PA House of Representatives
Republican Policy Committee

414, Main Capitol Building
Harrisburg, PA 17120
(717) 260-6144

Rep. Joshua D. Kail
Chairman

PA House Republican Policy Committee Hearing

“Job-Creating Tax Reform”

April 12, 2024, at 9 a.m.

East Allen Township Building
5344 Nor-Bath Boulevard
Northampton, PA 18067

9:00 a.m.	Welcome and Pledge of Allegiance
9:10 a.m.	**Neal Lesher** *Director of Government Affairs, Pennsylvania Chamber of Business and Industry*
9:15 a.m.	**Melissa Wilbur Morgan** *Assistant State Director, NFIB*
9:20 a.m.	**Questions for the Testifiers**
9:50 a.m.	**Closing Comments**

Testifier Biographies

PA House of Representatives Policy Committee Hearing

"Job-Creating Tax Reform"

Neal Lesher
Director of Government Affairs, Pennsylvania Chamber of Business and Industry

Neal Lesher joined the PA Chamber as a Government Affairs Director in October of 2022.

Prior to joining the PA Chamber, Neal served in senior leadership positions with the state House of Representatives, including serving as Chief of Staff to the Speaker of the House and as the Director of Policy and Communications for the Appropriations Committee Chairman.

He also has executive branch experience, serving as the Legislative Director for the Governor's Budget Office under the Corbett Administration. Neal also worked for the National Federation of Independent Business (NFIB) as their Legislative Director.

Neal has lived his whole life in central Pennsylvania and graduated from Susquehanna University in 2008 with a bachelor's degree in Political Science.

Melissa Wilbur Morgan
Assistant State Director, NFIB

Melissa Wilbur Morgan has served as the assistant state director for NFIB, the nation's leading small-business association, since September 2021. In this role, she supports all aspects of the organization's state advocacy, operations, political engagement, communications, and programming on behalf of NFIB's thousands of members across the Commonwealth.

Melissa previously worked for the Pennsylvania Association of Township Supervisors, and brings over a decade of state advocacy and local policy experience to her current position.

She is a graduate of Shippensburg University of Pennsylvania, with a bachelor's degree in political science, as well as a master's degree in public administration.

Testimony

Submitted on behalf of the
Pennsylvania Chamber of Business and Industry

Public Hearing on Business Tax Reform

Before the:
Pennsylvania House Republican Policy Committee

Presented by:

Neal Lesher
Director, Government Affairs

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Chairman Kail and members of the Policy Committee, my name is Neal Lesher and I am a Director of Government Affairs for the Pennsylvania Chamber of Business and Industry. The PA Chamber is the largest, broad-based business advocacy association in Pennsylvania. We represent employers of all sizes, crossing all industry sectors throughout the Commonwealth. Thank you for the opportunity to testify today regarding Pennsylvania's uncompetitive business tax climate.

Pennsylvania's uniquely harsh business tax and regulatory climate is stifling economic growth. WalletHub[1] recently identified Pennsylvania as the fifth worst state in the entire country in which to find a job. Three separate analyses recently found Pennsylvania among the bottom third of states nationwide for key economic indicators: U.S. News and World Report[2] ranks our economy 38th overall; SimplifyLLC[3] ranks us 37th for small business taxes; and the Tax Foundation[4] ranks the Commonwealth 31st in its overall state business tax climate index. Perhaps most strikingly, the Kauffman Foundation[5] found that Pennsylvania has the lowest rate of new entrepreneurs out of all 50 states.

As a corollary, businesses and people are fleeing Pennsylvania, and they are taking good-paying jobs with them. Axios[6] first reported in 2022 that more people

1 https://wallethub.com/edu/best-states-for-jobs/35641
2 https://www.usnews.com/news/best-states/pennsylvania
3 https://www.simplifyllc.com/best-and-worst-states-for-small-business-taxes/
4 https://taxfoundation.org/research/all/state/2024-state-business-tax-climate-index/
5 https://indicators.kauffman.org/indicator/rate-of-new-entrepreneurs
6 https://www.axios.com/local/philadelphia/2022/07/12/pennsylvania-migration-loss

were leaving Pennsylvania than moving in. Last year, the Bureau of Labor Statistics[7] reported that Pennsylvania was among the top five states for businesses leaving. Home Bay[8] identified Pennsylvania as having the fourth-highest rate of outbound migration in the first half of 2023, and recent studies from U-Haul[9] and United Van Lines[10] both indicate that employment opportunities are driving this worsening exodus of residents from Pennsylvania.

Build on bipartisan efforts and accelerate the reduction in the CNI

Last session, lawmakers came together in a bipartisan manner to advance significant tax reform (Act 53), including reducing the state's second highest in the nation corporate net income (CNI) tax rate of 9.99 percent and enacting various improvements targeted to small businesses. These measures will make our state more competitive, incentivizing investment and job growth, and create additional economic opportunities in the Keystone State. The PA Chamber appreciates these critical reforms, and we thank the General Assembly for its overwhelmingly bipartisan support for the 2022 tax code, with 88 percent of lawmakers voting for the bill.

Once the phasedown is complete and Pennsylvania reaches a 4.99 percent CNI tax rate, a Tax Foundation analysis projects Pennsylvania's ranking for corporate tax

[7] https://www.bls.gov/opub/mlr/2023/article/firm-migrations-in-the-united-states-magnitude-and-trends.htm
[8] https://homebay.com/where-should-i-move-2023/
[9] https://www.prnewswire.com/news-releases/u-haul-migration-trends-texas-florida-top-growth-states-again-in-2023-302024334.html
[10] https://www.unitedvanlines.com/newsroom/movers-study-2023

structure competitiveness will go from 44th in the country to 27th. In terms of overall competitiveness, Pennsylvania will have improved from 31st place to 17th, and we will have gone from the 2nd highest CNI tax rate in the nation to the 8th lowest, based on current rates.

While Act 53 represented a historic overhaul of the corporate tax structure, we know that other states are moving forward on pro-business reforms as well. We are in perpetual competition with other states. Since 2021, ten other states have used their revenue surpluses to make additional reductions in corporate taxes.

A lower CNI rate will not only generate more overall investment; studies show broad economic gains across the board when the CNI is reduced, including higher GDP, higher wages, greater home values and increased job creation by businesses of all sizes. A study[11] by the Senate that compared states with the highest corporate income tax rates to the states with lowest tax rates found that states with the lowest tax rates experienced 10 percent higher growth in state revenues from 2000 to 2020 compared to high tax rate states. It also found that decreasing the CNI rate will contribute to increases in the state's population, increased worker wages, and higher home values.

North Carolina is an illustrative example of a state that took an uncompetitive tax climate and turned it into one of the best. Since 2013, North Carolina's corporate

[11] [11] https://www.senatoraument.com/wp-content/uploads/sites/69/2021/06/CNI-research.pdf

income tax rate dropped from 6.9 percent to 2.5 percent – the lowest rate in the nation. After lawmakers saw the benefits of reducing tax rates, North Carolina is now on track to phase out their corporate net income tax entirely in the coming years. North Carolina has gone from 44th in the Tax Foundation's Business Tax Climate to 9th.

Before 2020, while a majority of states were consistently grappling with budget shortfalls, North Carolina was consistently averaging budget surpluses of $400 million.[12] Last year, North Carolina ended the year with a $3 billion-plus budget surplus, three times as much as Pennsylvania.[13] "At a time when companies are clamoring for workers while trying to navigate a treacherous economy, no state is meeting their needs more effectively than North Carolina," says CNBC[14], who ranked the state as the best state to do business for the past two years in a row.

The PA Chamber supports bipartisan efforts to accelerate the CNI phase down in order to maximize the benefits of tax reform and keep pace with other states. While Act 53 represents historic opportunity, it will also take until 2031 until the full benefits are realized. Can Pennsylvania really afford to wait?

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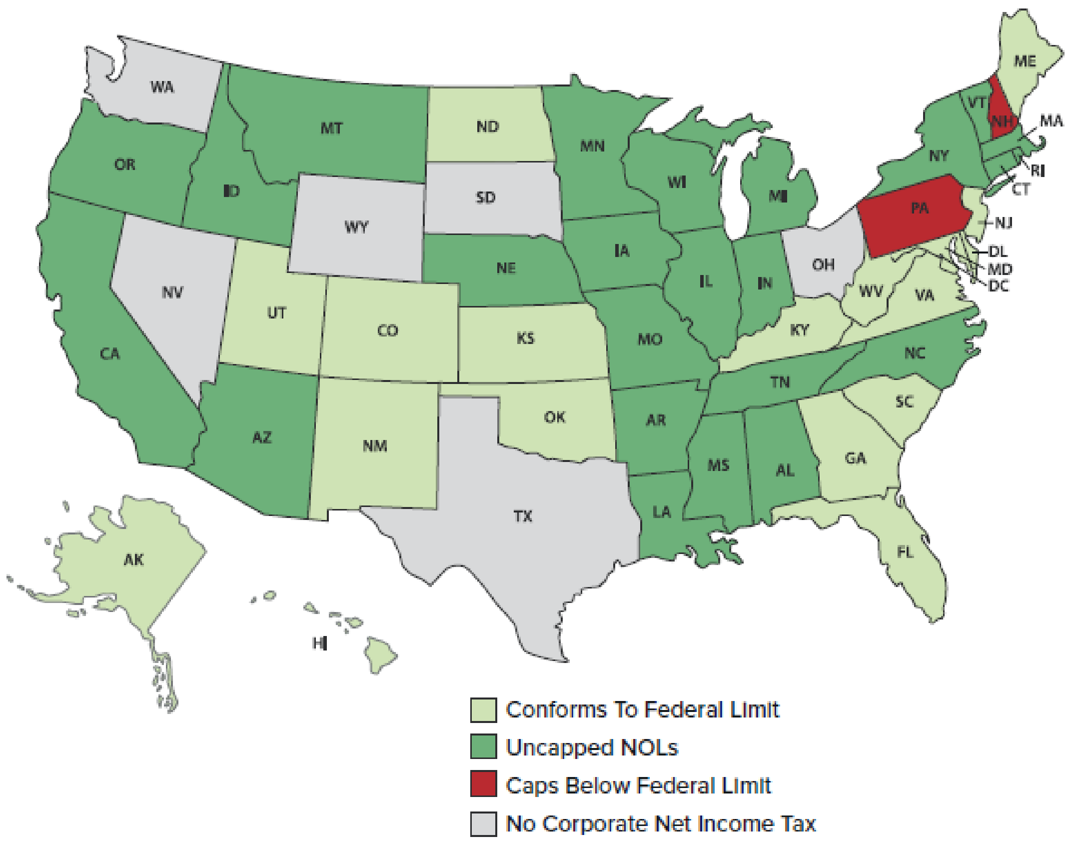
12 North Carolina Set to Post Another Large Budget Surplus | Tax Foundation

13 https://www.osbm.nc.gov/news/press-releases/2023/08/07/north-carolina-ends-fiscal-year-335-billion-revenue-3-billion-above-budget

14 https://www.cnbc.com/2023/07/11/north-carolina-is-top-state-for-business-led-by-workforce-economy-.html

End Pennsylvania's penalty on start-up businesses

Pennsylvania is an extreme outlier when it comes to treatment of Net Operating Losses (NOL). We are currently one of only two states that cap NOL deductions below the federal limit of 80 percent of taxable income. There are 20 states that align with the federal rules, while 24 states have no deduction cap at all.

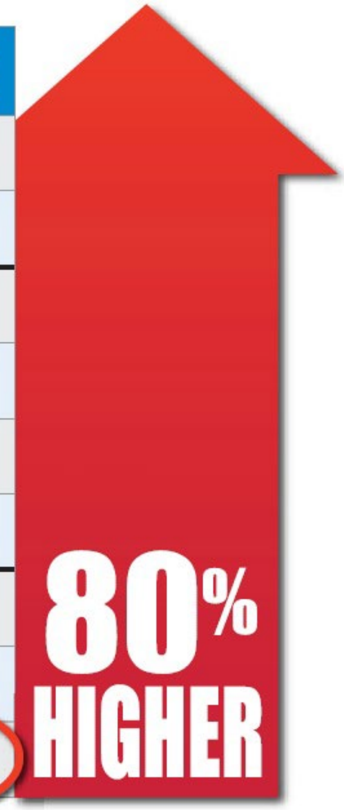


NOL carryforward is a tax provision that allows businesses having losses in a taxable year to carry those losses forward and deduct them from future years' profits. The ability to carry forward losses particularly impacts two types of businesses, both of which are critical to our economy. Start-up firms, including those in technology or bioscience, often experience significant losses in early years that could be reinvested by reducing future tax liabilities if they ultimately become profitable. Employers that operate in cyclical businesses, such as manufacturers in the commodity markets like metals, chemicals or pulp and paper where profits and losses can fluctuate in wide swings are also impacted.

Consider a hypothetical start-up company that has a choice to do business in Pennsylvania or in another state that has the same tax rates as Pennsylvania. In its first year of operation (2023), the company had significant start-up costs and recorded a $50 million loss. Once the business started generating sales, they earn a $75 million profit in 2024.

Under Pennsylvania's uncompetitive NOL rules, the company is limited to reducing their tax liability in 2024 by 40 percent of their taxable income. Unable to deduct the full amount of losses carried forward from the previous year, they end of paying an effective tax rate of 15.28 percent. In the other state, they are able to fully deduct their losses and end up paying the true tax rate of 8.49 percent. If you had the option between two states to start a company, would you choose Pennsylvania where you would pay an effective tax rate that is 80 percent higher?

$ Millions	Pennsylvania with 40% Cap	Uncapped State
2023 Taxable Income	($50.00)	($50.00)
8.99% CNI Rate	$0.00	$0.00
2024 Taxable Income	$75.00	$75.00
NOL Deduction	($30.00)	($50.00)
Taxable Income After NOL	$45.00	$25.00
8.49% CNI Rate	$3.82	$2.12
Total Net Income (2 Yrs)	$25.00	$25.00
Total Tax (2 Yrs)	$3.82	$2.12
2 Yr Effective Tax Rate	**15.28%**	**8.49%**



NOL allowances promote a fair tax system by reducing additional tax burdens on entrepreneurial risk, cyclical businesses, or those more susceptible to economic downturns. Pennsylvania is a national outlier in its harsh treatment of losses and fixing this flaw will promote future growth, provide more stability as businesses make long term investment and hiring decisions and make Pennsylvania more attractive to employers and entrepreneurs.

Avoid Punitive Tax Provisions

Unfortunately, some policy makers are still pushing measures that would take us in the wrong direction and make Pennsylvania less competitive. Last year, the house passed a comprehensive tax code bill along party lines that also included combined reporting and other provisions, which have torpedoed meaningful tax reform for years and which the Council on State Taxation (COST) has said would make Pennsylvania's corporate net income tax one of the most punitive and aggressive in the country. Tying combined reporting to pro-growth tax reform is counterproductive.

Support Small Business Tax Reforms

When discussing the business tax climate, we must understand that not all businesses are organized or taxed the same. Recent census data[15] shows that 71% of C-corporations in Pennsylvania have less than 20 employees. Corporate tax reform is small business tax reform!

We also know that that the majority of small businesses are organized as pass-through entities (S-corporations, partnerships and sole proprietors) which pay the state's Personal Income Tax (PIT) on business profits. The same census data shows that there are nearly 180,000 such small businesses in Pennsylvania who employ over 2.2 million people. Alarmingly, one proposal,[16] which the House Finance Committee conducted a hearing on earlier this year, seeks to increase the tax rate on these small businesses from 3.07 percent to 12 percent. Imposing a four-fold tax increase on

[15] https://www2.census.gov/programs-surveys/susb/tables/2020/us_state_naicssector_lfo_2020.xlsx.
[16] https://www.legis.state.pa.us/cfdocs/billInfo/billInfo.cfm?sYear=2023&sInd=0&body=H&type=B&bn=1773

small businesses would accelerate this mass exodus of businesses and workers from our state. Especially at a time when employers are still struggling with inflation, workforce shortages, and supply chain disruptions, this proposal is tragically shortsighted.

There are things that policy makers could do to improve our tax climate for small businesses. The first would be to repeal the accelerated sales tax requirement in Pennsylvania. Implemented originally in the early 2000s as a one-time budgetary gimmick, requires businesses that collect more than $25,000 in sales tax in the third quarter of the previous year to make monthly pre-payments equal to 50 percent of their expected sales tax collections. To simplify compliance and ease paperwork burdens on small businesses, the accelerated sales tax pre-payment requirement should be repealed. Repealing this requirement would allow small businesses to simply remit collected sales tax revenues in accordance with their filing period.

To promote fairness, Pennsylvania should also allow small businesses to carry forward net operating losses. While our treatment of NOLs for corporate taxpayers is particularly punitive, pass-through entities don't even have this ability to recover losses at all.

And lastly, to promote investment, output and job creation, Pennsylvania should allow full expensing of eligible equipment and property in the year the investment was made, known as bonus depreciation. Section 168(k) of the federal Tax Cuts and Jobs Act allowed for 100 percent expensing, which was gradually phased down to 80 percent in 2023. The PA Chamber supports legislation that would implement bonus depreciation at the state level, either at 100 percent expensing or a designated percentage of the federal provision.

Conclusion

Policy makers should build on recent bipartisan reforms and continue to reform the Commonwealth's tax structure with pro-growth initiatives that will make the Commonwealth more competitive without adding new hurdles on job creators.

Our state has the potential to be an economic powerhouse. We have world-class academic institutions and health care systems, abundant resources like energy and fresh water, groundbreaking innovation, and manufacturing hubs, close proximity to major population centers, and a talented workforce that is second to none. While our uncompetitive tax structure has historically held us back, pro-growth reforms will help unleash private-sector job creation and enable us to realize this potential.

Thank you again for the opportunity to testify and I am happy to answer any questions.