provides long-term fiscal stability without broad-based tax increases." Sec. McNulty said, "This budget will dramatically improve the competitiveness of our economy by lowering the tax rate for corporations while making taxation fairer for Pennsylvania's small businesses through combined reporting." She concluded, "By reforming government and working smarter, this budget provides billions in savings, while continuing to invest in education, protecting vital services, combating the opioid epidemic and setting our commonwealth on a sustainable fiscal course that will grow the Rainy Day Fund from \$245,000 today to almost \$500 million by 2022."

Rep. Dunbar discussed some of the revenue assumptions included in the proposed budget. He asked about the \$54 million through enhanced revenue collection with a majority coming from delinquent tax collection. Rep. Dunbar wanted to know if that is after the amnesty program. Sec. McNulty responded, "Yes." Rep. Dunbar pointed out that under the general government operations tab it indicates a decline in collections from delinquent accounts for 2016-17 and 2017-18. He wanted to know why there is a decline in this line while at the same time there is an assumption of increased revenue through enhanced collection. Sec. McNulty explained that the lines referred to by Rep. Dunbar do not reflect the amnesty and that a significant amount of the delinquent collections will be labeled amnesty rather than being labeled delinquency. She added, "We will still achieve a high level of delinquent collections."

Minority Chairman Markosek noted the importance of the Lottery in funding senior programs and he wanted to know what plans the Lottery has for enhancing revenue in the future. Drew Svitko, Executive Director, Pennsylvania Lottery, responded that the Lottery is "doing pretty well right now." He explained that the Lottery is always looking at ways to expand its points of distribution. Svitko pointed out they are currently testing the selling of Powerball and Mega Millions tickets at certain gas pumps in the commonwealth. Chairman Markosek then asked about internet Lottery games. Svitko responded that "I-Lottery" is something they are looking into. He added it is being done in a number of other jurisdictions and other lotteries. Sec. McNulty pointed out that the budget assumes that I-Lottery is going to be in place by May 1 and produce revenue by October 1.

Rep. Delozier asked about the ability to cross reference technology systems when someone may be receiving a check back for a refund on one hand but may owe taxes on another. Sec. McNulty explained that it is in place in the department's business tax systems. Rep. Delozier asked if that would also apply to the personal income tax. Sec. McNulty explained that it would depend if it was a delinquent account. Rep. Delozier commented that there have been proposals regarding individuals who win the Lottery and owe back child support or back taxes to have the amount owed deducted from the individual's Lottery winnings. She wanted to know if there any procedure in place to check. Sec. McNulty responded that the child support offset is already in place and the department always checks the tax status of all Lottery retailers prior to licensing them and prior to renewing their licenses. She noted that the only money withheld from Lottery winnings is child support.

Rep. Daley asked about the tobacco products tax and the digital downloads tax and the amount to DOR received through them. Sec. McNulty explained that the sales tax on digital downloads was estimated to bring in an additional \$46.9 million for the current fiscal year and it was estimated to bring in \$19 million through December. She said that the department's analysis indicates current collections are meeting the department's expectations. Regarding the tax on other tobacco products, Sec. McNulty explained it was estimated to bring in an additional \$62.7 million overall and the first payment was due in January for the first quarter and through January that revenue source has brought in \$7.9 million over estimates. Rep. Daley asked if the department received sufficient resources to implement these new taxes. Sec. McNulty responded that the department did not receive "any specific resources" to implement the tax package that was implemented last year. Rep. Daley commented that she has received numerous calls and letters regarding the vape tax and it causing the closure of businesses. She wanted to know if there is any evidence of companies going out of business because of the tax. Sec. McNulty responded that there has only been anecdotal evidence. Rep. Daley then asked how Pennsylvania's vape tax compares to other states. According to Sec. McNulty, other states have the same rate or higher on other tobacco products.

Rep. Santora asked if the funds from the governor's proposed severance tax going to be restricted to only funding public education. Dan Hassell, Deputy Secretary for Tax Policy, explained that the original severance tax proposal was on a different basis than the one that is before the committee today. He further explained the original proposal was developed at a point in time when the price of natural gas was very high. Hassell pointed out that gas prices have been falling over the past couple of years and have started to recover in the last few months. He said that he is not aware of a component that dedicates all the revenue to education. Hassell suggested the question be directed to the Budget Office.

Rep. Santora then discussed the governor's proposed \$100 million reduction in tax credit programs. He said that the proposal discusses converting \$100 million into block grants. Rep. Santora asked if the education tax credits (EITC) are part of the conversion into a block grant program. Sec. McNulty responded that the objective of the program is to save \$100 million in the costs of the tax credits and not to group them together and re-grant them. She said, "This represents a comprehensive approach to reining in the cost of tax credits in the budget."

Rep. Briggs commented that last year there was lot of conversation in the legislature about video gaming terminals in bars and taverns. He wanted to know if this expansion would have an impact on the Lottery. Sec. McNulty replied, "We believe there would be a negative impact on Lottery sales." Svitko added that they looked at Illinois as an example where they saw a two percent decline in their draw games and a nine percent decline in instant sales. Rep. Briggs said that the Independent Fiscal Office had recommended Michigan as a state to look at regarding I-gaming. Svitko explained that I-Lottery would not be the selling of existing products on line. He said that it would be more for the use of interactive games. Svitko go said the I-Lottery would be used to compliment the products provided at retail outlets across the commonwealth. Rep. Briggs then asked about the impact of Powerball on consumers. Svitko talked about what he described as "jackpot fatigue" and its impact on Lottery sales. He pointed out that last year's \$1.6 billion jackpot raised the bar for other Lottery products. Svitko noted the current Powerball jackpot is over \$400 million but sales have remained flat.

Rep. Knowles asked about the Lottery's credit card pilot program and how compulsive gamblers are tracked. Svitko explained that it is a very small pilot program and they are still

collecting data. He said that they are finding most Lottery sales are a cash transaction and there are fewer larger transactions with credit/debit cards. Svitko pointed out that the Lottery would be able to place limits on the use of cards that they would not be able to do with cash transactions. Rep. Knowles asked how many transactions have been denied because the person has maxed out their credit card. Svitko replied that he did not know. Rep. Knowles then asked what percentage of Lottery players are compulsive gamblers. Svitko explained that they partner with problem gambling experts. He further explained how the Lottery works with the Pennsylvania Council on Compulsive Gambling and how the Lottery receives a monthly report that tells them the source of the calls that come into the council's call center. Svitko commented, "Lottery products are a small percentage of the calls that come in." Rep. Knowles asked how much money should be allocated for compulsive gambling initiatives. Svitko responded that he did not know how to answer the question.

Rep. Bullock praised the department for its ability to "do more with less." She wanted to know the "breaking point" at which the department would not be able to do its job with the current complement. Sec. McNulty discussed how the department is looking at technology in order "to do more with less" and she explained some of the department's technology initiatives. Rep. Bullock then asked about the department's diversity numbers. Sec. McNulty responded that the department including the Lottery has 1,872 employees with the male/female breakdown nearly half and half. She told Rep. Bullock that 78 percent of the workforce is white; 13.5 percent is black; 2.8 percent in Hispanic; and 5.2 percent is Asian. Rep. Bullock then asked for the numbers for executive/managerial positions. Sec. McNulty responded that she would have to get that information.

Rep. Christiana wanted to know the average salary for the department's employees. Sec. McNulty said that it is \$52,491. Rep. Christiana then asked about the average healthcare costs for those employees. Sec. McNulty explained that the cost for the current year is \$455 per pay period (26 weeks' pay periods per year). Rep. Christiana asked if the department's operating funds cover the employer contribution to the pension benefits of the department's employees. Sec. McNulty replied, "Yes." Christin Heidingsfelder, Deputy Secretary of Administration, explained the retirement budget is a percentage of income and in the current year it is 29.95 percent.

Rep. Gainey asked about Lottery sales through the use of the internet and apps and its impact on the Lottery. Svitko explained that the Lottery is looking at all kinds of ways to increase distribution. He said that the Lottery is working on building a better infrastructure; building a community through a VIP Players' Club and social media program; and getting people to interact with the Lottery's products online. Svitko noted there would need to be legislation to allow selling product online. Rep. Gainey asked if expanding the technology will lead to reducing the physical distribution centers such as retail outlets. Svitko responded that there is no reason to change the current distribution system. He pointed out the technology would create a different type of product.

Rep. Quinn asked for an estimate of the outstanding delinquent state taxes. Sec. McNulty responded that at the end of fiscal year 2015-16 the amount was \$1.1 billion. Rep. Quinn asked how long those taxes have been outstanding. Sec. McNulty explained that it is revenue that is not expected to be collected until after June 30, 2017. Rep. Quinn wanted to know how many enforcement field agents there are. McNulty responded that the department currently has 178 people in their call centers and serving as field agents. She did point out there are some vacancies. Rep. Quinn asked if the vacancies exist because they are not funded. Sec. McNulty said that it was because of funding. Rep. Quinn wanted

to know what steps the field agents can take to collect the delinquent taxes. Sec. McNulty explained the various steps including tax liens. Rep. Quinn then asked what cross-referencing between agencies is done to collect delinquent taxes. Sec. McNulty explained how they can issue citations, wage garnishments, and bank account attachments.

Rep. Dean wanted to know how much of the department's retirement budget is allocated for paying off the pension debt. Heidingsfelder responded that she did not have the information. Rep. Dean commented that the commonwealth has "a serious structural deficit" and she described Gov. Wolf's proposal as "novel and innovative." Sec. McNulty commented that one of the important initiatives that the governor addresses is the corporate net income tax. She noted, "That is the biggest shortfall we are experiencing in the General Fund." Sec. McNulty added that is down 9.1 percent from last year. She discussed the governor's proposal for combined reporting. Sec. McNulty also commented on the weakness in the revenue growth from the sales tax.

Rep. Boback asked about Lottery machines in liquor stores. Svitko reported that Lottery machines have been installed in 312 stores. He explained that the Lottery is now in the phase of educating the liquor stores' customers and consumers about the machines being located in the stores. Svitko added that they believe sales will continue to grow. Rep. Boback wanted to know if there are plans install the machines in every store. Svitko explained how it would not make good business sense to put machines in every store. He did say there are plans to maybe install machines in an additional 20 to 30 stores. Rep. Boback asked how seniors benefit from the Lottery and how the Lottery publicizes that fact. Svitko responded that the Lottery's website outlines the various program funded by the Lottery including PACE/ PACENET, senior centers, area agencies on aging, transportation, property tax/rent rebate, and long-term care assistance.

Rep. Boback asked about the tax amnesty program. Sec. McNulty explained that an individual or business does not have to pay the penalty and they have to pay half of the interest. She added that the people who are under deferred payment plans and want to take advantage of the amnesty have to pay up.

Rep. Boyle asked how much more revenue would have been generated if a severance tax on Marcellus shale had been implemented in 2011. Sec. McNulty responded that the department would have to calculate that amount. She added there would have been less of a revenue problem if it had been implemented. Rep. Boyle asked if the amount would have been "hundreds and hundreds of millions." Sec. McNulty responded, "Yes."

Rep. Miccarelli asked about the McKinsey Report and its criticism of the department regarding tax collections and improving staff productivity. He asked Sec. McNulty for her reaction to the report's findings and if the money for the report was well spent. Sec. McNulty responded that the department has dedicated significant resources to cleaning up inadequate data. She explained how employees from different bureaus had to be utilized for the cleanup. Sec. McNulty further explained the report recognized the department's effort to improve its employees' productivity. Rep. Miccarelli asked if the report "got it wrong." Sec. McNulty responded that the report "only took a one year snapshot" of the department.

Rep. Kinsey asked about the department's mission. Sec. McNulty explained that it is to collect the commonwealth's revenues with integrity and accuracy to enhance the funding of programs. Rep. Kinsey complimented the department and its employees for the work that they do.

Rep. Grove commented that he had submitted a list of questions to Sec. McNulty ahead of time and he wanted to know the status of her response since it has been almost one month. Sec. McNulty pointed out the letter expected an answer in 90 days. She added, "We are on track." Rep. Grove asked when the department received the McKinsey Report. Sec. McNulty said that it was sometime in November or December. Rep. Grove then asked who from the department met with the people from McKinsey. Sec. McNulty replied, "Many people." Rep. Grove asked if the recommendations were brought to the department by McKinsey or to McKinsey from the department. Sec. McNulty responded, "Both."

Rep. Schweyer asked if loss of sales is a significant threat to the Lottery Fund. Svitko responded that he has been at the Lottery for over 20 years and they are always looking for ways to push sales and increase profits. Rep. Schweyer then asked about the overuse of Lottery funds for Medicaid purposes. Svitko explained that the Lottery is on the input side of the equation and cannot comment on the output side.

Rep. Ortity asked if the governor's severance tax proposal allow for any capital cost recovery like other states. Sec. McNulty explained that is under the income tax and not the severance tax. She added part of the governor's proposal addresses the impact fee. Rep. Ortity then asked if there would have been the same level of gas production if a severance tax would have been imposed in 2011. Sec. McNulty explained that they are anticipating production to increase. Rep. Ortity asked if the department tracks the revenue collected from shale counties with those collected in non-shale counties. Sec. McNulty reported the department has looked at sales tax collections and there has been some decline in shale counties.

Rep. Krueger-Braneky commented that until recently Pennsylvanians have been using natural gas imported from other states which have a severance tax. She wanted to know if it fair to say consumers in Pennsylvania have already been paying a severance tax. Sec. McNulty responded, "Yes it is." Rep. Krueger-Braneky asked if most of the gas being produced in Pennsylvania is being exported out-of-state. Sec. McNulty said that she is not sure that is most but some is being exported. Rep. Krueger-Braneky then asked who will ultimately pay for the cost of the severance tax. Sec. McNulty explained that the company would have to recover its costs for producing their product so it will be whoever is paying for that product. Rep. Krueger-Braneky wanted to know who the end consumer is for the natural gas being produced in Pennsylvania. Sec. McNulty said that department does not have that data.

Rep. Kampf asked about the proposed insurance premiums tax expansion. He also wanted to know if those entities are being taxed in some other way. Sec. McNulty said that the insurance premium tax proposal closes loopholes and exemptions in the tax base. She further explained it affects health maintenance organizations, nonprofit hospital plans and health service plans and other entities that are organized as risk assuming non-licensed insurers. Sec. McNulty spoke about the need to add these groups to the Tax Code. Rep. Kampf asked if any of these groups currently pay any other taxes. Sec. McNulty explained that some pay the corporate income tax or the personal income tax if they organized as non-C corporations. Rep. Kampf then asked about the proposal to reduce the tax credits and the impact on the EITC and the OSTC. Sec. McNulty explained that the saving has to come from a combination of the 19 tax credit programs. Rep. Kampf argued that the bulk of the savings would have to come from the EITC and the OSTC.

Rep. Flynn asked about the impact of the governor's proposed budget on working families. Sec. McNulty argued that the increase in the minimum wage would have the greatest impact. She said that the increase could generate an additional \$95 million in tax revenue.

Rep. Roae raised a concern that the benefit factor of employees in the property tax/rent rebate program is 93.4 percent and asked what drives the cost to be so high. Sec. McNulty confirmed department employees are unionized, but pointed out people working in that program make less than the department average of \$52,000 and pointed out that the fixed costs account for a higher percent overall for lower paid employees. Rep. Roae said most companies try to keep benefit costs much lower and argued that \$265 million is distributed through the program, but the cost to do that is \$15.6 million. He said that is \$31 per application for the department to process each application whereas it is only \$2.83 for the department to process a tax return. He wondered if the property tax/rent rebate applications are available online. Sec. McNulty replied they can currently only be filled out on paper but confirmed it will be part of the eventual modernization process, "but it's several years down the line."

Rep. Samuelson, minority chairman of the House Aging and Older Adult Services Committee, asked how many people work on that program. Sec. McNulty confirmed it is 67 people. Rep. Samuelson pointed out about 600,000 Pennsylvanians benefit from the program, meaning each employee is processing thousands of rebates each year. "That's a significant workload and the employees in the department should be commended." Rep. Samuelson then asked about the Lottery, which is dedicated to senior programs. He said administrative costs account for 1.89 percent and called it one of the most efficiently run lotteries in the country. Lottery sales, he continued, have grown to \$4.1 billion and asked about the proposal for online Lottery sales. Sec. McNulty explained a \$19 million increase is expected from that proposal. Rep. Samuelson asked how much would be lost if internet gambling is implemented without internet Lottery. Svitko could not quantify, but said it would be "really negative on the Lottery, especially long term." Rep. Samuelson asked how many people get the property tax/rent rebate. Sec. McNulty replied it was 560,400 last year and confirmed it is declining. Rep. Samuelson remarked many constituents miss the qualification threshold by a small amount and argued it is time to enact an adjustment.

Rep. Keller asked how much online filing has increased over the past six years. Sec. McNulty confirmed electronic filings are increasing, noting the vast majority of filings are electronic. She particularly noted electronic liquid fuels tax filings have increased from 40 percent last year to 98 percent due to incentives that were enacted. Rep. Keller commented it is the people of Pennsylvania making the commonwealth more efficient, not the government itself. He then asked what percentage of taxpayers is delinquent. Sec. McNulty said \$629 million was delinquent last year and the estimate of uncollected taxes is \$1.1 billion. Rep. Keller pointed out that a lot of the process is automated and the bulk of those are timely. Regarding performance measures, he continued, asked for three items that the department is working on to cut waste and bureaucracy. Sec. McNulty replied the department is trying to be more efficient and cited continual movement toward online filings, including lien filings, and sales tax desk review. Rep. Keller asked if the public can see those performance measures and how the government is measuring up. Sec. McNulty referred him to the governor's GO-TIME website, which has dollar amounts. She said those savings tend to result in increased collections for the General Fund in her department; not a decreased budget. Rep. Keller also asked for a list of each tax credit proposed and how much the commonwealth will get for each one. Sec. McNulty replied she does not know how much will come in from each tax credit until the Department of Community and Economic Development (DCED) analysis is completed.

Rep. Helm returned to the property tax/rent rebate program and said the estimated payment marks a decrease of \$5.2 million and 5,000 fewer households. She asked why fewer households will receive this money in light of the growing senior population. Sec. McNulty explained income levels are not indexed to inflation and, as it remains static, the population that qualifies is declining. She noted it would have to be addressed within the context of the overall Lottery Fund and again noted the many demands on that fund. Rep. Helm said she is often asked by people applying for the program. She also cautioned against shifting the application entirely online.

Rep. Helm next asked about taxes collected on other tobacco products. Sec. McNulty provided the estimated revenue for the entire fiscal year and year to date totals. She said \$62.7 million is expected in total from the other tobacco tax, of that \$46.2 is expected from smokeless tobacco, \$13.3 million from the tax on e-cigarettes, \$2.8 million from the tax on pipe tobacco, \$0.2 million from the tax on roll your own cigarettes, and \$1.9 million in sales taxes. To-date, she added, collections are \$7.9 million over estimate, but the department does not yet know the reason and whether that will be sustained.

Rep. Helm asked about the effect of the tax on vape shops. Sec. McNulty did not have any evidence of problems other than anecdotal situations. She said most of them are paying taxes and the department is working with them.

Rep. Dunbar asked if revenue enhancements have to do with add-back provisions. Sec. McNulty replied, "No." She confirmed, however, the department does track those provisions and agreed to share that information with the committee. Regarding combined reporting, Rep. Dunbar asked how much additional revenue is anticipated. Sec. McNulty replied the projection is combined with a rate cut, but said the data can be separated out. She said it is \$500,000,000 with the rate cut to 8.99 and explained these are legal transactions, but based on what she characterized as a loophole in the law. She explained there are "strict, narrow guidelines" for when the provisions apply and said the add-back provision generated \$32 million, close to the \$35 million estimate.

Rep. Santora asked about the cuts to tax credits. Sec. McNulty explained a group review of tax credits is underway, from which \$100 million needs to be saved. She indicated no specific cut will come from any particular credit. She confirmed EITC, OSTC, film credit, concert rehearsal, video game production, research and development, job creation, and PA resource manufacturing are all on the list. She remarked it might be easier to just give him a list. Turning to the EITC, Rep. Santora speculated that a straight reduction would mean 23,000 families could potentially be affected. He argued the EITC and OSTC benefit public schools.

Rep. Quinn asked about appropriations from restricted accounts in the Gaming Fund, "1401 accounts," which are used for various regulatory and administrative costs that agencies incur. Almost a year ago, she said, casinos received a letter those fees would be increasing with only three months' notice. She shared their concern for an accounting of those dollars and asked for responses to the casinos' requests. Sec. McNulty said the right-to-know requests of the casinos have been satisfied and said the assessments are driven by the sum of the appropriations to the four agencies and said the department will soon be letting the casinos know the new assessment, as they were told to expect. The rate, she said, will go to 1.9 percent on August 1 under the governor's proposal of \$35.9 million for the Gaming Control Board, \$30.7 million for State Police, \$6.5 million to Revenue to collect gaming taxes, and \$1.3 million to the Office of the Attorney General. She noted it was 1.7 percent last year and agreed to provide a breakdown of the agencies that the money goes to.

Chairman Saylor discussed the proposed cracker plant in Pennsylvania and expressed concern about the tax credit proposal considering the Governor signed an agreement with the cracker that included a tax credit. Hassel noted the legislative proposal is not written yet and expected DCED to take the lead on that. He said he would investigate and get an answer back to the committee.