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Return money to Pa. taxpayers; don't spend more

By Colin McNickle

While the administration of Pennsylvania Gov. Josh Shapiro is proposing attempting to grow the commonwealth's economy by giving away taxpayer money, a researcher at the Allegheny Institute for Public Policy says a better plan would be to return money to taxpayers.

"Putting money back in the hands of Pennsylvania's taxpayers is the better alternative to growing state government," says Eric Montarti, research director at the Pittsburgh think tank (in Policy Brief Vol. 24, No. 21).

The Pennsylvania Senate passed legislation that would reduce the state's personal income tax from 3.07 percent to 2.8 percent. It also would create a tax credit for volunteer emergency medical technicians and eliminate the gross receipts tax on electricity providers.

The personal income tax is levied against the taxable income of resident and nonresident individuals, estates and trusts, partnerships, S corporations, business trusts and limited liability companies that are not taxed as corporations for federal purposes.

"It was the largest source of tax revenue for the general fund in fiscal year (FY) 2022-23, with $17.6 billion in collections accounting for 39 percent of general fund revenue," Montarti notes.

Through April of FY 2023-24, collections totaled $15 billion. That's 1 percent below estimate but nearly 1 percent above collections compared to the same period in FY 2022-23.

Montarti says the last time the personal income tax rate was cut was 1993, when it was lowered from 2.95 percent to 2.8 percent. Since the tax was instituted in 1971, it has been reduced six times. It was raised to its existing 3.07 percent rate in 2004.

The proposed tax cut is estimated to reduce tax collections by $614.5 million in FY 2024-25, $1.7 billion in FY 2025-26 and $1.8 billion in FY 2026-27.

The personal income tax reduction has been offered as an alternative to the governor's spending plan, as put forth in his budget address, featuring additional spending for public education, mass transit and economic development, among other things.

"The budget's emphasis is on competing with other states for economic development with subsidies," Montarti notes. "Proposals include $500 million for site development; $20 million for innovation strategy; $3.5 million for local economic development strategies; $25 million for main street efforts; $18 million for tourism and marketing and $2 million for internships."

But those proposals, if adopted, make the odds of a personal income tax reduction long.

"Once these programs are enacted, they rarely go away," the think tank scholar reminds. "Instead, they just raise the state's expenditure obligations, which necessitates more tax revenue."

Montarti cites a 2024 Tax Foundation report that notes states, particularly Right-to-Work states, are making changes to their personal income tax rates.

"Of the 26 states that are Right-to-Work, six have no personal income tax, eight have flat rates and 12 have graduated rates," he says. "Flat rate states like Indiana, Kentucky and North Carolina made rate reductions; Georgia moved from a graduated structure to a flat-rate structure; graduated rate states like Iowa, Nebraska and South Carolina made reductions to their top brackets.

"As previous [Allegheny] Institute research has described, Pennsylvania is on a phasedown schedule for its corporate net income tax as well," Montarti says. "The rate for 2024 is 8.49 percent, with 0.5-point reductions scheduled through 2031.

"This year, Pennsylvania's rate ranks ninth-highest behind flat rate or top graduated rates in other states," he says.

But Montarti reiterates the better option for Pennsylvania's growth and prosperity is to mimic what works best elsewhere.

"A better way would be to look at the changes that are coming to … competitor states' income taxes and build a competitive strategy from that point forward," he says.

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