

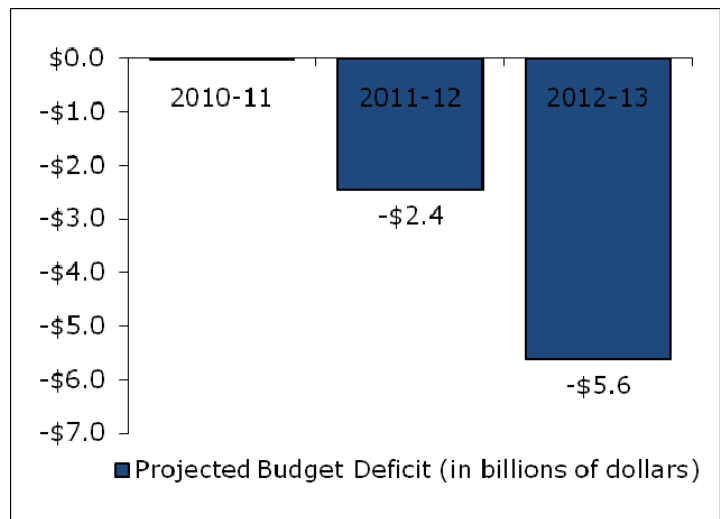
Governor Rendell Proposes Plan to Address Future Deficits Fairer Tax System with Lower Sales Tax Rate, Business Tax Cuts

Governor Edward G. Rendell presented a balanced 2010-11 budget that does not rely on any new taxes or deep cuts in critical services.

Pennsylvania is expected to receive \$2.8 billion in Recovery Act funding in FY 2010-11 and the end of these dollars could mean a projected \$2.4 billion budget gap in FY 2011-12. The commonwealth's budget will be hit by significant increases in pension contribution costs in the following year, more than doubling the 2012-13 budget shortfall to a projected \$5.6 billion.

The End of Federal Stimulus Funding and Other Factors will Lead to a String of Record Budget Deficits – Unless Pennsylvania Starts Taking Action Now

To address the future budget shortfalls due to the expiration of the federal stimulus program, Governor Rendell is proposing a revenue package that will close tax loopholes, lower tax rates, and reserve the dollars raised this year for future budget deficits. None of the revenues raised from these new sources would be used in the 2010-2011 budget. Instead, 100 percent of these funds would be set aside in a Stimulus Transition Reserve Fund that, by law, could not be tapped until July 1, 2011, nearly six months after the end of Governor Rendell's term of office.



Type of Revenue (millions of dollars)	Transfers from 2010 – 2011*	Transfers from 2011 - 2012	Total Transfer to Stimulus Transition Reserve Fund
Natural Gas Severance Tax	\$160.7	\$260.0	\$420.7
Tax Cigars & Smokeless Tobacco	\$41.6	\$46.8	\$88.4
Cut & broaden the Sales and Use Tax	\$531.5	\$863.3	\$1,394.8
Cut Business Taxes & Close Business Tax Loopholes	\$66.6	\$167.3	\$233.9
Eliminate the vendor discount for On-time Sales Tax Payments	\$73.6	\$76.0	\$149.6
Total	\$874.0	\$1,413.4	\$2,287.4

* Under the Governor's proposal, revenues raised in 2010-2011 must be held in reserve and can be used no earlier than July 1, 2011

The reform package benefits taxpayers by:

- Enacting a competitive tax on natural gas drilling to ensure that this rapidly growing industry starts making fair contributions to the commonwealth and to local governments.
- Ending Pennsylvania's distinction as the only state in the nation that does not tax tobacco products such as smokeless tobacco and cigars.
- Cutting the Sales and Use Tax rate from 6 percent to 4 percent by eliminating exemptions and including services to make for a fairer tax system.
- Reducing the Corporate Net Income Tax rate from 9.99 percent to 8.99 percent and enacting other pro-business, pro-growth reforms by adopting combined reporting.
- Ending the practice of giving vendors a discount for paying sales taxes in accordance with the law.

The vendor discount for on-time sales tax payments will be terminated July 1, 2010 and the rest of the tax changes will go into effect September 1, 2010. By closing these loopholes, the Governor's proposal would generate \$874 million 2010-11 – all of which will go into the Stimulus Transition Reserve Fund. In the following fiscal year, these taxes will generate another \$1.4 billion. This means that the Governor's plan will leave an additional \$2.3 billion to offset the expiration of the Stimulus Funds in Fiscal Year 2011, six months after Governor Rendell leaves office.

Common-Sense Tax Reforms Will Put \$2.3 Billion in Stimulus Transition Reserve Fund for When Pennsylvania Needs it Most

State	Highest Marginal Rate on Natural Gas
Alabama	4-8% of gross value
Alaska	22.5% plus 0.25% of net value
Arkansas	5%
Colorado	Up to \$10,750 and 5% of gross income above \$299,999
Florida	\$0.563 per thousand cubic feet (MCF)
Idaho	No more than \$0.005 per 50,000 cubic feet of gas
Illinois	0.10%
Indiana	The greater of 1% or \$0.03 per MCF
Kansas	8%
Kentucky	4.5% of gross value
Louisiana	\$0.03 - 0.13 per MCF
Michigan	5%
Mississippi	6%
Montana	0.76% - 15.06%
Nebraska	3%
Nevada	2-5%
New Mexico	3.75%
North Dakota	\$0.1476 per MCF as of June 30, 2009
Ohio	\$0.025 per MCF
Oklahoma	7%
Oregon	6%
South Dakota	4.5% of taxable value
Texas	7.5% of market value
Utah	3% - 5%
Tennessee	3%
Wisconsin	7%
West Virginia	5% plus \$0.047 per MCF
Wyoming	6%

The proposed severance tax (5 percent of value plus 4.7 cents per 1,000 cubic feet of gas produced) is in line with levies in other states and will not hurt development of the industry in Pennsylvania. The vast Marcellus Shale reserve underlies two-thirds of the state, yet today Pennsylvania is one of just six states that do not tax natural gas extraction.

The Governor's proposal to approve taxes cigars and smokeless tobacco has broad public support and was previously passed by the House of Representatives. Pennsylvania is the only state that does not tax smokeless tobacco or cigars. The Governor's plan will close this loophole and appropriately extend the Tobacco Products Tax.

Pennsylvania Will Cut Sales and Use Tax Rate From 6 Percent to 4 Percent

When Pennsylvania's sales tax was adopted in 1953, the levy applied to nearly all kinds of tangible goods. Since that time, 74 categories of goods have been exempted through frequent amendments pushed through by special interests. Governor Rendell proposes to reduce Pennsylvania's Sales and Use Tax rate from 6 percent to 4 percent by updating the tax base and eliminating 74 categories of exemptions.

In addition to continuing exempting food, clothing, and prescription drugs, the Governor's proposal would leave in place the original exemptions for manufacturers that cover processing, agriculture and machinery and equipment, and for non-profit cultural activities.

Under the proposed Sales Tax revision, 74 categories of exempt good and services would become subject to the new 4 percent rate. Some examples include wrapping and packing supplies, coal, rail transport equipment, fish feed, firewood, candy and gum, airline catering, investment metal bullion, and helicopters -- items that have been exempted over the years.

Tax Exemptions Have Chipped Away at Pennsylvania's Sales Tax Base Over the Past 50 Years

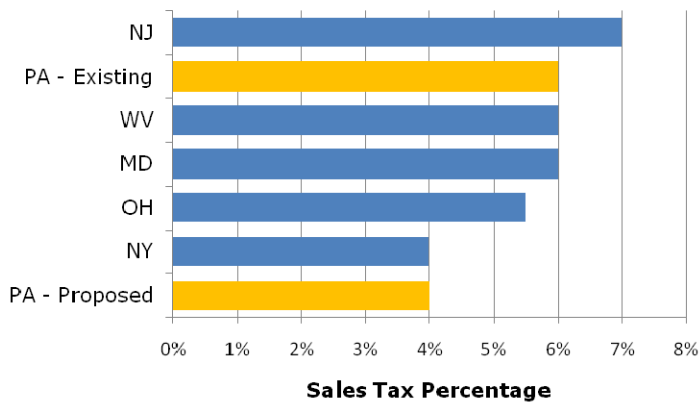
Under the Governor's plan, the sales tax would also apply broadly to services, a growing sector of the economy that is now mostly exempt. Services account for over two thirds of today's economy and include things like engineering, accounting, legal services, and consulting. Because these sectors of the economy are not subject to the sales tax, the entire burden falls on tangible goods such as furniture, appliances and electronics. This means that the sales tax rate on these consumer purchases is higher than it has to be.

The Governor’s plan would add nearly all services to the tax base, except for health care services and educational tuition.

By updating the tax base and eliminating 74 categories of exemptions, Pennsylvania can reduce its sales tax rate by one-third from 6 percent to 4 percent. When the new 4 percent rate goes into effect, Pennsylvania will have the second-lowest sales tax rate among states that have a sales tax. Pennsylvania’s sales tax rate would be the same as New York’s, but lower than the rates of Ohio, Maryland, West Virginia, and New Jersey.

Pennsylvania’s Sales Tax Rate Will Fall From 6 Percent to 4 Percent

The lower tax rate will, in effect, lower the price that consumers pay for goods that are currently taxed by 2 percent. This change will benefit many retailers located near the Pennsylvania border who have previously expressed concern about customers traveling across state lines to shop.



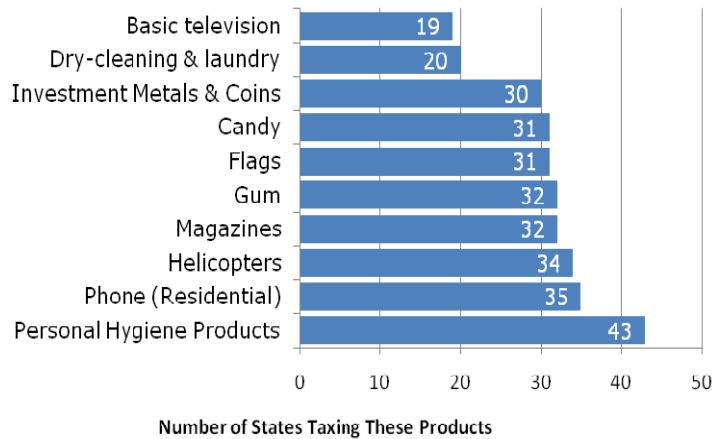
For items that will be taxed, more than 30 states already tax candy and gum, magazines and residential telephone service. The fact that so many other states already include the goods and services that Pennsylvania has eliminated from its tax base suggests that Pennsylvania can add these categories to the tax base without damaging its competitive position.

A Lower Corporate Tax Rate will Improve Pennsylvania’s Competitiveness

Pennsylvania business tax rates are higher than they need to be because too many firms do not pay their fair share. Today, 71 percent of Pennsylvania companies subject to the tax pay no Corporate Net Income taxes in Pennsylvania. This is because the “Delaware loophole” allows businesses to shift income and profits to no- or low-tax states and avoid paying Pennsylvania taxes. For example, a company might set up a headquarters office in locations like Delaware or Nevada and shift income to that affiliate, even though most of its day-to-day operations are located in Pennsylvania. The Governor’s business tax reform package will put an end to tax avoidance

Exemption	Year Exemption Enacted in PA
Wrapping and Packing Supplies	1956
Coal	1957
Commercial Vessels (Equipment, Maintenance)	1957
Dry-Cleaning & Laundry Services	1959
Caskets and Burial Vaults	1963
Magazines	1963
Flags	1963
Rail Transportation Equipment	1963
Catalogs and Direct Mail Advertising	1963
Fish Feed	1980
Trout	1982
School Buses	1982
Firewood	1983
Construction of Memorials	1985
Personal Hygiene Products	1991
Candy/Gum	1997
Airline Catering	2001
Investment Metal Bullion & Investment Coins	2006
Helicopters	2009

Sales Tax Plan Will Not Hurt Competitiveness; Many States Already Tax Goods and Services Pennsylvania Exempts



strategies that are being used today and will make Pennsylvania the 24th state to adopt a process called combined reporting.

Closing the loopholes that permit profits to be shielded from taxation means that related companies will be required to file a single tax return that combines the income of commonly owned in-state and out-of-state corporations. It will also eliminate inter-company transactions for tax purposes. By requiring companies to combine the profits of all of their various entities, combined reporting eliminates the incentive to shift income across state lines for tax avoidance purposes.

In 2004, Governor Rendell established a twelve-member Business Tax Reform Commission that endorsed the practice of requiring companies to report all profits produced from sales and transactions in Pennsylvania along, the shift to a single sales factor for the calculation of taxes owed and the uncapping of the net operating loss deductions to stimulate investment. At that time, seventeen states had enacted laws ending the practices that shift profits out of state. Since 2005, six more states including neighboring New York and West Virginia have implemented this reform. If Pennsylvania had moved more quickly, it would have been able to lower its corporate tax rate and adopt other pro-growth reforms years sooner.

Six Other States Recently Adopted Combined Reporting

States With Combined Reporting	Year Adopted
Texas	2006
West Virginia	2007
New York	2007
Michigan	2007
Massachusetts	2008
Wisconsin	2009

The tax changes level the playing field so that companies who conduct all their business in Pennsylvania are not carrying the tax burden for those that hide their profits in tax haven states or offshore. The adoption of the proposal will ensure a fair sharing of the corporate tax burden and enable the commonwealth to lower its Corporate Net Income Tax rate from 9.99 percent to 8.99 percent. Reducing the corporate net income tax rate by one percentage point to 8.99 percent will bring us closer to tax rates in nearby states.

By shifting to a single sales factor system, Pennsylvania will calculate taxes based on the share of a company's sales that take place in

Pennsylvania. The tax change is good for employers including manufacturers that already have a significant presence in Pennsylvania, but sell most of their goods and services in other markets. It also creates new incentives for employers to add jobs or build a new plant in the commonwealth. Ten other states already use the single sales factor model.

By lifting the cap on net operating loss deductions, Pennsylvania will become a more attractive place for entrepreneurs to start up new business and create new jobs. Many young companies, including technology and biotech firms, do not record profits for the first few years of operation. The Governor's plan will help create more jobs in these industries as well as support new job growth by alternative energy, clean transportation, and environmental cleanup companies. Pennsylvania will join 44 other states that do not have a dollar limit on net operating loss carry forwards.

Pennsylvania must begin preparing now for the end of federal stimulus funding in 2011. By enacting the measures the Governor called for today, Pennsylvania would accumulate \$2.3 billion for the 2011-12 fiscal year and be in a strong position to continue prospering after the end of federal stimulus funding.

Governor Rendell has proposed a balanced 2010-2011 budget that includes no new taxes and none of the revenues raised by this plan will go toward a Rendell-proposed budget. Instead, Governor Rendell is proposing reasonable tax reforms that will lower tax rates, improve tax fairness, and make balanced budgets possible in years to come.