

COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES

REPUBLICAN POLICY COMMITTEE HEARING

STATE CAPITOL
MINORITY CAUCUS ROOM
ROOM 418
HARRISBURG, PENNSYLVANIA

THURSDAY, JANUARY 29, 2009
10:03 A.M.

PRESENTATION ON
PENNSYLVANIA BUSINESS TAX REFORM COMMISSION
RECOMMENDATIONS

BEFORE:

HONORABLE STANLEY E. SAYLOR, CHAIRMAN
HONORABLE STEPHEN BARRAR
HONORABLE TOM C. CREIGHTON
HONORABLE CRAIG A. DALLY
HONORABLE SHERYL M. DELOZIER
HONORABLE GORDON DENLINGER
HONORABLE JOHN R. EVANS
HONORABLE SETH M. GROVE
HONORABLE SUSAN C. HELM
HONORABLE SCOTT E. HUTCHINSON
HONORABLE TINA PICKETT
HONORABLE CURTIS G. SONNEY
HONORABLE JERRY STERN

ALSO PRESENT:

ANDREW J. RITTER, JR.
EXECUTIVE DIRECTOR

DEBRA B. MILLER
REPORTER

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P R O C E E D I N G S

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CHAIRMAN SAYLOR: Good morning, everyone.

I want to thank you for joining us for what is an extremely important discussion in light of the Commonwealth's current revenue shortfall.

And in 2004, the Governor convened a Business Tax Reform Commission composed of a variety of bright individuals. This commission, with certain limitations, developed the best possible recommendations to improve Pennsylvania's business climate and grow our economy.

While some of those recommendations have been implemented, it is a shame that we have not worked together to more implement these kinds of recommendations that came out of the commission.

As he has in several budgets in the past, I expect Governor Rendell to propose one portion of the recommendation of combined reporting as a means to generate additional revenue.

The purpose of this hearing is to provide a forum for the Budget and Economic Policy Task Force and the Republican Caucus to discuss the commission's recommendations in a comprehensive manner instead of just focusing on the aspects that increase revenue.

1 With that being said, I now want to turn the
2 discussion over to three very esteemed gentlemen who
3 served on that commission: Joseph Bright, partner of
4 the Tax Practice Group of Wolf, Block, Schorr &
5 Solis-Cohen, LLP; Joseph Cottonaro, Senior Director
6 of Taxes for Hershey Foods, Corp.; R. Michael Cortez,
7 Vice President and General Counsel of Sheetz, Inc.

8 And before I ask Mr. Bright to start -- I
9 don't know which one of you is going to start first
10 -- I would like to have the members of the House of
11 Representatives introduce themselves.

12 If Ms. Delozier would start for us, please.

13 REPRESENTATIVE DELOZIER: Sure.

14 Sheryl Delozier. I represent the
15 88th District.

16 REPRESENTATIVE HELM: Sue Helm, the
17 104th District of Dauphin County.

18 REPRESENTATIVE CREIGHTON: Tom Creighton,
19 the 37th District, Lancaster County.

20 REPRESENTATIVE BARRAR: Steve Barrar from
21 Delaware and Chester Counties.

22 REPRESENTATIVE SONNEY: Curt Sonney,
23 4th District, Erie County.

24 REPRESENTATIVE DENLINGER: Gordon Denlinger,
25 the 99th District, eastern Lancaster County, and

1 co-chair with Representative Dally of the Budget Task
2 Force.

3 CHAIRMAN SAYLOR: Of course, I'm the
4 Republican Policy Chairman, Stan Saylor, from
5 York County.

6 REPRESENTATIVE PICKETT: Tina Pickett,
7 Bradford, Sullivan, and Susquehanna Counties.

8 REPRESENTATIVE GROVE: Seth Grove,
9 196th District, York County.

10 REPRESENTATIVE HUTCHINSON: Representative
11 Hutchinson, the 64th District, Venango County.

12 CHAIRMAN SAYLOR: Thank you, Scott.

13 Mr. Bright, or whoever would like to start
14 first.

15 MR. BRIGHT: Mr. Chairman, members of the
16 committee, let me start off by giving you just a
17 couple of quick points on what combined reporting is,
18 what the commission was asked to do and what they
19 said, and a quick note on some data.

20 First of all, what is combined reporting?
21 Combined reporting is an alternate method for
22 determining the tax base for a tax on corporate
23 income.

24 Alternate to what? The normal way of
25 determining the tax base -- and that is a technical

1 term which means the thing to which you apply the tax
2 rate -- is the income of the corporation. That is
3 the way Pennsylvania taxes corporations now when
4 there is corporate net income tax. One corporation;
5 that is what the tax is imposed on. And it adopts,
6 in Pennsylvania's case as in almost every other
7 State, Federal taxable income.

8 In combined reporting, the State, a State
9 that adopts combined reporting, combines the income
10 of another corporation and the corporation that is
11 actually here, hence the name "combined" -- you add
12 them together -- and you treat them as though they
13 were one corporation, or three or four or five,
14 whatever. You do that if they are members of what
15 tax lawyers call a unitary group, and that depends on
16 the degree of common ownership and some flow of value
17 among the members.

18 Percentage ownership is pretty easy to
19 determine; flow of value is very hard to determine.
20 So what we are talking about is moving from a
21 separate company, a single corporation tax base, to a
22 tax base that is the sum of several related
23 corporations. That is what it is about. Okay.

24 Now, the Tax Commission was asked to look at
25 the structure of Pennsylvania's taxes on

1 corporations, all taxes on corporations, and was
2 asked to come up with recommendations for change and
3 was requested to keep the recommendations revenue
4 neutral -- no gain, no loss. And by definition, if
5 you do that, it has to mean that you are going to
6 shift income. It can be no other way.

7 If the revenues, for example, for more
8 corporate taxes are -- just to make up a number --
9 \$100 million and you are going to come back with a
10 revenue neutral recommendation, you will still raise
11 \$100 million but you will raise it from different
12 people, or more likely from the same people in
13 different proportions. So that was the request.

14 So what did the commission say? My fellow
15 Commissioners will expand on this, but very briefly,
16 the number one concern of all the Commissioners and
17 the number one focus of lengthy testimony was that
18 Pennsylvania's 10-percent corporate net income tax
19 rate is too high and anticompetitive. It is too high
20 vis-a-vis the rest of the nation; it is too high
21 vis-a-vis States.

22 And people understood that in any market
23 economy, if you overcharge for what you are giving
24 people, that you tend to discourage buyers. That
25 applies to taxes; it applies to Wal-Mart; it applies

1 to everything. So the main concern of the commission
2 was to lower that rate.

3 Lower it by how much? The commission wanted
4 to see it lowered to 6 percent. That's a 40-percent
5 whack. They actually came out with a range, either
6 to 6 or maybe to 7. There was a little wiggle room.
7 So it is cutting it by 60 or by -- excuse me -- by
8 40 or 30 percent. That was the recommendation; that
9 was the number one concern.

10 Now, there was a price to be paid for that,
11 because if your charge is revenue neutrality and you
12 simply cut the rate, it is not going to work. The
13 numbers don't work. So the commission was willing to
14 recommend combined reporting, as I have just
15 described it -- that is, putting together the income
16 of related corporations and a few other changes -- in
17 order to get there, to get that lower rate.

18 But the driving recommendation, the number
19 one, the key piece, was lower the rate. The number
20 one key piece was not combined reporting in and of
21 itself. It was a price to be paid to get from here
22 to there, the point being the competitiveness of
23 Pennsylvania's corporate taxes.

24 So that is what the commission said. They
25 said some other things, and we can talk about that

1 later, but that is the gist of it.

2 Now, the commission made that recommendation
3 because the Department of Revenue had done its best
4 to analyze the economic effect of adopting combined
5 reporting, and the economic effect is very difficult
6 to determine. They tried hard, and it depends a lot
7 on what you do with net operating loss carryovers.
8 That is, if a company that was a separate company
9 taxpayer 5 years ago sustained losses for 3, 4,
10 5 years and those losses carry over, what do you do
11 with them? Do you just cut them off? Do you allow
12 them in part? Do you allow them in a limit?

13 Those are some of the factors that will
14 heavily determine the revenue estimate. So with that
15 revenue estimate in front of the commission, they
16 made that recommendation.

17 I recommend to you -- and this is my last
18 quick point -- I recommend to you very strongly a
19 paper done by Robert Cline -- C-L-I-N-E -- of
20 Ernst & Young for COST, which is the Council on
21 State Taxation, which is a nationwide organization
22 that advocates the interests of major corporations in
23 America.

24 COST sees things from a business
25 perspective, but they are, I would say, very widely

1 respected for the thoroughness and credibility of
2 their analyses and recommendations, bearing in mind
3 that they speak for a particular group.

4 This monograph, dated May of 2008, goes into
5 a lot of detail and is a very helpful and coherently
6 written piece. So if you don't know anything about
7 this subject, this is a good place to start.

8 He makes a lot of good points, and I will
9 leave you with this one point. One State in the
10 United States, according to him, has ever gone back
11 and actually calculated the effect of adopting
12 combined reporting, and that was Minnesota. No
13 other State has done it. And the effect was, no
14 change. There were no increased revenues. That is
15 what Minnesota determined on the basis of actual
16 data.

17 So you have a lot of estimates, and he
18 discusses in details other States' estimates,
19 including a pretty good brief synopsis of
20 Pennsylvania's estimates, all of which are good
21 shots, good tries, but they are estimates. There
22 was one study which determined what actually
23 happened.

24 So with that, I will let my fellow
25 Commissioners pick up the pieces I missed.

1 MR. COTTONARO: Good morning.

2 My name is Joe Cottonaro, and as with the
3 others here, I served on that commission. And what I
4 would like to do is share a little bit of the
5 overview of the commission, what our charge was, what
6 we did or accomplished in that process.

7 And as I understood our charge from the
8 Governor, it was to maintain in this process a
9 revenue neutrality in the outcome. We were also
10 limited to business taxes in this process. And I
11 think there was a realization at all levels in this
12 State that Pennsylvania needed to address its
13 competitive stance, both with other States as well as
14 a more global notion of the economy.

15 Today, if you were to take a company
16 situated in Pennsylvania, in the United States, they
17 would have the highest combined tax rate, income tax
18 rate on corporations in the world, and you would have
19 the setting where that is a competitive disadvantage
20 to creating jobs in Pennsylvania.

21 The commission's recommendations were a
22 series of changes to the existing tax system. The
23 discussions around those changes really focused on
24 each element, but the conclusion was clear that the
25 sum of those elements was what the Commissioners were

1 agreeing to, that the sum of those elements brought
2 the system into what we felt was a more competitive
3 stance.

4 So what did we look at? As Joe mentioned,
5 we looked at rate. That clearly was a top-line item.
6 It stands out there. Even within the United States,
7 it is sometimes viewed as the second highest in the
8 country. But if you were to adjust it for the
9 bracketing that goes on on income, much like you do
10 with individuals, it is the highest effective tax
11 rate in the United States, and so that was our
12 focus.

13 We looked at some sense of fairness. We
14 looked at how most States treat losses, cumulative
15 losses, NOLs. We were looking at how the trend was
16 progressing with apportionment. That is,
17 apportionment is a little more than, if you have a
18 company that is dealing beyond the boundaries of
19 Pennsylvania, which many are, then you have to have a
20 method for taking the overall income and allocating
21 it to particular States.

22 And historically, that had been a
23 three-factor system, but what we detected from our
24 review of this is that that was changing. States
25 were becoming very competitive amongst themselves,

1 and so they were looking to ways to provide their
2 growth in jobs with apportionment of this tax. The
3 two elements are the amount of income, the base, and
4 the rate that you apply to that base. So we brought
5 into play the notion of a single sales factor, and we
6 can look at that a little more in detail as the
7 discussions move on.

8 The other aspect, I mentioned rate and base,
9 and so the tradeoff was to increase the base of the
10 tax, and that is what sits behind combined
11 reporting.

12 Various States use different techniques.
13 Some disallow deductions; some have the combined
14 reporting. So that played in the context of an
15 enabler. What combined reporting did was it
16 enabled the rate to be reduced to a more competitive
17 level. And rates do matter in discussions and
18 deliberations.

19 So the conclusion that the commission
20 reached was that, looking at all of the different
21 elements of that package, the recommendation, this is
22 what we felt accomplished the charge that was given
23 to us.

24 I think at the time, it was very forward
25 looking. I think today it really is relevant, the

1 conclusions that we reached.

2 So I will pass that on to Michael.

3 MR. CORTEZ: Thank you.

4 My name is Mike Cortez, and I'm
5 Vice President and General Counsel for Sheetz. And
6 hopefully you have a copy of some prepared statements
7 that I had made, I was prepared to make, although I
8 am going to change them significantly because both
9 Joes on either side of me have covered most of the
10 important parts and I don't want to belabor those
11 facts. But let me go back and try to reiterate some
12 points that I think are critical and explain some
13 additional points.

14 First, as both Joes indicated, the
15 commission that we served on was tasked with coming
16 up with recommendations that were revenue neutral,
17 and they were revenue neutral not just in a broad
18 sense but in a very narrow sense. They were revenue
19 neutral within the two major business taxes that
20 corporations are faced with inside of Pennsylvania,
21 and that is the corporate net income tax and the
22 capital stock and franchise tax.

23 There were no other taxes that we had an
24 opportunity to look at or to review. We didn't have
25 an opportunity to review property taxes or any other

1 type of revenue source. It was revenue neutral only
2 within those two kinds of taxes.

3 And in addition, we didn't have any
4 opportunity to make recommendations on cuts of
5 expenditures or anything else that might save the
6 Commonwealth some money. It was a very narrow
7 charge, and so we operated within that very narrow
8 charge.

9 We also did not have an opportunity to take
10 at great length a look at what is called dynamic
11 modeling, and dynamic modeling is a pretty simple
12 concept. It is hard to quantify, which is one of the
13 reasons we didn't do it in a lot of detail, but it is
14 a simple concept.

15 If I told you that I was going to reduce
16 your corporate net income tax rate by half, chances
17 are you are going to increase economic activity
18 within the State. When you do that, you will
19 increase jobs; you will increase property, plant,
20 et cetera. And the fact of the matter is that your
21 hope is you are going to increase ultimately the tax
22 base, because you have increased economic activity;
23 you are going to increase payroll, and hence
24 individual income taxes; you are going to increase
25 sales taxes, because people are going to bring in

1 more product, et cetera.

2 It is a very easy sort of understandable
3 concept; it is difficult to quantify. So as a
4 result, we look at it. The assumption was, if we
5 were going to cut a rate, you would cut revenue
6 proportionately. Not a fair assumption, but it is
7 one that we had to make.

8 Another thing I want you to keep in mind is
9 that we heard a ton of testimony about the situation
10 that Pennsylvania found itself in, and it was not a
11 great situation.

12 Secretary Yablonsky, then Secretary of the
13 Department of Community and Economic Development,
14 came before us and I think rightly said that
15 Pennsylvania at the time was faced with some dire
16 economic issues. And I will try to remember the
17 numbers, but my recollection is that we were 50th,
18 the worst State in the Union, for trying to keep our
19 young people in this State. They were going out of
20 State to find jobs and to find other things.

21 In addition to that, we were 47th at the
22 time in U.S. job growth. And since that time, the
23 2009 Tax Foundation Study has ranked Pennsylvania as
24 41 out of 50 States in terms of our business tax
25 climate, one of the worst around.

1 And as we have already talked about, the
2 10 percent, 9.99-percent rate, depending on how you
3 look at it, is third, second, or the worst in the
4 country. And if you look at it from a worldwide view
5 and you add all the taxes together, maybe the worst
6 in the world. It is a very tough tax environment to
7 operate in.

8 So revenue neutral meant, in my opinion --
9 and if you have an opportunity to take a look at the
10 report, if you look at item 24, I say this -- revenue
11 neutral meant that you had a bad situation, one where
12 Pennsylvania was lagging behind other States, and we
13 had to be revenue neutral, which meant, as Joe
14 indicated, you pushed some money around. You created
15 some new winners and some new losers, but I'm not
16 sure that you helped the kind of situation that you
17 really wanted to help.

18 Now, the commission was tasked with coming
19 up with recommendations, and we did it. And you had
20 some very bright people. These guys know taxes
21 better than I'll ever know or frankly want to know,
22 and we had these guys come up, and myself included,
23 with some good recommendations.

24 Before I go there, I have one other comment
25 to make. We heard testimony from a group called

1 PA 21, the Pennsylvania 21st Century Tax Project, I
2 think it was called. They had some of the same kinds
3 of people -- leaders in business, leaders in
4 accounting, leaders in government, leaders in labor
5 -- on a commission or a group that met for years, and
6 they addressed the same kinds of issues with the same
7 sorts of goals that we did.

8 And just as a comparison, when you look at
9 their recommendations, which they tried to optimize
10 Pennsylvania's business tax structure, when you look
11 at their recommendations, their recommendations, when
12 you look at the same two taxes that we were looking
13 at -- the corporate net income tax and the capital
14 stock and franchise tax -- their recommendations were
15 \$760 million out of balance, meaning that when they
16 looked at what made said, they said that Pennsylvania
17 businesses are being overtaxed and we are going to
18 have to do something about it and we need to
19 stimulate growth. They did try to look at dynamic
20 modeling, et cetera. But the point is, they looked
21 at spending cuts, they looked at other things, and
22 they decided that they had to be \$760 million out of
23 balance, and yet we had to come up with a revenue
24 neutral response or recommendation.

25 Having said all that, we came up with our

1 recommendations, and those recommendations, as have
2 already been explained, were multifold.

3 We did agree to combined reporting. I think
4 combined reporting is a last resort. I think
5 combined reporting is a very unfriendly reporting
6 system. I think it is fraught with all kinds of
7 problems. It think it brings about litigation.

8 California has had combined reporting for
9 decades, and they are still arguing about the
10 fundamental principles, about definitions. I think
11 it is an unfriendly tax environment. I think
12 businesses view it as unfriendly, and I think in and
13 of itself it will keep business from growing and
14 coming into the State, which is the exact opposite of
15 what we had in mind.

16 So what could we do? Well, what we decided
17 to do was there were other positives that we had to
18 bring to bear as part of our recommendations.

19 As Joe and Joe have indicated, and they can
20 explain it better than I, there were things like
21 uncapping net operating losses. And again, these
22 guys can explain it better, but basically it allows a
23 company who has suffered a loss in one year to carry
24 those losses forward but offset income in the next.
25 We talked about the fact that that had to be done.

1 We talked about the single sales factor, and
2 as Joe has indicated, it is a method of apportioning
3 income, and it is friendly to business growth within
4 the State. It means that if you bring a plant -- if
5 you decide to build in this State, you are not going
6 to be punished for doing it.

7 The old system or the system that exists
8 where you have three factors -- property, payroll, as
9 well as sales -- if you bring equipment and jobs into
10 the State, it increases the factors, and therefore,
11 it increases the amount of tax that you are going to
12 have on your income in this State. We said that had
13 to be adjusted, and we recommended a single sales
14 factor.

15 Most importantly, we recommended a
16 significant cut in the CNI tax rate. It had to be
17 done. We were the worst in the country, in my
18 opinion, and we had to do something significant.

19 The recommendation of the commission was
20 ultimately somewhere between 6 and 6.99 percent, and
21 I got to tell you, there was an extremely strong
22 feeling that that had to be brought down much closer
23 to 6 percent.

24 If it was not done, the combined reporting,
25 in my opinion, in and of itself would hinder the

1 growth of jobs, of the economy, of business in
2 this State. So that recommendation was made as
3 well.

4 Now, the critical component of that or the
5 critical factor in all of that is what I want to read
6 to you. I want to read you a quote from the
7 commission's recommendations, and what we said was
8 that those recommendations were, and I quote,
9 "presented as a comprehensive plan designed to both
10 comply with the constraints of, and achieve, the
11 goals established by, the Executive Order [which
12 created it]. The Commission endorses the tax"
13 recommendations "contained in this plan as a package;
14 however, it does not endorse any of the
15 recommendations individually."

16 In other words, what you can't do -- this
17 isn't a smorgasbord. This was a very tough thing for
18 a lot of incredibly bright people to come up with.
19 It was a compromise. Their compromise is -- I didn't
20 like it all. I dislike -- if I haven't said it yet
21 -- I dislike combined reporting. I think it is a bad
22 thing.

23 Now, having said that, it was a compromise
24 that we came up with. If anybody ever says that you
25 can take combined reporting -- and that was the

1 commission's recommendation -- and doesn't in the
2 same sentence include a significant reduction in the
3 CNI tax rate, the uncapping of NOLs, single sales
4 factor -- you have to go through the recommendation
5 -- they are wrong. That is not what we recommended,
6 and frankly, I can guarantee you, because I was on
7 that commission, I don't know what the final vote
8 would have been but I can guarantee you, it would not
9 have been unanimous, because that was as far as I was
10 willing to go.

11 And I still think there are significant
12 issues, but it was what we were charged with, it was
13 within the confines of the Executive order, and we
14 did our best within that Executive order. But you
15 cannot pick and choose.

16 I would be happy to answer any questions.

17 CHAIRMAN SAYLOR: Thank you.

18 Before I go to the members for questions,
19 I would like to ask, Joe, if you don't mind --
20 Mr. Joe Bright -- to explain, not only to the members
21 but to those who are watching on TV, because some of
22 us who are around understand taxes; others don't
23 understand what the NOL is, what is single sales
24 factor and what does it mean, and if you could
25 explain that, Joe.

1 MR. BRIGHT: Sure. Those are two topics.

2 Let me take them one at a time. First, NOL.

3 NOL is, I believe, initials for
4 net operating loss, and what it means is, what it
5 refers to is that a taxpayer -- in this case, a
6 corporation, because that is what we are talking
7 about -- loses money in year 1 from operations.

8 Most tax systems allow you to offset money
9 you make in year 2 with the loss that you suffered
10 in year 1, and the reason for doing that is not out
11 of charity to business; it is to make the rate
12 uniform.

13 If a taxpayer loses \$10,000 in year 1 and
14 makes \$20,000 in year 2, then for that 2-year period,
15 if you do not allow an NOL carryforward, the real
16 rate is 20 percent, not 10 percent.

17 So the objective here is to make the stated
18 rate -- which in our case is 10 percent, rounded up
19 from this silly 9.99 -- the objective is to make that
20 rate uniform across a longer period of time than the
21 arbitrary 1-year accounting period.

22 You cannot administer an income tax unless
23 you have an accounting period. Otherwise, you would
24 never close the books and there is never any result.
25 So you have got to chop it up, and it could be on the

1 phases of the moon; it could be anything. We do it
2 on a yearly basis, and usually a calendar year but
3 not necessarily. But that can produce the kind of
4 distortion that I just mentioned.

5 So most systems allow NOL carryforwards, and
6 again, the purpose is to achieve a real honest to God
7 rate over more than one accounting period. That's
8 the purpose of it.

9 Single sales factor. When you are talking
10 about a tax on a corporation, you can talk about
11 three key decisions: what is it you tax, and how much
12 of the thing that you tax are you going to tax, what
13 percentage, and then the rate.

14 For example, we are taxing Federal taxable
15 income on a separate company basis in Pennsylvania.
16 That is point one.

17 Point two, if a corporation does all its
18 business in Ohio, it is a no-brainer that
19 Pennsylvania cannot tax any of it. The U.S.
20 Constitution will not permit it.

21 Well, how about if it does part of its
22 business in Pennsylvania and part in Ohio? The
23 answer is, Pennsylvania gets to tax part of it. And
24 the same thing with Ohio. This is a neutral
25 principle. It applies to every State, and it is

1 rigorously enforced by the U.S. Supreme Court.

2 So you have to, as tax accountants and
3 lawyers talk about, you have to allocate an
4 apportionment, which are the technical, magic terms
5 for dividing up the tax base of a multi-State
6 taxpayer.

7 Now, how do you do that? The devil is in
8 the details. There are lots of different ways of
9 doing it. And the systems -- and there are many of
10 them -- of apportioning, allocating and apportioning
11 income among States when you have a multi-State
12 taxpayer, is in a sense a wonderful thing. It puts
13 the children of tax accountants and lawyers through
14 college, because there is a lot of fight and a lot of
15 discussion and a lot of argument. Having said that,
16 it is an important economic point.

17 The traditional way of doing it, traditional
18 going back to after the Second World War, is on a
19 three-factor apportionment formula. So we have got
20 now a taxpayer doing business in both Pennsylvania
21 and Ohio, and we are trying to figure out how much
22 Pennsylvania taxes.

23 Net income is not a thing; it's a number.
24 You cannot say the net income is there, it's over
25 there, it's over there. It isn't anywhere; it's on

1 an accounting sheet. So you have got to figure out
2 how you whack it up.

3 Three-factor apportionment takes items of
4 tangible property in Pennsylvania, over all tangible
5 property, and tangible property consists of real
6 property and buildings and furniture and whatnot.
7 That is one item.

8 The second item is payroll, payroll
9 attributable -- and that is the magic word; there is
10 a lot of lawyer behind that -- attributable to
11 Pennsylvania over all payroll. And sales are gross
12 receipts; the same thing.

13 Now, in the traditional model, you take
14 those three -- we call them factors -- add them
15 together, divide by 3, and that's the fraction. That
16 is how much Pennsylvania gets to tax.

17 Now, that is not exactly what we do; that is
18 what we used to do. You can weight any of those
19 factors more or less as you in your judgment as
20 Legislators, because you are the guys who make the
21 rules, choose.

22 Right now, we heavily weight the sales
23 factor on the theory that most of the money is made
24 where the market is. That is the judgment that is
25 being made. It also has the effect, as Mike Cortez

1 alluded to, of reducing the impact on a taxpayer that
2 has a lot of plant and equipment in Pennsylvania.

3 So our taxpayer that is doing business both
4 in Ohio and Pennsylvania, has an office in Ohio but
5 its only plant is here in Pennsylvania -- big,
6 expensive plant; lots of machinery and so forth --
7 and let's just assume that it sells all of its
8 product to Ohio customers and nothing to
9 Pennsylvania, if you have a single sales factor,
10 it pays no tax. That is the effect of your doing
11 that.

12 It cuts two ways. The same set of facts.
13 Flip it in Ohio, we get all the tax under a single
14 sales factor.

15 So single sales factor is moving from
16 heavily weighting one, and it is usually the sales
17 factor that is heavily weighted, to exclusively
18 apportioning the income based on sales. That is what
19 it is about, and it is all under this rubric of
20 allocation and apportionment, or more casually,
21 dividing income of a multi-State taxpayer.

22 Is that responsive?

23 CHAIRMAN SAYLOR: Very good.

24 MR. COTTONARO: May I just embellish a
25 little bit these two points, because I view them

1 really as very strong competitive factors.

2 In the context of the Commonwealth, we have
3 many large industries that are very cyclical in
4 nature. That is to say, they have good years and bad
5 years. They have profitable years and lost years.

6 Almost all the States allow that to be
7 averaged out over years, and that is what the NOL
8 allowance does. And so it is very competitive out
9 there in the context of allowing a company to average
10 its good and its bad. That is what the standard is
11 in the country. It is not the standard in
12 Pennsylvania.

13 Single sales factor, again, is a competitive
14 factor. Traditionally, when you add jobs, expand
15 your place of business, it is treated negatively in
16 our system, and yet we bring in jobs, payroll and
17 assets, and that helps this Commonwealth.

18 Payroll, the personal income tax, and the
19 local governments rely a lot on taxing payroll. On
20 assets, it is a productive capability that enables
21 employment. Also, at least in real property in
22 Pennsylvania, it is an element of support, mostly for
23 the school districts in the Commonwealth.

24 So single sales is a competitive advantage
25 being employed by a growing number of States that

1 encourage rather than discourage job growth in the
2 Commonwealth.

3 So as I said, I viewed both of these
4 elements, when we talked about them in the
5 commission, as better enabling the State to compete
6 with not only neighboring States but with the growing
7 number of States throughout the nation.

8 CHAIRMAN SAYLOR: Thank you.

9 MR. COTTONARO: Thank you.

10 CHAIRMAN SAYLOR: As we go through, you guys
11 can jump in as the members ask questions. You can
12 all three answer the same question if you have
13 different aspects to your company. So I would
14 appreciate that.

15 I want to recognize Representative
16 Jerry Stern, who has joined us from Blair County
17 while the testimony was going on. Welcome,
18 Jerry.

19 And also, I would like to start off
20 questioning with Representative Scott Hutchinson of
21 Venango. No questions? You got that taken care of.
22 Okay.

23 Representative Denlinger.

24 REPRESENTATIVE DENLINGER: Thank you, and
25 thank you again for your testimony.

1 First a short question, and then a more
2 involved one.

3 In the discussions that you had, you
4 mentioned business tax was the topic. Obviously
5 a lot of business activity in this State is taxed
6 under the Sub S provisions and taxed at the personal
7 rate.

8 Was that also part of this discussion, or
9 was that kept off the table?

10 MR. COTTONARO: That was part of the
11 commission's discussion. In fact, it is addressed in
12 the commission's report.

13 And my conclusion, from memory on the
14 discussions around that, was really on an element of
15 fairness and a sense of what is happening in the
16 country.

17 The spread between how a business that could
18 qualify for a Sub S is taxed, the personal rate and
19 the corporate income tax rate, as I recall, was the
20 widest spread in the country.

21 And so in the context of trying to drive the
22 rate down, the corporate income tax rate down as low
23 as possible, Mike had mentioned there was discussion
24 between 6 and 7 percent with the expectation that it
25 would be more approximate to the 6 than to the 7,

1 there was a conclusion reached to add basically
2 1 percent to what we refer to as the Sub S rate as a
3 enabler to drive the corporate income tax rate down
4 and to provide a little more approximation of what is
5 occurring out in the country.

6 There is an interesting aspect in my own
7 mind to the Sub S. It is driven by the number of
8 shareholders that you have, whether you can qualify
9 or not qualify, as opposed to the nature of the
10 business or the size of the business. So if you are
11 a company, like the company I work with where we have
12 more than 100 shareholders, you just can't qualify
13 for that. You could have a business that is doing as
14 well or better, that is more closely held, that could
15 qualify for it.

16 So I think there are a lot of dynamics with
17 the Sub S. There is a wide array of smaller
18 businesses, and much like we do in a variety of
19 areas, you have to pay special attention to that,
20 because you have to nurture that, you have to be
21 sensitive to their particular plight. Other
22 companies are more in the market range of their
23 business dynamics, and perhaps there was an
24 opportunity to be a little more equal in the
25 treatment.

1 And I think if one thing in my mind the
2 commission didn't do was make that distinction, that
3 sensitivity to the two types. It focused too much
4 just on the number of shareholders that you have,
5 not the nature of the business that you are
6 conducting.

7 MR. BRIGHT: Do you want to go ahead?

8 MR. CORTEZ: Yeah; just a quick comment on
9 that.

10 As Joe indicated, the commission reached a
11 recommendation that in essence we added 1 percent at
12 the entity level to a pass-through entity, a Sub S
13 and other pass-throughs. There are other kinds of
14 pass-throughs. But we reached that conclusion that
15 we would add that 1 percent, and it is a great
16 example of what I said in my opening statements.

17 This set of recommendations was a set of
18 compromises. There were those on the commission who
19 really didn't like that, that they felt one of the
20 competitive advantages that Pennsylvania had was a
21 relatively low personal income tax rate.

22 Yet, when we looked at it in total and you
23 tried to figure out how we would achieve our goal of
24 trying to get close to revenue neutrality -- by the
25 way, we didn't quite get there, but we came real

1 close -- one of the things that we determined
2 was that that 1 percent could be added to a
3 pass-through.

4 But I got to tell you, I can remember one
5 Commissioner in particular who did not like that
6 recommendation, only agreed to it in the combination
7 of all the things that were in the package. And it
8 was a tough set of discussions and one that, as you
9 look back, and I'm not sure how I would vote again;
10 it's a real tough question, increasing. In essence
11 you are increasing, in my opinion, the personal
12 income tax rate for those who participate in a Sub S.

13 MR. BRIGHT: Could I offer an explanation of
14 what tax and accounting people are talking about when
15 we talk about Sub S?

16 Sub S is a legislative response to double
17 taxation. Sub S refers to a subchapter in the
18 Internal Revenue Code.

19 Generally speaking, the pattern of Federal
20 income taxation in most States is that a corporation
21 is taxed as an entity, and then when money is
22 distributed in the form of dividends to a
23 shareholder, it is taxed a second time.

24 So the same stream of earned income is being
25 taxed twice. That has been identified for 60 years

1 as an unattractive feature of United States taxation,
2 but it is still there.

3 After the Second World War, the critics of
4 that system tried to alleviate it to eliminate that
5 double taxation, and it resulted in a partial
6 elimination for a corporation that fell within
7 Subchapter S of the Internal Revenue Code, where you
8 can make an election to be treated as a partnership,
9 thereby eliminating the corporate level of taxation,
10 and the shareholders are treated as partners, and
11 they pay tax directly but only once. That's what is
12 going on.

13 Most States followed suit. This State
14 followed suit under, Governor Thornburgh I think
15 first put it in.

16 Pennsylvania's is a little bit different,
17 but it is essentially the same model. That is, you
18 do not pay any corporate net income tax if you are,
19 we call them S corporations, and the shareholders
20 pay personal income tax presently at the rate of
21 3.07 percent as a flow-through, as a partnership.
22 The same thing; it follows the pattern of a
23 partnership.

24 I am a partner in a partnership, so
25 Wolf Block, my partnership, does not pay corporate

1 net income tax; it doesn't pay capital stock tax.
2 It's not supposed to. The partners, me and my
3 partners, pay on our earnings personal income tax and
4 a similar model for Federal purposes. So that is
5 what we are talking about.

6 Now, the question then that we are getting
7 to here is, granted that that is how we came to where
8 we are; do we like it where we are here in
9 Pennsylvania, and should any change be made?

10 When you look at the cost being charged to
11 doing business in corporate form, 10 percent, or you
12 could say -- and this is grossly oversimplifying it
13 -- 13 percent, 10 plus the distributions on the
14 dividends, that is a considerable oversimplification
15 as compared to 3 percent in a partnership or an
16 S corporation form.

17 And we all know that small businesses are,
18 generally speaking, the drivers of jobs in the
19 economy. They hire the most people. They produce
20 more of the economic benefit. So if you lay another
21 layer of tax on them, you might inhibit that. You
22 got to wrestle with that. That is what the
23 discussion is about.

24 REPRESENTATIVE DENLINGER: Thank you for
25 those explanations.

1 And I remember, I followed your progress
2 back at the time the commission was operating, and
3 I really thought the Governor's mandate that you
4 stick with the revenue-neutral concept was a real
5 handcuffing of the effort that you were trying to
6 get into.

7 And clearly what we need to do is put all
8 ideas on the table and make Pennsylvania, you know, a
9 model State in terms of our competitiveness and our
10 business attractiveness, our business generation
11 ability.

12 The Governor didn't take that effort, and
13 frankly, as a bystander watching, it looked like a
14 mandate to make it look like we were doing reform
15 when in essence we had taken some of the
16 opportunities out of the mix. But that is just a
17 statement of personal opinion.

18 The last question I have, we are into, you
19 know, some of the explanations, we have different
20 ideas, and combined reporting, of course, is what we
21 expect the Governor to propose next week when he
22 makes his address. And the number that I have heard
23 thrown out is about \$500 million in additional
24 revenue to the State. That number can be challenged.
25 I do challenge it somewhat personally.

1 But just parking that number there for a
2 moment, clearly that means that additional tax will
3 be levied on activity not currently taxed, and where
4 I am still a little confused, and I am going to read
5 the Cline report, as Mr. Cortez recommended, but can
6 you in laymen's terms to some degree explain under
7 the unitary group how, based on ownership across
8 related entities, the flow of equity between those
9 entities, more tax will be derived? Can you give us
10 -- I know I am asking for the world here -- a short
11 explanation of how that results in \$500 million more
12 to the State?

13 MR. COTTONARO: I will start out with
14 answering your question. But you have in the
15 financial world combining all entities into one set
16 of numbers -- one balance sheet, one income statement
17 -- and we are pretty accustomed to seeing those
18 results.

19 So, for example, the Hershey Company. We
20 have companies in different countries, but what we
21 released, we released Tuesday morning our results,
22 and they were the combination of the results of
23 companies that we have in Mexico, Canada, the
24 United States, and other countries. So it is a
25 formal process. It has its accounting rules

1 around it.

2 What combined reporting does or attempts to
3 do is something similar to that. Instead of just
4 looking at each single company, you look at all of
5 your companies and you attempt to report the income,
6 the taxable income, for all of those companies.

7 Now, they all can -- in general, there are
8 two terms that are used in this effort. They use
9 "water's edge" as a terminology, and they use more of
10 a global notion.

11 The water's edge, what they are referring
12 to is just to look at entities that are part of --
13 that have the same ownership, that are within the
14 United States. And the idea then is to combine,
15 consolidate those entities that are in the
16 United States that have these commonalities --
17 ownership is the most visible one -- that allows
18 you then to arrive at a consolidated taxable
19 income.

20 Others look at a worldwide consolidation,
21 and then they expand that to include entities with
22 this common ownership that are outside of the
23 United States, and therein lies a lot of the
24 complexities.

25 If you are familiar with the accounting

1 rules, they have all the standards and processes that
2 go around it, and so, too, in the tax rules.

3 Now, within the United States, you have one
4 set of tax rules. If you expand it to include all of
5 your entities, then you basically have companies that
6 are reporting one way in their country outside the
7 United States and then have to convert that to the
8 U.S. rules within the country.

9 A lot of the complexities that sit around
10 that follow from the fact that you are attempting to
11 take different businesses, different entities with
12 different rules, and put them under one set of rules
13 and then combine them to arrive at a base, the
14 taxable income base.

15 It is an expanded base, and so in that
16 context you would, if everything else stayed the
17 same, you would expect to pay more tax in that. That
18 is the point that makes it very uncompetitive for a
19 State that has an existing uncompetitive taxing
20 structure.

21 REPRESENTATIVE DENLINGER: Okay.

22 MR. BRIGHT: Could I add a few comments to
23 that?

24 When you go to combined reporting, you are
25 going to have winners and losers and no change.

1 Let us go back to -- and I will modify my
2 example -- we have two commonly owned corporations,
3 one in Pennsylvania and one in Ohio, and let's say
4 they both make exactly the same amount of money and
5 they have the same sales. If you combine their
6 income, all else being equal -- and that is an
7 important qualification -- you get no change.

8 Now let's say that Loser Corp is in
9 Pennsylvania and Winner Corp is in Ohio. So up until
10 the change, you are taxing Loser Corp. When you add
11 together Winner and Loser, you get a net plus. That
12 is a revenue increase.

13 REPRESENTATIVE DENLINGER: Okay.

14 MR. BRIGHT: It flips. If Loser Corp is in
15 Ohio and Winner Corp is in Pennsylvania and you do
16 combined reporting, your revenues drop. So in doing
17 the estimate, it is really important to look at all
18 of that, because you are going to get both, just in
19 the nature of things.

20 And as I mentioned before, and as Cline goes
21 into some detail in his analysis here, it matters a
22 lot what you do with those NOLs. That has a big
23 impact.

24 And in looking at those revenue estimates,
25 you should look at them very carefully, bearing in

1 mind, again according to Cline, one State in the
2 United States actually measured the effect, and that
3 was Minnesota, and the short to interim consequences
4 of the move produced no increased revenue and no
5 decreased revenue.

6 It could be different here, but the question
7 you want to ask is, if so, why?

8 MR. CORTEZ: And one question. I want to
9 sort of flip your question -- or one comment. I want
10 to flip your question around a little bit.

11 Combined reporting, as we talked about
12 earlier, is a relatively complex set of rules, and it
13 is not the case that what you would do is take
14 existing infrastructure, existing knowledge within
15 the Department of Revenue, for example, and simply
16 flip it over and say, we are going to look at
17 combined reporting.

18 I think it is fair to say that there is a
19 knowledge base that has to be built up. There may be
20 additional people, additional -- it is not simply the
21 case that you change the reporting system and don't
22 have additional expenditures on the Commonwealth
23 side.

24 I am not talking about the revenue
25 generation. I think these two gentlemen have done a

1 better job than I can. I just want to make sure you
2 understand that it is a complex system that may very
3 well require additional resources on the Commonwealth
4 side to ensure that they accurately and adequately
5 police, enforce, and understand the system.

6 REPRESENTATIVE DENLINGER: And would it be
7 fair to say that one of the byproducts of that would
8 be litigation with corporations?

9 MR. CORTEZ: I think that is, and again,
10 these gentlemen probably know better than I, but I
11 would tell you that one of the hallmarks, at least
12 anecdotally, of a combined reporting State is
13 litigation, that there is a tremendous amount of
14 litigation, especially up front, to determine things
15 like, what is a unitary group? There are a lot of
16 things that have to be determined, and I think it is
17 fair to say that litigation can be expected.

18 REPRESENTATIVE DENLINGER: Okay. Thank you,
19 Mr. Chairman.

20 MR. COTTONARO: May I just embellish a point
21 that Mike made, because it was part of the discussion
22 when we did talk about combined reporting during the
23 commission's deliberations that was chaired by the
24 Revenue Secretary.

25 We did make the point that it does bring in

1 a different skill set for Revenue to administer and,
2 in that context, would require training, would
3 require rulemaking, all of which carry with it a
4 fairly long lead time.

5 And so in the context of the discussions
6 around combined reporting was this notion that there
7 was no immediacy to the enactment but that it needed
8 and required these skills to be learned, not only
9 from the taxpayers but also on the part of Revenue,
10 and that if it was going to be successfully
11 implemented, that the rules that were going to be
12 used by Revenue had to be disseminated through a
13 process that is, by its nature, somewhat
14 time-consuming.

15 So there was always the thought that that
16 would occur further out than the enactment of the
17 package.

18 REPRESENTATIVE DENLINGER: Thank you.

19 CHAIRMAN SAYLOR: Thank you.

20 I would like to recognize who has joined us.
21 Representative John Evans has joined us since we
22 started as well, and for questions, I would like to
23 recognize Representative Pickett.

24 REPRESENTATIVE PICKETT: Thank you,
25 Mr. Chairman.

1 It's pretty risky for me to ask a question
2 after my friend, Representative Denlinger, who is
3 certainly a very knowledgeable man in this area. But
4 I was the business owner who was always hoping my
5 accountant was trying to do the best he could for me,
6 so that is why I entered this.

7 But I did have one of my business owners in
8 my area say that if you go to Harrisburg, Tina, one
9 of the things I really hope is accomplished while you
10 are there is that you change the capital stock and
11 franchise tax. That seemed to be the one that he
12 really hated the most. So he is always in the back
13 of my mind when I hear these discussions.

14 And certainly Mr. Cortez talked about the
15 fact that he really didn't think that this study did
16 a very good job of overall looking at, how can we
17 make Pennsylvania more competitive; how do we create
18 more jobs and actually grow revenue in Pennsylvania
19 instead of keeping it neutral, which isn't
20 necessarily a great thing to look at.

21 So then I come to my question of, well, why?
22 We have heard about combined reporting since we have
23 been here. Our caucus has kind of spent a lot of
24 time trying to promote the other factors that I
25 suspect Mr. Cortez was referring to when he said

1 there are other ways to help business in
2 Pennsylvania.

3 Is it a way to say that we have a lower
4 corporate tax to be perhaps more attractive on the
5 front to people, or is there a thinking that because
6 you are looking at, with combined reporting you are
7 pulling in all the locations of a corporation, does
8 that by any way discourage people, if you are going
9 to expand or build another plant or whatever, there
10 is really no advantage to leaving Pennsylvania with
11 that opportunity? Leave it here; you are going to
12 have to use it in your Pennsylvania taxes anyway?

13 Does any of that -- I mean, I am back to my
14 why: Why would we even want to consider combined
15 reporting?

16 MR. BRIGHT: The people who advocate
17 combined reporting, or let's say the reasons for
18 doing it are a feeling that economically, the real
19 economic unit is not a single corporation but is
20 related corporations. That is what's behind all
21 this.

22 And under the present system, it is possible
23 for a corporation to form an affiliate out of State
24 which would lend money in State. That has the effect
25 of reducing your tax base here. You eliminate that

1 in combined reporting.

2 The critics of separate-company taxation
3 think that that is a feature of separate-company
4 taxation that should be eliminated, and their point
5 is, which you can accept or reject, but the point is
6 that it leaves too much ability in the hands of
7 taxpayers to structure their tax base in Pennsylvania
8 to reduce taxes.

9 Of course, they are going to do that,
10 because when you have a 10-percent tax rate that is
11 one of, if not the highest in the country, if you are
12 a tax director and you don't want to get fired, you
13 are going to come up with ways to reduce that tax.
14 That is what you are there for, and the treasurer
15 will demand it of you, and if you don't produce,
16 somebody else will. And I'm talking now about
17 lawful, proper methods that follow the law and are
18 correct but have the effect of reducing the tax base.
19 That is what you would expect; that is what the
20 shareholders expect.

21 So you have to make a judgment, is it okay
22 to leave that system in place, or do we want to say
23 that we are going to take that off the board and,
24 therefore, related corporations will not be able to
25 make that restructuring?

1 And the costs, you have heard some of the
2 costs. The costs are a tremendously more complicated
3 system, an uncertain revenue effect, notwithstanding
4 the projections that people often make, and the
5 perception that it is a burden on business to deal
6 with this.

7 Now, the commission was willing to volunteer
8 for that and recommend that, if the rate were cut by
9 40 percent. Absent that major rate or something
10 close to it, I am certain that some of the
11 Commissioners would have jumped off the train, maybe
12 all of them. Who knows.

13 Is that responsive?

14 REPRESENTATIVE PICKETT: Thank you.

15 MR. CORTEZ: Just to expand on that a little
16 bit, and to be fair to the Executive order which
17 created the commission, there was a discussion, if I
18 recall correctly in the Executive order, about
19 looking at ways to expand the base and lower the
20 rate, reflective of your earlier comment.

21 And one of the ways, one of the principle
22 ways, one of the things that combined reporting does
23 is it expands the base. The flip side of that in
24 conjunction with the order and also in conjunction
25 with revenue neutrality and the fact that you have to

1 be fair to the businesses in Pennsylvania, you expand
2 the base, it allowed us to lower the rate. So that
3 it allowed us to get to a point that was within the
4 Executive order, and to some extent, was able to
5 lower the rate. I'm not sure that it had the net
6 effect that one would want, but it did comply with
7 the Executive order.

8 Now, one of the other things to keep in
9 mind, as Joe indicated, there are legal, lawful
10 ways to try to reduce taxes in a
11 separate-company-reporting State such as
12 Pennsylvania.

13 I would only remind this committee that
14 those kinds -- if the tax rate in Pennsylvania was
15 1 percent, which it is not; it is 10, the tax
16 playing devices that you would jump through, the
17 hoops that you would jump through, become much less
18 important. It is a 1-percent base or a 1-percent
19 tax, and saving that 1 percent, I'm not saying
20 companies wouldn't try to do it, but the impact is
21 much less.

22 When you have the highest corporate net
23 income tax rate in the country, then the need to do
24 things to try to reduce that tax rate becomes more
25 critical. And so one of the things that our current

1 tax rate requires -- as Joe indicted, people might
2 lose their job if they didn't -- is if you go through
3 some expanded tax planning to try to figure out ways
4 to reduce your tax burden so that you can stay
5 competitive with other States and other countries and
6 the tax burdens that they have.

7 REPRESENTATIVE PICKETT: Thank you.

8 When you say that Minnesota found no
9 difference in their study, are you referring to
10 simply their revenue difference or are you also
11 including job growth?

12 MR. BRIGHT: I am repeating what Cline said
13 in his monograph, and what I understand him to be
14 saying is that Minnesota analyzed the actual revenue
15 effect -- just revenues, so-called static effect --
16 of adopting combined reporting. The projections were
17 for an increase in revenue. The actual fact was, at
18 least for that period that they analyzed it, no
19 change.

20 REPRESENTATIVE PICKETT: Thank you.

21 Thank you, Mr. Chairman.

22 CHAIRMAN SAYLOR: I want to recognize the
23 presence of Representative Craig Dally, who has
24 joined us also, and recognize Representative Grove
25 for questioning.

1 REPRESENTATIVE GROVE: Thank you,
2 Mr. Chairman.

3 Thank you for coming today, and I read in
4 your bio, Mr. Bright, that you were a lieutenant in
5 the Army, so I just wanted to thank you for your
6 service.

7 Mr. Cottonaro, you brought up the global
8 economy, which is crucial, and when we were debating
9 policy, we had such a focus on ranking the States
10 where we are at. We never really had that input
11 of where we are ranked in the entire global
12 perspective.

13 Hershey Foods, of course, has a huge global
14 footprint based on the business you do, and one of my
15 questions was, actually, how is Pennsylvania ranked
16 in the global market? It is something that I will
17 definitely agree with you on your opinion, probably
18 one of the bottom ranked.

19 Who has probably, in your opinion, the best
20 pro-business political entity in the globe, and any
21 insights on why that is?

22 MR. COTTONARO: The best in the globe.

23 REPRESENTATIVE GROVE: The best in the
24 globe.

25 MR. COTTONARO: That's a broad question.

1 REPRESENTATIVE GROVE: Yes.

2 MR. COTTONARO: I will tell you, maybe the
3 best way for me to answer that is what I observe
4 going on outside the United States, and what we have
5 seen in the last decade is a continual shift away
6 from income taxes, at least at the high end.

7 Over a decade ago, we were the lowest in the
8 world, and over time we have slipped to being the
9 highest in the world. You will often hear Japan
10 ranked a little higher, but my qualifier earlier on
11 was if you took a Pennsylvania State rate, added it
12 to the Federal rate, we would have the highest tax
13 rate in the world.

14 What I see occurring are countries
15 recognizing that taxes, not on a standalone basis but
16 in the context of a variety of indicators, of
17 competitiveness, lowering their corporate income tax
18 rates.

19 They do it with the belief that that will
20 allow them to attract and retain jobs and that they
21 recognize the point I had made earlier, that with
22 those jobs come the revenue from other sources,
23 whether it be a personal income tax, related
24 businesses that are then, their profitability is
25 enhanced.

1 And you do see this aspect of taxes of a
2 competitive nature. Canada has a plan in place to
3 significantly reduce their corporate income tax rate
4 over the next several years. Mexico, 2 years ago,
5 reduced their rate. The emerging countries have been
6 focusing on rates that are very competitive in the
7 world.

8 And so there is the idea that, again, it
9 plays a role. The tax rate is an indication of the
10 climate, and it is a very obvious one. It is a bit
11 of a barometer, if you will, on that point.

12 REPRESENTATIVE GROVE: Okay.

13 MR. COTTONARO: And the national effort has
14 been to broaden the base; hold the rate. There is
15 some discussion at the national level of reducing our
16 corporate tax rate.

17 In the States, Pennsylvania has always held
18 out, justifiably so, as having a very fair individual
19 income tax system. It is uniform. It is a broad
20 base and a low rate. And that became a bit of a
21 standard, if you will, with the commission, and if
22 you look at the entirety of the report, it was really
23 an effort to broaden the base, significantly lower
24 the rate, and treat businesses more fairly amongst
25 themselves.

1 So in that context, it had a strong goal.
2 It may have had some limitations on achieving that,
3 but the goal was, I think, a very, very good goal to
4 look to.

5 REPRESENTATIVE GROVE: Okay.

6 MR. COTTONARO: And so globally, as I said,
7 rates have been uniformly coming down. We are
8 globally the highest. So if you are a Pennsylvania
9 business, you have globally the highest rate both in
10 the context of your Federal rate, the highest in the
11 world, and your State rate, probably the highest in
12 the country.

13 REPRESENTATIVE GROVE: Thank you.

14 Mr. Cortez, your company does a lot of
15 business throughout Pennsylvania. You build new
16 facilities all the time. What are the items that you
17 see hampering -- because we have such a fractured
18 government base here; you know, every store is in
19 another different municipality -- what kinds of hoops
20 do you guys have to jump through, and what is that on
21 your base, looking at profit, and trying to maximize
22 that? What can we look at there to try to minimize
23 your costs?

24 MR. CORTEZ: Well, unrelated to taxes, I
25 assume.

1 REPRESENTATIVE GROVE: Yes.

2 MR. CORTEZ: There are -- listen,
3 Pennsylvania is our home base, and Pennsylvania is a
4 very good State to us.

5 There are issues in Pennsylvania that we
6 would love to have addressed unrelated to taxes,
7 whether it is tort reform and the ability to limit
8 certain kinds of lawsuits, et cetera, or it is just
9 streamlining government.

10 Pennsylvania has, I think, the largest
11 number of individual taxing and governing units of
12 any State in the Union, and so if you try to get
13 something done, you oftentimes have to deal with
14 numerous different jurisdictions. And if you have
15 employees throughout the State, you have to deal
16 with, although the Legislature just addressed this
17 last year and did an excellent job, you had to deal
18 with a number of differing taxing jurisdictions and
19 try to figure out who to pay and how much to pay and
20 who the collector was, et cetera. But streamlining
21 the government process in Pennsylvania would be
22 incredibly helpful.

23 And again, I don't want to underestimate.
24 Taxes, and again, I sat in the commission hearings,
25 and we had at least one person that I can recall that

1 indicated that taxes were not a factor in determining
2 how businesses grew or where they expanded to, and I
3 can tell you unequivocally that he must have been
4 talking about some business other than mine, because
5 we look at those factors and they are important to
6 us. They are a cost of doing business. So taxes are
7 an incredibly important limitation on growth.

8 REPRESENTATIVE GROVE: Okay. Thank you.

9 CHAIRMAN SAYLOR: I would just like to
10 recognize Representative Helm for some questions.

11 REPRESENTATIVE HELM: Thank you,
12 Chairman Saylor.

13 Having been a small business owner for
14 20-some years, I can relate to business taxes very
15 well. Like I made the statement many times that I
16 thought I was making money until every quarter when
17 I paid my taxes, I was right back where I started
18 from.

19 And I also represent a district that has a
20 lot of small businesses, and unfortunately, over the
21 last couple of years, some of them are not making
22 it, particularly one very good family-owned business
23 that felt they were forced to sell out because they
24 would either have to sell or they were going to go
25 under.

1 So this is extremely important to me,
2 extremely important to Pennsylvania on a whole. But
3 you did bring up the subject of the NOL carryforward,
4 which right now I think is a detriment to business,
5 and if we could extend it over years, I think it
6 would benefit businesses coming into Pennsylvania and
7 staying.

8 You also mentioned the single sales factor
9 and that States are adopting this plan, but unless I
10 missed it, what States do you feel would be the model
11 to look at for that?

12 MR. BRIGHT: To look at for a single sales
13 factor?

14 REPRESENTATIVE HELM: I'm just curious to
15 study that a little bit more.

16 MR. BRIGHT: There are several. The one
17 that comes to mind, I think, is Iowa, which I think
18 was the first to adopt a single sales factor. But I
19 think there are others. Off the top of my head, I
20 don't remember.

21 But I don't know that you need that
22 information. We know what a single sales factor
23 does, and you can pretty well compute on a static
24 basis the effect of adopting a single sales factor.
25 And then what you need to do is make the judgment, as

1 that gets you where you want or not.

2 I suppose you can look at the other States
3 and see how their revenues do under that kind of a
4 system and compare them. That, to me, is the
5 relevance of what other States do.

6 Is that responsive?

7 REPRESENTATIVE HELM: My other question was
8 with the Subchapter S corporations and the combined
9 reporting. Can you just expand a little bit on
10 that?

11 MR. BRIGHT: Those -- combined reporting and
12 Subchapter S are complete strangers. They don't have
13 anything to do with one another.

14 REPRESENTATIVE HELM: Okay.

15 MR. BRIGHT: Combined reporting is a method
16 of adding together the tax base of two or more
17 corporations, and an S corp, for tax purposes, is not
18 a corp; it's a partnership. That is to say, we all
19 know it is a corporation, it went to the Department
20 of State and got formed, but it made an election to
21 be treated as a partnership. Or to put it
22 differently, generally speaking, you do not combine
23 the income under a corporate tax of S corporations.

24 MR. COTTONARO: I think what I pick up in
25 your question is, would combined reporting -- was it

1 the intent of the commission to have combined
2 reporting affect Sub S companies, and it was not.

3 REPRESENTATIVE HELM: Okay. And I know you
4 brought that up in the very last of your report, but,
5 I mean, we absolutely have to look at something for
6 the businesses of Pennsylvania, because my district
7 in particular, and I imagine everybody down the line
8 could say the same thing, how we are just getting
9 calls and calls and calls from some of the companies
10 who still exist but their employees are concerned
11 that if we don't do something, their employer is
12 going to go to some other State. I mean, I have that
13 expressed to me weekly. So it is something that we
14 definitely have to look at and address and help
15 Pennsylvania.

16 MR. COTTONARO: Yeah; and I had mentioned
17 that I think one of the, to me, one of the aspects of
18 the commission's work that we weren't as attentive to
19 was the Sub S and the sensitivity in distinguishing
20 the small businesses from the more substantial
21 businesses.

22 But I could see, because we talked about an
23 entity-level tax, where someone would read that and
24 assume that that meant that they were going to have
25 to follow the combined reporting. I think that is a

1 very reasonable conclusion from that and one of the
2 aspects that we should have been more attentive to to
3 allay those concerns.

4 REPRESENTATIVE HELM: Okay. Thank you.

5 MR. CORTEZ: Let me just say something. You
6 sort of sparked a thought that I think it bears
7 repeating. It was something that I had not looked at
8 until I served on the commission.

9 But either one of the Commissioners or one
10 of the individuals providing testimony had asked sort
11 of the rhetorical question about how much of a tax a
12 corporation paid, and the answer was -- and you have
13 to listen to the entire concept -- the answer was
14 zero.

15 In other words, corporations don't have
16 printing presses. They don't go into the back and
17 just print money and then pay a tax with it. What a
18 corporation does, it only has a couple of different
19 avenues. If they have to pay a tax, they either have
20 to increase the cost or the price of what it is they
21 sell, they have to decrease things like wages, or
22 they have to give less to shareholders. That is it.
23 It is an expense.

24 So sort of to your point, the more that
25 businesses pay in taxes, the less competitive they

1 are. It has to have some negative impact somewhere,
2 so that if they are looking at other places that
3 don't have that impact, they could afford to charge
4 less, to provide their employees more, or to give
5 their shareholders more. But the money goes
6 somewhere, and those are basically the three places
7 it can go.

8 MR. BRIGHT: Could I add a footnote to
9 that?

10 An economist, whose name I don't recall,
11 famously said corporations do not pay taxes; they
12 collect them. The question is, who do they collect
13 them from? Are they taking them from the
14 shareholders? from their laborers? from consumers?

15 Economists do not uniformly agree on that.
16 They do agree on the proposition that it goes to
17 something and that the corporation really isn't a
18 thing, it is a legal concept, a very useful and
19 powerful one, but we should not be fooled into
20 thinking that it really exists in an economic
21 sense.

22 REPRESENTATIVE HELM: And I think in a small
23 business, the more taxes you pay, the less employees
24 you have. So that is where the problem lies.

25 Thank you.

1 CHAIRMAN SAYLOR: Thank you.

2 At this point, I would like to recognize
3 Representative Jerry Stern.

4 REPRESENTATIVE STERN: Thanks,
5 Chairman Saylor.

6 Welcome to Harrisburg, Michael. It is good
7 to have you down here.

8 MR. CORTEZ: Thank you.

9 MR. STERN: You shared many of those same
10 stories with me, and so I'm glad you had a chance to
11 share the inside of the commission's partial study
12 and report to this full committee.

13 And I just also wanted to congratulate you
14 on, I hear the word on the street, even in today's
15 environment, that you are hiring employees over
16 there.

17 MR. CORTEZ: We still are.

18 REPRESENTATIVE STERN: Well, that is good.
19 That's a good thing.

20 But we have talked about several things
21 here, and it was mentioned here earlier today, and if
22 you could come about and put together a
23 recommendation for the business community, to make it
24 within -- I understand what the Governor's Executive
25 order did, but that was kind of narrow. But if we

1 could make a -- basically open it up to a whole
2 spectrum to make it easier for Pennsylvania
3 businesses to operate in Pennsylvania without
4 penalizing or picking winners and losers.

5 This whole combined reporting thing, to me,
6 looks like a lawsuit waiting to happen, looks like
7 more litigation for Department of Revenue lawyers
8 picking on Pennsylvania businesses, trying to
9 determine who the winners and who the losers are, and
10 it just looks like a time-constraining thing that is
11 going to impact businesses and those employers that
12 are actually out there putting people to work.

13 In today's environment, with all these
14 layoffs and people being concerned about their job in
15 this economic climate that we find ourselves in in
16 this country, just if any of you would just briefly
17 suggest or give us your thoughts.

18 I know one of the things that Representative
19 Grove was touching on here today is, what else would
20 you do? Well, some of the things we have talked
21 about -- permitting processes. We have talked about
22 maybe some of the rules and regulations that
23 Pennsylvania imposes on businesses that in part
24 really attacks in a different form, in a fee or
25 something else. So it is a combination of things

1 that is a cost of doing business: Who pays those
2 fees? Who pays that tax, that regulation? And how
3 do we free up our businesses in Pennsylvania to be
4 better served to compete in this global economy?

5 That is the bottom line on how we can keep
6 people employed and keep our businesses vibrant,
7 because once they are vibrant, we know that the tax
8 revenues come in, and we find ourselves behind and
9 behind and behind in what the revenues in this
10 Commonwealth are facing right now.

11 So it is a combination, when the businesses
12 are doing well, then the tax flow into the State is
13 doing well. And sometimes I believe in State
14 Government that we just need to put ourselves more on
15 a spending diet than worrying about how to increase
16 our spending habits at the expense of our business
17 community and employees.

18 So any recommendations or final, just as you
19 close up here, thoughts as to how we can make that
20 happen. And if you had a leg to report again, or the
21 Governor's Executive order, if you could do that on
22 your own, what would you suggest in that Executive
23 order?

24 MR. COTTONARO: Well, one aspect that
25 companies, like the company I am with, we do a lot of

1 thinking forward planning, and in that context,
2 predictability is a very important aspect. That is
3 one of the, if you could capture in one word some of
4 the concerns around combined reporting, it would be
5 "predictability" as to how that is going to be
6 administered by a revenue group that is unaccustomed
7 to that.

8 The other sense is competitiveness in terms
9 of a rate. And so it does matter the size, and it is
10 a very clear barometer of an environment. So a
11 competitive rate.

12 A sense of fairness. Everyone likes to be
13 thought that they are being treated uniformly. Even
14 if it is uniformly bad, at least it is uniform. So
15 you look to uniformity.

16 The base in general. Taxing authorities
17 have been working to broaden base in a variety of
18 ways.

19 And so broadening base with a lower rate and
20 a competitive rate in a predictable environment are
21 appealing aspects to a tax system.

22 MR. CORTEZ: And, Jerry, just a couple of
23 thoughts come to mind.

24 I had mentioned earlier the PA 21 Project,
25 which is a project similar to the commission that we

1 all served on.

2 And understand that the commission, I am
3 critical in the sense of the parameters that the
4 commission was put under, but I also understand them.
5 There is a need for that exercise. It wasn't without
6 value; it had a ton of value. But if you were to ask
7 me how to make it better, I would tell you that there
8 is a need to expand the charter, look at things other
9 than the two major taxes, the two major business
10 taxes.

11 There are other revenue sources. There are
12 things that you need to consider. While it is
13 difficult, dynamic modeling, as I talked about
14 earlier, if you lower a tax rate, it is not
15 necessarily the case that you have a proportionate
16 reduction in revenue. You are going to increase
17 economic activity, and you are going to increase
18 revenue, through other sources perhaps, but you are
19 going to increase them. I think that needs to be
20 considered.

21 And there is also an incredible important
22 aspect of revenue, or the flip side of it, and that
23 is expenditures, and if you are going to look at ways
24 to improve the Commonwealth's position, then what you
25 have to look at is not just ways that you bring

1 revenue in but how do you spend the revenue that you
2 get? And I think that comprehensive picture is
3 something that needs to be taken. You have to
4 understand it and you have to look at it in total in
5 order to make a good set of recommendations.

6 I will also tell you that on the ride here,
7 I was talking with a gentleman and we were talking
8 about his company. It is a manufacturing company
9 with a great potential for growth, and what does it
10 need? Well, it needs communication. It needs
11 communication with the Commonwealth. It needs help.
12 It needs to understand what programs are available.
13 What programs are available through the Federal
14 government? How can it get cooperation to try to
15 bring those programs to bear so that they can expand,
16 so that they can create jobs, et cetera?

17 So I would ask again, what is it that we
18 might be able to do? I would tell you that a
19 cooperative program where we share ideas and
20 communication, government with business, would be
21 very helpful, and I will give you one example.

22 I gave the Legislature credit, and it
23 deserved it, for passing legislation last year that
24 streamlined the tax collection process. But another
25 part of that was also the Administration, and DCED in

1 particular really championed that effort as well, and
2 that's the kind of movement that I think we need. We
3 need that cooperation.

4 Business and government are not enemies, and
5 they need not be. The idea of business is to
6 generate jobs, is to generate wealth to not its
7 shareholders alone but to its employees and to the
8 community, and that needs to be kept in mind, and
9 that cooperation, that partnership, I think, is
10 critical.

11 MR. BRIGHT: Could I add a comment to your
12 question? Because this subject isn't complicated
13 enough, let me throw out another issue, and that is a
14 hidden tax on capital in Pennsylvania.

15 We are getting rid of the capital stock tax.
16 That is good. Nobody suggested so far that that
17 should be delayed; that is a good thing. But there
18 is another one, and that's the sales tax.

19 How can that be, you say? The sales tax is
20 what you pay at Wal-Mart or CVS when you buy
21 something. Yes and no.

22 Businesses pay a lot of sales tax. They
23 shouldn't. Every serious student, economist, writer,
24 thinker, that I know of on public policy agrees that
25 businesses should never pay a sales and use tax. The

1 tax should be on the consumer. It is a consumption
2 tax.

3 Pennsylvania is imperfect in following
4 that. We have a manufacturing exemption. So in
5 Joe Cottonaro's firm, when they make candy, the
6 machinery that they make it with is exempt and the
7 purchase of cocoa and other things that they purchase
8 is exempt because it is a sale for resale, but all of
9 their headquarter's equipment is taxable and
10 everything that isn't tied to manufacturing or
11 isn't a sale for resale is subject to a 6-percent
12 haircut.

13 As business's investment in technology
14 increases, as there are more powerful electronics
15 that enable people to do business, the tax on capital
16 in this State is increasing, and it is not exempt and
17 it should be, because any economist will tell you
18 that the distinction between exempting the chocolate
19 or the cocoa that you buy, because it is incorporated
20 into a sale product, and the computer that is driving
21 the human relations department, there is no
22 difference. It is all priced into the product. It
23 has to be. If it isn't, somebody should be fired.

24 My point is this: When you are looking at
25 the impact, people rarely talk about. The commission

1 didn't discuss it, because technically, that is under
2 a different rubric. It is not a corporate tax. In
3 form, it is a sales tax. But in actual operation it
4 is, it is a tax on capital, and therefore, to that
5 extent, a disincentive, particularly for new,
6 aggressive, technologically oriented businesses,
7 because that is where they are putting their
8 money.

9 REPRESENTATIVE STERN: Thank you.

10 CHAIRMAN SAYLOR: A couple of questions from
11 myself.

12 The first question I guess I have is, would
13 you gentlemen suggest in your testimony today, a
14 criticism I have had is, and I heard from the
15 business community as well as a lot of people
16 throughout this State, that we have a Department of
17 Labor and Industry that seems to be really a
18 department of job failure and not creating new jobs
19 in Pennsylvania but rather just disturbingly running
20 them out of the State.

21 Do you believe that there should be a
22 Department of Commerce which would create new jobs in
23 Pennsylvania? Their job is to help businesses to,
24 one, get established in Pennsylvania, create new
25 jobs, and look at these kinds of things that you are

1 talking about today. Would that be a benefit to the
2 business community of Pennsylvania?

3 MR. CORTEZ: As I just indicated in my
4 response to Jerry Stern, it seems to me, I think
5 there is a need for government and business to
6 partner together to try to get access to technology,
7 to funds available to it, to programs, et cetera.
8 And I think anything that the State can do to assist
9 one another in bringing business and jobs and growth
10 into the State is invaluable, and I think a
11 Department of Commerce could get that accomplished,
12 again with the thought that business and government
13 need not be enemies. They can work together to
14 attain a common goal, and I think a Department of
15 Commerce could get that accomplished.

16 CHAIRMAN SAYLOR: It seems to me that in
17 dealing with the different agencies as a State
18 Legislator, the biggest problem I have, not only for
19 the business community that I deal with as a State
20 Legislator but for my own constituents many times who
21 are trying to get information out of the Department
22 of Environmental Protection to the Department of
23 Labor and Industry, is one of detriment -- red tape;
24 a lack of the ability to even know what they are
25 doing over there many times in trying to get the job

1 done. They don't seem to be focused on cooperating
2 and getting it done but rather in, this is the rules
3 and this is what we want to see done and this is the
4 way it is, rather than saying, let's work this
5 problem out; let's solve the problems of, whatever it
6 may be, and make sure that, you know, we are
7 promoting Pennsylvania jobs here many times. Rather,
8 it seems to be more like, well, we want more fees
9 from you; we want more red tape; we want more
10 paperwork; and we never believe you.

11 So it just seems to me that that is one of
12 the problems that we face in this State, and I hear
13 from a lot of companies who, living on the Maryland
14 border -- my district borders the Maryland border --
15 and Maryland's taxes, other than the corporate taxes,
16 their personal income taxes are very high compared to
17 Pennsylvania, but it seems to me we are easily able
18 to attract people to come and buy homes in
19 Pennsylvania across the Maryland border but the
20 businesses tend to stay in Maryland because of the
21 red tape and the efforts of -- the difference in
22 opinion is how you treat businesses. It is not a
23 conflict situation but rather an amicable agreement
24 to work together.

25 We are not, as you said, Mr. Cortez, we are

1 not enemies; we are partners, so I appreciate that
2 comment.

3 The other thing -- and any of you gentlemen
4 -- the Governor has been saying basically that
5 70 percent of the corporations in Pennsylvania do not
6 pay taxes. Any comment on that?

7 MR. BRIGHT: Are they making money?

8 CHAIRMAN SAYLOR: I don't know where the
9 Governor gets his figures. He keeps throwing numbers
10 around and saying that 70 percent of the corporations
11 in Pennsylvania don't pay taxes. It would be
12 interesting to ask him, I guess, or for him to
13 identify to the General Assembly and to the public
14 what kinds of companies he is talking about and who
15 are they.

16 MR. BRIGHT: Do they include S corporations,
17 which by law do not pay taxes?

18 I don't know the answer. I think you have
19 to look at the number and figure out how you
20 calculate it and what is in it. But just the
21 conclusion is just that, it's a conclusion.

22 Could I go back---

23 CHAIRMAN SAYLOR: Go ahead.

24 MR. BRIGHT: ---to your prior comment?

25 CHAIRMAN SAYLOR: Go ahead.

1 MR. BRIGHT: Philadelphia took an
2 astonishing step a couple of weeks ago in
3 establishing a 3-1-1 number, and a citizen in
4 Philadelphia can dial 3-1-1 for any Philadelphia
5 service, anything -- trash, L&I, what have you -- and
6 the 3-1-1 operators are supposed to be trained to
7 connect them to the right person. They are not
8 supposed to know everything, but they are supposed to
9 know who you go to, and if it is more than one
10 person, to tell you.

11 Local government like our municipal
12 government is not the same as State Government, but
13 maybe there's a lesson here, and maybe pulling
14 together in one place a number, a person for people
15 to go to who will serve as a triage, will have two
16 effects: first of all, streamlining red tape; and
17 second, whoever does that job is going to start to
18 see the impact of disparate regulation and report
19 back to his or her boss and maybe changes will be
20 made. But to put it differently, put the burden of
21 coordination on the government and not on the
22 taxpayer.

23 CHAIRMAN SAYLOR: The next question for you.
24 Do either of the three of you see, if this
25 General Assembly and the Governor were to do a

1 combined reporting, and the Governor is only
2 advocating a tax portion, of course, but if we were
3 even to do the entire report, do either of you three
4 gentlemen believe that by passing combined reporting
5 in this State, that that would be in any shape or
6 form part of an economic stimulus package? Do you
7 really see it creating jobs and getting Pennsylvania
8 moving forward?

9 MR. COTTONARO: Are you saying--- I'm not
10 clear on something. Are you saying as part of a
11 broader package or in isolation?

12 CHAIRMAN SAYLOR: No. If we were to pass
13 this as the Governor is calling for it -- oh, I added
14 a little stipulation that we pass the full proposal
15 -- do you really believe that passing a proposal as
16 the commission had recommended, if we go around the
17 Governor and just not pass the tax portion but we
18 pass the entire package, would it be a job creator
19 for Pennsylvania and move us out of this economic
20 downturn?

21 MR. COTTONARO: That was the conclusion of
22 the commission in the context of attempting to
23 reshape the tax environment. And I think what sat
24 behind that was a belief that this kind of
25 multifaceted process, which really effectively did, I

1 think, three things: It lowered the rate
2 dramatically; it broadened the base; and it provided,
3 through the mechanism of the NOLs and single sales,
4 some incentives -- one, the NOL, which was a fairness
5 issue; and the second one, single sales that you
6 actually have to go out and earn? That is to say to
7 get the advantage of it, you need to expand your --
8 it gives you the opportunity to expand your base,
9 your payroll, your property in this State.

10 But I think what sat behind that was the
11 belief that the entire package was something that was
12 more competitive, remains a little bit more
13 competitive today.

14 MR. CORTEZ: And let me just go back one
15 step, because I can say, first, passing combined
16 reporting without the report, in my opinion, would be
17 a disaster. In and of itself, it is not something,
18 especially with a 9.99-percent rate, it would be
19 something that would be very difficult to understand
20 how it would have any positive effect on the
21 Commonwealth.

22 I think to Joe's point, the point of this
23 recommendation or set of recommendations was, given
24 the parameters of the Executive order, what is the
25 best that you can do? And I think there is a lot in

1 that set of recommendations that is designed to try
2 to encourage growth -- the single sales factor,
3 uncapping the NOLs, reducing significantly the rate.
4 There are things in there that I think are positive.

5 The concerns that I had with the
6 commission's recommendations were, how far did it
7 allow us to go? Were we able to take the full
8 breadth of the impacts of our recommendations into
9 account? What would happen if we did generate
10 revenue? What would happen if there was increased
11 economic growth?

12 And I think, if you ask me, could you take
13 these recommendations and make them better, the
14 answer is absolutely; I think we can. But those
15 recommendations, given where we were and the
16 parameters, I think are good, and they are designed
17 to try to encourage growth. Whether they would
18 accomplish it, you would have to wait and see.

19 CHAIRMAN SAYLOR: The last question, and
20 kind of for each of you gentlemen, and maybe more for
21 Mr. Bright, is, you know, in looking at the report by
22 Robert Cline from Ernst & Young, it talks a lot about
23 litigation in there, a lot of litigation going on in
24 States. I mean, California passed this several years
25 ago; they are still in litigation, which means a lot

1 of attorneys fees, on both sides, from businesses as
2 well as the State.

3 Would it be accurate, or maybe, Mr. Bright,
4 you can tell me, revenues, because of the lawsuits,
5 if we were to pass this, what kind of -- I mean, not
6 in dollars, but because of the lawsuits, would we
7 really see any major changes as far as revenue from
8 this kind of a report if we were to pass combined
9 reporting in the first year or two possibly?

10 MR. BRIGHT: My answer would be that the
11 litigation costs would be a factor but not the major
12 factor. I think the major factor is a hard, cold
13 analysis of the numbers and what do you do with
14 NOLs?

15 And in addition to litigation, you have what
16 I will call the ramp-up costs, and the Department of
17 Revenue quite candidly and correctly said 5 years ago
18 that there would be a substantial time to get people
19 trained, hired and trained, and ready to administer a
20 system like that, and that costs some money.

21 So you take that and you take the
22 litigation, that is a factor, but I personally
23 believe that that factor is of lesser importance than
24 looking very carefully at the kinds of tradeoffs that
25 we have been talking about when you adopt combined

1 reporting and where you really are likely to come
2 out. And bear in mind that although people have made
3 good and honest efforts to estimate it, the one study
4 of what actually happened showed no change.

5 CHAIRMAN SAYLOR: Very good.

6 And what you are saying then is the Governor
7 is calling for a reduction in our State workforce of
8 about a thousand to 2,000 employees at the same time
9 the Department of Revenue would have to hire new
10 employees to go out and, I shouldn't say harass, but
11 basically that is what they would be doing,
12 corporations to make sure this combined reporting is
13 put into effect.

14 MR. BRIGHT: Well, if you have any program,
15 you have got to administer it correctly and
16 accurately. So even if there is nothing that you
17 could fairly characterize as harassment, it is work.
18 You got to pay people to do that.

19 CHAIRMAN SAYLOR: It is more complicated.

20 MR. BRIGHT: Yes, it is considerably more
21 complicated, and you have got to be prepared to deal
22 with that.

23 CHAIRMAN SAYLOR: Okay.

24 Any other questions? Jerry. Representative
25 Jerry Stern.

1 REPRESENTATIVE STERN: Mr. Chairman, I think
2 what you are alluding to here is if in fact that
3 would be proposed and would be put on the table, that
4 these revenues or whatever those projections could
5 possibly be, whatever the number would be, \$400 or
6 \$500 or \$600 million, whatever the Governor is
7 projecting, would not be able to be part of any
8 budget solution to begin with because of the
9 uncertainties of what could happen in the future.

10 Correct?

11 CHAIRMAN SAYLOR: Correct; correct.

12 REPRESENTATIVE STERN: Thank you.

13 CHAIRMAN SAYLOR: I want to thank you
14 gentlemen for coming in. Any last comments?

15 Thank you for your time. We appreciate it.

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17 (The hearing concluded at 11:42 a.m.)

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1 I hereby certify that the proceedings and
2 evidence are contained fully and accurately in the
3 notes taken by me on the within proceedings and that
4 this is a correct transcript of the same.

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Debra B. Miller, Reporter

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