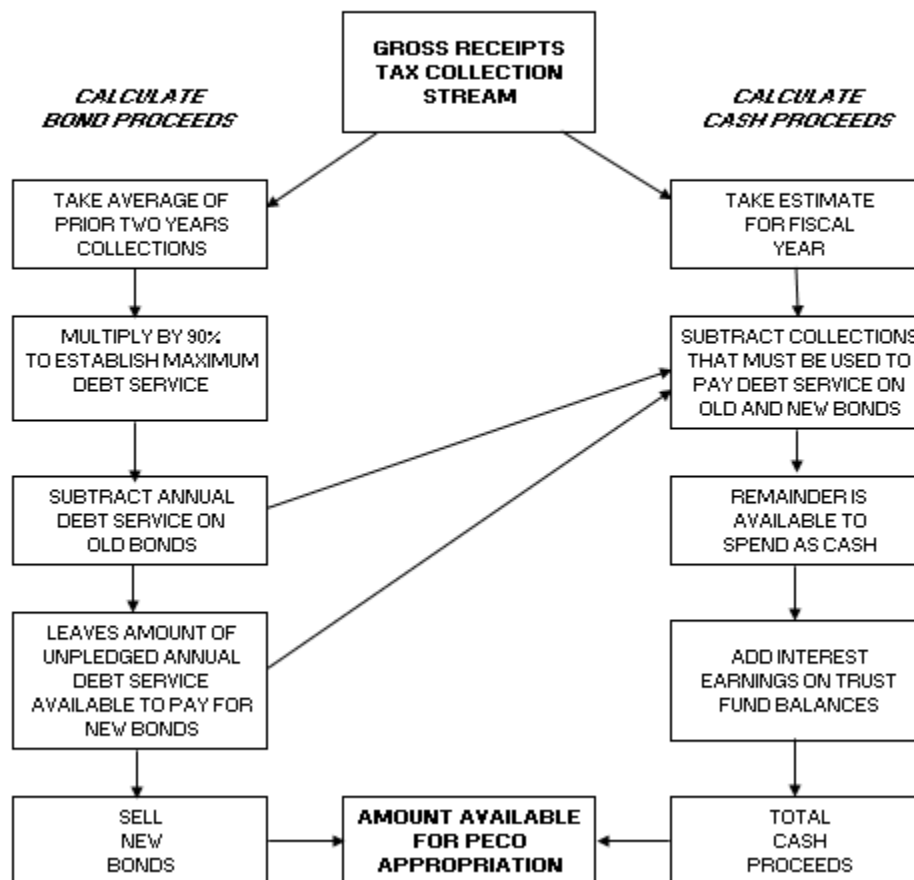


How the Gross Receipts Tax Becomes a PECO Appropriation

The Gross Receipts Tax is a relatively stable, if slow growing, tax source, making it an ideal revenue source for financing the sale of bonds. This stability helps make PECO bonds more marketable, lowering interest costs, and assuring bond buyers that the cash flow to make the interest payments on the bonds is reliable. However, it has been observed that the amount available for appropriation to the PECO program can and has fluctuated substantially from one year to the next. It may seem counter-intuitive that funding for a program can go up and down as much as PECO funding can, while at the same time the tax source supporting the program continues to grow.

Most of the funding for PECO comes from the sale of bonds, and it is changes in the sizes of the bond sales which are the primary reason for the fluctuation of the PECO appropriation. The changes in the bond sales are related to the Gross Receipts Tax collections, but in a rather indirect way (see ["Uses of the Gross Receipts Tax"](#) for additional information). What follows is an explanation of the process by which Gross Receipts Tax collections become the PECO appropriation.

HOW THE GROSS RECEIPTS TAX BECOMES A PECO APPROPRIATION



The PECO estimate is comprised of two kinds of funds, bond proceeds and cash proceeds. Both estimates begin with the Gross Receipts Tax, and the diagram below illustrates how the two fund sources are calculated. Bond proceeds are determined by criteria which are set forth in both statute and the Constitution. A certain portion of the Gross Receipts Tax collections is set aside for paying the debt on bonds. This portion is defined as 90% of the average annual tax collections of the prior two years. From this portion, called the maximum debt service capacity, the amount of already existing debt service is subtracted. The remainder is the amount of new debt service which can be used to finance the sale of new bonds. The state then sells these new bonds and places the proceeds in the PECO trust fund for spending on a set of projects which are stipulated in the Appropriations Act. Tax collections not needed for paying debt service, in addition to other cash sources of funds such as interest earnings, are appropriated as well.

As previously mentioned, most of the amount available for PECO spending (typically about three-fourths) comes from the sale of bonds. It is important to remember that each year, a PECO bond sale is made which obligates a portion of the Gross Receipts Tax collection stream into the future. In other words, the state gives up a portion of the future tax collections in order to enjoy the benefit of having a larger amount to spend on projects in the present time. At current interest rates and bond terms, this means giving up about \$1 in revenue for 30 years for every \$15 that is spent today. Thus it can be seen that as time goes by, most of the tax collections are not available for spending on PECO projects, but instead must be paid out as interest on the outstanding bonds. This also means that since the state sells the maximum amount of bonds it can each year, the ability to sell additional bonds the following year is dependent on there being an increase in the tax collections. When the tax collections increase, there is additional money to pay the interest on new bonds. If tax collections were to stay constant, there could be no new bond sales. Since most of the PECO appropriation is derived from the sale of new bonds, it is easy to see that the tax source must grow if there is to be significant funding for the PECO program.

It is also evident that the amount of growth in the tax collections is the most significant factor in the size of the PECO appropriation. In fact, a growth rate of 6%, for example, would generate bond proceeds which are twice as great as a growth rate of 3% would generate. The table below displays this phenomenon and the impact on the amount available for appropriation, using hypothetical tax collection figures.

Hypothetical PECO appropriation at different
tax collection growth rates (\$ millions)

	3% growth rate	6% growth rate
Cash proceeds	\$19.7	\$24.7
Bond proceeds	\$40.9	\$80.7

Total appropriation	\$60.6	\$105.4
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As can be seen in this example, the 3% difference in the tax collection growth rate (going from 3% to 6%) nearly doubled the amount bond proceeds, and produced a 25% increase in the cash proceeds.

In reality, of course, the growth rate in the tax is not equal from year to year. When growth rates are large, the PECO estimate is large, and when growth rates are small, the PECO estimate is small. Only relatively minor changes from year to year in the growth rate of the tax source are necessary to produce substantial changes in the amount available for the PECO appropriation.

NOTE: You can follow how the calculations were done which produced the results in the table, in the same format as the flow chart displayed above. Please select the [3% scenario](#) or the [6% scenario](#).