Legislative Budget and Finance Committee

The Impact of Act 32 on the Collection of Local Earned Income Taxes

Report Presentation by Philip Durgin, Executive Director, at October 19, 2016, Meeting

Good morning. Act 32 of 2008 made many significant changes to how Pennsylvania local earned income taxes are collected. The act also requires our Committee to evaluate the success of these changes and to make recommendations to improve the act.

Prior to Act 32, each of Pennsylvania's 2,900 jurisdictions were authorized to select an EIT collector, resulting in over 550 EIT collectors across the state. Due to the lack of uniform requirements and the confusion caused by such a large number of tax collectors, losses due to uncollected earned income taxes were estimated at between $100 million and $237 million annually. With the establishment of regional tax collection districts (TCDs) under Act 32, the number of taxing districts was reduced to 69, and the resulting number of tax collectors was reduced to fewer than 20.

The act lists 14 areas that we are to review to assess whether the act was successful in simplifying EIT collections and increasing the amount of EIT taxes collected. Rather than walk you through each of the 14 areas, I'll just summarize the highlights.

Virtually everyone we spoke to, including municipalities, school districts, employer groups, CPAs, and others involved in EIT collections, reported that, after experiencing some initial implementation challenges, Act 32 has been a resounding success in simplifying and improving EIT collections. While some offered suggestions for the General Assembly to consider to improve the act, the most common recommendation was to use Act 32 as a model to modernize the collection of other local taxes, such as property taxes, business privilege taxes, and local service taxes.

We used two different methodologies to estimate how much the efficiencies enacted by Act 32 might have increased EIT collections for municipalities and school districts. One methodology yielded an estimated increase of $158 million and the other, $188 million. Averaging these two together, we estimate that Act 32 has increased earned income tax collections by about $173 million annually. This equates to about an 8 percent increase over pre-Act 32 collections, even after adjusting for both wage and employment increases.

Act 32 requires tax collection committees, which are comprised of the school districts and municipalities within each tax collection district, to have an annual audit conducted of the financial statements and records of their tax collectors. These audits are to be filed with the Department of Community and Economic Development. If the audits contain any findings of noncompliance with Act 32, they are also to be filed with the Office of the Auditor General. These audits are quite detailed, and are required to present a lot of information beyond what would normally be included in a financial audit.

Our review of the 2014 audits found that six were completed but not filed with DCED, and that seven were not completed at all. Five others were missing the required Report on Compliance with Act 32 or were otherwise not in compliance with DCED's suggested audit format. Two audits had a finding of noncompliance with Act 32, but were not filed with the Office of the Auditor General as they should have been. 2012 was the first year all the requirements of Act 32 had to be implemented, so perhaps it's not surprising that we found that some counties had not yet fulfilled all these audit and reporting requirements.

We had a very good response to the questionnaires we sent out to the tax collection committees and the tax collectors, with 61 of the 69 tax collection committees and 16 of the 17 tax collectors responding. While the responses we obtained contain various recommendations for improvements in how the act is administered, they also demonstrate widespread praise for the improvements enacted by Act 32. The questionnaires and the responses we received are presented in Chapter III of the report.

The report contains three recommendations, the first of which is that DCED take a more active role in monitoring the tax collection committees to ensure that they conduct and submit the required annual audits. Although DCED does not have statutory oversight or enforcement responsibilities with regard to these committees or their tax collectors, the committees and tax collectors we contacted about the missing and deficit audits were responsive and appeared to be conscientious about their responsibilities, and all six of the tax collection committees that had not done audits for 2014 assured us that they would have audits conducted of their 2016 collections and disbursements. As such, we did not see a need, at least at this point, to recommend the law be amended to give DCED explicit enforcement authority, but rather that DCED first try a "remind-and-encourage" approach to see if that is sufficient to resolve these compliance issues.

The second recommendation is that DCED post information on tax collector costs on its internet website. This information would be helpful to the tax collection committees and, because it is included in the Act 32 audits, would also serve as an incentive to both DCED and the committees to ensure the annual audits are completed and submitted on time.

The third recommendation is that DCED continue its efforts to promulgate regulations regarding the administration of Act 32. These regulations, which have been over four years in the making, contain important requirements with regard to issues such as tightening the internal control requirements of tax collectors and strengthening certain bonding provisions. The regulations have gone through the public comment period and are currently before the IRRC.

Before closing, we'd like to thank the staff at DCED, and particularly those at the Governor's Center for Local Government Services, and the many tax collection committees, tax officers, municipal officials, and tax professionals who assisted us during this study.