

## **Enacted 2012-13 Budget Fact Sheet: Tax Code Changes Whittle Away at State's Revenue Base**

Changes to the state's Tax Code, enacted in House Bill 761 (Act 85 of 2012), are projected by the House Republican Appropriations Committee to reduce revenue collections by \$90 million in 2012-13, but the bill has much greater long-term costs.

In the act, the General Assembly creates new tax credits, tax reductions that won't be fully realized for several fiscal years, and changes that go into effect in 2013-14 or later, which will reduce future revenue collections more significantly. Included in this bill was the controversial multi-billion dollar tax credit for the proposed Shell ethylene cracker plant, which will go into effect in 2017.

Not included in the Tax Code bill, but having a substantial impact on balancing the budget, are previously enacted tax rate cuts for the capital stock and franchise tax (CSFT). The CSFT rate was cut from 2.89 mills to 1.89 mills at the beginning of 2012 and is scheduled for another one mill cut (bringing the rate to 0.89 mills) in 2013. These cuts are expensive and are reflected in decreased CSFT collections – which decline from \$539 million in 2011-12 to \$298 million in 2012-13, a reduction of 36%. Revenue lost from the CSFT cuts was not replaced, meaning a decline in the amount of funds available for schools, health care, and other critical services.

Tax credits continue to proliferate. The 2012-13 budget deal creates or expands several tax credit programs.

The Educational Improvement Tax Credit (EITC) program will grow from \$75 million to \$100 million, beginning in July 2012. Income eligibility for scholarship recipients increases from \$72,000 to \$90,000 for a family with one child, and the amount a company may “contribute” to the program grows from \$300,000 to \$400,000 in 2012-13 and to \$750,000 in 2013-14.

A new, closely related program, the Educational Opportunity Scholarship (EOS) Tax Credit, was created in the budget deal and is expected to cost \$50 million in 2012-13. Under the EOS, children living in the attendance boundaries of the lowest performing schools (defined as schools whose students perform in the bottom 15% on standardized tests) would be eligible to receive scholarships to attend private or religious school or to transfer to other school districts — if accepted by those schools or school districts.

Just like in the EITC program, businesses would donate the funds necessary for the scholarships, but would get a tax credit equal to 75% to 90% of the amount donated. Total credits would be capped at \$50 million per year, reducing General Fund tax collections by a like amount.

Other tax credits are expanded in scope, but not in dollar value. The Job Creation Tax Credit expands to offer \$2,500 per job for hiring previously unemployed workers, while maintaining the \$1,000 tax credit for other jobs created. The Neighborhood Assistance Tax Credit will now count donations to food banks. The Film Tax Credit allows an additional 5% credit for expenses in qualified production facilities meeting specific stage requirements, which is likely to benefit QVC, based in West Chester.

The budget also creates tax credits which do not go into effect until 2013-14 and beyond. The \$55 million Research & Development Tax Credit, which was supposed to sunset in 2015, will now continue indefinitely. The law establishes a \$3 million per year Historic Preservation Tax Credit equal to 25% of qualified expenditures incurred from rehabilitating historic commercial property. A new Community-Based Services Tax Credit is available to businesses donating funds to an approved nonprofit organization that provides services to individuals with intellectual disabilities or mental illness. This credit is capped at \$3 million per year. Both credits are effective July 1, 2013.

The Resource Manufacturing Tax Credit is created to attract Shell and other companies to build plants to manufacture ethylene from natural gas produced in the Marcellus Shale. The cracker credit, which begins in 2017, has no cap, meaning that it could be unlimited unless action is taken by the General Assembly. A company converting ethane to ethylene can receive a tax credit equal to \$0.05 per gallon of ethane purchased each year. To qualify, the facility must employ 2,500 full-time equivalent workers during the construction of the facility. If the taxpayer has no liability (as is expected with Shell, as it is in a Keystone Opportunity Expansion Zone), tax credits generated can be sold first to downstream companies — companies that use the ethylene produced — and then upstream companies — natural gas producers and pipelines — before being sold on the open market. Earlier versions of the credit were expected to cost \$66 million per year from 2017 through 2042 (a total cost of \$1.65 billion).

Other notable changes occurring in 2012-13 include:

- Adoption of the single sales factor method of apportionment for corporate net income tax (previous law was 90% sales, 5% property, and 5% payroll);
- Exclusion of family farm transfers between family members from the state's inheritance tax and realty transfer tax; and
- A number of administrative changes, including the elimination of semi-monthly sales tax filing, requiring companies paying royalties on oil/gas leases to issue federal Form 1099s to the Department of Revenue, and giving the Department of Revenue the power to attach bank accounts to satisfy tax liens.

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