Governor's Budget Proposal Maintains Capital Stock/Franchise Tax Phase-out But Asks Retailers to Pay More

by James L. Fritz

Governor Corbett has proposed a Pennsylvania 2012-13 budget that would hold spending flat overall while dealing with pension cost increases and other mandates. The business community, in general, would fare well because the Governor proposes to maintain the phase-out schedule for the Capital Stock and Franchise Taxes. However, larger retail vendors would take it on the chin because the Governor would essentially eliminate the 1% discount they currently receive for collecting sales taxes on behalf of the Commonwealth.

Sales Tax Discount Cap

As proposed by the Governor, a retail vendor's sales tax discount would be capped at $250 per month ($3,000/year). Thus, retailers making up to $5,000,000 of taxable sales per year would essentially continue to receive their full collection compensation ($5,000,000 x 6% = $300,000 tax x 1% = $3,000). However, larger retailers making sales many times that amount would receive only $3,000/year, regardless of the fact that their costs are much greater. Capping the discount would save the Commonwealth $41.3 million/year. Although the Governor has pledged not to increase taxes, the Secretary of Revenue has indicated that the administration views the discount as a "fee" paid by the Commonwealth and doesn't believe it is receiving value for the compensation paid. The retailers probably would like to see how the Department calculates the value of retailer efforts to determine taxability; administer exemption claims; collect, account for and remit the tax; and, deal with the Department's audits!

Capital Stock/Franchise Phase-Out

The Capital Stock and Franchise Tax rate was reduced to 1.89 mills on January 1, 2012 and is already scheduled to be reduced to 0.89 mills on January 1, 2013, with full elimination in January 2014. The business community views this as an onerous tax because it is collected even when companies lose money and is imposed on top of perhaps the highest Corporate Net Income Tax in the country. Apparently the Governor agrees and sees the maintenance of the phase-out as a major factor in encouraging businesses to invest in Pennsylvania. We will see over the next few months whether the Legislature also will maintain the phase-out schedule, or will push it back as has been done before in order to maintain revenues for state-funded programs.

Tax Credits

Major tax credit programs would remain at current levels under the Governor's budget proposal.

Educational Improvement	-	$75 million
R&D	-	$55 million

Job Creation	-	$10.1 million
Film Production	-	$60 million

Pressure on State-funded Programs

The budget assumes a 3.8% growth in tax collections, but this comes on the heels of adjustments reducing predicted current-year revenues by $719 million. Projected 2012-13 receipts include $6-7 million from the addition of a use tax line on annual personal income tax returns. The budget also assumes collections of $42.8 million resulting from online sellers complying with the Department of Revenue's recent bulletin asserting a sales tax collection obligation by many such sellers.

Many state-funded programs would take hits as money had to be found to fund increased pension contributions and other mandates. The State System of Higher Education's 14 universities would receive 20% less than in the current year while Penn State, Pitt and Temple would be cut by 30%. The Governor's Office seems to be maintaining that K-12 education would be level-funded, but the House Democratic Appropriations Committee asserts that actual funding would be decreased by more than $100 million.

Although some reduced appropriations to schools and local governments would be collapsed into block grants to give added flexibility, there very likely would be pressure to increase taxes at the local level to compensate for some state cuts. It seems obvious that the General Assembly will be pressured from many fronts to find additional revenues so that program cuts can be avoided and so that less pressure will be placed on school districts and local governments.

Tax Administration

The Department of Revenue would not escape budget cuts. The Department's general operations appropriation would be cut by 6%. The use of certified mail in mailing assessments would be eliminated for a cost savings of $750,000. The threshold for payment by electronic funds transfer would be reduced from $20,000 to $10,000 to speed cash flow and reduce costs by $100,000.

To enhance collections notwithstanding cuts in Department funding, the Department of Revenue would be given additional enforcement tools, including authority to attach bank accounts of delinquent businesses, increased penalties for failure to file pass-through entity information returns, and withholding at the source for certain non-wage income. The enhanced enforcement tools would be expected to yield additional revenues of $21.6 million.

The Department of Revenue's "Enhanced Revenue Collection Account" augmentation would be increased from $4.3 million to $10 million, and extended through FY 2016-17. This expenditure would be expected to yield collections of $100 million in FY 2012-13.

The Board of Finance and Revenue's budget would be cut by 5%.

The State Tax Equalization Board, which monitors real estate tax uniformity, would be eliminated and its functions absorbed by the Department of Community and Economic Development.
While the Governor mentioned transportation funding needs in his budget message, he left specific proposals to be dealt with another day.

If your company requires assistance in determining how you will be impacted by the FY 2012-13 budget process, please contact any member of our SALT group.