

## RESEARCH SUMMARY

## How to Improve Pennsylvania's Tax System

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Pennsylvania ranks nationally near the top in tax burden and near the bottom in business friendliness. While the state's flat personal income tax rate and relatively low sales tax rate are commendable, Pennsylvania's business taxes remain in serious need of reform.

In "How to Improve Pennsylvania's Tax System," Pavel A. Yakovlev, an associate professor of economics at Duquesne University, argues that lowering the state corporate income tax (CIT) rate could increase state economic activity without jeopardizing state tax revenues. A combination of business tax cuts and tax base broadening could make Pennsylvania's economy grow faster without jeopardizing its public finances.

### KEY POINTS

#### **Pennsylvania's Tax Burden Harms Its Economy by Increasing the Cost of Doing Business in PA**

- The state government took a step in the right direction by phasing out its archaic capital stock and foreign franchise tax, but the high corporate income and unemployment insurance taxes discourage business activity and make hiring workers more expensive.
- An ambitious 2015 study by the Tax Foundation found that Pennsylvania is ranked 49th in the nation for tax burden on corporate headquarters, 48th for tax burden on retail stores, and 46th for tax burden on distribution centers.

#### **Pennsylvania Policymakers Should Lower Corporate Income Tax and Unemployment Insurance Tax Rates**

- Pennsylvania's 9.99 percent CIT rate, the second highest in the nation, discourages corporations from locating in the state, while generating less than 7 percent of the state's total tax revenue. Lowering the state CIT rate to about 6 percent could increase corporate investment and employment in Pennsylvania with little reduction in tax revenue.
- Despite the commonly held view that the CIT is a tax on affluent business owners, the true burden of this tax is likely to fall on a wide variety of people. The CIT burden may fall not only on capital owners but also on workers and consumers, and it may be unequally distributed among corporations. Larger firms are often in a better position than smaller firms to take advantage of tax avoidance schemes.
- The state would also benefit from lowering its high unemployment insurance tax, which contributes significantly to its high tax burden ranking. If revenue neutrality is a priority, policymakers should be prepared to supplement potential revenue shortfalls by widening a tax base or increasing consumption taxes. Pennsylvania can raise sufficient revenue more easily by expanding its sales tax base, relying more on user fees, and adding a severance tax on natural gas to its revenue mix.