



Testimony

Submitted on behalf of the
Pennsylvania Chamber of Business and Industry

Public Hearing on Business Tax Reform

Before the:

House Republican Policy Committee

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Introduction

Chairman Reed and members of the committee thank you for the opportunity to testify before you today regarding business tax reform. My name is Sam Denisco and I am the Director of Government Affairs for the Pennsylvania Chamber of Business and Industry. The Chamber is the largest, broad-based business advocacy association in the Commonwealth. We represent business of all sizes ranging from Fortune 100 companies to sole proprietors crossing all industry sectors. Our membership comprises nearly fifty percent of the private workforce. With me today is Tom Bowen. Tom is a shareholder with Steven and Lee and Chairs the PA Chamber's Tax Executive Committee.

Importance of competitive business tax structure

Few issues draw as much attention as state business taxes for businesses seeking to locate or expand operations. Despite positive changes to the Commonwealth's business taxes over the last few years, the economic boom of the mid-to-late 1990s and increased international competition allowed most of Pennsylvania's competitors to reduce their business tax burdens significantly. As a result, the Commonwealth's business tax structure continues to have some of the highest rates in the nation and is more burdensome than most others. While the progress on business taxes in Pennsylvania was constructive, it did little to improve our overall competitiveness in the nation and around the world.

Tax policy should not discourage corporate headquarters locating in Pennsylvania

Sadly, we have seen a growing number of PA-based companies being acquired by out-of-state or foreign-based corporations. While there are other factors involved in these corporate takeovers, tax policy should not be a barrier to locating global and regional corporate headquarters operations in Pennsylvania.

PA can no longer afford to have the nation's highest effective corporate tax rate

Pennsylvania businesses have to make tough choices in order to compete successfully in a global economy. The top US federal income tax rate on corporations at 35%, is already among the highest globally, so any additional rate by states needs to be carefully considered, and PA has the highest effective rate (9.99%) among all 50 states¹. CNI tax rates are the most straightforward measure that businesses use when comparing states' business climates. While a reduction of just one percentage point to 8.99 percent would improve Pennsylvania's ranking by eight places, the Commonwealth still would remain well above the national average of 6.80 percent.

Mandatory unitary combined reporting will further erode PA's attractiveness

The PA Chamber opposes proposals to collect the CNI on a unitary combined basis because it is a potentially significant tax increase that would also impose massive administrative and litigation costs on Pennsylvania's job creators. For both affected taxpayers and the Department of Revenue, it will add considerable complexity and fiscal uncertainty. Mandatory unitary combined reporting is a far-reaching and harmful proposal that creates a specific disincentive for multi-state firms to do business in Pennsylvania.

¹ Although Iowa has a higher nominal rate (12.0% on income exceeding \$250,000), unlike Pennsylvania and most other states, it provides a deduction of 50% of the U.S. federal income tax. Accordingly, Iowa's highest effective corporate rate is 9.96% (corporations subject to the 34% U.S. rate; the effective rate drops to 9.90% for corporations subject to the top 35% US rate).

NOL cap should be removed

Pennsylvania is one of only five states that impose a cap on Net Operating Losses (NOLs)². In 2010 the cap was increased to the higher of \$3 million or 20 percent of a company's net income. While these changes were a welcomed improvement, the ongoing cap still represents a barrier to start-up companies looking to locate in Pennsylvania and a burden on cyclical companies looking to maintain existing operations.

By way of background, the vast majority of new start-up companies today are companies employing 100 or fewer employees. Due to the various components of start-up costs, these businesses tend to record significant losses in the first few years of operation. Likewise, cyclical businesses face regular fluctuations in income as part of their business operations. An NOL deduction that is free of any uncompetitive restrictions is an important way to help start-up companies and balance the effect of volatile economic conditions on cyclical businesses.

CNI apportionment should be fully market-based

The Corporate Net Income tax liability of a multi-state company is determined by an apportionment formula. In the 1990s, the legislature began the process of shifting to a formula that is based on a single sales factor. In 2010, the apportionment formula was changed to one that is based on 5 percent property, 5 percent payroll and 90 percent sales.

A 100 percent sales factor, or single sales factor, would help companies that have a significant investment of property and payroll in Pennsylvania. In practice, a corporation that increases its

² New Hampshire has a \$1 million NOL cap. The NOL caps in the other three states are temporary: Colorado has a \$250 thousand NOL cap through 2013, California has suspended its NOL deduction through this year, and Illinois has suspended its NOL deduction through 2013.

Pennsylvania holdings and the number of employees in Pennsylvania would not be penalized under a SSF because property and payroll would no longer be considered as part of the tax calculation.

The sales factor for services is currently based on the state where they are performed. To reverse this to have services performed in the Commonwealth, Pennsylvania should adopt a customer-base sourcing. This market-based sourcing has been the rule in Maryland for several years and is being adopted in a growing number of states³ to keep and grow their service jobs. This would be consistent with the destination-based sourcing used for product sales.

Capital Stock/Franchise Tax should continue to be phased-out on schedule

In May of 2000, the General Assembly recognized that Pennsylvania's Capital Stock and Franchise Tax (CSFT) represented an unfair, burdensome tax on Pennsylvania businesses. Subsequently, in May of 2000, the General Assembly initiated a 10-year phase-out of the CSFT. Since 2000, the CSFT phase-out was delayed three times in order to generate more revenue for the Commonwealth's General Fund. Under the original phase-out plan, the CSFT was to be eliminated by January 2009, but the changes have delayed the elimination of the tax until January 2014.

Most states do not impose a franchise tax based on capital stock value. There are only 9 other states⁴ that charge both an income tax and an uncapped capital-based franchise tax. Complicating matters, Pennsylvania businesses must pay the CSFT regardless of whether the business earned a profit. This is particularly burdensome for new business ventures and companies that may be struggling in a slow economy. In effect, the CSFT is a tariff on every dollar invested in

³ 10 other states besides Maryland have adopted market-based sourcing of service sales: California (effective this year), Georgia, Iowa, Illinois (2009), Maine (2007), Michigan (2008), Minnesota, Oklahoma (2010), Utah (2009) and Wisconsin.

⁴ Arkansas, Louisiana, Massachusetts, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee and West Virginia.

Pennsylvania. Continuing the original phase-out, as proposed in Governor Corbett's most recent budget proposal, would re-inject stability and predictability for Pennsylvania businesses that count on sound fiscal policies as they locate and expand their operations.

Conclusion

Pennsylvania needs to be increasingly competitive, for both jobs and capital. Companies and investors have choices, both globally and among the states, to place their investments and we want businesses to remain here, invest here and grow here.

Again, thank you for giving me the opportunity to present remarks on behalf of the PA Chamber. I am happy to answer any questions you may have at this time.