

**Testimony for Mike Cortez
House Republican Policy Committee Meeting
Thursday, January 29, 2009**

I. Introduction

II. Tax Commission background

- A. Established by Governor Rendell's Executive Order 2004-3
- B. Scope and substance of Commission considerations pre-determined in Executive Order
- C. The Executive Order's charge to the Commission was restrictive
 - 1. Required revenue neutrality – tax shifting
 - 2. Set forth a relatively short time frame
 - a. Too much information, too little time
 - b. NO opportunity for dynamic modeling
 - 3. Limited to "business taxes"
 - a. Corporate Net Income Tax
 - b. Capital Stock and Franchise Tax

III. Tax Commission final recommendations – my perspective

- A. Mandatory Unitary Combined Reporting was met with skepticism – business "unfriendly"
 - 1. Concern over what impact it would have on business competitiveness
 - 2. Tremendous complexity to a combined reporting system
 - a. Is the Department of Revenue prepared to handle such a massive transition?
 - b. Are the Courts prepared for overwhelming number of legal challenges as happened in other states? – California enacted years ago – still litigating definitions/concepts.
 - 3. Fear of the consequences of such a system
 - a. Another business-unfriendly measure in PA
 - b. Increased costs to the Commonwealth administratively and judicially
 - c. Delayed revenues to the Commonwealth
- B. Only acceptable in conjunction with significant positive changes to the tax structure
 - 1. Full Net Operating Loss carry forwards
 - a. PA is one of only 2 states that cap NOLs
 - b. PA businesses are at a disadvantage to similarly situated businesses in other states
 - 2. Full adoption of the Single Sales Factor for corporate net income tax apportionment purposes
 - a. Current formula increases a company's tax burden if it:
 - 1) Hires more employees (payroll factor)
 - 2) Expands its physical presence (property factor)
 - b. Eliminating the payroll and property factors clearly encourages expansion in PA and benefit home-town businesses
 - 3. Lower the CNIT rate to the lowest rate possible
 - a. 6.9 with Commission recommendations, including pass-through tax
 - b. At all times urged a rate below 6 percent

IV. Post-Commission commentary

- A. Just as concerned, if not more so, regarding the implementation of combined reporting.
 1. Was to be a take-it-or-leave-it package, but immediately after Commission released recommendation, a different proposal emerged
 - a. No pass-through entity tax component
 - b. Raised CNIT to 7.9
 - c. Regardless of opinion of these two components, it did not represent Commission recommendations.
 2. Introducing a combined reporting proposal in this economy seems counter-productive
 3. Not to mention, the state's tax structure still is horribly uncompetitive
 - a. PA's 9.99 percent CNIT rate is second highest in the country and the highest effective rate in the country considering Iowa has a sliding scale that ranges from 5% to 12%
 - b. 2009 Tax Foundation study ranked PA's Corporate Tax Index at 41 of 50 states (Note: PA ranked 28th overall in the Tax Foundation's Business Tax Climate Index, of which the Corporate Tax Index is but one of five criteria. The five criteria measured include the following: Corporate Tax, Sales Tax, Individual Tax, Unemployment Tax and Property Tax. Arguably, Sales, Personal and Property for businesses help lower the overall number considering the Corporate Tax ranking of 41.)
 - c. Secretary Yablonski (Department of Community and Economic Development) testified that PA was starting from a position of weakness; 47th in U.S. job growth; 50th in losing our students to other states
 - d. Revenue Neutrality. Pennsylvania 21st Century Tax Policy Project (PA21). Same goals as the Tax Commission. Legal, business, accounting, labor, government experts. If you look only at the major business taxes, their recommendation is \$760 million out of balance.

V. Conclusion

- A. PA's corporate tax system is deficient
- B. Need positive changes to spur economic growth
- C. Serious, legitimate competitive concerns regarding combined reporting
- D. IF it's to be considered, do so carefully and with all the facts, and include positive changes to counterbalance anticipated negative impact.
- E. Combined reporting **MUST** be considered in conjunction with addressing the glaring problems with PA's business tax structure
 - a. Significant rate reduction to a competitive level
 - b. NOL cap elimination like 49 other states and the federal government
 - c. Adoption of SSF to encourage hiring and expansion in PA
- F. Personally, combined reporting is last resort.
- G. Commission's recommendations were "presented as a comprehensive plan designed to both comply with the constraints of, and achieve, the goals established by, the Executive Order [which created it]. The Commission endorses the tax contained in this plan as a package; however, it does not endorse any of the recommendations individually."
- H. Thank you for the opportunity to provide my perspective.
- I. Any questions?