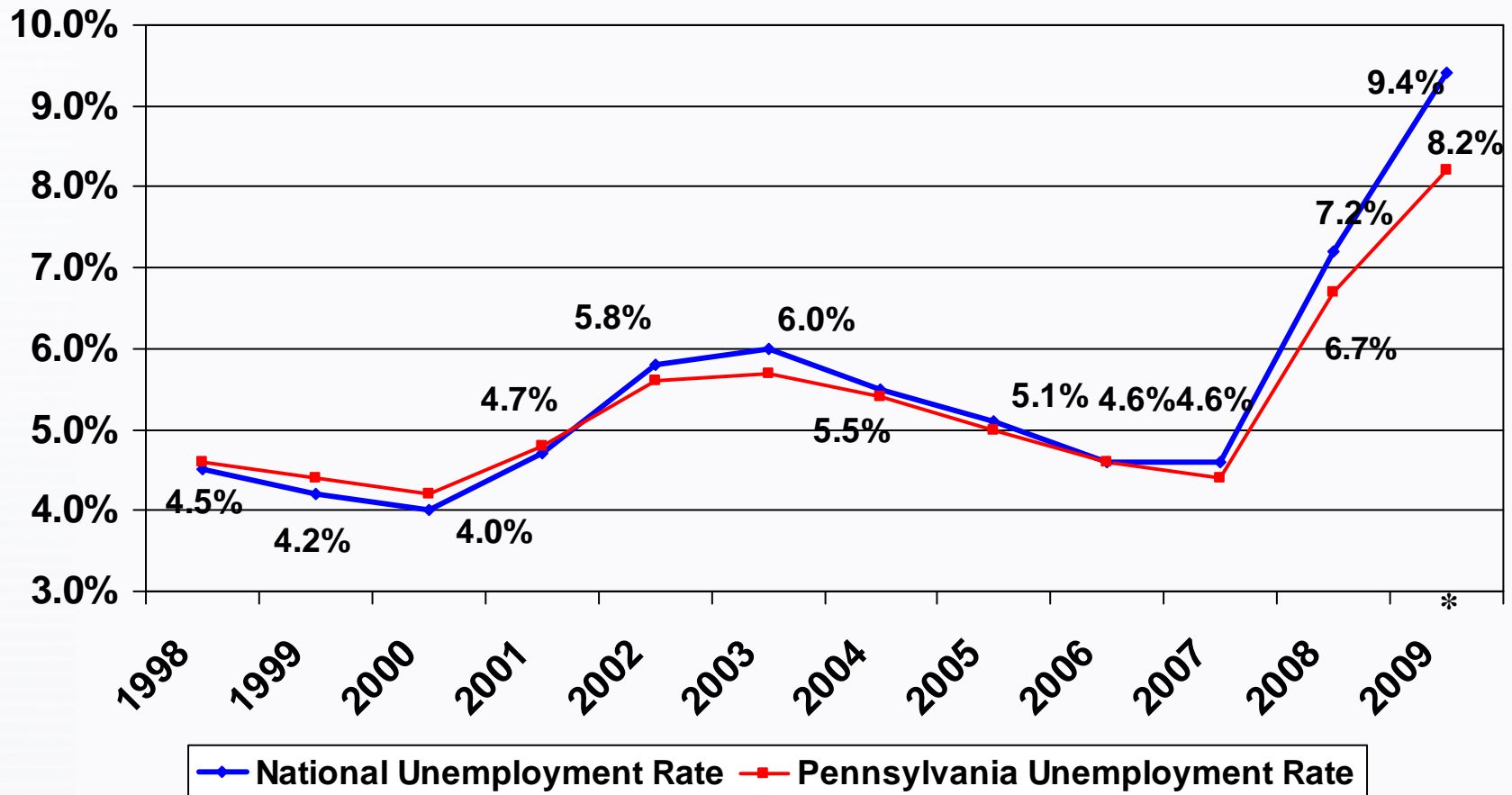


Review of 2009-10 Proposed Budget

The Economic Downturn and Its Impact on Pennsylvania

National and State Unemployment Rates at Five-Year Highs

Pennsylvania Remains Below the National Average

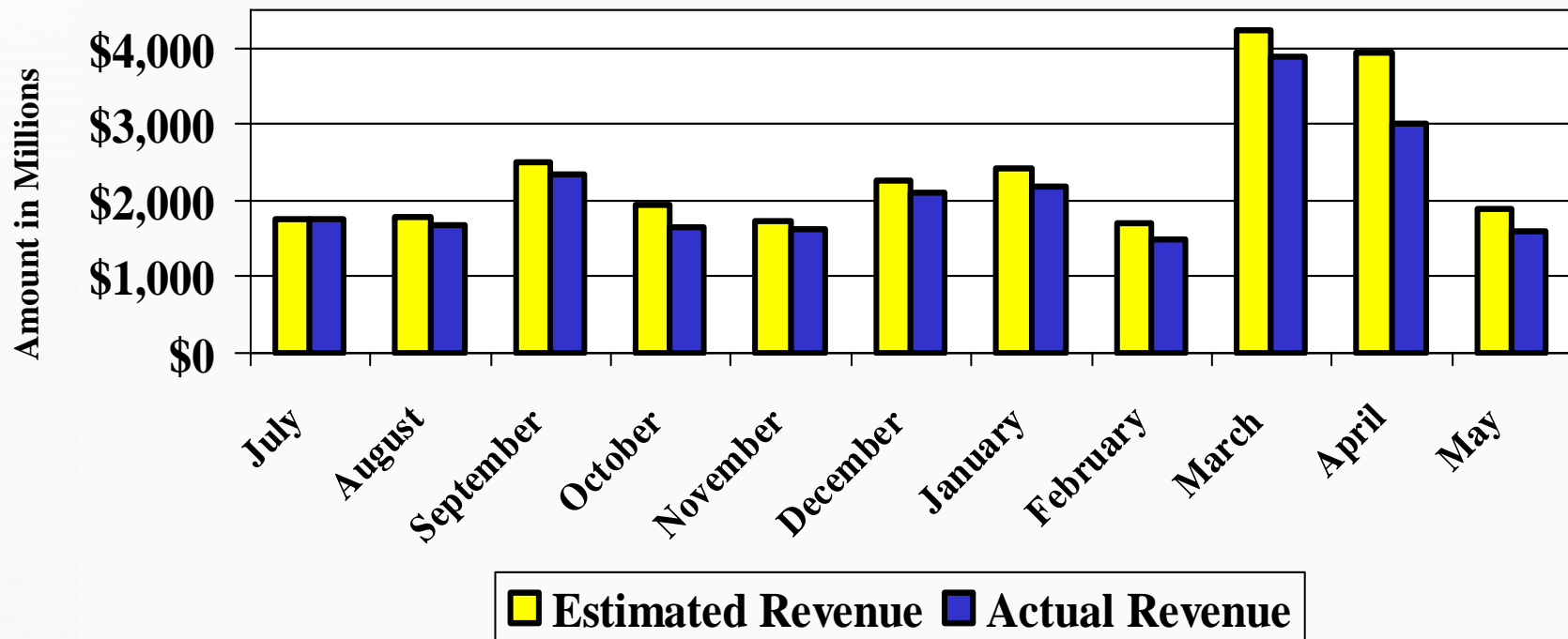


*May 2009 data.

2008-09 General Fund Revenues

Estimated versus Actual Revenue Collections

*After the first eleven months of fiscal year 2008-09,
General Fund collections were \$2.8 billion lower than estimated.*



Administrative Actions

Starting in September 2008, the Governor directed the following cost-saving administrative actions:

- Directed agencies to reduce spending by an average of 4.25 percent, which saved \$464 million.
- Implemented a general hiring freeze.
- Restricted out-of-state travel.
- Banned the purchase of new vehicles and reduced the size of the fleet by 1,000.
- Froze cabinet and non-union employees' salaries.

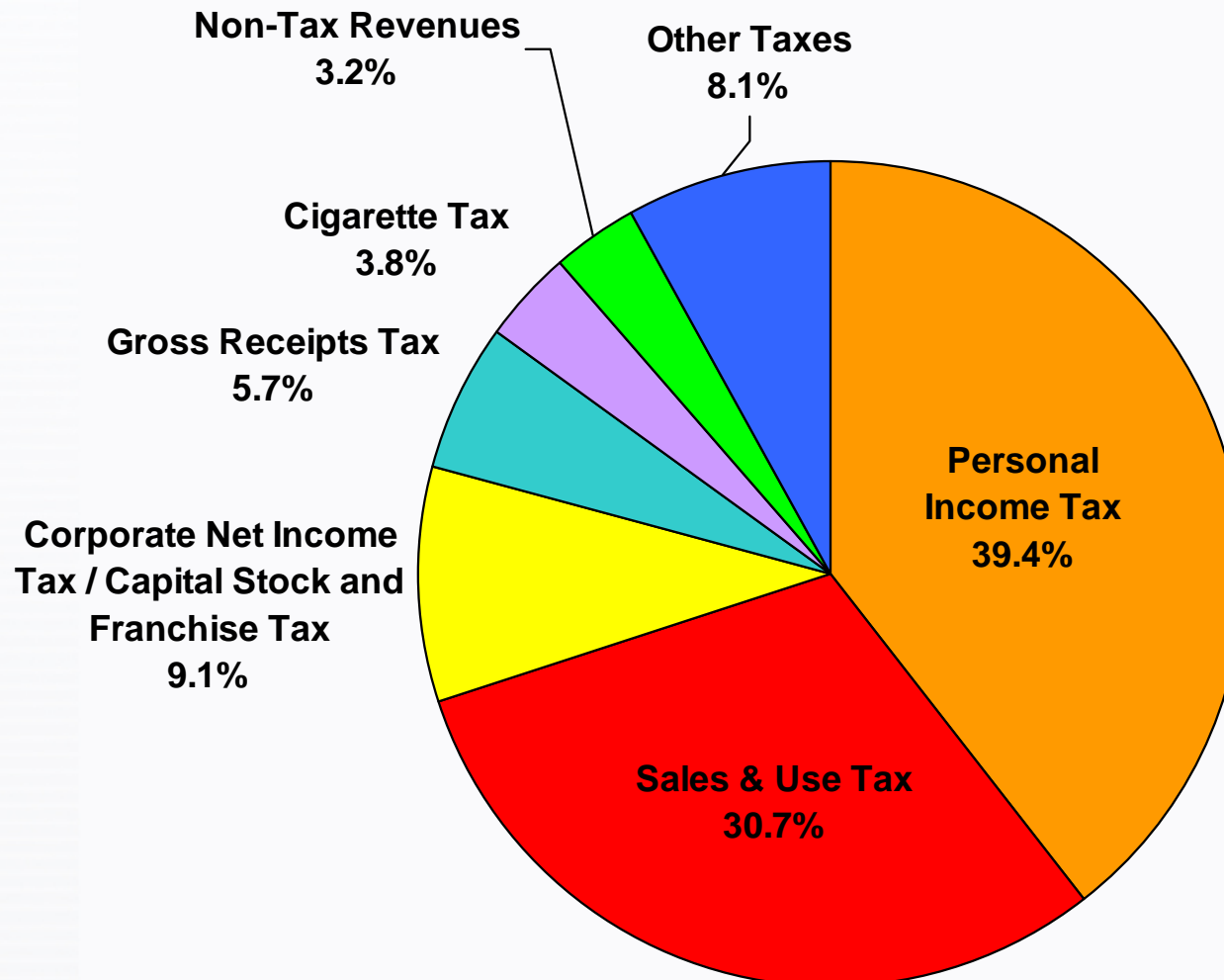
Proposed Fiscal Year 2009-10 Budget

Guiding Principles of 2009-10 Budget

This budget:

- Was \$26.6 billion in February; the Governor's June 17 proposal reduces the budget to \$26.1 billion.
- Continues to eliminate waste and improves government operations, enabling the commonwealth to achieve \$1.75 billion in annual recurring savings.
- Cuts more positions in addition to the 2,100 positions eliminated since Jan. 2003.
- Reduces spending in almost all areas under the Governor's jurisdiction.
- Proposes to invest more than \$537 million as the second year of a multi-year plan to rebuild Pennsylvania's infrastructure.
- Proposes to expand the adultBasic insurance program to provide affordable basic health care for an additional 50,000 uninsured adults. There are more than 255,000 Pennsylvanians on the adultBasic waiting list.

2009-10 General Fund Revenue Sources

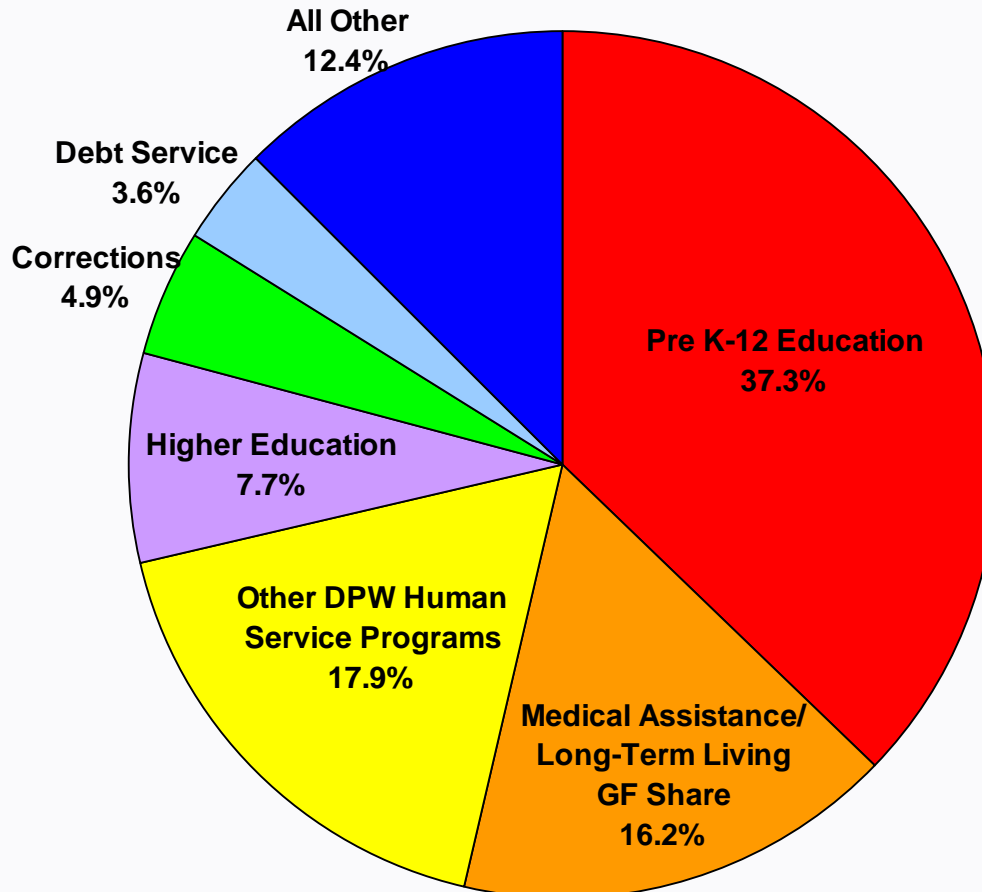


More than two-thirds (70 percent) of General Fund revenues are derived from the Personal Income Tax and the Sales & Use Tax.

2009-10 General Fund Expenditures

The 2009-10 budget Governor Rendell proposed in February was \$26.6 billion, a decrease of \$64.5 million, or 0.2 percent, from 2008-09.

June 17 the Governor ordered \$500 million more in cuts, for a budget proposal of \$26.1 billion.



Spending on Education, Medical Assistance / Long-Term Living, other Department of Public Welfare programs, Corrections and Debt Service comprises nearly 88 percent of total General Fund expenditures.

**Total GF Expenditures:
\$26.1 Billion**

Program Reductions and Eliminations

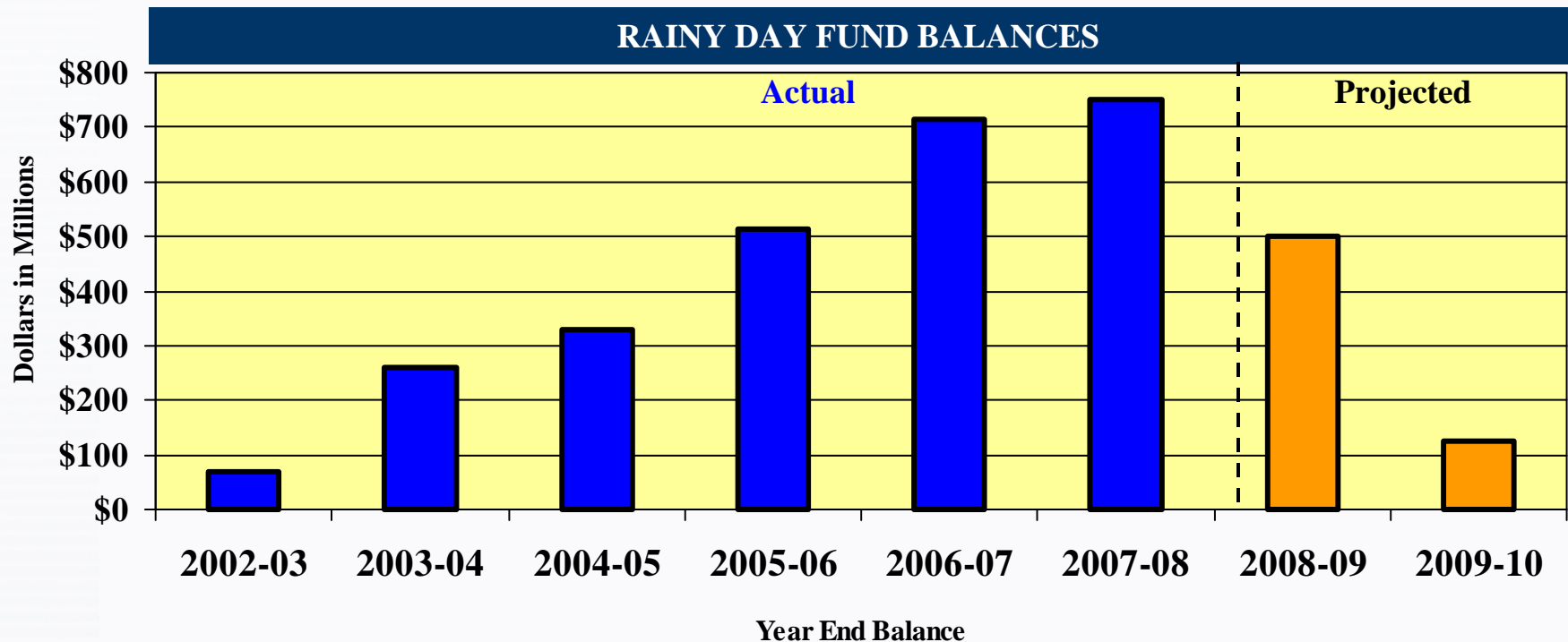
2009-10 budget reduces or eliminates funding for programs in nearly every agency.

Even with federal fiscal relief and new revenue sources, it will be essential to make painful reductions to administrative spending as well as numerous popular programs to ensure the commonwealth's budget remains in balance once federal fiscal relief is no longer available.

	Number of Appropriations Affected	Funding Change
Programs Eliminated	101	\$ - 395.0 million
Programs with Reduced Funding (Feb. 2009)	346	\$ - 582.2 million
Additional Programs with Reduced Funding (June 17)	???	\$ - 440.0 million
TOTAL	447 + ???	\$ - 1.417 billion

Status of Pennsylvania's Rainy Day Fund

Through disciplined budget management, the balance in the Rainy Day Fund increased from \$70 million in 2002-03 to more than \$750 million in 2007-08. This budget proposes transfers from the Rainy Day Fund in 2008-09 and 2009-10 to stabilize the General Fund during these difficult economic times.



2009-10 General Fund Budget: Four Proposed Tax Changes

Implement severance tax on natural gas	\$107 Million
Eliminate 1 percent vendor sales tax discount	\$75 Million
Increase of 10 cents per pack to the cigarette tax	\$61 Million
Institute tax on other tobacco products (36 cents per ounce)	\$38 Million
SUB TOTAL	\$281 Million

On June 16, the Governor proposed the following measures to generate additional revenue for 2009-10:

Temporary increase of 0.5 percent to the state personal income tax	\$1.5 Billion
Suspending the phase-out of the capital stock and franchise tax	\$400 Million
SUB TOTAL	\$1.9 Billion
TOTAL	\$2.181 Billion

Budget Comparison: Governor vs. Senate Republicans

Gov. Rendell has made \$2 billion in careful, considerate budget cuts since September 2008.

The Senate Republicans' budget makes reckless cuts to valuable services and is still \$1 billion out of balance.

GOVERNOR'S BUDGET \$26.1 BILLION

Increases basic education funding by \$418 million to help minimize property tax increases and preserve education opportunities for children. Proposes \$550 million in tuition relief for college students.

Strategically invests in Pennsylvania's infrastructure and economic development to promote job growth.

SENATE REPUBLICANS' BUDGET \$24.6 BILLION

For the first time in 25 years, supports spending less than the Governor proposes for schools.

- Cuts basic education funding by 19 percent
- Could result in 3,700 teacher layoffs
- Eliminates tuition aid for 24,000 students
- Eliminates pre-K Counts and Head Start programs for 9,300 students

Cuts \$229.8 million on top of Governor's proposal, to hinder business development, job training and maintenance, infrastructure development and tourism.

Budget Comparison: Governor vs. Senate Republicans

The GOP also wants to cut \$250 million in state tax credits for various programs.

~ Pittsburgh Post-Gazette, May 5

GOVERNOR'S BUDGET \$26.1 BILLION

Protects Pennsylvanians most in need by providing sufficient funding for mental retardation, autism, attendant care, long-term care and disability services.

Expands adultBasic and Children's Health Insurance Program (CHIP) to provide affordable basic health care to 50,000 uninsured adults and 24,000 more kids.

Institutes targeted taxes on cigarettes, other tobacco products and natural gas extraction. Proposes raising the personal income tax to 3.57 percent and freezing the capital stock and franchise tax.

SENATE REPUBLICANS' BUDGET \$24.6 BILLION

Cuts \$70.2 million in services for special needs residents, reducing or eliminating care for more than 16,000 Pennsylvanians.

Eliminates and sacrifices \$117.7 million in funding for child services.

- Cuts 12,000 kids from CHIP
- Eliminates child care for 7,700 children
- Reduces child welfare funding

Creates no new revenue streams to fund state programs. Rather, cuts many state budgets by 10 to more than 50 percent, while legislative budgets are cut by less than 4 percent.

Revenue Department Modernization

The Revenue Department is in year two of a seven-year initiative to improve efficiency of all tax collection operations.

Key initiatives:

- All major information technology systems supporting the department have been in existence for more than 20 years, some for more than 35 years.
- The main tax systems are written in COBOL, a computer language so outdated it is no longer taught in classrooms and is incredibly difficult to maintain and update.
- The new tax processing system will allow the department to improve efficiency, reduce administrative costs, respond more quickly to changing tax laws and improve overall taxpayer services.

Financial support:

- Legislature allocated \$5 million to plan for 08-09.
- Requested \$21.2 million for 09-10; reduced to \$18.2 million.

Delinquent Tax Collections and Enforcement Initiatives

Delinquent Collection & Enforcement Initiatives

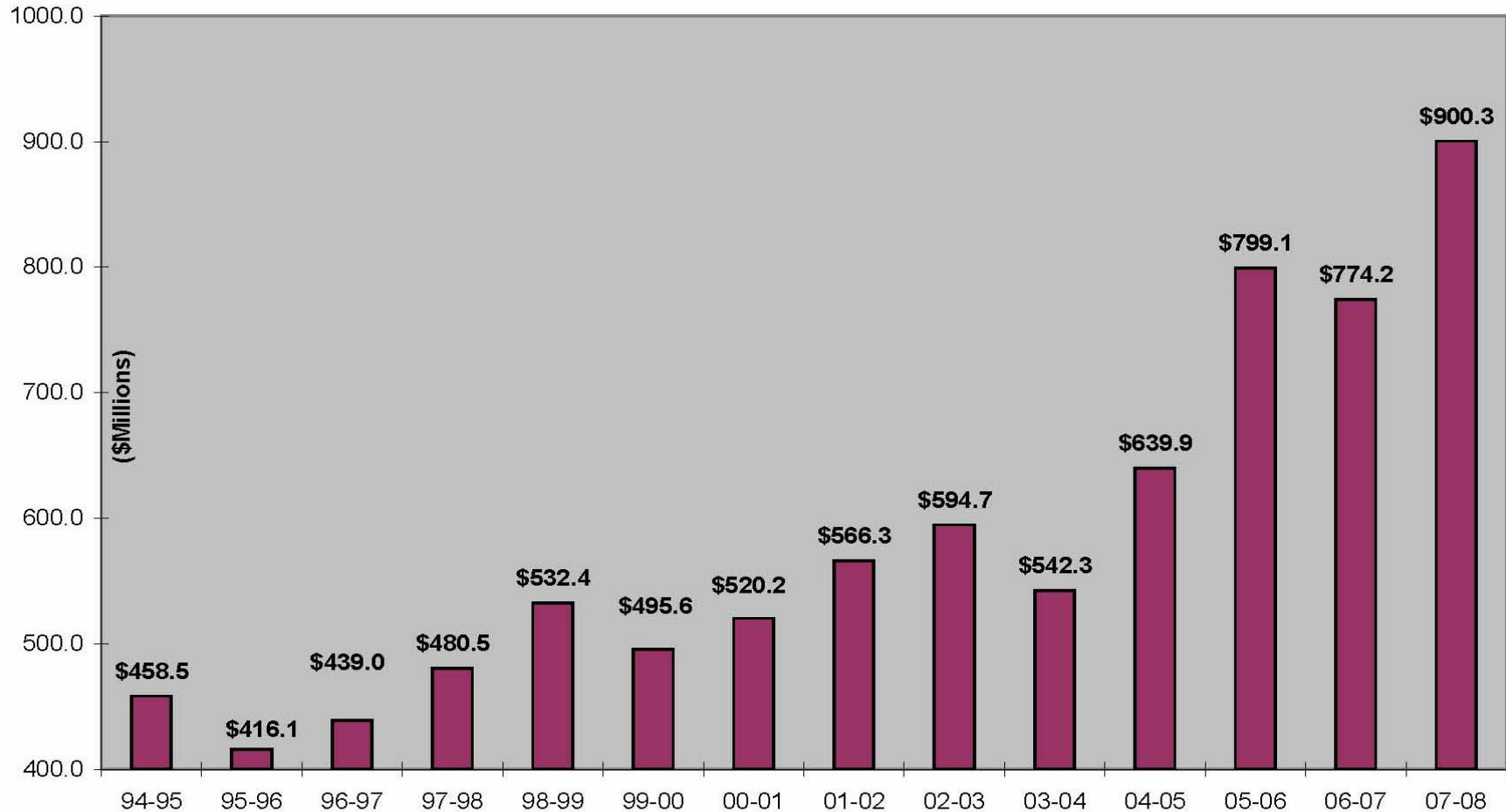
Through May, fiscal-year-to-date delinquent tax collections total \$646 million.

Key initiatives:

- Promote Tax Delinquent List
\$87 million in unpaid taxes collected from delinquent taxpayers; an additional \$20.7 million forthcoming in payment plans since 2006
- Increase use tax collection & awareness
\$59 million collected from 23,000 new use tax accounts since 2006
- Reach out to Internet purchasers to collect cigarette & use taxes
\$19.8 million has been recovered and \$2.7 million has been secured through payment plan agreements since 2007
- Ensure tax compliance in conjunction with issuance/renewal of state licenses
\$5.6 million collected so far this fiscal year
- Focus on income tax nonfilers with income from partnership/proprietorship business activities
A pilot project generated nearly \$600,000 in assessments, demonstrating the effort's worthiness

In fiscal year 2007-2008, the Revenue Department collected a record \$900.3 million in delinquent taxes.

DELINQUENT TAX COLLECTIONS BY FISCAL YEAR (\$ In Millions)



Tax Amnesty Programs: Not Wise Tax Policy

The 1995-96 tax amnesty program generated \$93 million in tax collections, but netted only \$30 million.

- Normal delinquent collections decline following amnesty periods.
- Amnesty programs encourage people to wait for the next amnesty deal rather than pay taxes on time.
- The summary report following the 1995-96 amnesty program recommended **AGAINST** future amnesty programs.

Department of Revenue

Accounts Receivable Summary

Collectible Accounts

	(Millions)				
	2008	2007	2006	2005	2004
Corporation taxes	2.3	48.2	65.2	145.5	186.2
Sales and use tax	47.2	57.5	50.8	49.7	30.5
Employer withholding tax	12.0	9.3	6.0	3.8	2.5
Personal income tax		46.4	53.3	92.7	55.1
Inheritance tax	2.2	2.7	2.2	2.4	1.6
Collectible Total	63.7	164.1	177.5	294.1	276.0

Uncollectible Accounts

	2008	2007	2006	2005	2004
Corporation taxes	1.9	12.9	20.3	47.9	54.9
Sales and use tax	6.2	16.6	12.0	15.1	21.4
Employer withholding tax	2.3	11.3	8.3	9.4	9.5
Personal income tax		3.8	9.7	12.1	14.9
Inheritance tax	0.0	0.0	0.1	0.2	0.3
Uncollectible Total	10.4	44.6	50.4	84.7	101.0

Business Taxes In Pennsylvania

Pennsylvania's Business Tax Climate Remains Favorable

The non-partisan Tax Foundation rates PA's business tax climate more favorable than five of its six neighboring states – NY, NJ, MD, OH and WV. PA's 2009 ranking is near the middle of the pack nationally, 28th best among the 50 states.

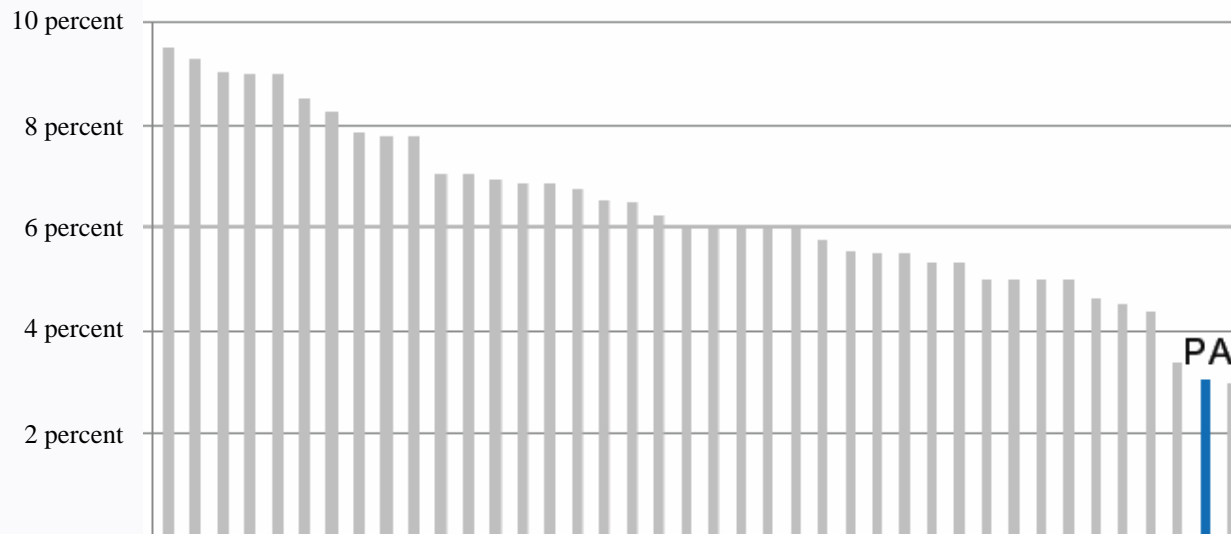
- The Tax Foundation found the state-local tax burden in Pennsylvania lower than New Jersey, New York, Maryland and Ohio.
- A 2007 Ernst & Young study in conjunction with the Council on State Taxation showed that Pennsylvania businesses pay a smaller share of total state and local taxes than the national average and pay lower taxes than businesses in three of our six neighboring states.
- With one of the lowest personal income tax rates in the country – 3.07 percent paid by both residents and more than half of Pennsylvania's businesses - the commonwealth has been able to attract companies and provide state services at a relatively low cost to the taxpayer.

Pennsylvania S Corporation Tax Filings

PA S corporations are exempt from the corporate net income tax, and instead shareholders include their share of business income in their PA personal income tax filings. This effectively allows corporations to pay their business income tax at the personal income tax rate of 3.07 percent rather than the CNI tax rate of 9.99 percent.

In 2008-09, this equates to combined savings of \$1.1 billion for more than half of Pennsylvania's businesses.

PA's Income Tax is the 2nd Lowest of the 40 States that Levy this Tax

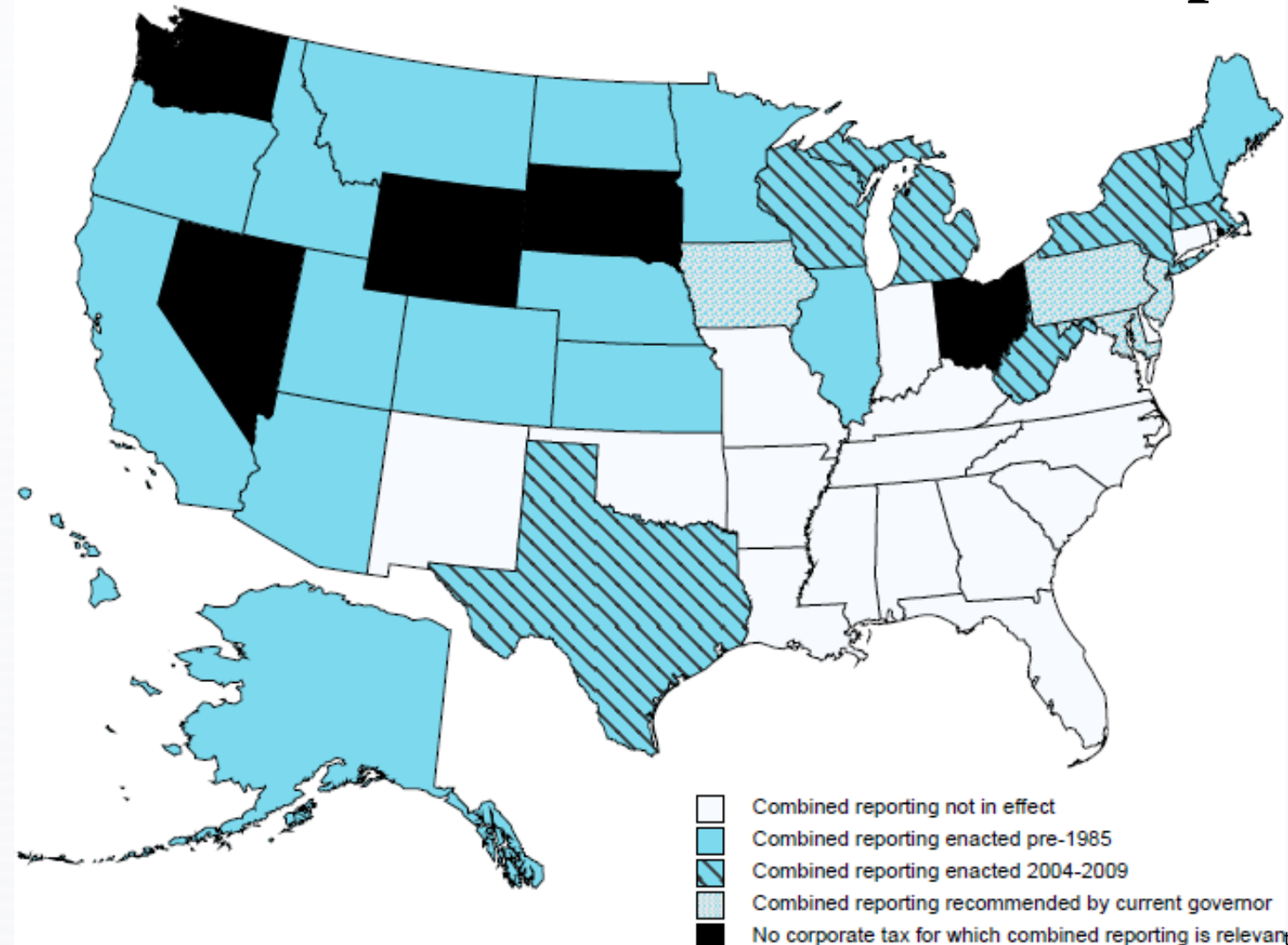


Business Tax Reform Still Needed

In March 2004, the Governor created the Business Tax Reform Commission to recommend changes to make Pennsylvania's business tax structure more competitive. The Commission made the following unanimous recommendations to improve Pennsylvania's business tax climate.

RECOMMENDATION	PROGRESS MADE
Reduce capital stock and franchise tax annually, to elimination	<i>The rate was 6.99 mills when Gov. Rendell took office; it's now 2.89 mills. By law, the rate should go down this year to 1.89 mills.</i>
Eliminate annual cap on net operating loss deductions	<i>Deduction increased in 2007 from \$2 million to the greater of \$3 million or 12.5% of net income</i>
Change corporate net income tax sales factor weighting to 100%	<i>Sales factor changed from 60 to 70% in 2007</i>
Reform PA's tax appeals process	<i>Act 119 of 2006: changed settlement to assessment; assessments more than \$300 sent via certified mail; uniform 90-day appeal period for most taxes</i>
Reduce corporate net income tax from 9.99% to 7.9%	<i>No action taken. Both initiatives still have the strong support of the Governor.</i>
Close tax loopholes by implementing mandatory unitary combined reporting	

Current State of Combined Reporting



Seven states — Massachusetts, Michigan, New York, Texas, Vermont, West Virginia, and Wisconsin — have adopted combined reporting since 2004, bringing the number of states implementing this policy to 23 out of 45 with a CNI tax.

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DEPARTMENT OF REVENUE

TAX UPDATE

Edward G. Rendell, Governor Stephen H. Stetler, Acting Secretary of Revenue

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GOVERNOR'S REPORT ON STATE PERFORMANCE

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- VOLUNTEER FIRE, AMBULANCE AND RESCUE PERSONNEL MAY NOW APPLY FOR TAX CREDIT *Page 4*
- FED/STATE E-FILE FOR PERSONAL INCOME TAX, FORMS AND SCHEDULE CHANGES FOR TAX YEAR 2008 *Page 5*
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- PERSONAL INCOME TAX PAYMENT VOUCHER LETTERS TO BE DISCONTINUED IN 2010 *Page 6*
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GOVERNOR'S REPORT ON STATE PERFORMANCE

With the weak economy putting increased pressure on state revenues, Governor Edward G. Rendell's latest Governor's Report on State Performance gives taxpayers and the General Assembly clear information on the effective use of tax dollars.

The report — the second of its kind from the Rendell administration — promotes government transparency by providing details on the accomplishments of 34 state agencies in the 2007-08 fiscal year.

"In these times of economic hardship, Pennsylvania's citizens deserve assurances that we are making the best use of the taxes they pay to provide government services," the Governor said. "They want to know that their investment in the commonwealth is being spent wisely."

Department of Revenue highlights, featured on Pages 207 - 210 in the Government Efficiency section of the recently released report, include the following.

Cumulative business tax cuts of \$2.5 billion in 2007-08, including:

- \$862.2 million from the continuing phase-out of the capital stock/foreign franchise tax;
- \$44.8 million from an increased sales factor in the corporate net income tax apportionment formula;
- \$64.9 million from an increased cap on net operating loss carry-forward deductions;

Continued on Page 2

FAST FACT:

Income tax credit forms for volunteer responders are now available at www.revenue.state.pa.us.

Page 1

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