Testimony

Submitted on behalf of the
Pennsylvania Chamber of Business and Industry

Public Hearing on Business Tax Proposals

Before the:
Pennsylvania House Finance Committee

Presented by:

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Chairman Samuelson, Chairman Greiner and members of the Finance Committee, my name is Alex Halper and I am Vice President 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 improving Pennsylvania's business tax climate.

The U.S. Department of Labor issued a report[1] this month that included a ranking of states based on net firm migration; in other words, the number of companies moving into a given state, offset by the number of companies moving out. Pennsylvania ranked as the fifth worst state in the country. This position is untenable and portends an increasingly challenging economic future for the Commonwealth if this trend continues. We urge lawmakers to emphasize competitiveness, including improving Pennsylvania's tax climate for employers.

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

[1] https://www.bls.gov/opub/mlr/2023/article/firm-migrations-in-the-united-states-magnitude-and-trends.htm

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 last year's 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 structure competitiveness will go from 44th in the country to 27th. In terms of overall competitiveness, Pennsylvania will have improved from 29th 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, nine 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[2] 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 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 10th.

Before 2020, while a majority of states were consistently grappling with budget shortfalls, North Carolina was averaging budget surpluses of $400 million.[3] This year, North Carolina is expected to have a $3 billion-plus budget surplus, three times as much as Pennsylvania.[4] "Powered by an economy that has hit its stride, and turbocharged by a long track record of innovation, North Carolina is America's Top

[2] [2] https://www.senatoraument.com/wp-content/uploads/sites/69/2021/06/CNI-research.pdf

[3] North Carolina Set to Post Another Large Budget Surplus | Tax Foundation

[4] Forecast: North Carolina expects $3B-plus surplus this year | AP News

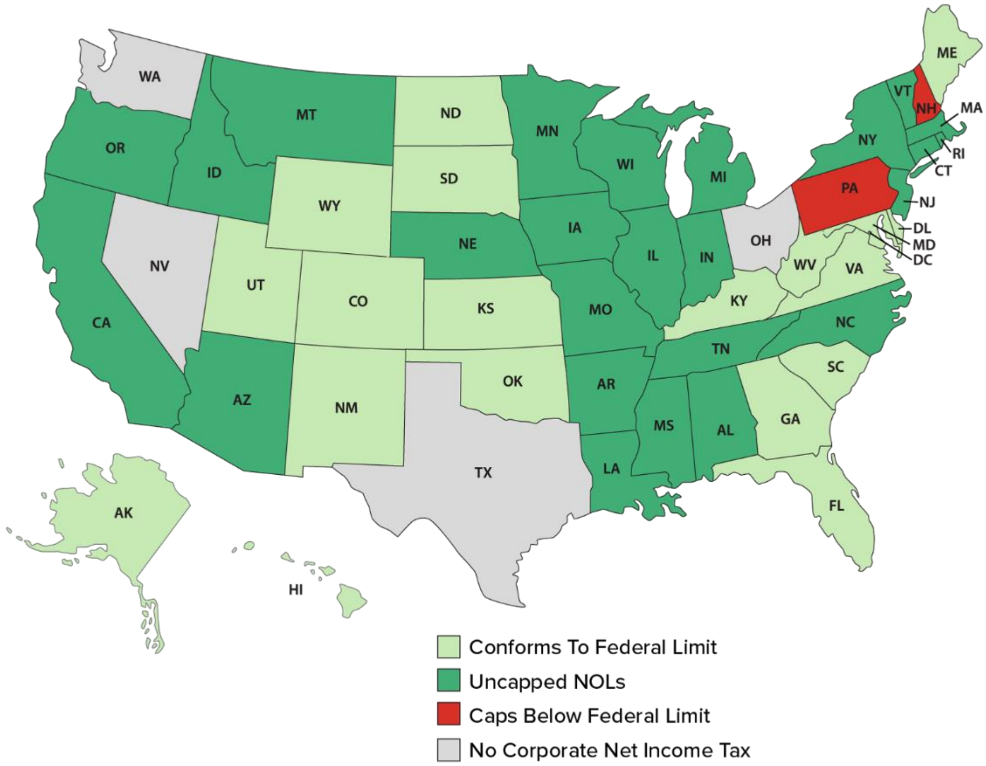
State for Business in 2022," according to CNBC.[5]

The PA Chamber supports the call from Gov. Josh Shapiro and lawmakers from both sides of the aisle 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 a decade?

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 19 states that align with the federal rules, while 25 states have no deduction cap at all.

[5] North Carolina is No. 1 in America's Top States for Business 2022 (cnbc.com)

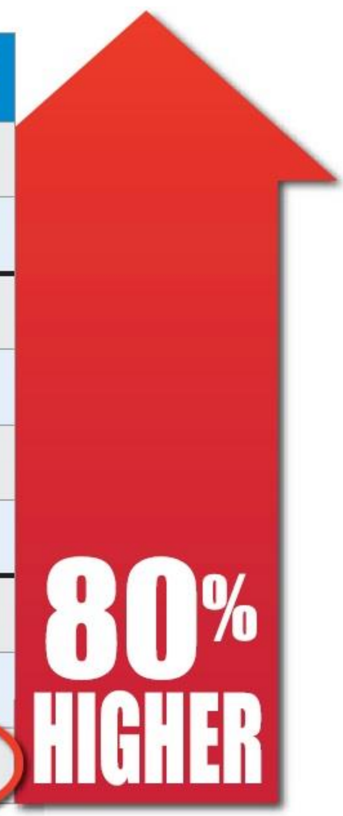


NOL carryforward is a tax provision that allows businesses who experience losses in a taxable year to carry those losses forward and deduct them from future years' profits. The ability to carry forward losses particularly impacts two types of businesses, both of which are critical to our economy. Start-up 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.

Mandatory unitary combined reporting will further erode PA's attractiveness

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

Combined reporting is also outdated and unnecessary given our current tax laws. The PA Chamber has worked with lawmakers on both sides of the aisle to ensure that intercompany transactions are not used for tax avoidance purposes.

In 2013, a bipartisan compromise was reached by the General Assembly, the Department of Revenue, the PA Chamber, and other stakeholders to directly address the issue of tax avoidance. This agreement, commonly referred to as the "add-back" provision of the tax code, requires a company to add-back any transaction to their reported income that was done for the principal purpose of tax avoidance. This provision resulted in an annual increase of $60-$80 million in tax collections.

In 2022, the PA Chamber again agreed to a compromise. As part of the bi-partisan comprehensive tax reforms adopted in Act 53 of 2022, Pennsylvania adopted enhanced rules regarding market sourcing and economic nexus. Market sourcing rules changed the sourcing for sales of certain intangible property (e.g., franchisee income, gain from the sale of intellectual property, income from lending and other financial transactions) to where the benefit is received instead of where the activity is performed. Economic nexus rules now require corporations with no physical presence in Pennsylvania, but sales of $500,000 or more sourced to Pennsylvania, to file a CNI return. These measures provide certainty and increased revenues by about $200 million annually to the Commonwealth.

Combined reporting adds great complexity, would disadvantage Pennsylvania among many of its competitors and would further validate Pennsylvania's reputation as less hospitable for business expansion and relocation.

Conclusion

Policymakers should build on recent bi-partisan reforms and continue to reform the Commonwealth's tax structure with pro-growth initiatives that will make the Commonwealth more competitive without creating a business climate even more hostile to business.

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