

# CAPITAL PERSPECTIVE

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A REPORT TO LEAGUE MEMBERS ON SIGNIFICANT STATE GOVERNMENT DEVELOPMENTS

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## State Taxation of Business in Pennsylvania - A Primer

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### Introduction

On February \_\_ Governor Ridge unveiled his proposed budget for the new fiscal year beginning July 1, 1999. That budget proposal includes new tax cuts for Pennsylvania businesses. For most citizens, and a number of business people as well, the nature and significance of those tax cuts is not clear. This Capital Perspective provides PEL's members and other interested readers with background on

Pennsylvania's business tax system. More specifically, this article describes what types of business taxes are levied in Pennsylvania, taxes, what amounts are collected from those tax levies, and why business should pay. In addition, the article provides a brief overview of what the business community can receive in return for the taxes paid.

### Business Tax Sources in Pennsylvania

It is a common belief that most states tax the business community through only a few direct taxes based on a company's income or property in a state. However, when all state tax sources are examined, it is clear that the business community pays a variety of state taxes using several different tax bases.

Most states are generally consistent with the types of taxes levied. All but six? states levy a tax based on income. Pennsylvania levies a Corporate Net Income (CNI) tax at the rate of 9.99%. At the beginning of 1998 this was the fourth highest rate of the 44 states levying a similar tax. The base of the tax is similar in most states.

Only 23 states levy corporation franchise tax. In four of these states, the tax payer has the option of paying the franchise tax or the state's

corporate net income tax. In Pennsylvania, both taxes are required and Pennsylvania imposes one of the highest effective rates in the country.

Most states apply special business taxes on specific industries. The special taxes are imposed due to the specific nature of the business does not fairly lend itself to the across-the-board levies. Pennsylvania levies the following special business taxes: Utility Gross Receipts Tax, Utility Property Tax, Insurance Premiums Tax, Financial Institutions Taxes, and a few very minor other taxes.

In addition to taxes assessed for the sole purpose of taxing business, the business community also pays portions of other generally levied taxes. For example, just like individual consumers, businesses pay sales tax on most of their purchases. Surprisingly, businesses pay about

50% of the sales and use taxes collected by the Commonwealth, according to the Pennsylvania Tax Blueprint.

Pennsylvania law also allows certain smaller businesses to pay the Personal Income Tax (PIT) rather than the CNI. These businesses include

sole proprietorships, partnerships, and corporations, usually smaller companies, which met certain “Subchapter-S” criteria. These companies can take advantage of Pennsylvania’s exceptionally low PIT rate. Approximately 7.5% of the PIT is paid by business.

### **Amount of Taxes Paid by Business in Pennsylvania**

In 1997-98, the Pennsylvania Department of Revenue collected an estimated \$7 billion from businesses. The following table enumerates the sources of those tax collections. Somewhat of a surprise is that the largest amount collected from

business is not generated by a “business tax” but by the Sales and Use tax and to a lesser extent the PIT personal income tax, tax sources levied on most taxpayers.

#### **Pennsylvania Business Tax Collections Fiscal Year 1996-97 (\$000)**

Corporate Net Income	\$ 1,697,077
Capital Stock and Franchise	954,503
Utility Gross Receipts	717,508
Utility Property	137,164
Insurance Premiums	202,157
Financial Institutions	287,719
Other minor business taxes	13,048
Sales and Use Tax (estimated)*	2,607,577
Personal Income Tax **	427,655
Total	\$ 7,035,408

\* Estimated based on Pennsylvania Tax Blueprint findings

\*\* Includes personal income tax on net profits for calendar year 1996

### **Business’ Share of Total Taxation in Pennsylvania**

The previous section provides a static picture of tax collections. This section examines how business tax collections are in proportion to total taxes collected by Pennsylvania state government and how those proportions have changed over the

past several years. This can be an important point, especially when lawmakers consider raising or lowering taxes. “Fair share” for the business sector is usually a factor in the decision-making process. The Table below summarizes these trends.

**Share of Total State Tax Collections  
Paid by Business by Major Tax Source  
1992-93 to 1997-98**

<b>Tax</b>	<b>1992-93</b>	<b>1993-94</b>	<b>1994-95</b>	<b>1995-96</b>	<b>1996-97</b>	<b>1997-98</b>	<b>1998-99 Est.</b>
Corporate Net Income Tax	10.1%	10.4%	12.0%	10.2%	10.0%	9.6%	9.4%
Capital Stock and Franchise Tax	6.1%	5.9%	5.6%	5.5%	5.6%	5.8%	5.6%
Other Business Taxes	8.3%	8.3%	8.0%	7.7%	7.4%	7.1%	7.2%
Sales and Use Tax (estimated)	16.8%	17.1%	17.4%	17.8%	17.8%	17.3%	17.7%
Personal Income Tax (estimated)	2.4%	2.4%	2.5%	2.6%	2.5%	2.5%	2.5% (est)
<b>Total - Business Taxes</b>	<b>43.7%</b>	<b>44.1%</b>	<b>45.5%</b>	<b>43.8%</b>	<b>43.3%</b>	<b>42.3%</b>	<b>42.4%</b>

Business now pay about 42 % of total state tax collections in Pennsylvania when considering all sources. The exact amount in not known since the amount sales and personal income tax paid by business can only be estimated. The portion of total taxes paid by business has been declining after a peaking in 1994-95, a year of unusually

high CNI tax collections. Business tax reductions in recent years are the primary reason for the sustained decline since 1994-95. The Department of Revenue projects the business share decline to continue slowly should the current tax laws remain unchanged.

**Why the Business Community Should Pay Taxes**

Theories and philosophies abound as to why the business community should pay taxes. Proponents of low or no business taxes suggest that, in reality, businesses don't pay taxes. Taxes, as an added cost of business, are passed along in the form of higher prices and/or lower profits to be shared by owners. Therefore, the burden is carried by consumers and stockholders/owners. At the other end of the spectrum, supporters of high business taxes assert that business' "deep pockets" should pay for government services deemed to be indispensable not only to business but the public at large. These services extend past the obvious direct benefits such as transportation infrastructure and police protection to include

less direct benefits such as education and welfare.

Both of these extreme position are difficult to support factually. However, there is some rational reasoning to support a position in between. Businesses, including their owners and customers, do need certain government provided services not available through the private sector. Therefore government seeks to recoup, through user fees and taxes, reimbursement in proportion to those services received.

As with any taxing scheme, the relationship between taxes paid and benefits received is often very difficult to quantify for the business

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community as a whole much less for individual business. The business taxpayer receives very little in direct state level program spending. However, business requires state investments in education and workforce development, for example, to be competitive.

One final element in the taxation of business is consideration of the ability to export tax burden.

For example, by any measure the State of Alaska is one of the highest tax burden states. Conversely, residents of Alaska are exposed to some of the lowest taxes. Through the taxes on oil, Alaska is able to get taxes transferred to oil users in other states. Pennsylvania has little opportunity to export tax burdens.

## Conclusion

The above statistics paint a good news/bad news scenario. The good news is that business taxes are declining as a portion of total taxes. On the negative side, business still pay a significant amount of taxes, much more than is obvious, even to the trained eye.

It is difficult to measure Pennsylvania's tax burden compared to the tax burdens in other competing

states. Beauty is often in the eye of the beholder. The imposition of certain taxes not in existence in other states and Pennsylvania's higher than average rates on taxes targeted at corporations strongly imply that Pennsylvania continues to compare unfavorably. However, Pennsylvania's low personal income tax rate presents a significant cost advantage to those eligible companies.

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