

PICPA Testimony
by
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Pennsylvania Senate Majority Policy Committee
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Introduction and Background

Good morning, Chairman Laughlin and members of the Senate Majority Policy Committee. On behalf of the Pennsylvania Institute of Certified Public Accountants (“PICPA”), thank you for the opportunity to provide testimony on the impact of the Sterling Act and Local Tax Enabling Act on Pennsylvania, including Philadelphia and its suburban communities.

My name is Matthew Melinson. I am a CPA with nearly 30 years of experience as a state and local tax professional. As a partner at Grant Thornton LLP, a global public accounting and consulting firm, I currently lead the firm’s state and local tax practice for the Atlantic Coast Region, and I have served in various national and regional leadership positions. I serve on the PICPA Board of Directors and am a long-time editorial board member of the *Pennsylvania CPA Journal*, the PICPA’s flagship publication, where I am also responsible for state and local tax articles. I have previously served on Philadelphia Mayor Nutter’s Task Force on Tax Policy and Economic Competitiveness in 2009 and was a member of the Philadelphia City Council’s Tax Reform Working Group in 2021-22. I am a long-standing member of the Philadelphia Department of Revenue Commissioner’s Tax Advisory Committee and have served on the Bucks County Tax Collection Committee since its inception in 2010. I have been a resident of Ivyland, Pennsylvania since 2003 after living in Philadelphia for over thirty years.

The PICPA was founded in 1897 and is the second oldest and fourth-largest CPA organization in the United States. Our membership includes more than 20,000 practitioners in public accounting, business and industry, government, and education. The PICPA seeks to be a nonpartisan technical resource and strategic partner with governors, legislators and local tax administrators on various tax issues and policies. We are proud of this working relationship and believe our contributions have made Pennsylvania a better place to live and operate a business.

We understand that the Committee is considering legislation that would seek to change the current application of the Philadelphia nonresident wage and net profits tax credit, commonly referred to as the “Super Credit.” The Super Credit operates as a direct reduction against local earned income tax liability owed by suburban taxpayers who also pay Philadelphia wage tax. As a PICPA representative, my role is not to take a particular position but rather to provide the Committee with a background and technical understanding of the law and how it is currently applied, and how it could potentially be applied if changed.

Local income taxes in Pennsylvania are known as earned income taxes (EIT), wage taxes, net profits taxes, or some combination thereof. The Local Tax Enabling Act (LTEA) of 1965, also known as Act 511, authorizes all municipalities and school districts outside the City of Philadelphia to levy an EIT, and nearly 3,000 localities do so. The EIT is levied on wages, salaries, commissions, net profits or other compensation as defined under the Pennsylvania personal income tax law. In most circumstances, an individual pays the higher of the EIT rate

imposed by their resident jurisdiction or the rate imposed by their jurisdiction of employment. The EIT rate is commonly, but not always, capped at 1% of earned income and is split between the municipality and the school district.

Under the Sterling Act of 1932, Philadelphia is given broad authority to impose a wide range of taxes, including the wage and net profits tax. The wage and net profits tax applies to income earned by Philadelphia residents regardless of where they work, in addition to income earned by nonresidents who work in the city. Currently, the resident wage and net profits tax rate is set at 3.79% and the nonresident rate at 3.44%.

Super Credit – General Application

Unlike any other local taxing jurisdiction in Pennsylvania, a taxpayer who earns income in Philadelphia may claim a Super Credit against their EIT liability. Act 511 requires local taxing jurisdictions to credit their residents for taxes paid to Philadelphia on income earned in the city. This credit is allowed on a “dollar for dollar” basis and is based upon tax paid, meaning that if someone is subject to tax in the city for more than approximately 30% of the time (given the Philadelphia rate differential), a full credit against their EIT liability is available. The operation of the Super Credit is unusual relative to how most tax credits are applied throughout the country, as crediting provisions are generally wage-based rather than based upon tax paid. Consider the following examples to show how the Super Credit applies:

Example 1 – A taxpayer lives in Township A, which imposes a local EIT at a 1% rate on all income earned by township residents. The taxpayer has a full-time job based in Philadelphia but works remotely at home 60% of the time. During the 2019 tax year, the taxpayer earned \$100,000, with \$40,000 of her wages earned in Philadelphia with the remaining \$60,000 earned in the township. The taxpayer’s employer withholds Philadelphia wage tax at the nonresident rate ($\$40,000 \times 3.44\% = \mathbf{\$1,376}$), while no tax is withheld on the business income earned in the township. With the Super Credit, the taxpayer may offset her entire EIT liability ($\$100,000 \times 1\% = \mathbf{\$1,000}$) with no additional tax dollars due to the township.

The taxpayer would pay **\$1,376** in tax (all paid to Philadelphia) due to the Super Credit.

Example 2 – In contrast, under a traditional wage-based crediting rule, the taxpayer would pay an additional \$600 on the portion of income earned in Township A (and not taxed by Philadelphia), for a total of **\$1,976** in tax.

In other words, the taxpayer would pay **\$1,976** in tax (\$1,376 paid to Philadelphia and \$600 paid to Township A) without the Super Credit.

Increased Impact of Remote Work

While the application of the Super Credit is a long-standing policy that has been affirmed by Pennsylvania courts,¹ the potentially lasting effects of the pandemic have amplified the impact of the Super Credit in recent years. According to the U.S. Census Bureau data, remote work has

¹ See, e.g., *Dunmire v. Applied Bus. Controls, Inc.*, 440 A.2d 638 (Pa. Commw. Ct. 1981); *Berks Cnty. Tax Collection Comm. v. Pa. Dep’t of Cmty. & Econ. Dev.*, 60 A.3d 589 (Pa. Commw. Ct. 2013) *aff’d*, 82 A.3d 405 (Pa. 2013).

steadily increased in the years leading up to the COVID-19 pandemic. The impact of the pandemic pushed more employees into remote or hybrid work, with a 2021 American Community Survey estimating that approximately 17.9% of employees primarily worked remotely during 2021, tripling the amount (5.7%) from 2019. Other recent studies from firms like McKinsey & Company² (consulting firm) and Zippia³ (recruiting firm) reflect that the percentage of remote workers is even higher.

The Super Credit has gained increased attention in an environment of widespread remote work as Philadelphia continues to apply its policy to tax nonresident income according to a so-called “requirement of employment” or “convenience of the employer” standard. In the case of a nonresident employee working for a Philadelphia-based employer, this policy requires that the employee’s income be subject to wage tax if the employee chooses to work remotely outside Philadelphia for their own convenience, instead of as a requirement of the employer. First adopted in the 1980s, the policy was likely implemented in response to the practice of nonresident employees working from home on certain Fridays or weekend days and considering those days as non-Philadelphia working days to reduce their overall wage tax liability.

Pennsylvania’s personal income tax regulations also include a rule akin to Philadelphia’s requirement of employment standard.⁴ By extension, Act 511 taxing jurisdictions have the authority to adopt this rule since the Act 511 definitions of earned income and net profits tie to Pennsylvania personal income tax law.⁵ However, in my experience, neither Pennsylvania nor Act 511 taxing jurisdictions have aggressively enforced this rule, and the same may be said of Philadelphia’s own enforcement until recent years.

To illustrate the impact of the Super Credit on a Philadelphia nonresident employee working remotely from an Act 511 taxing jurisdiction in our post-pandemic environment, consider the following examples.

Example 3 – A taxpayer lives in Township A, which imposes a local EIT at a 1% rate. The taxpayer has a full-time job with a Philadelphia-based employer earning \$100,000 a year but the employee chooses to work from home for approximately 90% of the year. Assuming that the taxpayer is working from home for her own convenience, the taxpayer would pay nonresident wage tax on her entire income ($\$100,000 \times 3.44\% = \mathbf{\$3,440}$). The Super Credit would offset the taxpayer’s entire EIT liability of \$1,000 even though the taxpayer worked remotely from Township A for 90% of the time.

Taxpayer would pay **\$3,440** in tax (all paid to Philadelphia).

Example 4 – In contrast, if the taxpayer’s employer required her to work remotely for 90% of the year, the Super Credit would offset a portion of the taxpayer’s EIT liability. In

² André Dua, Kweilin Ellingrud, Phil Kirschner, Adrian Kwok, Ryan Luby, Rob Palter, and Sarah Pemberton, *Americans are embracing flexible work—and they want more of it*, McKinsey & Company (June 23, 2022), <https://www.mckinsey.com/industries/real-estate/our-insights/americans-are-embracing-flexible-work-and-they-want-more-of-it>.

³ Jack Flynn, *25 Trending Remote Work Statistics [2023]: Facts, Trends, and Projections*, Zippia (Oct. 16, 2022), <https://www.zippia.com/advice/remote-work-statistics/>.

⁴ 61 Pa. Code § 109.8.

⁵ 53 Pa. Stat. § 6924.501.

other words, the taxpayer's **\$344** wage tax liability ($\$10,000 \times 3.44\% = \344) would reduce the taxpayer's \$1,000 resident EIT liability to **\$656** ($\$1,000 - \$344 = \656).

Taxpayer would pay **\$1,000** in tax (\$344 paid to Philadelphia and \$656 paid to Township A).

Example 5 – If the Super Credit were eliminated, and the taxpayer's employer required her to work remotely for 90% of the year, the taxpayer would pay **\$1,244**. The taxpayer would pay nonresident wage tax on 10% of her income ($\$10,000 \times 3.44\% = \344) and the remaining 90% of her income would be taxable to Township A ($\$90,000 \times 1\% = \900).

Taxpayer would pay **\$1,244** in tax (\$344 paid to Philadelphia and \$900 paid to Township A).

The above examples illustrate the unique interaction of the Super Credit with Philadelphia's nonresident wage tax policy against the backdrop of sustained remote work in recent years. In today's remote work environment, limiting or eliminating the Super Credit would impact both local taxing jurisdictions and taxpayers in different ways.

Credit Prioritization Under Sterling Act and LTEA

Another issue not yet emphasized, given this is a likely focus by other governmental officials testifying, is that Philadelphia is permitted to keep the tax collected from suburban Pennsylvania residents, rather than crediting it back to the taxpayer's home location. In other Pennsylvania localities, that are governed by Act 511 rather than the Sterling Act, the tax collected at a work location is fully remitted back to the resident locality, if that locality has a rate equal to or higher than the work location. So, another potential consideration by the legislature is whether to reconsider which jurisdiction maintains the tax and to what extent when a non-resident works in Philadelphia.

Example 6 – Assume the same as Example 2 above, considering the impact if the legislature were to require Philadelphia to remit tax back to the resident jurisdiction to the extent of its tax rate (1%). Of the \$1,976 paid by the Taxpayer, the City of Philadelphia would ultimately keep \$976 while Township A would receive \$1,000.

Example 7 – Assume the same as Example 5 above, considering the impact if the legislature were to require Philadelphia to remit tax back to the resident jurisdiction to the extent of its tax rate (1%). Of the \$1,244 paid, the City of Philadelphia would ultimately keep only the balance of \$244 while Township A would receive \$1,000 ($\$100,000 \times 1\%$).

Example 8 – Assume a suburban resident works 100% of his time within Philadelphia and earns \$100,000, considering the impact if the legislature were to require Philadelphia to remit tax back to the resident jurisdiction to the extent of its tax rate (assume 1%). Of the \$3,440 the taxpayer would pay ($\$100,000 \times 3.44\%$), the City of Philadelphia would ultimately keep \$2,440 since the home jurisdiction would receive \$1,000 ($\$100,000 \times 1\%$).

Summary and Conclusion

Localities which impose an EIT, especially those closest to Philadelphia, would likely receive an increase in revenue owing to increased local EIT collections that are not limited by the Super

Credit. Philadelphia would likely incur a relatively significant decrease in revenue if the city was required to remit tax revenue to the extent of the local EIT rate collected from suburban residents to Act 511 jurisdictions. Finally, taxpayers living in a jurisdiction imposing an EIT and working for a Philadelphia employer less than 100% of the time would likely pay more tax if they were no longer able to offset their entire local EIT liability. So, the equation may look like this:

Increase to revenues of suburban jurisdictions which impose EIT = (a) Philadelphia revenue loss as result of a credit priority change, plus (b) additional tax paid by suburban residents who work in Philadelphia less than 100% of the time.

In summary, there appears to be at least three issues for lawmakers to consider:

1. What would be the impact of the corresponding tax increase on suburban residents who work in Philadelphia but for less than 100% of the time?
2. Is the “requirement of employment” or “convenience of the employer” rule optimal policy, particularly when considering the application of the Super Credit?
 - a. Any potential changes to this policy should be considered not only for Philadelphia wage tax, but also Pennsylvania and Act 511 EIT municipalities, which have the authority to enforce this policy.
3. Should Philadelphia be able to continue to keep the full amount of tax paid by suburban residents who work in Philadelphia, as has historically been the case? Or should Philadelphia be required to reimburse the municipalities, likely to the extent of tax collected based upon the suburban EIT rate (most commonly, 1%)?

Each of these issues are relatively complex and are not necessarily mutually exclusive. Thank you for the opportunity to present this testimony. I would be happy to answer any questions.

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