Memorandum

To: House Finance Committee Members
From: Sharon Ward and Michael Wood, Pennsylvania Budget and Policy Center
Date: January 21, 2013

Re: House Bill 48 (Bloom) Inheritance Tax and House Bill 78 (Cutler) Loans Tax

The above-referenced bills are on the agenda for consideration on January 22. We write to ask that you give careful consideration to the bills, which we believe have significant flaws.

House Bill 48 would exempt from the inheritance tax the transfer of all business assets, including real estate, between members of the same family. This legislation creates a new loophole that could easily be exploited, would be very costly, and would likely violate the uniformity clause.

This bill would broaden the family farm exemption, which was enacted in 2012. Farm property is specifically enumerated in the Constitution as eligible for special treatment under tax law. In addition, the farm exemption is expected to have a relatively modest cost and serves a recognized public purpose, to shield productive farmland from development pressure. The business property that would be exempt from taxation under this proposal enjoys no special protection under the Constitution and its exemption has no valid public purpose. The Pennsylvania Constitution is clear that taxation must be uniform – and this bill would create vastly different rates of taxation on estates of comparable value.

The term business asset is poorly defined in the bill, which could leave intangible assets like investments in stocks and bonds exempt from taxation. This would create a new loophole to be exploited, which would add to the bill's cost and heighten its inequity.

This provision differs from the farm exemption in another important way. Farmland is a tangible asset that cannot be moved, as such the requirement that the land be kept within the same family group for five years is relatively simple to verify. The similar provision in HB 48 would be easy to avoid and difficult to enforce, as some business assets, for example cash and inventory, are highly mobile and easy to hide.

HB 48 rigs the tax system against the middle class. The relatives of a factory owner or law firm would receive assets they did nothing to earn tax free, while the relatives of the secretary or line worker would be liable for the tax. That is simply not fair.

Enacting House Bill 78 would create another tax loophole. The bill would eliminate the bank loans tax, which is a very important piece of the tax code that helps to defer a type of sham financial transaction.

Without the tax, an owner of a corporation could "lend" money to the company and receive interest payments at a rate significantly higher than the market rate. Both sides profit as the company can deduct the loan, while transferring profits to the owner, who would pay tax at the low 3.07% personal income tax rate. This asset shifting has little business purpose or economic value other than tax avoidance. The loans tax raises the economic cost of the loan, which serves as a deterrent.

By eliminating the tax, Pennsylvania is giving a green light to a financial shell game.

The bill's proponents argue that it would assist real estate tax flippers. Providing a tax incentive for speculators does not seem to be a high priority of most Pennsylvanians.

Both provision cost money, leaving fewer dollars available for education, hospitals, disabilities services or other core state functions.

Thank you for your consideration.