



Legislative Budget and Finance Committee

A JOINT COMMITTEE OF THE PENNSYLVANIA GENERAL ASSEMBLY

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Homestead Property, Sales and Use, and Personal Income Tax Estimates

Pursuant to
Senate Resolution 3 of
Special Session No. 1 of 2005

February 2006

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Report Summary

Senate Resolution 3 of the Special Session calls on the LB&FC to determine (1) the amount homestead properties pay in school district, county, and local government property taxes; (2) the amount of revenue generated by a 1 percentage point increase in the state Sales and Use Tax; and (3) the amount of revenue generated by each 0.1 percentage point increase in the state Personal Income Tax.

Homestead Property Taxes

Because no reliable estimate exists of the property taxes paid by Pennsylvania homesteads as defined by Act 50 of 1998, the Local Government Commission, in cooperation with the Assessors Association of Pennsylvania, surveyed all county assessment offices asking them to estimate the percentage of residential assessed values attributable to homesteads. Fifty-nine counties responded, which yielded a weighted average of 73.4 percent of residential assessed value, or 52.0 percent of the statewide assessed value of all property, being attributable to homesteads.

We then applied that percentage to the actual and estimated property tax collections as reported by the Pennsylvania Department of Revenue. The table below shows the results of these calculations and how they compare to Department of Revenue estimates, which are based on 2003 U.S. Census data for owner-occupied housing.

LB&FC and Department of Revenue Estimates of Homestead/Owner-Occupied Housing Property Taxes (\$ Billions)

	FY 2004-05 <u>(Estimate)</u>	FY 2005-06 <u>(Estimate)</u>	FY 2006-07 <u>(Estimate)</u>
LB&FC Estimate (homestead)	\$6.7	\$7.1	\$7.4
Department of Revenue Estimate (owner-occupied)	<u>6.5</u>	<u>6.8</u>	<u>7.2</u>
Difference	\$0.2	\$0.3	\$0.2

Sales and Use Tax

The following table shows our estimate of the amount of revenue that would be generated by a 1 percentage point increase in the state Sales and Use Tax in comparison with the estimates developed by the Department of Revenue.

LB&FC and Department of Revenue Estimates of Revenue Generated by a 1 Percent Sales and Use Tax Increase Effective 7/1/2006 (\$ Billions)

	FY <u>2006-07</u>	FY <u>2007-08</u>	FY <u>2008-09</u>	FY <u>2009-10</u>	FY <u>2010-11</u>
LB&FC Estimate	\$1.34	\$1.38	\$1.42	\$1.46	\$1.50
Department of Revenue Estimate.....	<u>1.35</u>	<u>1.40</u>	<u>1.45</u>	<u>1.50</u>	<u>1.55</u>
Difference	\$.01	\$.01	\$.03	\$.04	\$.05

Personal Income Tax

The table below shows our estimate of the amount of revenue that would be generated by each 0.1 percentage point increase in the state Personal Income Tax in comparison with the estimates developed by the Department of Revenue.

Projected Revenue Generated by Each One-Tenth Percentage Point Increase in the State Personal Income Tax Rate Effective 7/1/2006 (\$ Millions)

	FY <u>2006-07</u>	FY <u>2007-08</u>	FY <u>2008-09</u>	FY <u>2009-10</u>	FY <u>2010-11</u>
LB&FC Estimate	\$306.3	\$316.3	\$327.9	\$339.7	\$350.9
Department of Revenue Estimate.....	<u>314.9</u>	<u>331.4</u>	<u>350.0</u>	<u>362.4</u>	<u>382.0</u>
Difference	\$ 8.6	\$ 15.1	\$ 22.1	\$ 22.7	\$ 31.1

I. Introduction

Senate Resolution 3 of Special Session No. 1 of 2005 calls on the Legislative Budget and Finance Committee to determine:

1. in cooperation with the Local Government Commission, the amount of revenue needed to eliminate all local property taxes levied by school districts, county governments, and local governments for all homesteads in the Commonwealth,
2. the amount of revenue generated by each 1 percentage point increase in the state Sales and Use Tax, and
3. the amount of revenue generated by each 0.1 percentage point increase in the state Personal Income Tax.

The study methodology is explained in detail in the report text.

Acknowledgements

Legislative Budget and Finance Committee and Local Government Commission staff gratefully acknowledge the cooperation and assistance provided by the Assessors Association of Pennsylvania and its members in providing the homestead data used in this report.

Important Note

This report was developed by Legislative Budget and Finance Committee staff. The release of this report should not be construed as indicating that the Committee's members endorse all the report's findings and recommendations.

Any questions or comments regarding the contents of this report should be directed to Philip R. Durgin, Executive Director, Legislative Budget and Finance Committee, P.O. Box 8737, Harrisburg, Pennsylvania 17105-8737.

II. Homestead Property Taxes

Table 1 shows the assessed value of residential and all real property as reported by the Pennsylvania State Tax Equalization Board (STEB).

Table 1

STEB Assessed Real Property Values		
(\$ Billions)		
<u>Residential</u> <u>(Assessed Value)</u>	<u>Total All Property</u> <u>(Assessed Value)</u>	<u>%</u> <u>Residential</u>
\$247.0	\$351.5	70.3%

Source: State Tax Equalization Board, 2004 data.

However, STEB residential property is not the same as homestead property as defined under Act 1998-50 (53 Pa.C.S. Sec 8401).¹ In particular, STEB residential figures include properties such as single family dwellings that have been converted into residential rental units, seasonal (vacation) properties occupied less than 50 percent of the year, an apartment over a garage, mixed residential/commercial, and certain types of apartment buildings. Thus, STEB residential values include the value of certain properties that are not homesteads as defined in Act 50.²

To arrive at an estimate of the assessed value of the Commonwealth's homestead properties, the Local Government Commission conducted a survey of all county assessment offices asking them to estimate the percent of the assessed value (as reported by SREB) of residential property they believe attributable to homestead properties as defined in Act 50. Fifty-nine of the 67 counties responded (an 88 percent response rate, representing 82 percent of the Commonwealth's population).

¹Homestead definition: A dwelling, including the parcel of land on which the dwelling is located and the other improvements located on the parcel for which any of the following apply: (1) The dwelling is primarily used as the domicile of an owner who is a natural person. The homestead for real property qualifying under this paragraph shall not include the land on which the dwelling is located if the land is not owned by a person who owns the dwelling. (2) The dwelling is a unit in a condominium as the term is defined in 68 Pa.C.S. § 3103 (relating to definitions) and the unit is primarily used as the domicile of a natural person who is an owner of the unit; or the dwelling is a unit in a cooperative as the term is defined in 68 Pa.C.S. § 4103 (relating to definitions) and the unit is primarily used as the domicile of a natural person who is an owner of the unit. The homestead for a unit in a condominium or a cooperative shall be limited to the assessed value of the unit, which shall be determined in a manner consistent with the assessment of real property taxes on those units under 68 Pa.C.S. (relating to real and personal property) or as otherwise provided by law. If the unit is not separately assessed for real property taxes, the homestead shall be a pro rata share of the real property. (3) The dwelling does not qualify under paragraphs (1) and (2) and a portion of the dwelling is used as the domicile of an owner who is a natural person. The homestead for real property qualifying under this paragraph shall be the portion of the real property that is equal to the portion of the dwelling that is used as the domicile of an owner.

²In addition, STEB reported that farm houses on 10 or more acres of property, which can qualify as homesteads, are classified as "agricultural," not residential, for STEB classification purposes.

Most (53 of 59) counties reported that homestead properties accounted for between 50 and 85 percent of their county’s total residential value.

We calculated a weighted homestead average³ and applied that percentage (73.4 percent of residential, or 52.0 percent of all property value) to the property taxes collected by school districts, counties, and municipalities to arrive at the amount of property taxes paid by homesteads in FY 2003-04.⁴ The table below shows the results of these calculations.

Table 2

LB&FC Estimates of Homestead Property Tax Collections		
(\$ Billions)		
	FY 2003-04 <u>(Actual)</u>	LB&FC Estimate of % Attributable to <u>Homesteads</u>
School District Property Taxes.....	\$ 8.76	\$4.56
County Property Taxes	1.94	1.01
Municipal Property Taxes ^a	<u>1.56</u>	<u>.81</u>
Total	\$12.26	\$6.38

^aPhiladelphia is included in the municipal, not county, figures.

Source: LB&FC homestead percentages applied to Department of Revenue tax collection data.

Table 3 shows the projected revenue we estimate attributable to homestead properties based on Department of Revenue estimates of total property taxes collected by the various jurisdictions. Based on these estimates, we project homestead properties will generate approximately \$6.7 billion in FY 2004-05, \$7.1 billion in FY 2005-06, and \$7.4 billion in FY 2006-07.

³Total estimated assessed homestead value of responding counties/total assessed value of all property in the responding counties

⁴Under Pennsylvania’s Constitution, property taxes must be levied at the same ratio of assessed value to market for residential, commercial, industrial and agricultural properties. This allowed us to apply the estimated homestead assessed value percentages directly to collected property taxes.

Table 3

LB&FC Estimates of Future Homestead Property Tax Collections
(\$ Billions)

	FY 2004-05 (Estimate)		FY 2005-06 (Estimate)		FY 2006-07 (Estimate)	
	Total	Homestead	Total	Homestead	Total	Homestead
School District Property Taxes ..	\$ 9.2	\$4.8	\$9.7	\$5.1	\$10.3	\$5.3
County Property Taxes.....	2.0	1.0	2.1	1.1	2.1	1.1
Municipal Property Taxes ^a	<u>1.7</u>	<u>.9</u>	<u>1.8</u>	<u>.9</u>	<u>1.9</u>	<u>1.0</u>
Total.....	\$12.9	\$6.7	\$13.6	\$7.1	\$14.3	\$7.4

^aPhiladelphia is included in the municipal, not county, figures.

Source: LB&FC homestead percentages applied to Department of Revenue tax collection estimates.

Table 4 compares our estimates with those developed by the Department of Revenue, whose estimates are based on the percentage of housing determined to be owner-occupied for 2003 as reported by the U.S. Census Bureau.⁵ To arrive at our estimates, we applied the homestead percentages we developed (52.0 percent of the assessed value of all property) to the Department of Revenue's estimates for total property taxes generated by all the various taxing jurisdictions (school, county, and municipal).

Table 4

**LB&FC and Department of Revenue Estimates of
Homestead/Owner-Occupied Housing Property Taxes**
(\$ Billions)

	FY 2004-05 (Estimate)	FY 2005-06 (Estimate)	FY 2006-07 (Estimate)
LB&FC Estimate (homestead)	\$6.7	\$7.1	\$7.4
Department of Revenue Estimate (owner-occupied).....	<u>6.5</u>	<u>6.8</u>	<u>7.2</u>
Difference	\$0.2	\$0.3	\$0.2

Source: LB&FC homestead percentages applied to Department of Revenue tax collection estimates.

⁵Under the Census definitions, a housing unit is considered occupied "if a person or group of persons is living in it at the time of the interview or if the occupants are only temporarily absent, as for example on vacation. The persons living in the unit must consider it their usual place of residence or have no usual place of residence elsewhere." A housing unit temporarily occupied at the time of enumeration entirely by persons with a usual residence elsewhere is classified as vacant. Typical examples are people in a vacation home, persons renting living quarters temporarily for work, and migrant workers.

Number of Homesteads

Senate Resolution 3 also requests information on the number of homesteads in Pennsylvania. As part of the survey of county assessment offices, we therefore also requested information on the number of homestead applications sent out by the assessment offices and the number returned. The 55 county assessment offices responding to all portions of the survey reported that they had mailed 3,617,886 applications, of which 2,302,985 had been returned, a return rate of 63.7 percent.

These 55 counties represent 80.3 percent of the Commonwealth's population. Assuming that the large majority (95 percent) of the returned applications are determined to be eligible homesteads, we estimate there are a minimum of 2.7 million homestead properties in the Commonwealth. This, however, is undoubtedly an underestimate because not all homesteads have been mailed applications,⁶ and of those homesteads that have received an application, not all have been returned.

As an alternative estimate, the U.S. Census reported that in 2003, Pennsylvania had 3.45 million owner-occupied housing units. Although not all owner-occupied housing units may qualify for homestead status,⁷ it is likely that the vast majority would meet the Act 50 definition.

⁶In particular, we were informed that some school districts do not mail out homestead applications if they do not participate in Act 50 or Act 72.

⁷For example, subsidized housing would be owner-occupied but not necessarily qualify as a homestead. Seasonal, recreational or occasional use properties are classified as "vacant," not "occupied".

III. Estimate of Revenue Generated by a One Percentage Point Increase in State Sales and Use Tax

Table 5 shows the amount collected in Sales and Use Tax for each year since FY 1985-86.

Table 5

Sales and Use Tax Collections*

Fiscal year Ending June 30	Collections (000)	Collections Per 1 Percentage Point (000)
1986	\$3,241,419	\$ 540,237
1987	3,568,903	594,817
1988	3,846,585	641,098
1989	4,085,875	680,979
1990	4,224,983	704,164
1991	4,197,700	699,617
1992	4,499,734	749,956
1993	4,828,823	804,804
1994	5,124,463	854,077
1995	5,526,850	921,142
1996	5,682,355	947,059
1997	6,036,480	1,006,080
1998	6,152,191	1,025,365
1999	6,605,756	1,100,959
2000	7,018,332	1,169,722
2001	7,203,756	1,200,626
2002	7,292,499	1,215,416
2003	7,519,561	1,253,260
2004	7,728,543	1,288,091
2005	7,999,952	1,333,325

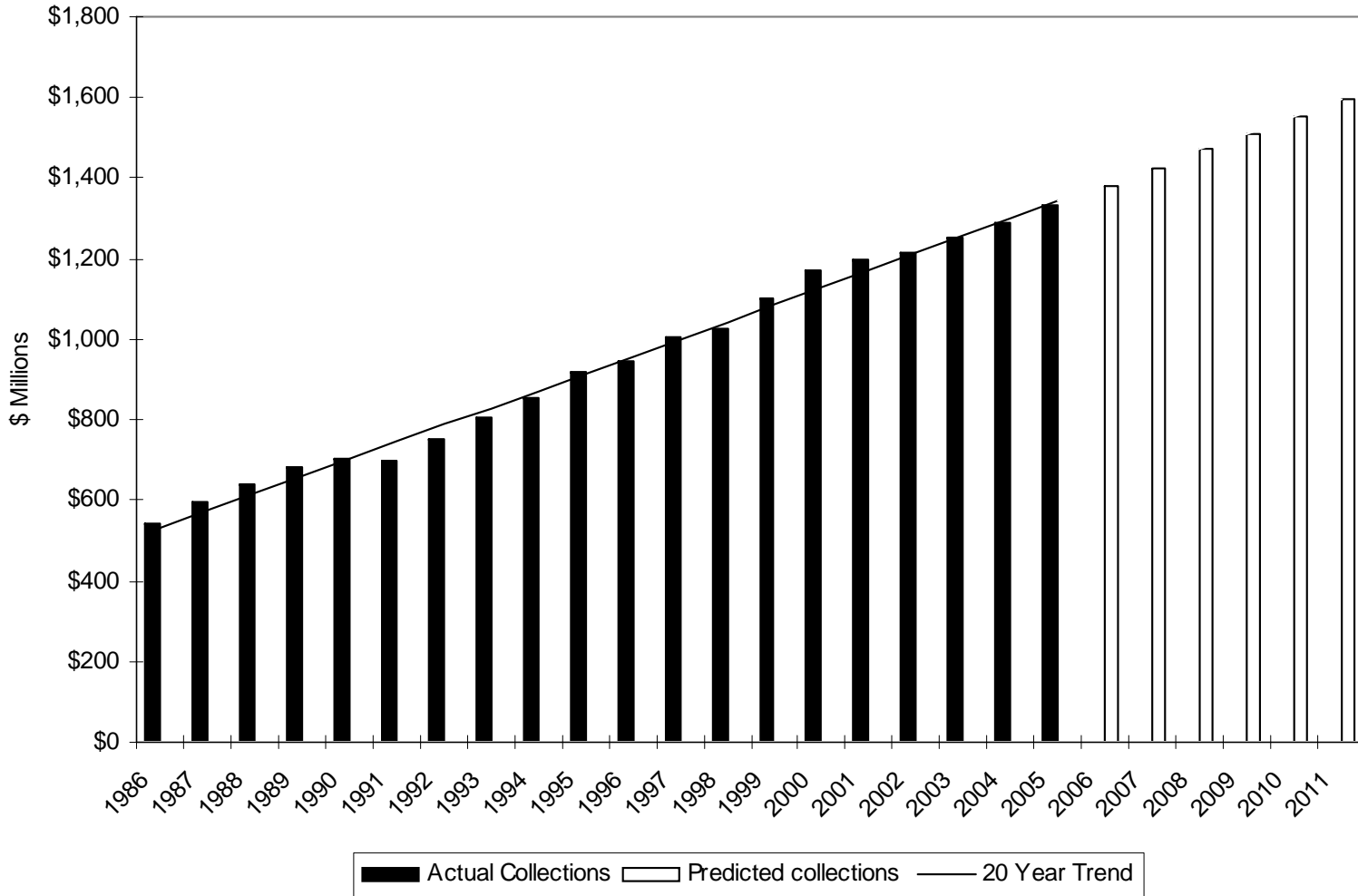
*Includes motor vehicle taxes. Does not include cigarette, malt beverage, or liquor taxes.

Source: Developed by LB&FC staff from information contained in Department of Revenue *Statistical Supplement* reports.

Exhibit 1 plots the amount actually collected and the LBFC staff estimate of how much would be generated over the next six years by each one percentage point in the Sales and Use Tax (i.e., total collected divided by six) if the 6 percent SUT rate is maintained.

Exhibit 1

**Actual and Projected Sales and Use Tax Collections
Per 1 Percentage Point
(At 6 percent rate)**



Source: Developed by LB&FC staff from information contained in Department of Revenue *Statistical Supplement* reports (actuals) and LB&FC projections.

As Exhibit 1 shows, between 1986 and 2005 a near perfect correlation exists between the amount of sales and use tax collected and the fiscal year.⁸ Because the correlation is so strong, we used this approach—a simple, straight-line regression—to project future sales tax revenues. As shown below, we then adjusted these estimates for (1) elasticity⁹ and (2) internet and cross-border sales¹⁰ effects.

Specifically, we projected future sale tax revenue based on 3-year, 10-year, and 20-year data to reflect short-, mid- and long-term trends. We used the average result from these regressions as our best estimate of how much the sales and use tax would generate, in total, on an unadjusted basis.¹¹ We then used Pennsylvania Department of Revenue estimates to calculate the percentage of revenue from a 6 percent to 7 percent increase in the SUT that would be lost due to elasticity and internet and cross-border effects. We then applied those percentages to our estimated gains.

As shown in Table 6, we estimate a one percentage point increase in the state Sales and Use Tax would generate \$1.34 billion in FY 2006-07, \$1.38 billion in FY 2007-08, \$1.42 billion in FY 2008-09, \$1.46 billion in FY 2009-10, and \$1.50 billion in FY 2010-11.

Table 6

LB&FC Best Estimate of Revenue Generated by a 1 Percent Sales and Use Tax Increase Effective 7/1/2006					
(\$ Billions)					
	FY <u>2006-07</u>	FY <u>2007-08</u>	FY <u>2008-09</u>	FY <u>2009-10</u>	FY <u>2010-11</u>
LB&FC Estimate of Total SUT Revenues if 6% Rate Maintained	\$8.55	\$ 8.82	\$ 9.08	\$ 9.33	\$ 9.59
LB&FC Estimate if 7% Rate Enacted Effective 7/1/06 (Unadjusted)	9.97	10.29	10.59	10.88	11.18
Elasticity Effect	(.38)	(.39)	(.40)	(.41)	(.43)
Cross-Border and Internet Effect	<u>(.46)</u>	<u>(.47)</u>	<u>(.49)</u>	<u>(.50)</u>	<u>(.52)</u>
LB&FC Best Estimate (Adjusted).....	\$1.34	\$ 1.38	\$ 1.42	\$ 1.46	\$ 1.50

⁸For the 20-year regression, $r=.996$ and $R^2=.992$. $r=1.0$ is a perfect correlation, and an R^2 of .992 means that the fiscal year variable explains 99.2 percent of the variance in revenue.

⁹Implied decline in the consumer portion of the SUT base according to the Pennsylvania Consumption Tax Model (PCTM).

¹⁰Assumes consumer cross-border and internet sales will increase as the PA SUT rate increases.

¹¹The 3-year model was included in the averages for 1.5 years (July 1, 2005, through December 31, 2006), the 10-year model was included for 5 years (until June 30, 2010), and the 20-year model was used in the average for all years.

Table 7 shows a comparison between our estimates and the Department of Revenue's estimates.

Table 7

**LB&FC and Department of Revenue Estimates of Revenue Generated by a
1 Percent Sales and Use Tax Increase Effective 7/1/2006**
(\$ Billions)

	<u>FY</u> <u>2006-07</u>	<u>FY</u> <u>2007-08</u>	<u>FY</u> <u>2008-09</u>	<u>FY</u> <u>2009-10</u>	<u>FY</u> <u>2010-11</u>
LB&FC Estimate	\$1.34	\$1.38	\$1.42	\$1.46	\$1.50
Department of Revenue Estimate ^a	<u>1.35</u>	<u>1.40</u>	<u>1.45</u>	<u>1.50</u>	<u>1.55</u>
Difference	\$.01	\$.01	\$.03	\$.04	\$.05

^aDated 12/20/05.

IV. Estimate of Revenue Generated by Each One-Tenth Percentage Point Increase in State Personal Income Tax

Table 8 shows the tax rate and the amount collected in personal income tax for each year since FY 1985-86.

Table 8

Personal Income Tax Collections

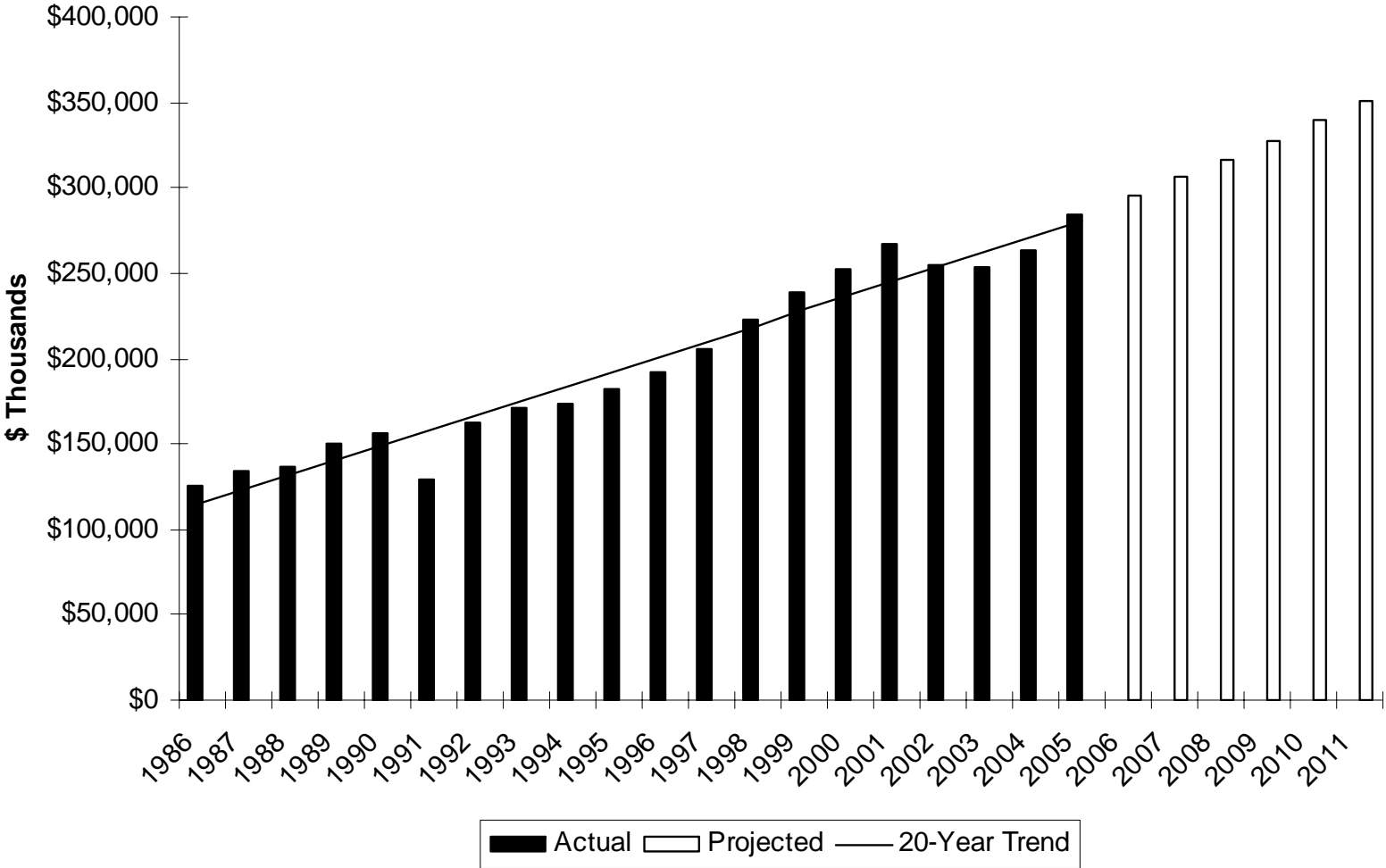
Total for Year Ending June 30	Tax Rate	Collections (\$000)	Actual Per .1 Percentage Point (\$000)
1986	0.0216	\$2,710,603	\$125,491
1987	0.0210	2,817,526	134,168
1988	0.0210	2,879,970	137,141
1989	0.0210	3,146,956	149,855
1990	0.0210	3,294,309	156,872
1991	0.0260	3,363,587	129,369
1992	0.0295	4,807,421	162,963
1993	0.0280	4,789,995	171,071
1994	0.0280	4,872,745	174,027
1995	0.0280	5,083,152	181,541
1996	0.0280	5,374,301	191,939
1997	0.0280	5,745,633	205,201
1998	0.0280	6,236,383	222,728
1999	0.0280	6,683,575	238,699
2000	0.0280	7,066,013	252,358
2001	0.0280	7,491,462	267,552
2002	0.0280	7,138,668	254,952
2003	0.0280	7,105,885	253,782
2004	0.0294	7,733,804	263,503
2005	0.0307	8,746,800	284,912

Source: Developed by LB&FC staff from Department of Revenue *Statistical Supplement* reports.

Exhibit 2 shows the amount generated for each one-tenth percentage point in the personal income tax and the 20-year trend line. As the exhibit shows, a close correlation exists between the amount of personal income tax collected and the

Exhibit 2

**Actual and Projected Personal Income Tax Collections
Per One-Tenth Percentage Point in the PIT Rate**



Source: Developed by LB&FC staff from Department of Revenue *Statistical Supplement* reports (actuals) and LB&FC projections.

fiscal year,¹² although the correlation is not as strong as for the Sales and Use Tax. Because the linear approach does not fit as well for PIT collections as for the Sales and Use Tax, we also developed an exponential model based on the average annual increase in PIT collections since 1986, which has been 4.41 percent. We then averaged the results of the two models to develop our best estimate.¹³ To allow direct comparisons with the Department of Revenue estimates, which are cash receipts estimates, we did not deduct tax refunds, which in fiscal year 2004-05 totaled \$464 million.

As shown in Table 9, we estimate each one-tenth percentage point increase in the state personal income tax would generate approximately \$306 million in FY 2006-07, \$316 million in FY 2007-08, \$328 million in FY 2008-09, \$340 million in FY 2009-10, and \$351 million in FY 2010-11. Table 9 also shows a comparison between our estimates and those of the Department of Revenue.¹⁴

Table 9

Projected Revenue Generated by Each One-Tenth Percentage Point Increase in the State Personal Income Tax Rate Effective 7/1/2006					
(\$ Millions)					
	FY <u>2006-07</u>	FY <u>2007-08</u>	FY <u>2008-09</u>	FY <u>2009-10</u>	FY <u>2010-11</u>
LB&FC Estimate	\$306.3	\$316.3	\$327.9	\$339.7	\$350.9
Department of Revenue Estimate ^a	<u>314.9</u>	<u>331.4</u>	<u>350.0</u>	<u>362.4</u>	<u>382.0</u>
Difference	\$ 8.6	\$ 15.1	\$ 22.1	\$ 22.7	\$ 31.1

^aDated 12/20/05.

¹²For the 20-year regression, $r=.975$ and $R^2=.950$. $r=1.0$ is a perfect correlation, and an R^2 of .950 means that the fiscal year variable explains 95 percent of the variance in revenue.

¹³This “best” estimate can be considered somewhat conservative. Had we used only the exponential model (annual increases of 4.41 percent), our estimates would have been: 2006-07, \$310.6 million; 2007-08, \$324.3 million; 2008-09, \$338.6 million; 2009-10, \$353.5 million; and 2010-11, \$369.1 million.

¹⁴The Department of Revenue reported its estimates are based on an economic model that is forecasting strong economic growth over the next several years.

V. Appendix

APPENDIX A

PRINTER'S NO. 31

THE GENERAL ASSEMBLY OF PENNSYLVANIA

SENATE RESOLUTION

No. 3 Special Session No. 1 of 2005

INTRODUCED BY LOGAN, ORIE, FONTANA, PIPPY, FERLO, MELLOW, COSTA,
BOSCOLA, D. WHITE, LAVALLE, KASUNIC, O'PAKE, WOZNIAK,
RAFFERTY AND STOUT, DECEMBER 15, 2005

INTRODUCED AND ADOPTED, DECEMBER 15, 2005

A RESOLUTION

1 Imposing research requirements upon the Legislative Budget and
2 Finance Committee with regard to property tax reform.

3 WHEREAS, More than 117,000 taxpayers have signed the petition
4 supporting the elimination of local property taxes, commonly
5 known as the "Stop Taking Our Properties (STOP) Primary
6 Residence Protection Plan"; and

7 WHEREAS, Local property taxes are the major source of revenue
8 for the 501 school districts in Pennsylvania; and

9 WHEREAS, The local property tax system is an unfair,
10 regressive and subjective method which never allows a person to
11 own one's home; and

12 WHEREAS, Local property taxes disproportionately burden many
13 senior citizens and working families; and

14 WHEREAS, Reports vary widely on the amount of money needed to
15 eliminate local property taxes; therefore be it

16 RESOLVED, That the Legislative Budget and Finance Committee,
17 in consultation and cooperation with the Local Government

1 Commission, determine the number of homesteads, as defined under
2 53 Pa.C.S § 8401 (relating to definitions), in this
3 Commonwealth; and be it further

4 RESOLVED, That the Legislative Budget and Finance Committee,
5 in consultation and cooperation with the Local Government
6 Commission shall determine the amount of revenue needed to
7 eliminate all local property taxes levied by school districts,
8 county governments and local governments in Pennsylvania for all
9 homesteads in this Commonwealth; and be it further

10 RESOLVED, That the Legislative Budget and Finance Committee

Appendix A (Continued)

11 determine the amount of revenue generated by each Statewide 0.1%
12 increase in the Personal Income Tax and by each 1% increase in
13 the Sales and Use Tax; and be it further
14 RESOLVED, That the Legislative Budget and Finance Committee
15 report its findings to the Senate within 60 days of the adoption
16 of this resolution.

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