

2009-2010 ESTIMATE DOCUMENTATION



**PA Department of Revenue
Bureau of Research
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GENERAL FUND REVENUE ESTIMATES*

\$ millions

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
<u>Revenue Sources</u>	<u>Revised</u>	<u>Budget</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>
TOTAL - GENERAL FUND	26,658.4	27,314.1	29,090.5	30,855.4	32,350.7	33,504.7
TOTAL - TAX REVENUE	26,202.1	26,452.5	28,170.5	29,696.1	31,510.9	32,665.5
TOTAL - Corporation Taxes	4,956.0	4,769.8	4,760.2	4,837.4	4,940.9	4,995.7
Corporate Net Income	2,037.2	1,918.8	1,926.4	2,048.3	2,052.9	1,994.9
Capital Stock & Franchise	801.3	578.4	305.0	110.1	73.0	43.1
<u>Selective Business Total</u>	<u>2,117.5</u>	<u>2,272.6</u>	<u>2,528.8</u>	<u>2,679.0</u>	<u>2,815.0</u>	<u>2,957.7</u>
Utility Gross Receipts	1,444.3	1,562.3	1,773.5	1,915.4	2,056.3	2,165.3
Utility Property	42.1	50.5	50.1	52.7	55.3	58.1
Insurance Premiums	422.5	451.3	494.3	498.8	492.3	508.8
Financial Institutions	191.1	190.1	191.6	191.9	190.0	203.4
Other	17.5	18.4	19.3	20.2	21.1	22.1
TOTAL - Consumption Taxes	9,339.9	9,758.9	10,394.4	10,672.6	11,208.4	11,410.4
Sales and Use	8,274.5	8,389.6	8,971.3	9,213.8	9,707.4	9,890.6
Cigarette	782.1	1,035.5	1,060.6	1,079.3	1,102.8	1,101.8
Other Tobacco Products	NA	37.9	53.4	56.5	59.7	63.3
Malt Beverage	26.0	26.0	26.0	26.0	27.0	28.0
Liquor	257.3	269.9	283.1	297.0	311.5	326.7
TOTAL - Other Taxes	11,906.2	11,923.8	13,015.9	14,186.1	15,361.6	16,259.4
Personal Income	10,755.8	10,754.7	11,598.9	12,378.3	13,248.8	13,873.6
Severance	NA	107.2	236.0	353.5	490.7	631.9
Realty Transfer	320.2	237.5	329.9	403.8	468.9	524.1
Inheritance	819.5	813.6	840.2	1,039.5	1,142.2	1,218.8
Minor and Repealed	10.7	10.8	10.9	11.0	11.0	11.0
TOTAL - NONTAX REVENUE	456.3	861.6	920.0	1,159.3	839.8	839.2
Liquor Store Profits	125.0	80.0	80.0	80.0	80.0	81.0
<u>Licenses, Fees & Miscellaneous Total</u>	<u>299.8</u>	<u>750.1</u>	<u>808.5</u>	<u>1,047.8</u>	<u>728.3</u>	<u>726.7</u>
Licenses and Fees	129.7	120.9	120.9	120.9	120.9	121.9
Miscellaneous	170.1	629.2	687.6	926.9	607.4	604.8
<u>Fines, Penalties & Interest Total</u>	<u>31.5</u>	<u>31.5</u>	<u>31.5</u>	<u>31.5</u>	<u>31.5</u>	<u>31.5</u>
F, P & I On Taxes	27.5	27.5	27.5	27.5	27.5	27.5
F, P & I Other	4.0	4.0	4.0	4.0	4.0	4.0

* Individual accounts may not sum to totals due to rounding.

GENERAL FUND REVENUE ESTIMATES

Annual Percent Changes *

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
<u>Revenue Sources</u>	<u>Revised</u>	<u>Budget</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>
TOTAL - GENERAL FUND	-4.5%	2.5%	6.5%	6.1%	4.8%	3.6%
TOTAL - TAX REVENUE	-4.0%	1.0%	6.5%	5.4%	6.1%	3.7%
TOTAL - Corporation Taxes	-9.2%	-3.8%	-0.2%	1.6%	2.1%	1.1%
Corporate Net Income	-15.7%	-5.8%	0.4%	6.3%	0.2%	-2.8%
Capital Stock & Franchise	-21.4%	-27.8%	-47.3%	-63.9%	-33.7%	-41.0%
<u>Selective Business Total</u>	4.8%	7.3%	11.3%	5.9%	5.1%	5.1%
Utility Gross Receipts	7.1%	8.2%	13.5%	8.0%	7.4%	5.3%
Utility Property	-5.8%	20.0%	-0.8%	5.2%	4.9%	5.1%
Insurance Premiums	1.0%	6.8%	9.5%	0.9%	-1.3%	3.4%
Financial Institutions	-0.4%	-0.5%	0.8%	0.2%	-1.0%	7.1%
Other	5.4%	5.1%	4.9%	4.7%	4.5%	4.7%
TOTAL - Consumption Taxes	-2.3%	4.5%	6.5%	2.7%	5.0%	1.8%
Sales and Use	-2.6%	1.4%	6.9%	2.7%	5.4%	1.9%
Cigarette	-0.2%	32.4%	2.4%	1.8%	2.2%	-0.1%
Other Tobacco Products	NA	NA	40.9%	5.8%	5.7%	6.0%
Malt Beverage	-1.1%	0.0%	0.0%	0.0%	3.8%	3.7%
Liquor	2.4%	4.9%	4.9%	4.9%	4.9%	4.9%
TOTAL - Other Taxes	-3.0%	0.1%	9.2%	9.0%	8.3%	5.8%
Personal Income	-1.4%	0.0%	7.8%	6.7%	7.0%	4.7%
Severance	NA	NA	120.1%	49.8%	38.8%	28.8%
Realty Transfer	-25.5%	-25.8%	38.9%	22.4%	16.1%	11.8%
Inheritance	-1.1%	-0.7%	3.3%	23.7%	9.9%	6.7%
Minor and Repealed	-90.4%	0.9%	0.9%	0.9%	0.0%	0.0%
TOTAL - NONTAX REVENUE	-28.1%	88.8%	6.8%	26.0%	-27.6%	-0.1%
Liquor Store Profits	56.3%	-36.0%	0.0%	0.0%	0.0%	1.3%
<u>Licenses, Fees & Miscellaneous Total</u>	<u>-40.8%</u>	<u>150.2%</u>	<u>7.8%</u>	<u>29.6%</u>	<u>-30.5%</u>	<u>-0.2%</u>
Licenses and Fees	5.9%	-6.8%	0.0%	0.0%	0.0%	0.8%
Miscellaneous	-55.7%	269.9%	9.3%	34.8%	-34.5%	-0.4%
<u>Fines, Penalties & Interest Total</u>	<u>-35.1%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>
F, P & I On Taxes	-25.1%	0.0%	0.0%	0.0%	0.0%	0.0%
F, P & I Other	-66.1%	0.0%	0.0%	0.0%	0.0%	0.0%

* Figures reflect changes in unrounded receipts.

MOTOR LICENSE FUND REVENUE ESTIMATES*

\$ millions

<u>Revenue Sources</u>	<u>2008-09 Revised</u>	<u>2009-10 Budget</u>	<u>2010-11 Estimate</u>	<u>2011-12 Estimate</u>	<u>2012-13 Estimate</u>	<u>2013-14 Estimate</u>
TOTAL - MOTOR LICENSE FUND	2,583.3	2,682.6	2,445.0	2,506.8	2,526.2	2,546.6
TOTAL - LIQUID FUELS TAXES	1,199.0	1,215.8	1,222.6	1,230.4	1,239.2	1,248.9
Liquid Fuels	547.2	568.5	571.9	575.9	580.5	585.8
Fuels	158.9	157.6	158.3	159.0	159.6	160.3
Motor Carriers / IFTA	39.0	39.2	39.4	39.6	39.8	40.0
Alternative Fuels	0.6	0.6	0.6	0.6	0.6	0.6
Oil Company Franchise	453.2	449.9	452.4	455.3	458.6	462.2
TOTAL - LICENSES & FEES	898.7	877.3	901.1	942.1	955.5	966.2
Special Hauling Permits	20.7	21.6	22.6	23.5	24.6	25.6
International Registration Plan (IRP)	110.2	83.4	85.8	88.3	90.8	93.4
Operators' Licenses	62.7	59.8	59.1	62.6	63.9	61.0
Vehicle Registration & Titling	673.0	679.3	699.3	732.1	739.4	748.1
Other Fees - Bureau of Motor Vehicles	32.2	33.3	34.4	35.6	36.9	38.1
TOTAL - OTHER MOTOR	485.7	589.4	321.2	334.3	331.5	331.5
Revenue/Gross Receipts Tax	(0.0)	0.0	0.0	0.0	0.0	0.0
Vehicle Code Fines/Clearing Account	32.2	32.2	32.2	32.2	32.2	32.2
Miscellaneous - Treasury	(69.9)	33.9	65.8	79.0	76.2	76.2
Miscellaneous - Transportation	22.5	22.39	22.25	22.11	21.97	21.84
Miscellaneous - General Services	0.8	0.87	0.94	1.02	1.11	1.2
Turnpike Payments	500.0	500.0	200.0	200.0	200.0	200.0

* Individual accounts may not sum to totals due to rounding.

MOTOR LICENSE FUND REVENUE ESTIMATES

Annual Percent Changes *

<u>Revenue Sources</u>	<u>2008-09 Revised</u>	<u>2009-10 Budget</u>	<u>2010-11 Estimate</u>	<u>2011-12 Estimate</u>	<u>2012-13 Estimate</u>	<u>2013-14 Estimate</u>
TOTAL - MOTOR LICENSE FUND	-3.2%	3.8%	-8.9%	2.5%	0.8%	0.8%
TOTAL - LIQUID FUELS TAXES	-3.0%	1.4%	0.6%	0.6%	0.7%	0.8%
Liquid Fuels	-7.5%	3.9%	0.6%	0.7%	0.8%	0.9%
Fuels	1.1%	-0.8%	0.4%	0.4%	0.4%	0.4%
Motor Carriers / IFTA	0.3%	0.5%	0.5%	0.5%	0.5%	0.5%
Alternative Fuels	-43.8%	0.0%	0.0%	0.0%	0.0%	0.0%
Oil Company Franchise	1.2%	-0.7%	0.6%	0.6%	0.7%	0.8%
TOTAL - LICENSES & FEES	3.1%	-2.4%	2.7%	4.5%	1.4%	1.1%
Special Hauling Permits	2.0%	4.3%	4.3%	4.3%	4.4%	4.4%
International Registration Plan (IRP)	72.1%	-24.3%	2.9%	2.9%	2.9%	2.9%
Operators' Licenses	2.1%	-4.6%	-1.2%	6.0%	2.1%	-4.6%
Vehicle Registration & Titling	-3.1%	0.9%	3.0%	4.7%	1.0%	1.2%
Other Fees - Bureau of Motor Vehicles	0.3%	3.5%	3.5%	3.5%	3.5%	3.4%
TOTAL - OTHER MOTOR	-13.2%	21.4%	-45.5%	4.1%	-0.8%	0.0%
Revenue/Gross Receipts Tax	NA	NA	NA	NA	NA	NA
Vehicle Code Fines/Clearing Account	-6.3%	0.0%	0.0%	0.0%	0.0%	0.0%
Miscellaneous – Treasury	-235.1%	-148.6%	94.0%	20.0%	-3.5%	0.0%
Miscellaneous – Transportation	-0.4%	-0.6%	-0.6%	-0.6%	-0.6%	-0.6%
Miscellaneous - General Services	15.6%	8.75%	8.05%	8.51%	8.82%	8.11%
Turnpike Payments	0.0%	0.0%	-60.0%	0.0%	0.0%	0.0%

* Figures reflect changes in unrounded receipts.

Tax revenues are affected by legislative and judicial modifications on both the national and state levels. The following is a list of recently enacted significant changes in state law that may affect unrestricted General Fund and Motor License Fund tax revenues.

ACT #79 of July 10, 2008 made the following changes:

To the Keystone Opportunity Zones:

- Expands the Keystone Opportunity Zone (KOZ) program. Under this legislation, KOZs that are set to expire within the next five to ten years will have the option of extending benefits for seven to ten years. Zones that expire in January of 2008 will be given until June 2009 to apply for the extension.
- The Department of Community and Economic Development (DCED) may designate up to 15 additional zones beginning on January 1, 2010. These newly designated zones must be sponsored by a political subdivision. Moreover, a political subdivision may be able to swap underutilized zones for new locations within the political subdivision. Applications must be received by DCED by December 31, 2008.
- Under this legislation, contractors, pursuant to a contract with a qualified business, landowner or lessee, may purchase, exempt from Sales and Use Tax, any tangible personal property or services for use in the zone by the qualified business.
- The formula for calculating the taxable income of a corporation is only based upon the payroll and property factors. The sales factor has been eliminated from the calculation.
- The bill further prohibits a person or business from knowingly employing an illegal alien. Those found to be in violation may be required to repay all tax benefits received for a two-year period while being located within the zone.

ACT #1 of the Special Session of July 9, 2008 made the following changes:

To the Alternative Energy Production Tax Credit:

- Taxpayers that develop or construct alternative energy production projects located within the Commonwealth, which have a useful life of at least four-years, may apply to the Department of Environmental Protection (DEP) for a credit beginning in September 2009. The amount of the credit may be up to 15% of the amount paid for the development and construction of alternative energy production project but may not exceed \$1,000,000 per taxpayer. Unused portions of the credit may be carried forward for up to five taxable years from the year in which the credit is awarded. Credits may not be applied to previous tax years. Additionally taxpayers may, upon approval by the DEP, sell or assign an unused credit after one year from the date that the credit was approved. The total amount of credits that may be awarded annually is as follows:
 - \$5 million for Fiscal Years 2008-09 through 2011-12;
 - \$7 million in Fiscal Year 2012-13;
 - \$10 million in Fiscal Years 2013-14 through 2014-15; and
 - \$2 million in Fiscal Year 2015-16.

ACT #66 of July 9, 2008 made the following changes:**To the Volunteer Responder Retention and Recruitment Tax Credit:**

- Qualified active volunteer ambulance, fire and rescue personnel are eligible for a credit of up to \$100 to be used against their Pennsylvania Personal Income Tax liability. The credit is available for Tax Years beginning after December 31, 2007 and ending before January 1, 2009. Eligibility of volunteers for the credit will be determined based upon certification by their designated supervisor or chief under a point system approved by the State Fire Commissioner and State EMS Director. If the entire credit cannot be used against the volunteer's tax liability for the year in which it was awarded, it may be carried forward to succeeding tax years. The amount of credits awarded cannot exceed \$4,500,000.

To the Personal Income Tax:

- Monies from the check-offs for breast and cervical cancer research will now be transferred to the Pennsylvania Breast Cancer Coalition, rather than the Department of Health.

ACT #61 of July 9, 2008 made the following changes:**To the Educational Improvement Tax Credit:**

- Makes Subchapter S corporations and other pass-through entities eligible for the Education Improvement Tax Credit (EITC) program, which allows business firms to receive tax credits for certain contributions made to non-profit, scholarship and education improvement organizations. Business firms applying for tax credits for a second year of a two-year commitment may apply beginning on May 15. Other business firms applying for tax credits may apply beginning on July 1. Pass through entities may apply beginning on July 7. The bill also increases the annual credit limit per taxpayer from \$200,000 to \$300,000 for scholarship and education improvement organizations, and increases the annual credit limit for contributions to pre-kindergarten scholarship organizations from \$100,000 to \$150,000.

ACT #42 of July 4, 2008 made the following changes:**To the Cigarette Fire Safety and Firefighter Protection Act:**

- Beginning July 1, 2009, only self-extinguishing cigarettes that have been tested, certified and stamped may be sold in Pennsylvania. Cigarette manufacturers must submit certifications to the Department, with a \$1,000 fee per brand, stating that the cigarettes offered have been tested pursuant to the standards set forth in the Act. The Department, the State Fire Commissioner and the Attorney General are charged with enforcing the Act. Manufacturers, wholesalers and stamping agents found in violation may be subject to a penalty not to exceed \$10,000 per sale; \$25,000 for subsequent offenses. Retailers found to be in violation may be subject to fines of up to \$500; \$5,000 for subsequent offenses.
- Certification fees collected will be deposited into the Cigarette Fire Safety and Firefighter Protection Act Enforcement Fund to support the processing, testing, enforcement and oversight duties under the Act. Monies received from penalties will be deposited into the Fire Prevention and Public Safety Fund to support fire safety and prevention programs administered by the State Fire Commissioner.

ACT #32 of July 2, 2008 made the following changes:**To the Local Earned Income and Net Profits Tax:**

- Consolidates on a county-wide basis the collection of the local earned income and net profits taxes. Each tax collection district will have one appointed tax collector. The number of local collectors will be

reduced from 560 to 69 beginning January 1, 2010. Municipalities are included in the tax collection district in which its school district is located. Local taxing districts may enter into an agreement with the Department for the exchange of information necessary for the administration and enforcement of local tax collection. Furthermore, the DCED, in consultation with the Department shall develop forms and regulations for local tax collection.

ACT #77 of December 18, 2007 made the following changes:

To the Hazardous Sites Cleanup Fund:

- Permits the State Treasurer to transfer \$40 million of capital stock franchise tax revenue to the Hazardous Sites Cleanup Fund for fiscal years 2008-09 and beyond (Effective immediately).

ACT #55 of July 25, 2007 made the following changes:

To the Personal Income Tax:

- The check-off for breast and cervical cancer research will no longer have an expiration date. Extends the expiration date for wild resource conservation and organ and tissue donor awareness to December 31, 2009. (Effective immediately)

To the Bank Shares Tax:

- Permits banks involved in mergers or acquisitions to deduct goodwill from the book value of total equity capital generated as a result of combinations.
- Applicable to combinations occurring after June 30, 2001 and to the returns due on March 15, 2008.

To the Film Production Tax Credit:

- Establishes the Film Production Tax Credit for certain production expenses of the producers of feature films and certain television commercials or shows intended for a national audience. In order to qualify, 60% of total production expenses must be incurred in Pennsylvania and compensation paid to individuals or payments made to entities representing individuals for services provided in the film may not exceed \$15 million. The tax credit is equal to 25% of qualified film production expenses and may be used against the PIT, CNIT, or CSFT. (Effective immediately)

To the Neighborhood Assistance Tax Credit:

- Extends the Neighborhood Assistance Tax Credit (NATC) to include pass-through entities.
- The credit may now be sold or assigned.
- Increase the amount of the NATC awarded to a taxpayers and private companies by 5%.
- The amount of credits awarded annually cannot exceed \$500,000 (increased from \$250,000) for contributions or investments for single projects.
- NATC provisions are effective immediately.

To the Resource Enhancement and Protection Tax Credit:

- Establishes the Resource Enhancement and Protection (REAP) tax credit for the cost of agricultural operations that enhance farm production and protect natural resources. Dependent on the type of project, a tax credit in the amount of 75% of the eligible project or 50% of the project costs may be awarded up to a maximum amount of \$150,000 for each eligible applicant or project. This tax credit may be used

against personal income tax, corporate net income tax, capital stock and franchise tax, bank shares tax, title insurance company premiums tax, insurance premiums tax, and mutual thrift institutions tax.

- REAP tax credit provisions effective October 23, 2007, except credits for legacy sediment which cannot be issued prior to July 1, 2008.
- The total amount of credits that can be awarded in a fiscal year is \$10 million.

To the Sales and Use Tax:

- Includes the remanufacturing of locomotive parts in the manufacturing exemption. (Effective immediately)
- Repeals SUT exclusion for the production of commercial motion pictures effective October 1, 2007.
- Expands refund for bad debt to include private label credit cards from retailers. Applies to amounts deducted as bad debts on Federal income tax returns required to be filed after January 1, 2008.

Miscellaneous Provisions:

- Provides a nexus exemption for the customers of powered metallurgy parts manufacturers. Exemption is applicable to taxable years beginning after December 31, 2004, as well as taxable years as to which there is an appeal prior to the effective date of this act.

ACT #45 of July 20, 2007 made the following changes:

To the Education Improvement Tax Credit:

- Increases the annual cap on credits from \$59 million to \$75 million. This change increases the amount available for contributions to scholarship organizations from \$8.7 million, and the amount available for contributions to educational improvement organizations from \$4.3 million to \$22.3 million. The total amount of credits available for kindergarten organizations will now be \$8 million per year, an increase of \$3 million. (Effective immediately)

ACT #44 of July 18, 2007 made the following changes:

To Operation of the Turnpike Commission:

- Turnpike Commission will enter into a 50-year lease agreement with PennDOT, requiring the Commission to make payments to PennDOT. In return, the Commission will be allowed to toll and operate Interstate-80.
- Authorizes the Commission, in consultation with PennDOT, to prepare a civil engineer's report, financial analysis, and application to US Department of Transportation for the conversion of Interstate 80 to a toll road pursuant to any Federal program for which it may be eligible. This action requires explicit approval from the General Assembly prior to conversion of Interstate 80 to a toll road.
- Moves up the date of increasing fares on the turnpike to 2009. Fares were originally slated to be increased by 25% in 2010. Fares will continue to increase at a rate of 3% annually after 2009.

To Transportation Funding:

- Replaces the current funding for transit agencies with a revenue neutral dedicated portion of the SUT, which is equal to 4.4% of collections.

To Local Taxation:

- Permits Allegheny county to levy a tax on liquor by the glass of up to 10% or a rental car tax of \$2 a day to cover their local share of transportation funding.

ACT #189 of November 29, 2006 made the following changes:

To the Sales and Use Tax:

- Exempts the sale of copies of official documents sold by government agencies or courts from tax. (Effective immediately)

ACT #182 of November 29, 2006 made the following changes:

To the Personal Income Tax:

- Exempts amounts paid by the U.S. Government or the Commonwealth for active state duty emergency service inside or outside of the Commonwealth from the definition of compensation.
- Applies to taxable years beginning after December 31, 2006.

ACT #151 of November 20, 2006 made the following changes:

Allows for the creation of Strategic Development Areas (SDA):

- Businesses located within the SDAs receive relief from various local and state taxes, including the corporate net income tax, the capital stock and franchise tax, the sales and use tax, and the personal income tax. In addition, insurance companies and certain regulated transportation companies are eligible to earn tax credits based on the number of jobs created within the SDA.
- The program is administered by the Department of Community and Economic Development and tax benefits may not extend beyond December 31, 2022. (Effective immediately)

ACT #116 of July 6, 2006 made the following changes:

To the Sales and Use Tax:

- Clarifies that clean rooms and their component systems are included under the manufacturing and processing exemption and as such, are exempt from tax.

To the Corporate Net Income Tax:

- Increases the sales factor weight to 70 percent for calculating corporate net income tax apportionment. This applies to taxable years beginning after December 31, 2006.
- Expands the cap on net operating losses to \$3 million, or 12.5 percent of taxable income, whichever is less. This applies to taxable years beginning after December 31, 2006.

To the Research and Development Tax Credit:

- Increases the cap on credits from \$30 million to \$40 million.
- Increases the amount of credits allocated for small businesses from \$6 million to \$8 million.
- Increases the small business credit from 10 percent to 20 percent of qualified research and development expenses.
- Extends the credit to include expenses incurred during taxable years ending on or before December 31, 2015.

- Changes apply to credits awarded after June 30, 2006.

ACT #114 of July 11, 2006 in part, made the following changes:

To the Educational Improvement Tax Credit:

- Raises the annual cap on credits from \$44 million to \$54 million. This change increases the amount available for contributions to scholarship organizations from \$29.3 million to \$36 million, and the amount available for contributions to educational improvement organizations from \$14.7 million to \$18 million. (Effective immediately)

ACT #67 of July 6, 2006 made the following changes:

To the Sales and Use Tax:

- Exempts the sale of investment metal bullion and investment coins from the sales and use tax. This exemption does not include jewelry or works of art made from coins, nor does it include medallions. (Effective September 6, 2006)

To the Personal Income Tax:

- Links the Pennsylvania definitions of small corporation and qualified subchapter S subsidiary to the Internal Revenue Code, as amended through 2005. The effect is that, pursuant to recent Federal changes in the American Jobs Creation Act, the number of shareholders allowed for purposes of Pennsylvania S corporation designation increases from 75 to 100. Requires a Federal S corporation to be a Pennsylvania S corporation unless it specifically files an election not to be considered an S corporation for Pennsylvania purposes. The election requires the consent of 100 percent of the members. The election due date is extended and election revocations are prohibited for the six months. Applies to taxable years beginning after December 31, 2005.
- Provides a personal income tax exemption for contributions made to Health Savings Accounts (HSAs) and Archer Medical Accounts (AMAs). These changes are consistent with Federal treatment of these contributions. Applies to taxable years beginning after December 31, 2005.
- Provides a personal income tax exemption for qualified tuition program (QTP) contributions, rollovers, undistributed earnings, and distributions used for qualified higher education expenses. Applies to taxable years beginning after December 31, 2005.

To the Capital Stock and Franchise Tax:

- Excludes single member restricted professional companies (RPCs) from the definition of corporation, and consequently, from paying the capital stock and franchise tax (CSFT).
- Reduces the net income of a limited liability corporation (LLC) or business trust by the amount of distributions made by the entity to any member materially participating in the business activities of the entity. Applies to any LLC or business trust that is not taxable as a corporation for Federal income tax purposes and is effective for taxable years beginning after December 31, 2005.
- Increases the applicable valuation deduction used in calculating capital stock value from \$125,000 to \$150,000. Applies to taxable years beginning after December 31, 2006.
- Accelerates the CSFT phaseout by 0.1 mills. The rate for tax year 2006 is reduced from 4.99 mills to 4.89 mills and declines by 1 mill per year thereafter until the tax is eliminated. Applies to taxable years beginning after December 31, 2005.

To the Realty Transfer Tax:

- Reduces the amount of the transfer to the Keystone Recreation, Park, and Conservation Fund from 15 percent to 2.1 percent for transfers occurring between July 1, 2006 and June 30, 2007. The transfers occurring on or after July 1, 2007 are at 15 percent.

To the Inheritance Tax:

- Reduces the value of agricultural conservation easements by fifty percent for purposes of inheritance tax assessments. Applies to estates of decedents with dates of death on or after July 6, 2006. (Effective immediately)

ACT #65 of July 2, 2006 in part, made the following changes:**To Tax Credits:**

- The Organ and Bone Marrow Donor Act provides for a tax credit for expenses incurred when a business firm grants to any of its employees a paid leave of absence for the purpose of donating an organ or bone marrow. Credits can be used against the taxes imposed under Articles III, IV, VI, VII, VIII or XV of the Tax Reform Code. The credit is available for tax years beginning on or after January 1, 2006. (Effective immediately)

Special Session ACT #1 of June 27, 2006 made the following changes:**Creates the Taxpayer Relief Act:**

- Provides an allocation for a portion of Pennsylvania gaming revenue to school districts to provide for property tax reduction.
- Allows school districts to impose an earned income tax (EIT) or personal income tax (PIT) after a front-end referendum. The added revenue must be used to provide additional homestead and farmstead exclusions.
- Requires each school board to appoint a local tax study commission to review certain past and present tax, revenue, and demographic data, and make recommendations whether the school district should increase the EIT, or impose a PIT, in order to provide property tax reductions for homesteads and farmsteads.
- Requires a school board to seek voter approval for any proposed tax increase exceeding an annually established index.
- Requires all school districts to submit a preliminary budget by February 14, 2007. The preliminary budget, along with a schedule of any proposed tax rate increases, must be submitted to the Department of Education (PDE) by February 19, 2007.
- Provides that any school district imposing an EIT and net profits tax is subject to section 13 of the Local Tax Enabling Act.
- Provides that any school district imposing a PIT is subject to all regulations adopted by the Department of Revenue for purposes of administering the Pennsylvania personal income tax.
- Establishes the Property Tax Relief Fund and the Property Tax Relief Reserve Fund.
- Requires the Secretary of the Budget to certify the amount of revenue in the Property Tax Relief Fund and the Property Tax Relief Reserve Fund that is available for distribution as property tax relief. The

certification must be completed by April 15 and include the amount currently in the Funds, as well as all revenue which is reasonably projected to be deposited into the Funds during the following 6-month period. The Secretary may only certify an amount that is sustainable in subsequent years.

- Provides that no property tax relief shall be granted until at least \$400 million is available for distribution in the Property Tax Relief Fund.
- Repealed Act 72 of 2004, also known as the Homeowner Tax Relief Act.

To the Property Tax Rent Rebate (PTRR) Program:

- Expands the income parameters to include homeowners with an eligible income of up to \$35,000. The income eligibility requirements for renters remain at \$15,000.
- Changes the basis on which rebates are calculated from a percentage of the claimant's property tax/rent bill (where the percentage was based on income) to a fixed dollar amount based on the claimant's income.
- Provides a supplemental rebate for homeowners with incomes of \$30,000 or less and a property tax bill that exceeds of 15% of that income.
- Utilizes gaming revenue to provide for an additional rebate for homeowner residents of a city of the first class (Philadelphia), a school district of the first class A (Pittsburgh), or a city of the second class A (Scranton).

ACT #42 of May 11, 2006 made the following changes:

To the Film Production Tax Credit:

- Repealed the Film Production Tax Credit, Article XVII-C of the Tax Reform Code. (Effective June 30, 2006)
- Created the Film Production Grant program by amending Title 12 to add Chapter 41 to the Pennsylvania Consolidated Statutes. This replaces the Film Production Tax Credit Program.

ECONOMIC OUTLOOK

In constructing its tax revenue estimates, the Pennsylvania Department of Revenue and the Office of the Budget are assisted by economic forecasts provided by two main sources of forecast data: 1) IHS Global Insight, Inc. of Lexington, Massachusetts, and 2) Moody's Economy.com, Inc. of West Chester, Pennsylvania. Both of these firms are private economic forecasting and consulting firms that provide forecast data to the commonwealth and other customers. Various projections from IHS Global Insight's national forecast as well as a recent forecast produced by Moody's Economy.com were used to develop the revenue estimates in this document for the budget year and other future fiscal years. Analyses and discussion in this section, as well as the revenue estimates used in the budget, are based on a combination of data from each source and further analysis from the Department of Revenue and the Office of the Budget.

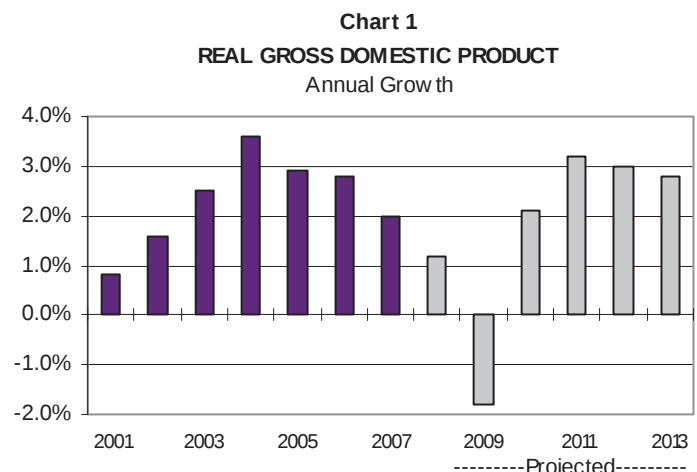
Recent Trends

During the most recent 73-month long period of economic expansion, the United States (U.S.) economy grew at an average annual rate of 2.6 percent. Chart 1 displays actual growth in real gross domestic product (GDP) from 2001 to 2007 and projected growth for 2008-2013.

By the fall of 2007, the U.S. economy was beginning to feel the first effects of the housing and financial crisis that was about to unfold. Housing construction and sales of new and existing houses began to slide precipitously. The deepening of the housing recession is estimated to have sliced 1.2 percent from overall economic growth in the latter part of 2006 and in 2007. In 2007 new home construction saw its largest decline in nearly three decades, off 24.8 percent from 2006 levels. The 2007 decline in new home construction was the second largest decline since 1980, when the new home market plunged 26 percent in the wake of double-digit inflation and 21 percent interest rates.

The current housing slump has already surpassed the housing slump of 1990 and is rivaling the 1979-1980 housing crash. Existing home sale prices fell in 2007 for the first time on record, and building permits fell 25.2 percent. New home starts of 1.353 million in 2007 were nearly half the level of 2005, when there were more than 2.3 million new home starts. Since then, new housing starts have plunged to 904,300 units in 2008, a decline of 33 percent from 2007 levels.

Problems related to housing construction, housing sales and housing finance have spread to other areas of the economy, infecting the credit markets and ravaging Wall Street. The availability of easy and cheap credit since 2001 had led to a housing boom, aggressive consumer spending and rising debt levels. Home values increased by double digit rates seemingly every year and housing construction exploded. Historically low interest rates led to many mortgages that were approved for borrowers with less-than-perfect credit (also known as "subprime" mortgages), based on the assumption that home values would continue to rise. Subprime mortgages were peddled extensively in high-growth areas such as California, Arizona, Nevada, Florida and Texas. Invariably, the subprime mortgages were adjustable-rate mortgages, which were affordable to the borrowers only at the low introductory rates. As interest rates rose and mortgages began to reset at higher rates,



many homeowners could no longer afford to make their payments. Defaults and foreclosures began to accelerate in late 2006 and continued through 2008.

As the economy – in particular, the housing market – slowed and sub-prime mortgages began resetting at higher rates, defaults and foreclosures soared nationally. Once-attractive asset-backed securities and mortgage-backed bonds began to lose value as the underlying cash flows from homeowners started to wane. Investment banks and the broader financial markets have been hardest hit by the bursting of the housing bubble, as they have been forced to write down more than \$1 trillion dollars in losses, primarily based on the crashing values of these asset-backed housing securities. In response to mounting losses associated with housing, financial institutions have significantly tightened their lending standards and access to credit has virtually dried up for all but the most prime consumer and business borrowers. Unprecedented losses by financial institutions have resulted in either the merger, bankruptcy or government bailout of such venerable Wall Street firms as Bear Stearns, Merrill Lynch, Lehman Brothers and Wachovia. Similarly, major mortgage firms such as Countrywide, Washington Mutual, IndyMac and AIG Insurance have faced bankruptcy only to be sold at fire-sale prices or rescued by the U.S. government. Perhaps most important, housing finance giants Freddie Mac and Fannie Mae were placed in conservatorship by the U.S. government to prevent their collapse in September 2008. Combined, these two government-created firms have lent or underwritten more than \$5.3 trillion of the estimated \$12 trillion in U.S. mortgages – or roughly 45 percent of the mortgage market. These events, combined with the collapse of Lehman Brothers investment bank on September 15, 2008 and the federal rescue of AIG Insurance two days later sent the financial markets into a harrowing dive. By December 1, 2008, the National Bureau of Economic Research announced what was already painfully obvious – the U.S. economy had been in a recession since December 2007.

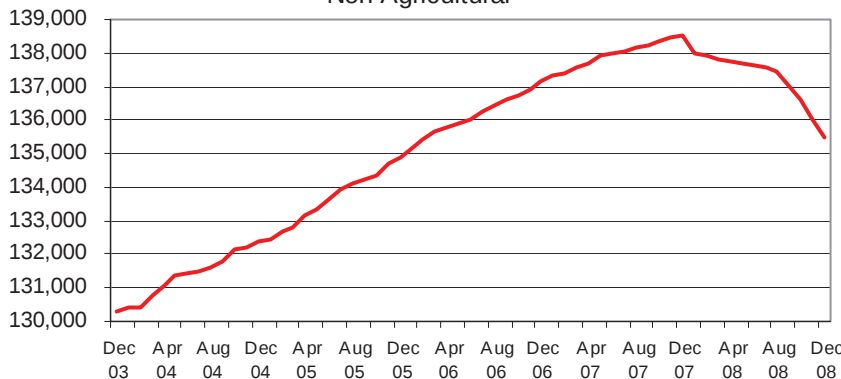
At 14 months, the current contraction already exceeds the average postwar recession length of 10 months. Assuming the current recession last until May 2009, it will be the longest recession since World War II. The recessions of 1973-75 and 1980-81 each lasted 16 months. Since most economists do not predict an end to the current recession before late 2009, the current contraction will likely be the longest recession since the Great Depression, which technically lasted 43 months. Further, the depth of this recession is much steeper than the two most recent recessions of 2001 and 1991. If forecasters are correct, peak-to-trough declines in real GDP could rival those of the 1973-75 and 1980-81 recessions, when the peak-to-trough declines in real GDP were 3.1 percent and 2.6 percent respectively. Unlike many other recessions, the current recession was not caused by a downturn in a few specific industries. It started with a housing bust and metastasized into a full-blown credit crisis that eventually destabilized the entire U.S. financial system.

The credit boom of this decade masked a troubling trend: Over the past decade, strong U.S. productivity growth has coincided with declining real incomes for most Americans. The credit crisis has likely dispelled the notion that the U.S. economy can expand while its manufacturing base dwindles. Before the current crisis, the presumption had been that innovation and productivity gains would create wealth and new jobs. Over the past 10 years, growth in real GDP has averaged 2.7 percent annually but according to many calculations, U.S. consumers have rung up nearly \$3 trillion in excess borrowing and spending over the same period. Thus, the consumption that occurred over the past decade and that supported the economic expansion was not made possible by income growth but by consumer borrowing. Without this artificial boost to spending, real GDP would likely have been considerably lower. Similarly, the global economic boom was fueled by unsupported and out of control borrowing by consumers, businesses and nations. As such, the housing market was not the only sector of the global economy that was not in balance with its underlying fundamentals. Essentially, the entire economy was outspending its resources. Data from the federal Bureau of Labor Statistics supports this premise. Over the past 10 years, U.S. productivity has risen a total of 29.7 percent while real wages have only

grown 2 percent. Real wages and salaries peaked in the U.S. in early 2003. Historically, real wages and productivity have gone up in tandem. Rampant borrowing and spending by consumers masked underlying problems in the economy. Excluding personal consumption, real economic growth averaged only 1.3 percent during the 10 years ending in 2007 – the slowest rate since the 1950's. Therefore, if consumption had not been artificially inflated with excess borrowing, the economy would have appeared much weaker.

From 2001 through 2007, the three main pillars of the U.S. economy were consumer spending, business investment and exports. Consumers continued spending following the bursting of the dot com bubble around 2000. They increased their spending following the terrorist attacks and recession of 2001, straight through to the first two quarters of 2008. However, it appears that American consumers have finally been overwhelmed by the erosion of their financial base – the value of their homes – because consumer spending has fallen dramatically since the summer of 2008. It is estimated that households have lost more than \$8 trillion in net worth since the fall of 2007 due to falling home equity and stock prices. That drop exceeds the \$4.2 trillion decline after the 2000 stock market collapse. The result has been a dramatic drop in consumer spending. What started as a housing-led recession is now a full-scale consumer-led recession, which brings all of the textbook problems of prior recessions: decreased demand, the slashing of inventories and capital investment, layoffs and so on.

Chart 2
US EMPLOYMENT
Non-Agricultural



Following slow job growth from 2001 to 2003, more than 8.2 million jobs were created during the most recent economic expansion. Chart 2 shows that there was significant growth in U.S. employment from January 2004 to late 2007. Employment growth started to slow in the latter part of 2007 and more significantly during early 2008. By the summer of 2008, job losses began to occur more frequently. Monthly claims for unemployment compensation increased to 400,000 to 500,000 per month by the fall of 2008. All told, the U.S. economy lost 2.6 million jobs in

2008 – more than the number of jobs lost in the recession of 1973-75 or that of 1980-81. The U.S. unemployment rate rose steadily in 2008, reaching 7.2 percent in December. The rise in the unemployment rate accelerated in the second half of 2008.

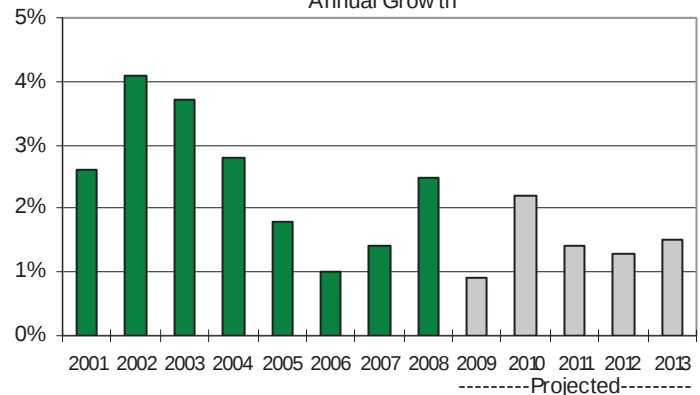
Layoffs have hit nearly all sectors of the U.S. economy, from manufacturing and construction to financial services and retail sales. Some sectors have been particularly hard hit. Unemployment rates in the construction and mining trades were 12.1 percent by November 2008. The unemployment rate in manufacturing and production followed at 9.4 percent, including the loss of nearly 300,000 jobs in the auto industry. These losses are on top of the nearly 1.8 million manufacturing jobs lost between 2001 and 2007. However, a few sectors of the economy were still producing jobs, such as health care and education. These industries alone contributed 3.5 million new jobs during the most recent economic expansion. Despite the recession, health care and education employers have created 500,000 new jobs since December 2007 when the recession began. Data shows that employers who can add jobs during a recession are often the industry leaders in the next expansionary period. During the recession of 1991, employment in software engineering and

computer programming continued to rise leading to the technology boom of the 1990s. During the recession of 2001, banks, mortgage brokers and real estate agencies added jobs, contributing to the housing boom.

Just as consumer spending is declining significantly, so too are U.S. exports which had remained strong through much of 2008. While the housing sector had been in recession since 2007 and consumer spending slowed in 2008, exports remained a boon to the economy. While the national economy expanded to grow at a rate of just over 1.0 percent for 2008, it is estimated that, excluding the net effect of exports and imports, the economy would have contracted at a rate of 0.6 percent over the same period. With business investment and consumer spending plunging, worldwide demand is also declining. This combination is proving devastating to U.S. manufacturers, as factory output has fallen at an annual rate of nearly 16 percent through the third quarter of 2008 – a rate not seen since the severe 1980-81 recession.

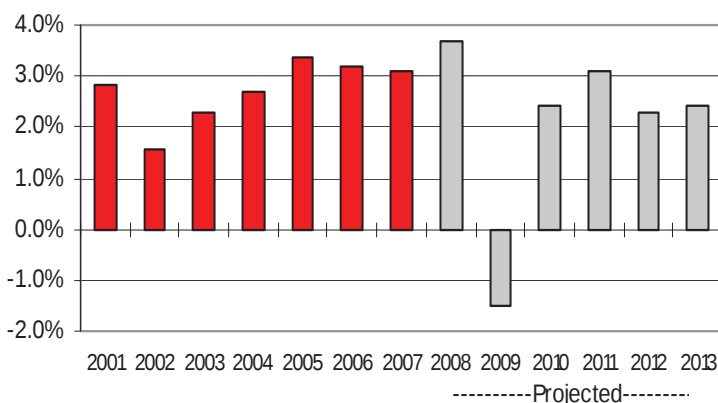
As the national economy slowed in late 2007, entering a recession in December, businesses again were looking to gains in productivity to soften the impact. Job growth slowed correspondingly as productivity posted year-over-year gains of 1.4 percent in 2007 and 2.5 percent in 2008. Chart 3 provides data on productivity gains from 2001 through 2008 and a forecast of productivity gains for 2009 through 2013. Gains in productivity recently achieved in 2007 and 2008 are still lower than the 3 percent to 4 percent annual gains seen during the “jobless recovery” of the 2002-04 period. The modest increases in productivity have helped to support minor growth in real GDP over the past year.

Chart 3
PRODUCTIVITY GAINS
Annual Growth



Gains in productivity, combined with declining wages, job losses and declines in consumer and business spending have rendered moot any discussion of inflation in the near term. However, rising energy prices in 2007 and early 2008 contributed greatly to the current recession. Every postwar recession has been preceded by a spike in oil prices, and the current recession is no different, as the price of a barrel of oil reached \$150 by mid-2008. Led by surging energy costs, inflation peaked at 3.7 percent in 2008, as shown in Chart 4. The 2008 peak level of inflation was the highest rate since the 1991 recession, when it was 5.4 percent. Since the collapse of the credit and equity markets in the fall of 2008, consumption has declined, wages are depressed and oil prices have retreated consistently, hovering at around \$40 per barrel.

Chart 4
INFLATION-CONSUMER PRICE INDEX
Annual Growth



The Federal Reserve Board began to raise interest rates in June 2004. From that time through December 2006, the Federal Reserve implemented a total of 17 quarter-point rate hikes, which raised the federal funds rate from 1 percent to 5.25 percent. Much of this increase occurred during 2005, when the federal funds rate rose two full percentage points. Since that time, a slowing

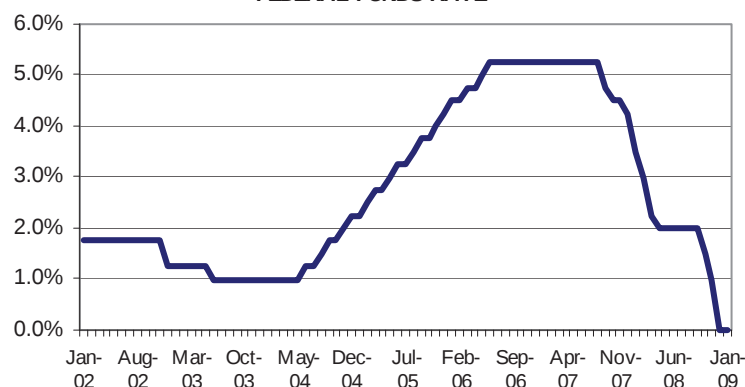
economy, lower job growth and a significant recession in the housing market led the Federal Reserve to restart its interest rate cuts in an attempt to keep the broader U.S. economy out of recession during 2007. That year, the Federal Reserve lowered the federal funds rate by a full percentage point late in the year. The Fed started with a half-point reduction in the federal funds rate in September, followed by quarter-point reductions in October and December. These reductions were combined with corresponding reductions in the discount rate – the rate the Federal Reserve charges to make direct loans to banks. Further, the Federal Reserve and the European Central Bank have injected hundreds of billion of dollars and euros into the world financial markets to try to ease liquidity constraints and avoid a recession. By January 2008, the Federal Reserve dramatically lowered the federal funds rate by three-quarters of a point, in response to the deepening housing recession, the continued credit crunch and plunging global financial markets. The same day, the Federal Reserve also lowered the discount rate by a corresponding three-quarters of a point. The surprise rate cut is the first monetary policy action taken by the Federal Open Markets Committee between scheduled meetings since September 17, 2001. Chairman Ben Bernanke and the Federal Reserve continued to lower the federal funds rate throughout 2008, finally reaching “a target rate” of between 0.0 and 0.25 percent in December 2008, as shown in Chart 5. Further, the Federal Reserve has dramatically expanded its balance sheet to inject more than \$2 trillion in liquidity into the financial markets in order to stem the credit crisis.

Current Conditions

The U.S. economy entered the current recessionary period in December 2007. The economic slowdown was triggered by a nationwide crash in the housing market, which caused a dramatic tightening of credit. This credit crunch sapped consumer spending power, leading to a rapid decline in consumer consumption. The slowdown in spending and the lack of available credit affected the business community, which responded by laying off workers. At the same time, the crises in housing and credit were quickly reflected in the financial markets, with investors ranging from multi-billion-dollar municipal pension funds to individual workers saving for retirement suffering huge losses in their investment portfolios. This sharp decline in the value of investments further reduced consumer spending, leading to more business closings and more layoffs in many sectors of the economy. So goes the textbook circular pattern of a classic recession in which various recessionary forces build strength, feeding off of each other as the economy slides downward. For all the talk of a new economic paradigm having developed over the past two decades, the underlying fundamentals of the U.S. economy remain jobs, income and wealth and consumer spending.

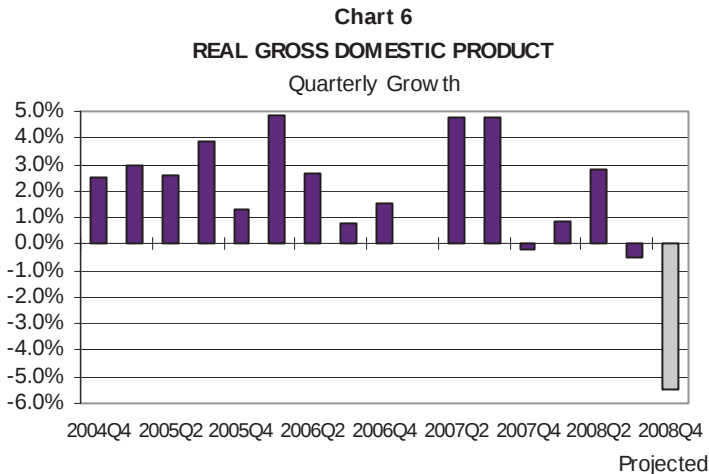
While overall real GDP growth for 2008 is expected to finish just over 1 percent for the year, as shown in Chart 1 earlier, an examination of real GDP on a quarterly basis reveals the sharp reversal the U.S. economy has undertaken since the fourth quarter of 2007. Discounting the short-term effects of the 2008 tax rebates, the U.S. economy has contracted in three of the past five quarters. The 0.5 percent contraction in the third quarter of 2008 will likely be followed by a 5 percent to 6 percent contraction in the fourth quarter of 2008.

Chart 5
FEDERAL FUNDS RATE



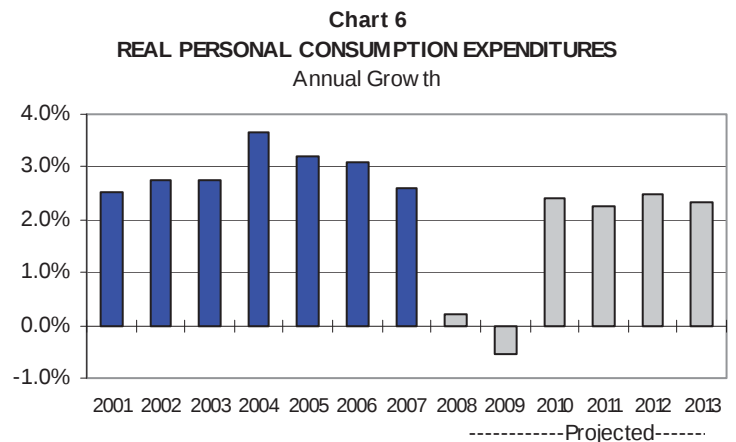
Employment in the U.S. peaked in December 2007 just as the recession was beginning, as shown in Chart 2. Since that time, job losses have been growing. First, monthly job losses were measured in the tens of thousands monthly from December 2007 through August 2008. Beginning with the stunning crash of Lehman

Brothers on September 15, 2008 and the bailout of insurance giant AIG a few days later, job losses ballooned upward at an alarming rate, averaging nearly 500,000 jobs lost per month from September through December 2008. During all of 2008, U.S. employers eliminated 2.6 million jobs, cutting 1.9 million in the last four months of the year alone. These staggering job losses pushed the December 2008 unemployment figure to 7.2 percent, the highest figure since January 1993. As result, the labor markets have not been this gloomy since the 1980-81 recession, when unemployment hit 10.8 percent. Beyond job losses, hours worked are being reduced as well.



During December, the average number of hours worked fell to 33.3 hours per week, down two-tenths of an hour to the lowest level since recordkeeping for this data began in 1964. The loss of jobs has been widespread throughout the economy but the manufacturing and construction sectors have been hardest hit. Since December 2007, more than 790,000 manufacturing jobs have been lost and construction jobs are down 899,000 from their peak in September 2006. Slumping retail sales have led to the loss of nearly 550,000 retail jobs since December 2007. Fully one-third of the retail job losses occurred at automobile dealerships as that industry has been particularly affected during this recession. The professional and business services sector lost nearly 500,000 jobs in 2008. Employment in the financial services area has fallen by 148,000 jobs in 2008. In fact, the only major economic sector adding jobs in 2008 was health care, which added 372,000 positions in the past 12 months.

Job losses, declines in household wealth and tighter credit are just a few of the factors adversely impacting consumer spending. Widely regarded as the main engine of the U.S. economy and accounting for fully two-thirds of GDP, consumer spending has been in a tailspin since the recession deepened in the summer of 2008. It is estimated that households have lost more than \$8 trillion in net worth since the summer of 2007 due to falling home equity and stock prices. These stunning losses account for the large-scale retreat in consumer spending as shown in Chart 6, which shows the annual average growth in real personal consumption expenditures for the period 2001 through 2007, with forecasts for 2008 to 2013. With consumers no longer able to tap into growing equity in their homes and individual investors faced with a nearly 40 percent drop in the S&P 500 since September, consumer spending plunged during the third quarter of 2008, down 3.7 percent annually. This decline was the largest since 1980, when credit controls were imposed by the Carter Administration. Consumer spending is expected to be down for the fourth quarter of 2008 as well; that figure will be released in early 2009. December retail sales have already been released; they were down 7.5 percent



from the prior year, a foreboding sign. Further, the December decline in retail sales marked the sixth consecutive month of slumping retail sales. Consumer spending has never declined for three consecutive quarters since records were first kept in 1947. Yet, economists now expect the decline in consumer spending to continue during the first quarter of 2009. If this projection holds true, the peak-to-trough decline in consumer spending could be the largest of any postwar recession. The unusually heavy drag on the economy from consumer restraint is the largest factor contributing to the severity of the current recession. (Recall that the 2001 recession was tempered by the consumer's willingness to keep spending.)

In response to this pullback in consumer spending, businesses began to cut back sharply on production. From August through October 2008, factory orders plunged 12 percent, a record three-month drop, and companies continue to slash capital spending, inventories and hiring. All of this retrenching, of course, compounds the adverse effects of the recession. Through November, orders for capital goods, excluding defense and aircraft, had dropped at a 28 percent annual rate from the third quarter. Automobile output is expected to have plunged 60 percent during the fourth quarter of 2008. Exports are also slumping; they are on a path to post their largest quarterly decline in 35 years. The World Bank expects global trade to decline by 2.1 percent in 2009, following a 27-year boom cycle. In fact, the current recession marks the first time in the postwar era that a simultaneous global recession has occurred in the U.S., Europe and Japan. The nearly 40 percent drop in the S&P 500 index is the largest since 1937; according to Bloomberg News, financial firms have disclosed more than \$1 trillion of write-downs and credit-market losses since 2007 linked to subprime mortgages.

Early data from 2009 shows that the U.S. housing market continues to implode. U.S. Commerce Department data indicates that housing starts fell 16 percent last month to an annual rate of 550,000. This level is the lowest since statistics were first kept in 1945. With excess supply and very weak demand, it is likely that housing starts will remain depressed for several years. During all of 2008, housing starts were down 33 percent from 2007 to 904,300, also the fewest since 1945. Housing starts declined in three of the four regions of the U.S., led by the Midwest, where housing starts were down 25 percent. Interestingly, housing starts actually rose 13 percent in the Northeast. Not only are fewer new homes being built, but more people in existing homes are losing their homes. Filings for foreclosures in December 2008 were 41 percent higher than in December 2007. The National Association of Realtors reports that at least 40 percent of the sales of existing homes are attributable to the sales of foreclosed properties.

Monetary policy efforts by the Federal Reserve to date have been aimed at the financial markets generally and the mortgage industry in particular. Reductions to the federal funds rate, as shown in Chart 5, have been extraordinary in scale and frequency. The Fed's December 16, 2008 announcement that it was lowering its target federal funds rate to a range of 0.0 to 0.25 percent is the lowest in the history of the Federal Reserve, which was founded in 1913. Additionally, the Fed has committed to buy large volumes of "tainted mortgages" in an effort to stabilize the mortgage industry.

Previously, the Federal Reserve had concentrated on interest rate reductions as its main monetary policy tool. Now the Fed has adopted a policy it calls "quantitative easing," which pumps massive volumes of money into the financial system, affecting the rates of interest on virtually all credit instruments. The implied goal of the Fed is to provide cheaper credit to all parts of the economy, starting with housing. While the federal funds rate cannot go below zero, the Fed has virtually unlimited power to stimulate the economy with monetary policy by buying up mortgage-backed securities, Fannie Mae and Freddie Mac corporate debt and other assets. On November 25, 2008, the Federal Reserve announced that it would begin buying up to \$600 billion in mortgage debt and mortgage-backed securities from Fannie Mae, Freddie Mac and the Federal Home Loan

Bank. This approach has already led to a reduction in mortgage rates for consumers. Additionally, the Fed has announced that it will start to pump nearly \$200 billion into the student loan, auto loan, credit card and small-business loan industries in 2009 to further stimulate growth. Such actions have dramatically driven up the Fed's balance sheet, which currently stands at \$2.2 trillion, up from \$900 billion in September 2008. Expectations are that the Fed's balance sheet could reach \$5 trillion by the end of 2009.

By using any and all means at its disposal, the Federal Reserve is trying to avoid a bout of deflation from occurring in the U.S. Such a situation occurred in the U.S. in the 1930s and in Japan in the 1990s. Deflation is characterized by slumping demand, rising unemployment and frozen credit which continue to impact each other in a vicious cycle. It is essentially inflation in reverse, with wages and prices moving downward in a coordinated pattern. Sustained declines in demand and falling prices force businesses to cut prices ever deeper.

When deflation occurs in an economy, the inflation rate drops below zero into negative percentages. Inflation data from 2008 strongly suggests that the U.S. economy is hovering on the brink of deflation. Since July 2008, the inflation has fallen from 5.6 percent to 1.1 percent. The December 2008 inflation rate declined from the previous December for the first time since 1955. The October and November CPI figures showed the largest single monthly drops in annual CPI growth rates during the postwar period. Inflation levels are expected to drop below zero in 2009 on the heels of steep declines in energy and commodity prices and the rapid decline in consumer demand during the second half of 2008.

The Forecast

Since peaking in 2004, growth in the national economy had been slowing annually. Starting in December 2007, the U.S. economy entered a recession. Discounting the effect of one-time stimulus/tax rebate checks issued in early 2008, quarterly growth in real GDP has been non-existent for the past year, as shown in Chart 5.

Real GDP is expected to have grown at a very subdued rate of 1.2 percent in 2008 – the lowest level of growth since 2001. The economy contracted 0.5 percent in the third quarter of 2008 and expectations are that

the fourth quarter contraction in real GDP could reach 5 percent to 6 percent. Similar economic contraction is forecast for the first and second quarters of 2009, according to a combination of data from both IHS Global Insight and Moody's Economy.com economic forecasts.

Annual growth in real GDP is projected to be -1.8 percent in 2009, with significant contraction during the first two quarters, followed by minimal positive growth in the last two quarters of 2009. A combination of data from both forecasting sources is highlighted in Table 1. This table presents actual data for 2007 and forecasts for the 2008-2010 period for several national economic indicators. As noted, both real and nominal GDP growth have slowed significantly during 2008, but remained positive. The current forecast anticipates that the recession will deepen and that the economy will experience four

Table 1
Forecast Change in
Key US Economic Indicators
Annual Percentage Growth*

Indicator	2007	2008p	2009p	2010p
Nominal GDP	4.8	3.5	-0.3	3.4
Real GDP	2.0	1.2	-1.8	2.1
Real Personal Consumption	2.8	0.2	-0.5	2.4
Corporate Profits (After Tax)	2.2	-14.5	1.2	9.2
Unemployment Rate (Rate)	4.6	5.8	8.2	8.6
CPI	3.1	3.7	-1.5	2.4
Federal Funds (Rate)	5.0	2.0	0.1	1.2

*Assumptions in this chart, as well as other assumptions, are incorporated in the 2009-10 fiscal year revenue estimates.

p=projected

straight quarters of negative growth from the fall of 2008 until summer 2009. Additionally, all of the major economies of the world are simultaneously in a recession for the first time in the postwar period. For that reason, there are no external forces to support growth. Economic forecasts now project the first decline in real world GDP in the postwar era. Modest growth is forecast for 2010 and beyond, but the economy will strain to get through 2009. The current 13-month recession is expected to last up to 24 months, making it the longest recession since the Great Depression and the second longest since 1910.

Declines in housing construction and housing finance led the economy into recession. Until the housing markets stabilize, the depths of the current recession will remain unknown. New housing starts plummeted in the later part of 2008, down 33 percent from the prior year, finishing at just 904,000 units, a record low since 1945. The economic forecast is for continued weakness in new housing starts through the second quarter of 2009. Total housing starts are expected to bottom out at 604,000 units in 2009, a 33 percent decline from the 2008 levels, which were already the worst on record. The rapid decline in housing starts reflects the combination of excess supply in the market, weak demand and a continuation of the credit crunch. The Federal Reserve's actions to inject massive amounts of liquidity into the financial system has driven the average 30-year mortgage rate to below 5 percent, but most of the benefit has been attained by those refinancing existing debt rather than by those purchasing new homes. Overall housing prices are expected to continue to decline through the first quarter of 2010.

Declining wealth from home values and losses in the stock market have erased an estimated \$8 trillion in household wealth since 2007. Those losses, combined with declining real wages and increasing unemployment, have caused U.S. consumers to drastically reduce their spending since the middle of 2008, as shown in Chart 6. Real consumer spending is expected to decline for four straight quarters, starting with the third quarter of 2008. Real personal consumption is expected to decline 0.5 percent in 2009. A projected 2.3 percent peak-to-trough drop in real personal consumption is expected. This would be the largest such decline since the 1980 recession. According to economists, any turnaround in consumer spending in the spring of 2009 depends on the enactment of additional fiscal stimuli such as new tax cuts or rebates. One bright spot is that declining energy prices are expected to assist consumers and stretch their purchasing power. In addition, personal income growth is expected to return in 2009, despite rising unemployment. Growth in real personal income is expected to reach 2.3 percent in 2009, up from just 0.6 percent growth in 2008 as shown in Chart 9 below.

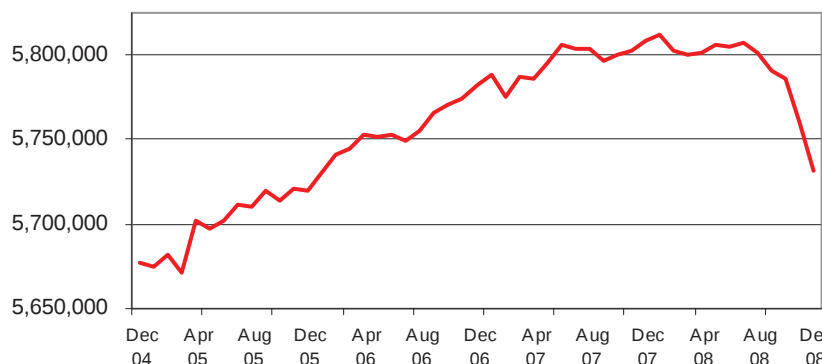
The U.S. economy is expected to continue to shed jobs in 2009. More than 2.6 million jobs were lost in 2008 and more losses are expected in 2009. Job losses are expected to average around 500,000 monthly in early 2009 before slowing in the later part of 2009. Total peak-to-trough job losses from December 2007 until 2010 are projected to be 5 million jobs. The U.S. unemployment rate in December 2008 was 7.2 percent; economists estimate it will reach close to 9.0 percent by the end of 2009 before job growth returns in 2010.

Pennsylvania Outlook

The commonwealth's economic performance is largely dependent upon job growth. Pennsylvania's labor market, specifically the non-agricultural sectors, started to grow significantly in January 2004. Despite this increased job creation, the state unemployment rate began to rise in 2004. Unemployment in Pennsylvania reached 5.7 percent in December 2004. This rising unemployment rate despite increased job creation was due to growth in the state's labor force during 2004, as more job seekers re-entered the expanding job market. At that time, growth in the state labor force was greater than the national average.

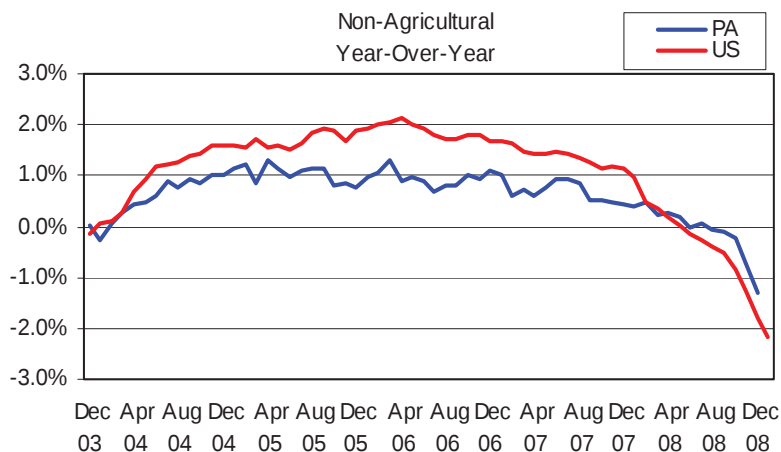
Continued job creation, combined with somewhat slower growth in the overall labor force during 2005 and 2006, produced a decline in Pennsylvania's unemployment rate, to a low of 3.8 percent in March 2007. As the U.S. and state economies slowed in late 2007, employment in the commonwealth peaked in January 2008 at 5.811 million non-agricultural jobs. Since December 2007 and the start of the national recession, Pennsylvania has lost 76,200 jobs. The loss of jobs in Pennsylvania started slowly in early 2008 and was measured in a few thousand per month as shown in Chart 7. Beginning in the fall of 2008, job losses began to accelerate, with

Chart 7
PENNSYLVANIA EMPLOYMENT
Non-Agricultural



26,000 jobs lost in November and 28,000 jobs lost in December. This reduction in jobs is the largest 12-month drop since the 1991 recession. However, Pennsylvania's 12-month job loss rate of -1.3 percent is still better than the national average of -1.9 percent. In December 2008, the commonwealth's unemployment rate was 6.7 percent, its highest level since March 1994. The national unemployment for December 2008 was 7.2 percent. Pennsylvania's unemployment rate has now been equal to or below the national average for 70 of the past 72 months.

Chart 8
EMPLOYMENT GROWTH
Non-Agricultural
Year-Over-Year



Despite the loss of more than 76,000 jobs, the commonwealth has still created 106,400 jobs since January 2003.

Pennsylvania's 2008 projected job losses were lower than the projected national average, and remained less steep than those of the surrounding states of New Jersey, Delaware and Ohio. As job losses were more subdued in Pennsylvania in 2008, the commonwealth moved up to 30th in the ranking of average annual state growth in employment (with the first being the best). Pennsylvania has traditionally been around 40th or below in this ranking, even during periods of strong job creation. The comparatively low ranking is somewhat deceptive though: While the

state does not generally produce as many new jobs when the economy is going strong, the commonwealth also does not suffer as much as the rest of the country as a whole during periods of economic contraction as shown in Charts 8 and 9.

This pattern has been evident since the 1990s, following the significant diversification of the Pennsylvania economy in the previous 30 years. A reduced reliance upon manufacturing and mining employment has been part of this trend, along with the expansion of education and health care-related jobs in the commonwealth. Both of these sectors are less prone to recessions. Employment in the commonwealth saw job losses across all sectors in 2008 except for the educational and health services sectors which had job growth of 2.0 percent in 2008 and the government sector, which had job growth of 0.4 percent in 2008. Manufacturing and the

construction sectors had the worst year-over-year rate of job losses in Pennsylvania in 2008, with manufacturing jobs down 3.9 and construction jobs down 3.6 percent. The information, trade and transportation, financial services, leisure and hospitality, and professional and business services sectors also saw job losses in 2008.

As job losses are expected to continue nationally through 2009, the slower rate of job losses in Pennsylvania is expected to push the commonwealth up to 14th among the 50 states in terms of annual job growth in 2009, according to estimates by IHS Global Insight. Annual employment growth in Pennsylvania is forecast at around -0.5 percent in 2009, while positive job growth is expected to return in 2010 at a rate of 0.6 percent annually. Slightly more robust job growth is forecast for the commonwealth after that, with growth of 1.1 percent in 2011 and 1.3 in 2012. As the national economy begins to recover in 2010, the rate of job growth in Pennsylvania is expected to again lag behind the national average from 2010 through 2012.

Housing construction continued to slow in Pennsylvania in 2008, down from a high of 45,000 new units in 2005 to just under 25,000 units in 2008. Economic forecasts project that housing starts will fall another 12 percent in 2009. Sales of new and existing homes also declined by 24 percent during 2008. Further, while home prices have been falling dramatically throughout the nation, home price appreciation in Pennsylvania has simply stalled since 2007.

While the commonwealth has been less susceptible to the bursting of the housing bubble than the rest of the nation, the ensuing credit crunch is taking a toll on Pennsylvanians. Job losses and declining wealth have pushed many Pennsylvanians into foreclosure. The number of Pennsylvania homes repossessed nearly doubled in 2008. Additionally, more than 37,000 properties received foreclosure notices in 2008, a jump of 127 percent over 2007 levels. While these figures are disconcerting, Pennsylvania remains in better shape than many other states. At 0.68 percent of all homes owned, the commonwealth's 2008 foreclosure rate ranked just 33rd among the 50 states and the District of Columbia, according to figures compiled by the Associated Press.

Chart 9
PA AND US REAL PERSONAL INCOME
Annual Growth

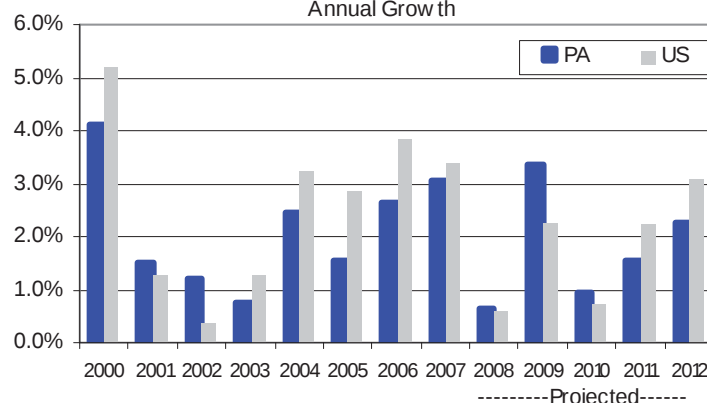
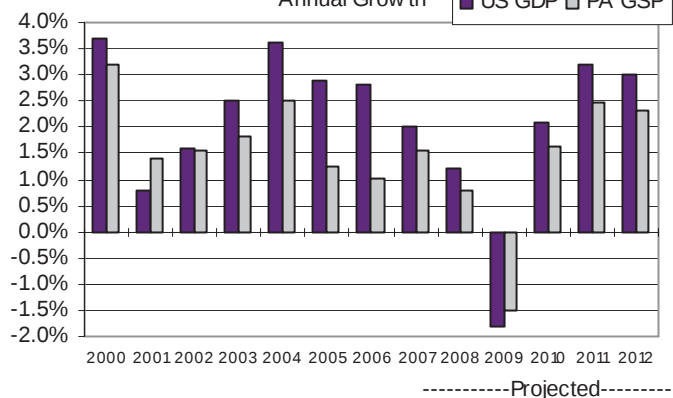


Chart 10
REAL US GDP vs. REAL PA GSP
Annual Growth



The inverse relationship of the U.S. and the commonwealth growth in personal income has re-emerged during the current recession. Chart 9 plots actual and projected annual real personal income growth for Pennsylvania and the United States for the years 2000 through 2012. As shown, growth in Pennsylvania real personal income exceeded the national average during the 2001 recession and the subsequent “jobless-recovery” period through mid-2003. As the national economy gained traction in late 2003, personal income in the U.S. began to exceed the Pennsylvania average – although

Pennsylvania's personal income growth remained strong and positive. As the recession of 2008 took hold and deepened, the rate of growth in real personal income plunged for the nation as a whole, as it did for the commonwealth. However, the decline in the rate of growth was less severe for Pennsylvania for the rest of the nation. Economists expect that the rate of growth in real personal income for Pennsylvanians will exceed the national average through 2010. This strong performance is partially the result of the diversification of the Pennsylvania economy and a stronger state labor market. Growth in less recession-prone industries such as health care, pharmaceuticals, education and government have aided the commonwealth.

The short-term outlook for Pennsylvania is that its economy remains heavily dependent on the national economy. Economic growth in Pennsylvania has a high correlation with growth in the U.S. economy, as illustrated in Chart 10. As with trends in real personal income during expansionary periods, Pennsylvania's gross state product lags behind the rate of growth in U.S. gross domestic product. The greatest recent gap between the two rates of growth was in 2006. Since then, the commonwealth's rate of growth in gross state product has steadily gained on the rate of growth in U.S. gross domestic product. The commonwealth is expected to suffer less of an economic contraction than the U.S. in 2009, essentially out-performing the national economy. Beginning in 2010 through 2012, the gap between the two rates of growth is expected to widen as the national economy expands.

Reprinted from the 2009-10 Governor's Executive Budget, pp. A1.4-A1.14

Economic Indicators ^{1/}

Quarterly Comparisons

	<u>2009.1</u>	<u>2009.2</u>	<u>2009.3</u>	<u>2009.4</u>	<u>2010.1</u>	<u>2010.2</u>
<u>Percent Change Versus Year Ago In</u>						
Nominal GDP	0.4	-0.9	-1.2	0.4	1.8	3.2
Real GDP \$00	-1.7	-2.5	-2.2	-0.6	0.8	1.8
GDP Price Index	2.0	1.7	1.0	1.0	1.0	1.4
Consumption	-1.8	-2.8	-1.9	1.8	3.7	4.4
Business Investment	-8.1	-14.5	-18.9	-16.6	-10.3	-2.8
PA Wages & Salaries	1.9	1.3	0.9	1.1	1.6	2.2
<u>3-Month T-Bill Rate</u>	0.1	0.3	0.5	0.8	1.2	1.5
<u>PA Unemployment Rate</u>	6.6	7.0	7.1	7.2	7.3	7.3

Annual Comparisons

	<u>Predicted June of 2008</u>				
<u>Percent Change In:</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2008</u>	<u>2009</u>
Nominal GDP	3.5	-0.3	3.4	3.5	3.4
Real GDP \$00	1.2	-1.8	2.1	1.4	1.3
GDP Price Index	2.3	1.4	1.3	2.1	2.1
Consumption	3.6	-1.2	4.3	5.3	3.3
Business Investment	3.5	-14.5	-0.2	3.7	-0.6
PA Wages & Salaries	3.4	1.3	2.4	3.7	3.1
<u>3-Month T-Bill Rate</u>	1.4	0.4	1.8	1.9	2.4
<u>PA Unemployment Rate</u>	5.5	7.0	7.2	4.9	5.1

^{1/} Global Insight, US Macro Forecast, December 2008 Standard Scenario and June 2008 Standard Scenario.
PA Regional Forecast, December 2008 Standard Scenario and June 2008 Standard Scenario.

For the 2008-09 revised and 2009-10 budget estimates, three types of models were used: (1) econometric, (2) structural and (3) combined structural and econometric models. An econometric model assumes that tax revenues are a function of one or more economic factors. An example of such a model is the realty transfer tax model. Structural models forecast revenue based on the statutory requirements, on the timing of tax remittances, and on projected changes in aggregate liabilities. Projected changes in tax liabilities are estimated either from economic data or from historic patterns.

Econometric models are estimated using least squares regression. Regression analysis assumes a linear relationship where the dependent variable, y , equals the sum of the products of independent variables, x_n , and their respective coefficients, β_n , plus an error term, e :

$$y = \beta_0 + \beta_1 x_1 + \dots + \beta_n x_n + e.$$

A regression equation, $y = \beta_0 + \beta_1 x_1 + \dots + \beta_n x_n + e$, differs from the true equation by the error term, e . The method of least squares regression estimates values for the coefficients $\beta_0, \beta_1, \dots, \beta_n$ such that the sum of the squared error terms is minimized. Once a regression equation is determined, a projection of future estimates may be derived using forecasts of the independent variables.

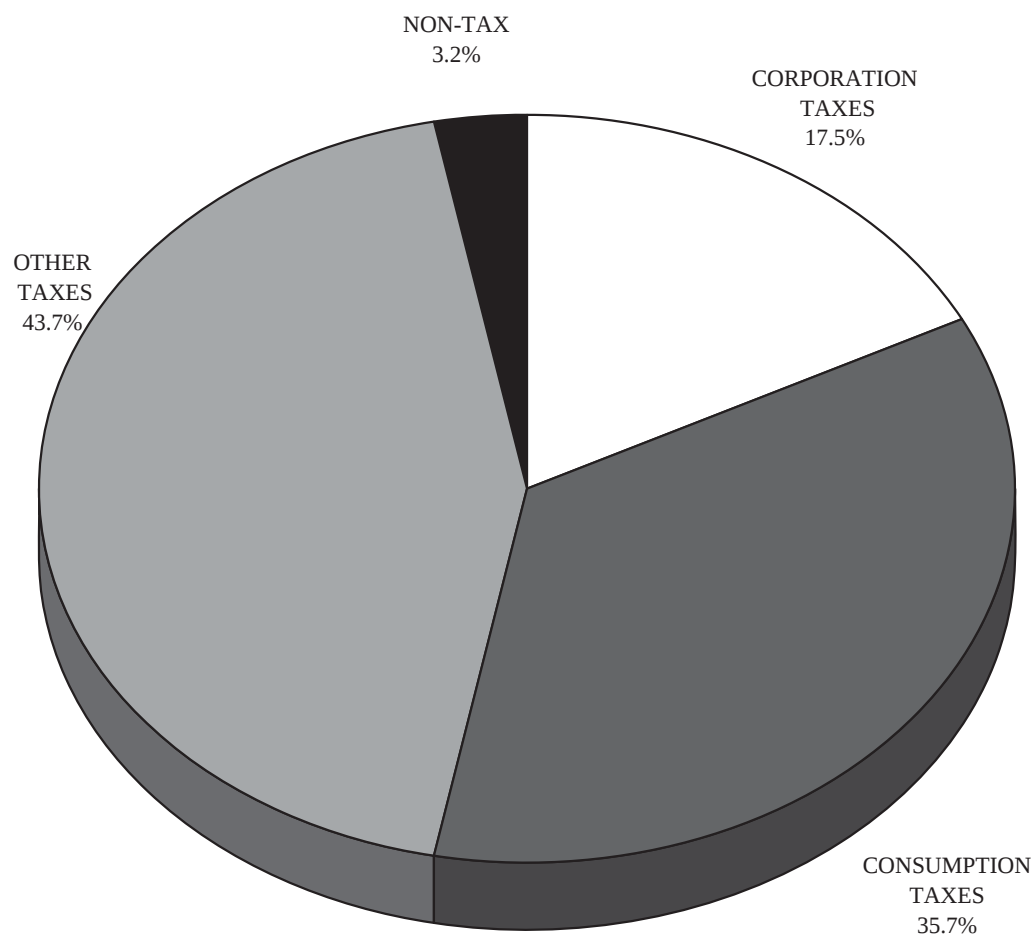
Certain econometric models need to be adjusted for a serial correlation bias. The autoregressive coefficient of the residual, ρ (rho), is used to adjust these forecasts. The corrected forecast equals:

$$\text{Forecast Value}_{n+t} + (e_n \times \rho^t),$$

where t equals the number of observations into the forecast period and n equals the last period of actual data. All models, for which a value of ρ is given, are adjusted to correct for a serial correlation bias.

GENERAL FUND REVENUE

Fiscal Year 2009-10



CAPITAL STOCK AND FRANCHISE TAX

HISTORICAL DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	896.3	-1.9%
2003-04	984.3	9.8%
2004-05	1,025.9	4.2%
2005-06	1,080.9	5.4%
2006-07	1,000.0	-7.5%
2007-08	1,019.9	2.0%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	801.3	-21.4%
2009-10	578.4	-27.8%
2010-11	305.0	-47.3%
2011-12	110.1	-63.9%
2012-13	73.0	-33.7%
2013-14	43.1	-41.0%

MODEL: Econometric and Structural

EQUATION: $PAYMENTS = 2.2646 ZBAVE - 200.7694$

VARIABLES:

$PAYMENTS$ - Annual CSFT payments. These amounts are rate adjusted to 12.75 mills.

$ZBAVE$ - 5 year moving average of annual US corporate profits.

STATISTICS:

$\bar{R}^2$	=	0.906	DF	=	12
F	=	126.59	N	=	14

COEFFICIENT T-STATS:

β_0	=	11.25	β_1	=	-1.33
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The estimates result from an econometric approach that uses tax year liabilities rate adjusted to 12.75 mills to predict annual capital stock and franchise tax. These standardized growth rates are then utilized in the structural cash flow model.

CAPITAL STOCK AND FRANCHISE TAX (Cont'd)

The cash flow model applies the growth rates from the econometric model to a tax year cash liability number (i.e., sum of cash payments in a tax year) with appropriate tax rates applied. The tax year cash liability numbers are transformed into a fiscal year cash flow with appropriate adjustments for tax base and apportionment changes affecting tax year 1995 and later.

Act 89-2002 suspended the CSFT transfers to the Hazardous Sites Cleanup Fund unless the Fund balance falls below \$5 million. Act 77-2007 reinstated the transfers to the Hazardous Sites Cleanup Fund. Beginning in fiscal year 2008-09, the minimum of \$40 million or all revenues collected under Article VI will be transferred.

Please refer to the Legislative Overview section for more details on other legislative changes affecting CSFT.

CIGARETTE TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	826.7	209.9%
2003-04	856.4	3.6%
2004-05	784.4	-8.4%
2005-06	792.1	1.0%
2006-07	778.6	-1.7%
2007-08	784.0	0.7%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	782.1	-0.2%
2009-10	1,035.5	32.4%
2010-11	1,060.6	2.4%
2011-12	1,079.3	1.8%
2012-13	1,102.8	2.2%
2013-14	1,101.8	-0.1%

MODEL: Structural

Act 89-2002 increased the cigarette tax rate to 5.0 cents per cigarette and included a floor tax due ninety days after the effective date of the Act. In addition, Act 46-2003 increased the cigarette tax rate to 6.75 cents per cigarette and provided for a floor tax due ninety days after the effective date of the Act.

Beginning in fiscal year 2002-03, a fixed amount of \$30,730,000 is transferred to CHIP and a fixed amount of \$20,485,000 is transferred to ACEP each year via two equal semi-annual payments in January and July. Effective January 7, 2004, the Health Care Provider Retention Account (HCPRA) receives 18.52% of cigarette tax receipts. Transfers to the HCPRA occur monthly and are based on collections in the prior month.

The Governor's Executive Budget proposes a 10 cent tax increase for a total of \$1.45 per pack. In addition, the proposal calls for the elimination of the HCPRA transfer. These changes are reflected in the above estimates.

CORPORATE NET INCOME TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	1,396.6	-1.5%
2003-04	1,678.0	20.1%
2004-05	1,921.4	14.5%
2005-06	2,237.0	16.4%
2006-07	2,492.5	11.4%
2007-08	2,417.6	3.0%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	2,037.2	-15.7%
2009-10	1,918.8	-5.8%
2010-11	1,926.4	0.4%
2011-12	2,048.3	6.3%
2012-13	2,052.9	0.2%
2013-14	1,994.9	-2.8%

MODEL: Econometric and Structural**EQUATION:** $\ln CNI = 0.8688 \ln PROFITS - 0.2482 UTDUM + 1.8182$

VARIABLES:

CNI - Corporate net income tax receipts on a tax year basis for all corporations. These receipts have been adjusted to reflect an equally-weighted (33.3%) sales factor, no net operating loss provision, and a rate of 9.99%.

PROFITS - Annual US corporate profits.

UTDUM - Dummy variable that controls for the deregulation of utility companies.

STATISTICS:

$\bar{R}^2$	=	0.941	<i>DF</i>	=	14
<i>F</i>	=	128.18	<i>N</i>	=	17

COEFFICIENT T-STATS:

β_0	=	14.38	β_1	=	-5.28
β_2	=	4.65			

CORPORATE NET INCOME TAX (Cont'd)

The regression equation predicts tax year revenues for all corporations. These revenues are at a constant rate and are adjusted to exclude the impact of the changing treatment of net operating loss (NOL) carryforwards and the sales factor in the apportionment formula. Act 89-2002 increased the carryforward for net operating losses to 20 years, beginning with tax year 1998. Act 116-2006 increased the cap for net operating losses to the greater of 12.5% of taxable income or \$3 million, and the sales factor used in the apportionment formula was changed to 70%.

The UTDUM variable is incorporated for tax years following the deregulation of the utility industry. The addition of this variable controls for the deregulation and the subsequent restructuring of these companies. This variable is introduced into the econometric portion of the calculation for tax years 2001 and beyond.

A structural model is used to convert the tax year payments at constant rates to payments at rates, NOL provisions, and apportionment formulas applicable under current law. This model adjusts for any impact of federal tax law changes. The model then transforms tax year payments into fiscal year cash collections.

FINANCIAL INSTITUTIONS TAXES**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	214.4	-0.9%
2003-04	217.6	1.5%
2004-05	208.9	-4.0%
2005-06	204.7	-2.0%
2006-07	213.6	4.3%
2007-08	191.9	-10.2%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	191.1	-0.4%
2009-10	190.1	-0.5%
2010-11	191.6	0.8%
2011-12	191.9	0.2%
2012-13	190.0	-1.0%
2013-14	203.4	7.1%

EQUATION: $FIT = MTIT + BST$

VARIABLES:

FIT - Financial Institutions Tax

MTIT - Mutual Thrift Institutions Tax

BST - Bank and Trust Company Shares Tax and Title Insurance Company Shares Tax

MUTUAL THRIFT INSTITUTIONS TAX**MODEL:** Structural

The mutual thrift institutions tax (MTIT) structural model estimates are flat during the projection period. MTIT collections are expected to remain flat for a number of reasons.

Little or no expansion is expected within the industry in the forecast period as the past trend in mergers and acquisitions has yielded to appeal litigation seeking to reduce or eliminate the tax liability of some taxpayers. Any successful appeals will decrease the MTIT base, thus no growth is projected over the forecast period.

Also, aggressive tax planning on the part of taxpayers is another reason for holding the forecasted MTIT flat. Shifting items between related companies or from one state to another can decrease the amount of tax due to Pennsylvania, thus reducing the MTIT collections.

FINANCIAL INSTITUTIONS TAX (Cont'd)

SHARES TAX

MODEL: Structural

The bank shares tax structural model estimates are flat during the projection period. Collections are expected to remain flat for a number of reasons, including taxpayer appeals and tax planning. Much of the expansion and consolidation within the industry has occurred through mergers and acquisitions. This activity has resulted in appeal litigation seeking to reduce or eliminate the tax liability of some taxpayers. To the extent that these suits are successful, the bank shares tax base will be diminished, thus, no base growth is projected over the forecast period.

Tax planning on the part of banks has become more evident in recent years. Shifting items between related companies or from one state to another can decrease the amount of taxable shares apportioned to Pennsylvania, thus reducing bank shares collections.

After forecasting base estimates with no growth, two adjustments are made to arrive as a cash estimate. First, revenue is added to estimates in the anticipation of continued combination activity which generates goodwill that can increase a bank's liability. Revenue is then taken out of estimates to account for the passage of Act 55 of 2007, which allows banks to deduct goodwill generated through combination activity from their total equity capital.

FINES, PENALTIES, AND INTEREST**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	34.9	7.2%
2003-04	35.1	0.6%
2004-05	32.0	-8.8%
2005-06	35.5	11.0%
2006-07	41.7	17.5%
2007-08	48.5	16.3%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	31.5	-35.1%
2009-10	31.5	0.0%
2010-11	31.5	0.0%
2011-12	31.5	0.0%
2012-13	31.5	0.0%
2013-14	31.5	0.0%

These revenue estimates have two sources. Fines, penalties, and interest on taxes collected by the Department of Revenue have been estimated for the current fiscal year based on actual collections to date. The fines, penalties, and interest included here are those associated with corporation taxes. A small portion of other fines and penalties revenue is collected by several different departments. Each of these departments prepares estimates which are reviewed and totaled by the Department of Revenue.

GROSS RECEIPTS TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	846.8	19.2%
2003-04	1,012.4	19.6%
2004-05	1,125.9	11.2%
2005-06	1,151.0	2.2%
2006-07	1,293.3	12.4%
2007-08	1,348.9	4.3%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	1,444.3	7.1%
2009-10	1,562.3	8.2%
2010-11	1,773.5	13.5%
2011-12	1,915.4	8.0%
2012-13	2,056.3	7.4%
2013-14	2,165.3	5.3%

MODEL: Structural

These estimates are derived from a database of gross receipts tax history and liability predictions as well as economic data. The estimates are prepared on a sector-by-sector basis: electric, telephone and transportation. The telephone sector is then further broken down into collections from intrastate, interstate, and wireless telecommunications services. Total predicted liabilities are transformed to a fiscal year payment basis to obtain the receipts forecast.

The impact of electric competition (Act 138-1996), via the revenue neutral reconciliation (RNR) mechanism, is included in the estimates beginning in fiscal year 1998-99. The RNR rate is added to the base rate of 44 mills on sales of electric energy. The RNR rates for tax years 1999, 2000, 2001 and 2002 established pursuant to Act 138-1996 were -2 mills, +6 mills, -1 mill and +15 mills, respectively. Act 89-2002 permanently established the RNR rate for the electric sector at 15 mills beginning for tax year 2003. Therefore, the total gross receipts tax rate for the electric sector is 59 mills for tax year 2003 and forward.

Act 46-2003 expanded the 50 mill gross receipts tax rate on telecommunication receipts to include receipts on interstate landline calls either originating or terminating in Pennsylvania and mobile telecommunications messages billed to a service address in Pennsylvania. This change was effective for transactions after December 31, 2003. Mobile telecommunications providers were required to make first year estimated payments on a modified schedule. This schedule required them to pay 40% of their estimated payments for tax year 2004 by March 15, 2004, 40% by June 15, 2004, and 20% by September 15, 2004.

Act 89-2002 provides for a gross receipts tax (GRT) surcharge if refunds for public utility realty tax (PURTA) appeals exceed \$5 million in any fiscal year. The surcharge is calculated based on the amount of PURTA refunds during the prior fiscal year. These changes are effective January 1, 2003.

GROSS RECEIPTS TAX (Cont'd)

The following table shows the GRT surcharge by tax year:

2003	0.0 mills
2004	0.0 mills
2005	0.6 mills
2006	0.0 mills
2007	1.2 mills
2008	2.8 mills
2009	0.0 mills

Another factor having a significant impact on the GRT forecast is the fact that electric generation rate caps are expiring in 2010 and 2011 for the five largest electric distribution companies. It is believed that the expiration of these rate caps will cause significant increases in the electric GRT, particularly in fiscal year 2010-11.

INHERITANCE TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	693.8	-11.0%
2003-04	747.6	7.8%
2004-05	716.1	-4.2%
2005-06	745.2	4.1%
2006-07	756.6	1.5%
2007-08	828.6	9.5%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	819.5	-1.1%
2009-10	813.6	-0.7%
2010-11	840.2	3.3%
2011-12	1,039.5	23.7%
2012-13	1,142.2	9.9%
2013-14	1,218.8	6.7%

MODEL: Econometric and Structural**EQUATION:** $ASSETS = 0.8453 GDP + 1.5535 SP$

VARIABLES:

ASSETS - Assets subject to tax at the time of death.

GDP - Annual gross domestic product in current dollars.

SP - Annual Standard and Poor's Index of Common Stocks.

STATISTICS:

$\bar{R}^2$	=	0.978	<i>DF</i>	=	15
<i>F</i>	=	385.56	<i>N</i>	=	17

COEFFICIENT T-STATS:

β_0	=	21.51	β_1	=	4.04
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These estimates result from an econometric model that utilizes US gross domestic product and the Standard and Poor's Index to predict Pennsylvania taxable assets by year of death.

A structural model is used to distribute taxable assets by date of death. Those assets are then divided into transfer classes and distributed into the proper fiscal years. The appropriate tax rate is then applied to the taxable assets in order to estimate fiscal year cash payments.

INHERITANCE TAX (Cont'd)

The passage of the Federal Economic Growth and Tax Relief Reconciliation Act of 2001 eliminates the basis of the Pennsylvania estate tax by establishing a phase-out schedule for the federal credit for state death taxes. The Act phases-out the federal credit by 2005, thus eliminating Pennsylvania estate tax collections by 2007-08. The Act is set to expire in 2011, thus estate tax collections are expected to be minimal in 2010-11 and increase more dramatically in 2011-12. Estate taxes are forecasted separately using the US gross domestic product. The phase-out of the federal credit and its eventual expiration are accounted for using a structural model based on historical cash flow.

INSURANCE PREMIUMS TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	330.6	10.0%
2003-04	390.8	18.2%
2004-05	410.7	5.1%
2005-06	390.4	-4.9%
2006-07	412.5	5.7%
2007-08	418.2	1.4%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	422.5	1.0%
2009-10	451.3	6.8%
2010-11	494.3	9.5%
2011-12	498.8	0.9%
2012-13	492.3	-1.3%
2013-14	508.8	3.4%

MODEL: Econometric and Structural**EQUATION:** $PAYMENTS = 0.7397 OTHERINC + 39.5964$

VARIABLES: $PAYMENTS$ - Total tax year insurance premiums tax receipts.
 $OTHERINC$ - Other labor income excluding health benefits.

STATISTICS: $\bar{R}^2 = 0.881$ $DF = 14$
 $F = 111.85$ $N = 16$

COEFFICIENT T-STATS:

$\beta_0 = 10.58$ $\beta_1 = 1.75$

The regression equation predicts tax year payments. A regression is also used to forecast tax liability by tax year. A structural model then transforms tax year payments and liabilities into regular and estimated payments that are distributed to the appropriate fiscal years.

LICENSES, FEES, AND MISCELLANEOUS

HISTORICAL DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	627.4	88.2%
2003-04	696.9	11.1%
2004-05	509.1	-26.9%
2005-06	368.6	-27.6%
2006-07	573.6	55.6%
2007-08	506.5	-11.7%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	299.8	-40.8%
2009-10	750.1	150.2%
2010-11	808.5	7.8%
2011-12	1,047.8	29.6%
2012-13	728.3	-30.5%
2013-14	726.7	-0.2%

This category consists mainly of revenues from the sale of licenses, the collection of fees from numerous sources, transfers from other funds, and interest earned on General Fund deposits.

Fiscal year 2002-03 collections include two one-time transfers to the General Fund of \$10.3 million in “tipping fees” and \$100 million from the Storage Tank Fund. These transfers were authorized under Act 90-2002 and Act 91-2002, respectively. In addition, Act 91-2002 shortened the dormancy periods for various types of unclaimed property and provided for the liquidation of the escheated securities portfolio held by Treasury. These changes significantly impact 2002-03 revenue collections in this category.

Act 45-2003 further shortened the dormancy period for certain types of unclaimed property including that associated with insurance company demutualizations. This change considerably impacts 2003-04 and 2004-05 revenue collections.

Estimates made by the collecting departments for other revenue items are reviewed and totaled by the Department of Revenue.

The Governor’s Executive Budget proposes several changes to this area including transfers from the Health Care Providers Retention Account, the Oil and Gas Fund, the Tobacco Endowment, and changes to the treatment of Escheats. These changes are reflected in the above estimates.

LIQUOR STORE PROFITS**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	155.0	29.2%
2003-04	50.0	-67.7%
2004-05	54.9	9.8%
2005-06	80.0	45.7%
2006-07	150.0	87.5%
2007-08	80.0	-46.7%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	125.0	56.3%
2009-10	80.0	-36.0%
2010-11	80.0	0.0%
2011-12	80.0	0.0%
2012-13	80.0	0.0%
2013-14	81.0	1.3%

These estimates have been received from the Liquor Control Board and the Office of the Budget.

LIQUOR TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	193.2	13.1%
2003-04	195.2	1.0%
2004-05	212.5	3.3%
2005-06	223.0	5.0%
2006-07	239.5	7.4%
2007-08	251.2	4.9%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	257.3	2.4%
2009-10	269.9	4.9%
2010-11	283.1	4.9%
2011-12	297.0	4.9%
2012-13	311.5	4.9%
2013-14	326.7	4.9%

These estimates have been received from the Liquor Control Board (LCB) and were reviewed by the Department of Revenue. In January 2009, the LCB replaced their 13 accounting periods with monthly revenue collections.

Act 91-2002 required the LCB to remit liquor tax collected for all fiscal months ending within a calendar month by the last day of that calendar month. This change resulted in one additional liquor tax payment in fiscal year 2002-03.

MALT BEVERAGE TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	26.7	0.3%
2003-04	26.2	-1.9%
2004-05	24.9	-5.0%
2005-06	26.2	5.0%
2006-07	25.2	-3.8%
2007-08	26.3	4.4%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	26.0	-1.1%
2009-10	26.0	0.0%
2010-11	26.0	0.0%
2011-12	26.0	0.0%
2012-13	27.0	3.8%
2013-14	28.0	3.7%

MODEL: Structural

These estimates are based on current collection patterns. Act 46-2003 extended the Malt Beverage Tax Credit to December 31, 2008. In addition, Act 46-2003 increased the volume of malt or brewed beverages that eligible brewers may produce from 300,000 barrels to 1.5 million barrels annually.

MINOR AND REPEALED TAXES**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	17.7	157.9%
2003-04	6.6	-62.7%
2004-05	3.6	-45.6%
2005-06	-17.4	-583.3%
2006-07	-15.5	10.9%
2007-08	111.6	820.0%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	10.7	-90.4%
2009-10	10.8	0.9%
2010-11	10.9	0.9%
2011-12	11.0	0.9%
2012-13	11.0	0.0%
2013-14	11.0	0.0%

Minor and repealed tax revenues are derived from the tax on legal documents, the spirituous and vinous liquors taxes, and excess vehicle rental tax collections. Act 50-2001 repealed the spirituous and vinous liquor tax effective July 1, 2001.

Monies for the Job Creation Tax Credit (JCTC) program are removed from the minor and repealed tax category on the issuance of a commitment letter by the Department of Community and Economic Development. Act 23-2001 increased the cap to \$22.5 million per fiscal year beginning in 2001-02 and authorized the Department of Community and Economic Development to award prior year credits not previously issued as well as credits recaptured for failure to create jobs. Monies are brought back to this category from a restricted account when the taxpayer claims the credit by filing a tax credit certificate with the Department of Revenue, or when the credit is rescinded for failure to create the required jobs.

The practice of revenue accounting for the credits will be discontinued in fiscal year 2007-08. The fiscal year 2007-08 receipts for minor and repealed tax revenues includes the impact of transferring the balance of the restricted account back to the General Fund.

OTHER SELECTIVE BUSINESS TAXES**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	14.6	5.8%
2003-04	18.4	26.0%
2004-05	17.1	-7.1%
2005-06	20.6	20.4%
2006-07	17.3	-16.0%
2007-08	16.6	-4.0%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	17.5	5.4%
2009-10	18.4	5.1%
2010-11	19.3	4.9%
2011-12	20.2	4.7%
2012-13	21.1	4.5%
2013-14	22.1	4.7%

This revenue source consists primarily of loans tax collections and undistributed monies in the corporation tax clearing account.

OTHER TOBACCO PRODUCTS TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	NA	NA
2003-04	NA	NA
2004-05	NA	NA
2005-06	NA	NA
2006-07	NA	NA
2007-08	NA	NA

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	NA	NA
2009-10	37.9	NA
2010-11	53.4	40.9%
2011-12	56.5	5.8%
2012-13	59.7	5.7%
2013-14	63.3	6.0%

MODEL: Structural

The Governor's Executive Budget includes a proposed tax on other tobacco products, namely smokeless tobacco, cigars, cigarillos, and loose smoking tobacco. The proposed tax is imposed at a rate of 36 cents per ounce for smokeless and loose smoking tobacco, or 36 cents per 10 cigars or cigarillos. The proposed tax is effective October 1, 2009.

The revenue estimates included in the Governor's Executive Budget are based on data for ounces of smokeless tobacco consumed in Pennsylvania and cigars consumed in the US, adjusted to Pennsylvania based on population. The results are then further adjusted for an anticipated decline in consumption as a result of the new tax.

PERSONAL INCOME TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	7,105.9	-0.5%
2003-04	7,733.8	10.2%
2004-05	8,746.8	13.1%
2005-06	9,524.1	8.9%
2006-07	10,261.6	7.7%
2007-08	10,907.7	6.3%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	10,755.8	-1.4%
2009-10	10,754.7	0.0%
2010-11	11,598.9	7.8%
2011-12	12,378.3	6.7%
2012-13	13,248.8	7.0%
2013-14	13,873.6	4.7%

MODEL: Econometric and Structural

EQUATIONS:

A) $PIT = WITH + NONWITH$

B) $\ln QWITH = 0.9766 \ln QWASA + 18.5156 QRATIO + 0.0718 Q1 - 1.7537$

C) $\ln EST = 0.8598 \ln PRID + 0.1313 \ln CAPGAIN$

D) $\ln ANNUALS = 0.8555 \ln USID + 0.2730 \ln CAPGAIN$

VARIABLES:

PIT - Fiscal year personal income tax receipts.

WITH - Fiscal year employer withholding receipts.

NONWITH - Fiscal year estimated and annual receipts.

QWITH - Cash quarterly personal income tax receipts from employer withholding payments rate adjusted to 3.07%.

EST - Tax year estimated personal income tax payments rate adjusted to 3.07%.

ANNUALS - Tax year annual personal income tax payments rate adjusted to 3.07%.

PERSONAL INCOME TAX (Cont'd)

<i>QWASA</i>	-	Quarterly US wages and salaries.
<i>QRATIO</i>	-	Ratio of quarterly Pennsylvania wages and salaries to quarterly US wages and salaries.
<i>Q1</i>	-	First quarter dummy.
<i>PRID</i>	-	Annual US proprietors income, interest, dividends, and rents.
<i>CAPGAIN</i>	-	Annual US capital gains.
<i>USID</i>	-	Annual US interest and dividends.

STATISTICS (Equation B):

$\bar{R}^2$	=	0.997	<i>DF</i>	=	85
<i>F</i>	=	10736.2	<i>N</i>	=	89

COEFFICIENT T-STATS (Equation B):

β_0	=	40.65	β_1	=	4.46
β_2	=	19.18	β_3	=	-4.68

STATISTICS (Equation C):

$\bar{R}^2$	=	0.971	<i>DF</i>	=	15
<i>F</i>	=	829.44	<i>N</i>	=	18
ρ	=	0.435			

COEFFICIENT T-STATS (Equation C):

β_0	=	93.39	β_1	=	4.48
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PERSONAL INCOME TAX (Cont'd)**STATISTICS (Equation D):**

$$\begin{array}{llll} \overline{R}^2 & = & 0.970 & DF & = & 15 \\ F & = & 787.22 & N & = & 18 \\ \rho & = & 0.640 & & & \end{array}$$

COEFFICIENT T-STATS (Equation D):

$$\begin{array}{llll} \beta_0 & = & 49.30 & \beta_1 & = & 5.39 \end{array}$$

The personal income tax estimate is derived from forecasts of withholding, estimated, and annual payments adjusted to a constant rate. Estimated and annual payments are modeled separately.

QWITH is an econometric model that predicts employer withholding payments using US wages and salaries and the ratio of PA wages and salaries to US wages and salaries. A seasonal dummy is used in quarter one to reflect employer annual reconciliation payments.

EST is an econometric model that predicts estimated personal income tax payments on a tax year basis. US proprietors' income, interest, dividends, and rents (US PRID) and US capital gains are used as independent variables. Tax year cash payment amounts are transformed into a fiscal year cash flow with aggregate adjustments for tax base changes.

ANNUALS is an econometric model that predicts tax year annual personal income payments using US interest, dividends, and capital gains. Tax year cash payment amounts are transformed into a fiscal year cash flow with aggregate adjustments for tax base changes.

Adjustments are made to account for tax law changes, including those made to the tax base and special poverty provisions (SP). In addition, the forecast is adjusted to reflect the Act 46-2003 increase in the personal income tax rate from 2.8% to 3.07% effective January 1, 2004. Please refer to the Legislative Overview section for more details on the legislative changes.

Total personal income tax forecasts equal fiscal year withholding payments and fiscal year cash estimated and annual collections.

The Governor's Executive Budget includes a proposal that would require entities with greater than \$20,000 of withheld personal income tax per quarter to file semi-weekly, on the same schedule as federal taxpayers. This change would first occur in 2010-11 and is reflected in the above estimates.

PUBLIC UTILITY REALTY TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	50.8	76.1%
2003-04	50.3	-1.0%
2004-05	41.2	-18.1%
2005-06	40.2	-2.4%
2006-07	47.5	18.2%
2007-08	44.7	-5.9%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	42.1	-5.8%
2009-10	50.5	20.0%
2010-11	50.1	-0.8%
2011-12	52.7	5.2%
2012-13	55.3	4.9%
2013-14	58.1	5.1%

MODEL: Structural

The public utility realty tax (PURTA) revenue estimates are derived from a database of utility realty tax liability history and predictions based on data from reports filed by public utility realty taxpayers, as well as those filed by local taxing authorities (LTAs). Total predicted liabilities were transformed into a fiscal year basis to obtain the receipts forecasts.

Act 46-2003 repealed the transfer of 7.6 mills of PURTA to the Public Transportation Assistance Fund (PTAF) effective June 30, 2003. As a result, beginning in fiscal year 2003-04 this revenue is included in the General Fund PURTA estimates.

REALTY TRANSFER TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	362.6	24.8%
2003-04	400.6	10.5%
2004-05	472.5	17.9%
2005-06	552.5	16.9%
2006-07	571.0	3.3%
2007-08	429.6	-24.8%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	320.2	-25.5%
2009-10	237.5	-25.8%
2010-11	329.9	38.9%
2011-12	403.8	22.4%
2012-13	468.9	16.1%
2013-14	524.1	11.8%

MODEL: Econometric**EQUATION:** $\ln RTT = 0.8893 \ln AVGPRICE + 0.6414 \ln PASTARTS + 0.9292 CONS - 1.3788$

VARIABLES:

RTT - Fiscal year realty transfer tax receipts.

AVGPRICE - US average home price (average of new and existing units).

PASTARTS - Pennsylvania housing starts.

CONS - US nonresidential construction.

STATISTICS:

$\bar{R}^2 = 0.990$ $DF = 14$

$F = 549.36$ $N = 19$

$\rho = 0.163$

COEFFICIENT T-STATS:

$\beta_0 = 4.07$ $\beta_1 = 4.14$

$\beta_2 = 3.02$ $\beta_3 = -1.16$

REALTY TRANSFER TAX (Cont'd)

These estimates result from an econometric approach using US average home price (average of new and existing units), Pennsylvania housing starts, and US nonresidential construction output to model the realty transfer tax collections.

Act 89-2002 reduced the amount of the Keystone Recreation, Park, and Conservation Fund (KRPCF) transfer to 10% from January 2002 through June 2002, and to a rate of 7.5% from July 2002 through June 2003. Beginning in July 2003, the rate of transfer returned to 15%.

Act 67-2006 reduced the KRPCF transfer to 2.1% from July 2006 through June 2007. The rate returned to 15% for transfers occurring in fiscal year 2007-08 and thereafter.

SALES AND USE TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	7,519.6	3.1%
2003-04	7,728.5	2.7%
2004-05	8,000.0	3.5%
2005-06	8,334.2	4.2%
2006-07	8,590.8	3.1%
2007-08	8,496.5	-1.1%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	8,274.5	-2.6%
2009-10	8,389.6	1.4%
2010-11	8,971.3	6.9%
2011-12	9,213.8	2.7%
2012-13	9,707.4	5.4%
2013-14	9,890.6	1.9%

MODEL: Econometric and Structural

EQUATIONS:

A) $ST = NON-MOTOR + MV$

B) $NMCASH = 0.6617 CEMOD + 0.0580 ADJFI + 0.1162 Q2 + 0.1049 Q3 + 0.1608 Q4 + 9.6884$

C) $\ln MVCASH = 0.9137 \ln CEAUTO - 7.9481 PAAGE-RATIO + 10.5152$

VARIABLES:

ST - Fiscal year sales and use tax receipts.

$NON-MOTOR$ - Fiscal year non-motor vehicle sales and use tax receipts.

MV - Fiscal year motor vehicle sales and use tax receipts.

$NMCASH$ - Quarterly non-motor vehicle sales and use tax receipts.

$MVCASH$ - Fiscal year motor vehicle sales and use tax receipts.

$CEMOD$ - US Consumer expenditures on durables, non-durables, and services.

$ADJFI$ - US nonresidential fixed investment adjusted to exclude fixed investment in industrial and transportation equipment.

SALES AND USE TAX (Cont'd)

<i>Q1</i>	-	First quarter dummy.
<i>Q2</i>	-	Second quarter dummy.
<i>Q3</i>	-	Third quarter dummy.
<i>CEAUTO</i>	-	US consumer expenditures on motor vehicles and parts.
<i>PAAGE-RATIO</i>	-	Ratio of Pennsylvanians aged 45-64 to the whole Pennsylvania population.

STATISTICS (Equation B):

$\bar{R}^2$	=	0.998	<i>DF</i>	=	62
<i>F</i>	=	5605.37	<i>N</i>	=	68

COEFFICIENT T-STATS (Equation B):

β_0	=	30.91	β_1	=	3.02
β_2	=	33.77	β_3	=	30.44
β_4	=	46.74	β_5	=	350.91

STATISTICS (Equation C):

$\bar{R}^2$	=	0.965	<i>DF</i>	=	30
<i>F</i>	=	439.82	<i>N</i>	=	33

COEFFICIENT T-STATS (Equation C):

β_0	=	26.19	β_1	=	-7.43
β_2	=	58.89			

SALES AND USE TAX (Cont'd)

NON-MOTOR is the result of a transformation of *NMCASH* which allows for the lag between the time of sale and the appropriate sales tax due date (usually one month). Equation B is an econometric model which predicts accrual sales and use tax estimates using consumption and nonresidential fixed investment. Adjustments are made to account for exemptions from the tax base and special fund transfers. Please refer to the Legislative Overview section for more details on these legislative changes. The resulting estimates are then converted to a cash basis forecast.

MV is an econometric model that predicts annual motor vehicle sales and use tax revenues using US consumer expenditures on autos and Pennsylvania's ratio of residents between 45 and 64 years old.

Total fiscal year sales and use tax forecasts equal cash non-motor vehicle forecasts plus cash motor vehicle forecasts.

The Governor's Executive Budget includes a proposal that would require entities with a 3rd quarter liability of greater than \$25,000 in non-motor vehicle sales and use tax to remit tax bi-monthly. This change would first occur in 2010-11 and is reflected in the above estimates.

SEVERANCE TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	NA	NA
2003-04	NA	NA
2004-05	NA	NA
2005-06	NA	NA
2006-07	NA	NA
2007-08	NA	NA

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	NA	NA
2009-10	107.2	NA
2010-11	236.0	120.1%
2011-12	353.5	49.8%
2012-13	490.7	38.8%
2013-14	631.9	28.8%

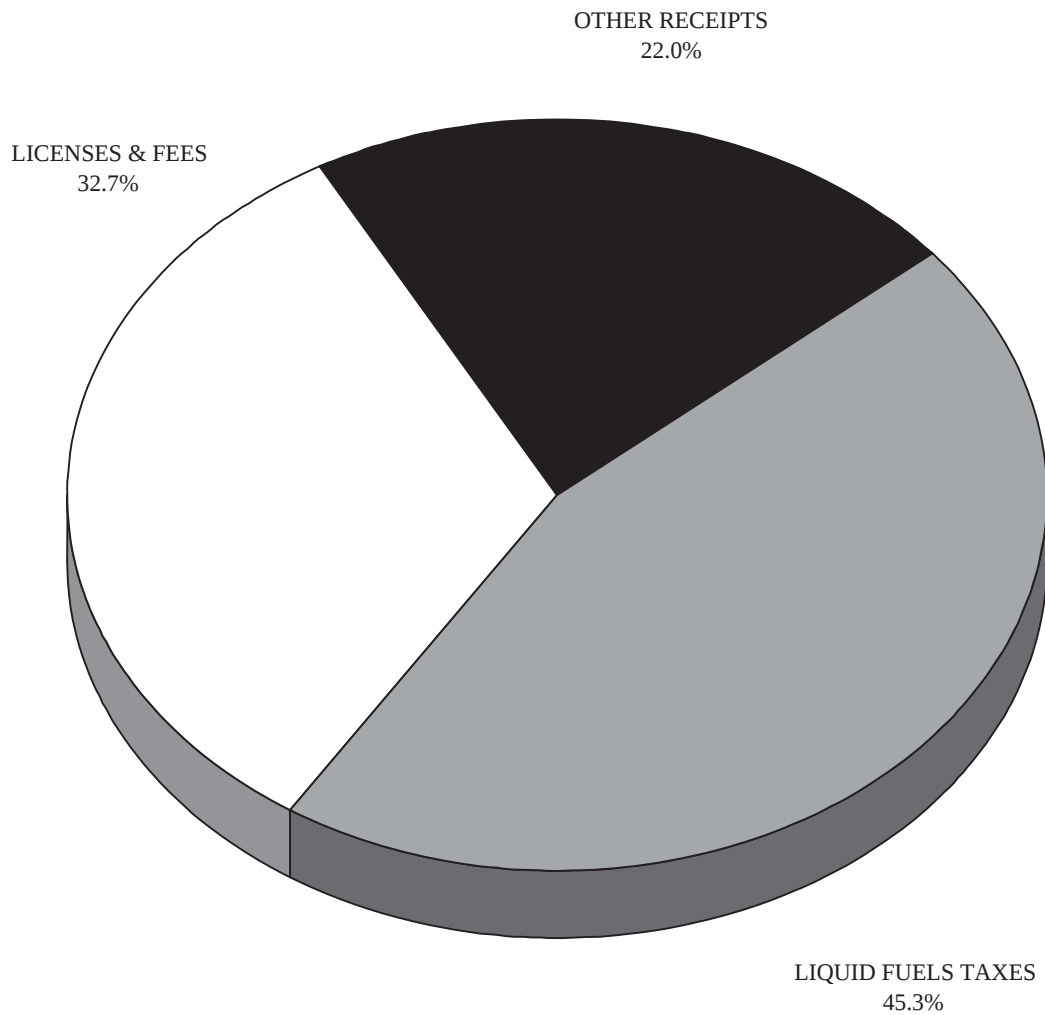
MODEL: Structural

The Governor's Executive Budget includes a proposed tax on natural gas severed from land in Pennsylvania. The proposed tax is imposed at a rate of 5% of the market value and \$0.047 per thousand cubic feet. The proposed tax is effective October 1, 2009.

The revenue estimates included in the Governor's Executive Budget are based on a forecast of existing natural gas production as well as increased future production from the Marcellus Shale region. Price forecasts from the Energy Information Administration as well as forecasts from Global Insight are used to calculate the value of natural gas production.

MOTOR LICENSE FUND **REVENUE**

Fiscal Year 2009-10



LIQUID FUELS TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	579.4	0.2%
2003-04	587.1	1.3%
2004-05	588.4	0.2%
2005-06	581.8	-1.1%
2006-07	589.2	1.3%
2007-08	591.7	0.4%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	547.2	-7.5%
2009-10	568.5	3.9%
2010-11	571.9	0.6%
2011-12	575.9	0.7%
2012-13	580.5	0.8%
2013-14	585.8	0.9%

MODEL: Structural

The liquid fuels portion of this tax is assessed at 12 cents per gallon on gasoline consumption. Eleven and one-half cents, minus discounts plus penalties and interest, are deposited in the Motor License Fund as unrestricted receipts. The forecasts reflect these unrestricted receipts.

The liquid fuels portion of the liquid fuels and fuels tax revenue is based on estimated gasoline collections. All historical and forecasted tables are shown on a cash basis.

The fiscal year 2008-09 estimate is based on year-to-date actual collections projected through the end of the fiscal year. Future fiscal year collections are predicated on the forecast for fuel prices and the current economic outlook.

FUELS TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	148.8	0.3%
2003-04	155.0	4.2%
2004-05	157.4	1.5%
2005-06	162.4	3.2%
2006-07	162.8	0.2%
2007-08	157.1	-3.5%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	158.9	1.1%
2009-10	157.6	-0.8%
2010-11	158.3	0.4%
2011-12	159.0	0.4%
2012-13	159.6	0.4%
2013-14	160.3	0.4%

MODEL: Structural

The fuels portion of this tax is assessed at 12 cents per gallon on diesel fuel and other special fuels. Eleven and one-half cents are deposited in the Motor License Fund as unrestricted receipts. The forecasts reflect these unrestricted receipts.

The fuels portion of the liquid fuels and fuels tax revenue is based on estimated consumption for these fuels. All historical and forecasted tables are shown on a cash basis.

The fiscal year 2008-09 estimate is based on year-to-date actual collections projected through the end of the fiscal year. Future fiscal year collections are predicated on the forecast for fuel prices and the current economic outlook.

ALTERNATIVE FUELS**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	0.8	0.0%
2003-04	0.6	-25.0%
2004-05	0.7	16.7%
2005-06	0.6	-14.3%
2006-07	0.2	-66.7%
2007-08	1.1	478.0%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	0.6	-43.8%
2009-10	0.6	0.0%
2010-11	0.6	0.0%
2011-12	0.6	0.0%
2012-13	0.6	0.0%
2013-14	0.6	0.0%

MODEL: Structural

Effective October 1, 1997, the alternative fuels tax is imposed on all fuels not taxed as liquid fuels or fuels and used to propel motor vehicles on the public highways. The tax on each gasoline gallon equivalent of alternative fuels equals the current total of the liquid fuels and fuels tax and the oil franchise tax applicable to one gallon of gasoline. The alternative fuels tax revenue is based on estimated alternative fuel collections.

MOTOR CARRIERS ROAD/IFTA TAXES**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	33.3	30.1%
2003-04	28.0	-15.9%
2004-05	32.0	14.3%
2005-06	35.9	12.2%
2006-07	40.4	12.5%
2007-08	38.9	-3.8%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	38.9	0.3%
2009-10	39.2	0.5%
2010-11	39.4	0.5%
2011-12	39.6	0.5%
2012-13	39.8	0.5%
2013-14	40.0	0.5%

MODEL: Structural

Motor carriers road tax (MCRT) revenues consist primarily of fuel taxes and decal fees. The fuel tax is collected at 12 cents per gallon plus an oil franchise tax component. The oil franchise tax rate is levied on a cents per gallon basis and is established at the beginning of each calendar year beginning in 1998. The oil franchise tax rate per gallon of fuel consumed in Pennsylvania for calendar year 2007 is 19.2 cents for liquid fuels and 26.1 cents for fuels. Tax-paid fuel purchases offset gross tax due. Also included in road tax are penalties and interest. International Fuel Tax Agreement (IFTA) historical data serves as the estimating base for this tax. Decal fees consist of receipts from the purchase of \$5 annual identification markers.

The fiscal year 2008-09 estimate is based on year-to-date actual collections projected through the end of the fiscal year. Historical data serves as the estimating base for this tax.

OIL COMPANY FRANCHISE TAX**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	343.1	1.7%
2003-04	342.4	-0.2%
2004-05	381.3	11.4%
2005-06	445.2	16.8%
2006-07	462.8	4.0%
2007-08	447.7	-3.3%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	453.2	1.2%
2009-10	449.9	-0.7%
2010-11	452.4	0.6%
2011-12	455.3	0.6%
2012-13	458.6	0.7%
2013-14	462.2	0.8%

MODEL: Structural

The oil company franchise tax (OFT) is levied on a cents per gallon basis effective October 1, 1997. The Department of Revenue is required to establish tax rates by each January 1st and these rates remain in effect for the entire calendar year. The calculated rates are based on the average wholesale price of fuel over the 12-month period ending the prior September 30. For calendar year 2009 the rates are 19.2 cents per gallon for liquid fuels and 26.1 cents per gallon for fuels. The OFT rate for future years is estimated based on the current economic outlook and the forecast for fuel prices.

The oil company franchise tax revenue is based on estimated liquid fuels and fuels consumption multiplied by the appropriate tax rate. All historical and forecasted tables are shown on a cash basis.

Revenues equal to fifty-seven mills of the tax are deposited as unrestricted revenue in the Motor License Fund. The remaining revenues are restricted and are not reflected in the revenue forecasts. Revenues accruing from this tax are directly proportional to the estimated taxable gallons of liquid fuels and fuels.

MOTOR LICENSE FUND ESTIMATE METHODOLOGIES

LICENSES & FEES

HISTORICAL DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	828.8	1.8%
2003-04	843.2	1.7%
2004-05	876.9	4.0%
2005-06	877.8	0.1%
2006-07	870.0	-0.9%
2007-08	872.1	0.2%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	898.7	3.1%
2009-10	877.3	-2.4%
2010-11	901.1	2.7%
2011-12	942.1	4.5%
2012-13	955.5	1.4%
2013-14	966.2	1.1%

MODEL: Structural

Estimates were forecasted by the Department of Revenue in conjunction with the Department of Transportation.

The fluctuations in receipts in operators' licenses revenues are primarily caused by the four year renewal cycle. Historically, International Registration Plan (IRP) collections have been affected by new states joining this organization and delayed payments from states experiencing technical difficulties.

OTHER MOTOR RECEIPTS**HISTORICAL DATA**

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2002-03	64.5	28.5%
2003-04	129.4	100.6%
2004-05	120.1	-7.2%
2005-06	162.0	34.9%
2006-07	165.4	2.1%
2007-08	559.4	238.3%

FORECASTED DATA

\$ Millions

<u>Year</u>	<u>Receipts</u>	<u>Growth</u>
2008-09	485.7	-13.2%
2009-10	589.4	21.4%
2010-11	321.2	-45.5%
2011-12	334.3	4.1%
2012-13	331.5	-0.8%
2013-14	331.5	0.0%

MODEL: Structural

Estimates were forecasted by the Department of Revenue in conjunction with the Department of Transportation.

These estimates include payments from the Pennsylvania Turnpike to the Motor License Fund as provided by Act 44 of 2007. The first payments were mandated for FY 2007-08. The payment for FY 2007-08 was \$450 million. For the following two years, the payment is to be \$500 million. Thereafter, the amount will be reduced to \$200 million.