



## REPORT ON KEY ISSUES FROM THE HOUSE APPROPRIATIONS COMMITTEE

# BUDGET BRIEFING

DWIGHT EVANS, DEMOCRATIC CHAIRMAN

October 9, 2009

## 2009/10 Budget: Commonwealth Checkbook

### Spending

The 2009/10 state budget contains total state spending of approximately \$27.798 billion, which is \$455 million less than the General Fund obligation for fiscal year 2008/09. The 2009/10 state spend includes \$2.6 billion in federal funds resulting from the American Reinvestment and Recovery Act. The total spend assumes approximately \$699 million for non-preferred appropriations, which have not yet been passed into law as of October 9, 2009.

### Income

The 2009/10 fiscal year began with a deficit of approximately \$2 billion and an official revenue estimate of \$25.561 billion. In order to maintain spending of approximately \$500 million less than the previous year, additional revenues were needed to balance the budget. The total amount of recurring revenue is \$607.5 million, and the total amount of non-recurring revenue is \$1.99 billion to be used in the budget year.

The General Assembly passed a Tax Code bill (House Bill 1531) which created new taxes in the amount of \$116.5 million, consisting of a cigarette tax of 25 cents per pack and an equivalent tax on small cigars. The Tax Code bill also contained fund transfers, a freeze in the capital stock and franchise tax rate, and reductions to the corporate net income tax, which net an additional \$510 million in recurring revenues. Non-recurring revenues in the Tax Code consist of changes to sales tax payment

schedules, fund transfers, and the creation of a tax amnesty program, which total \$1.1 billion.

In addition to the Tax Code, the Fiscal Code (House Bill 1614) includes recurring revenue fund transfers of \$44 million and non-recurring revenues consisting of the leasing of state forest land and fund transfers to be used in the budget year of \$705 million. The General Appropriations bill (House Bill 1416) includes almost \$177 million in non-recurring fund transfers. Other income which would be needed to balance the budget could come from the establishment of table games in licensed casinos. The legislation authorizing table games revenue of approximately \$200 million is still under consideration as of October 9, 2009.

### Gross Receipts Tax on Managed Care

In response to a federal change that took effect October 1, 2009, the Governor's Executive Budget proposed a two percent statewide assessment on all managed care organizations as a new funding source for Medical Assistance managed care, replacing the previous assessment which ended September 30, 2009 in accordance with federal law. As an alternative to the Governor's proposed statewide assessment, House Bill 1531 institutes a state gross receipts tax on managed care organizations (MCOs) that are under contract with the Department of Public Welfare

(DPW) and enroll Medical Assistance recipients – these are the same managed care organizations that paid the recently terminated assessment. Revenue from the gross receipts tax will be used to draw down additional federal Medicaid matching funds for the Medical Assistance managed care program. The Commonwealth earns the additional federal match by making supplemental payments to the Medicaid MCOs that equals the gross receipts tax paid by the MCOs and then seeking federal reimbursement for the supplemental payments.

The gross receipts tax on managed care organizations will generate \$528.548 million in 2009/10 and \$529.459 million in 2010/11. The Commonwealth will, in turn, incur a concomitant

expense in the form of the supplemental payments (which will be incorporated in the monthly rate that DPW pays the MCOs). These payments are expected to draw additional federal Medicaid matching funds of \$316.118 million in 2009/10 and \$317.060 million in 2010/11. Consequently, the net revenue gain to the Commonwealth is equal to the federal Medicaid match.

If the federal government determines that this tax is not permissible for federal financial participation, the tax will cease to be imposed.



**QUESTIONS AND COMMENTS**  
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| <b>Total Recurring and Non-Recurring Revenue by Act</b> |                     |
|---|---------------------|
| Tax Code  | 1,735,836           |
| Fiscal Code   | 748,671             |
| General Appropriations                                  | 176,633             |
| <b>Total</b>  | <b>\$ 2,661,140</b> |

Tables on the following pages show a more detailed explanation of all revenue changes included in the Tax Code, Fiscal Code, and General Appropriations bill.

**General Fund Revenues in Tax Code, Fiscal Code,  
and General Appropriation Act Estimate  
(\$ Thousands)**

| Revenue Source/Description   | FY 2009-10      |
|--|-----------------|
| <b>Tax Reform Code (House Bill 1531)</b>   |                 |
| <b><i>Sales and Use Tax</i></b>  |                 |
| Exempts helicopters and helicopter parts and maintenance from the state sales and use tax.   | <b>(100)</b>    |
| Accelerates the payment schedule for sales tax remittances.  | <b>211,400</b>  |
| <b><i>Personal Income Tax</i></b>  |                 |
| Accelerates the payment schedule for personal income tax remittances. This would not take effect until fiscal year 2010/11.  | -               |
| <b><i>Check-offs</i></b>   |                 |
| Extends the expiration date of the following tax check-offs that appear on tax return forms: Wild Resource Conservation, Organ Donation Awareness, Military Families, and Juvenile Diabetes.   | -               |
| <b><i>Corporate Net Income Tax</i></b>   |                 |
| Makes changes to the Corporate Net Income Tax (CNIT) by (1) expanding the Net Operating Loss (NOL) carry-forward; and (2) providing an increased advantage to multi-state corporations that have more property and payroll in Pennsylvania. Specifically, multi-state corporations apportion taxable income based on a weighted average of the portion of property, payroll, and sales located in PA compared with other states. HB 1531 further increases the weight placed on the sales factor. Tax year 2009: the NOL cap is increased from 12.5% to 15% of taxable income (or \$3 million); the weight of the sales factor is increased from 70% to 83%. Tax year 2010: the NOL cap is increased from 15% to 20% (or \$3 million); the weight of the sales factor is increased to 90%. | <b>(73,200)</b> |
| <b><i>Capital Stock and Franchise Tax</i></b>  |                 |
| Increases the fixed formula deduction from the value of capital stock (the tax base) in the calculation of the Capital Stock and Franchise Tax (CSFT) which is advantageous to all taxpayers (changes from \$150,000 to \$160,000). More smaller business taxpayers would owe no tax as a result.  | <b>(500)</b>    |
| Slows down the phase-out of the Capital Stock and Franchise Tax by maintaining the rate at 2.89 mills for the next two fiscal years (this was the rate in 2008). The CSFT will be completely phased out by 2014.   | <b>373,900</b>  |
| <b><i>Gross Receipts Tax</i></b>   |                 |
| Imposes a Gross Receipts Tax of 59 mills on Managed Care Organizations that are parties to Medicaid managed care contracts with the Department of Public Welfare in order to draw down federal reimbursement dollars. See narrative above for more details.  | -               |
| <b><i>Tobacco Taxes</i></b>  |                 |
| Increases the cigarette tax by 25 cents per pack (total tax will be \$1.60 per pack or 8 cents per stick).   | <b>100,100</b>  |

| <b>Revenue Source/Description</b>  | <b>FY 2009-10</b>   |
|--|---------------------|
| Expands cigarette tax to include small cigars, which are defined as any roll for smoking that weighs no more than 4 pounds per thousand, where the wrapper is made of tobacco.   | <b>16,400</b>       |
| Re-directs the portion of the cigarette tax that was going to the Health Care Provider Retention Account to the General Fund.  | <b>170,900</b>      |
| <b><i>Fund Transfers</i></b>   |                     |
| Eliminates the Health Care Provider Retention Account, which diverts the balance in the fund to the General Fund.  | <b>707,936</b>      |
| <b><i>Tax Credits</i></b>  |                     |
| Makes changes to the Educational Improvement Tax Credit program: Adds students with a disability and special education schools to those benefitting from the program; increases the maximum annual household income limit for student eligibility in 2011/2012 to \$60,000; increases the income allowance in 2011/2012 to \$12,000 and adds an annual CPI adjustment for both beginning in July, 2012; includes a multiplier to be applied to the annual household income for families with students with disabilities; expands the eligible pre-K program to allow programs that operate over the summer recess to qualify for the EITC program. | -                   |
| Reduces the amount of tax credits awarded for the next 2 fiscal years. All programs affected and expected to be utilized in the next two years are as follows: Neighborhood Assistance Program, Employment Incentive Payments, Job Creation Tax Credit, Research & Development Tax Credit, Education Improvement Tax Credit, Film Production Tax Credit, Resource Enhancement and Protection Tax Credit, First Class Cities Economic Development District Tax Credit, Call Center Tax Credit. Contains a complete suspension for the next 2 fiscal years of the Alternative Energy Production Tax Credit Program, which has not begun yet.         | <b>39,000</b>       |
| <b><i>Tax Amnesty</i></b>  |                     |
| Contains a tax amnesty program that will run from April 26 through June 18, 2010. This program will waive half the interest and all penalties on eligible taxes (includes all PA taxes administered by the Department of Revenue) that are delinquent as of June 30, 2009. This program also applies to unknown liabilities for five years prior to June 30, 2009.   | <b>190,000</b>      |
| <b>Total Revenue Associated with Tax Code</b>  | <b>\$ 1,735,836</b> |
| <b>Fiscal Code (House Bill 1614)</b>   |                     |
| <b><i>Fund Transfers</i></b>   |                     |
| Allows a transfer of \$2.3 million in unspent, uncommitted funds to be transferred from the Health Care Cost Containment Council to the General Fund.  | <b>2,300</b>        |
| Redirects Tobacco Settlement Fund monies to the General Fund and provides for transfers from the Health Endowment Account to the General Fund.   | <b>150,000</b>      |
| Allows for a transfer of \$755 million from the Rainy Day Fund to the General Fund and keeps any surplus from the 2009-10 fiscal year that would otherwise have been deposited in the Rainy Day Fund to the General Fund. It is assumed that only half of this will be used in the 2009/10 fiscal year.  | <b>392,371</b>      |

| <b>Revenue Source/Description</b>  | <b>FY 2009-10</b>  |
|--|--------------------|
| Transfers all funds available in the Health Care Provider Retention Account (approximately \$708 million) to the General Fund. Provisions for this transfer also are contained in the Tax Code (see above).  | -                  |
| Allows for a transfer of \$100 million from the Medical Care Availability Reduction of Error Fund to the General Fund, leaving a remaining balance of \$50 million.  | <b>100,000</b>     |
| Diverts surcharges on certain violations of the Vehicle Code from the Catastrophic Loss Benefits Continuation Fund to the General Fund. This will be a recurring transfer.   | <b>44,000</b>      |
| <b><i>Marcellus Shale Leasing</i></b>  |                    |
| In 2009/10, \$60 million shall be transferred from the Oil and Gas Lease Fund to the General Fund. On an annual basis, \$50 million of royalties deposited into the Fund will be transferred to the Department of Conservation and Natural Resources to be used in the same fashion as the Department currently uses money in the Fund, except that the Department will be required to give preference to the operation and maintenance of state parks and forests. The use of all other royalties deposited into the Fund will be subject to appropriation by the General Assembly. | <b>60,000</b>      |
| <b>Total Revenue Associated with Tax Fiscal Code</b>   | <b>\$ 748,671</b>  |
| <b>General Appropriations Act (House Bill 1416)</b>  |                    |
| <b><i>Fund Transfers</i></b>   |                    |
| Allows for a transfer from the Higher Education Assistance Fund to the General Fund.   | <b>11,284</b>      |
| Allows for a transfer from the Keystone Recreation, Park and Conservation Fund in the amount of funding that is available to the Department of Education for local library rehabilitation and development, to the State System of Higher Education for deferred maintenance and to the Pennsylvania Historical and Museum Commission for historic site development.  | <b>18,349</b>      |
| Allows for a transfer from the Dog Law Restricted Revenue Account.   | <b>4,000</b>       |
| Transfers funds from the Oil and Gas Lease Fund.   | <b>143,000</b>     |
| <b>Total Fund Transfers Associated with the General Appropriations Act</b>   | <b>\$ 176,633</b>  |
| <b>Total Revenue</b>   | <b>\$2,661,140</b> |

### Budget Package Revenue Sources by Type

|   |                     |
|---|---------------------|
| <b>Tax Code: New Taxes in House Bill 1531</b>                       |                     |
| Small Cigars (8 cents per stick)                                    | 16,400              |
| Cigarette Tax (25 cents per pack, or 8 cents per stick)             | 100,100             |
| <b>Subtotal New Taxes in HB 1531</b>                                | <b>116,500</b>      |
| <b>Tax Code: Tax Changes (recurring) in HB 1531</b>                 |                     |
| CSFT Freeze at 2.89 mills   | 373,900             |
| NOL/Single Sales Factor Changes                                     | (73,200)            |
| Helicopter Exemption  | (100)               |
| CSFT Fixed Formula Deduction (\$150k to \$160k)                     | (500)               |
| Tax Credit Suspensions  | 39,000              |
| Redirect Cigarette Tax (HCPRA to General Fund)                      | 170,900             |
| <b>Subtotal Tax Changes in HB 1531</b>                              | <b>510,000</b>      |
| <b>Tax Code: Subtotal Recurring Revenue in HB 1531</b>              | <b>626,500</b>      |
| <b>Fiscal Code: Rrecurring Revenue in HB 1614</b>                   |                     |
| Catastrophic Loss Benefits Continuation Fund Transfer               | <b>44,000</b>       |
|   |                     |
| <b>Tax Code: Non-recurring Revenue in HB 1531</b>                   |                     |
| Sales Tax - Semi-monthly Schedule                                   | 211,400             |
| PIT Standardization with Federal Standards (effective FY 2010-11)   | -                   |
| Tax Amnesty Program   | 190,000             |
| Draw Down HCPRA Balance   | 707,936             |
| <b>Tax Code: Subtotal Non-recurring Revenue in HB 1531</b>          | <b>1,109,336</b>    |
| <b>Fiscal Code: Non-recurring Revenue in HB 1614</b>                |                     |
| Transfer from Rainy Day Fund  | 392,371             |
| Leases of State Forest Land   | 60,000              |
| Health Care Cost Containment Council                                | 2,300               |
| Tobacco Settlement Fund   | 150,000             |
| Transfer from MCARE (leaves \$50 million balance)                   | 100,000             |
| <b>Fiscal Code: Subtotal Non-recurring Revenue in HB 1614</b>       | <b>704,671</b>      |
| <b>General Appropriations Act: Non-recurring Revenue in HB 1416</b> |                     |
| Transfer from Keystone Recreation & Conservation Fund               | 18,349              |
| Transfer from Higher Education Assistance Fund                      | 11,284              |
| Transfer from Dog Law Account                                       | 4,000               |
| Transfer from Oil and Gas Leas Fund                                 | 143,000             |
| <b>General Appropriations: Subtotal Non-recurring in HB 1416</b>    | <b>176,633</b>      |
|   |                     |
| <b>Total Proposed Revenue</b>                                       | <b>\$ 2,661,140</b> |