TO: The Honorable Members of the PA Senate
FROM: Neal Lesher, Director, Government Affairs
DATE: October 13, 2023
RE: HB1219 – Omnibus Tax Code

Last week, the House sent an omnibus tax code bill (H.B. 1219) to the Senate that includes two provisions the PA Chamber has championed. When considered on their own, expediting the phasedown of Pennsylvania's Corporate Net Income tax (passed 150-53) and increasing the cap on Net Operating Losses (passed 166-37) received broad bipartisan votes, as was the case earlier this year in the Senate Finance Committee.

However, the proposal that the House passed also includes combined reporting and other related provisions, which had torpedoed meaningful tax reform for years and which the Council on State Taxation (COST) states **would make Pennsylvania's corporate net income tax one of the most punitive and aggressive in the country.** The following are specific provisions in H.B. 1219 we believe are counterproductive.

Unitary Combined Reporting:
The PA Chamber opposes Unitary Combined Reporting: it would significantly increase the cost and complexity of filing tax returns and lead to an increase in tax appeals and litigation. It would also create a specific disincentive for multi-state firms to do business in Pennsylvania and create volatility in revenue collections. Studies commissioned in Maryland and Virigina recommended against adopting combined reporting and found that it would actually result in less tax revenue in certain years.

Unfettered Powers:
The legislation gives essentially unfettered powers to the Department of Revenue to arbitrarily audit and add income to a taxpayer's return, without objective standards, and forces the taxpayer to challenge these decisions through an already flawed appeals process.

Trapped Net Operating Losses:
The legislation doubles down on Pennsylvania's harsh treatment of Net Operating Losses (NOLs) by limiting the ability of a taxpayer to use NOLs across the entire group, and instead limits their use to only offsetting that member's own income. In some cases, this will result in "trapped" NOLs that can never be used by the taxpayer. This will also make Pennsylvania an outlier as other states, and federal consolidated reporting, allow the ability to share losses among group members. In fact, earlier this year, New Jersey updated its law to allow for NOLs to be shared.

Discouraging Foreign Investment:

The legislation seeks to tax foreign income in a manner inconsistent with federal tax laws and adds income from any corporation incorporated or doing business in a specific list of countries, including major trade partners such as The Netherlands, Ireland, Switzerland and Luxembourg. When other states enacted similar provisions, it drew sharp diplomatic reactions from the ambassadors of these countries. Those states have since repealed their lists. Seeking to tax foreign income would make Pennsylvania particularly unattractive for foreign owned companies to open operations in the Commonwealth and raises considerable constitutional concerns under the Commerce Clause.

Undoing Bipartisan Compromises:
The PA Chamber has worked with lawmakers on both sides of the aisle to ensure that intercompany transactions are not used nefariously for tax avoidance purposes.

In 2013, a 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.

Last year, the PA Chamber agreed to additional compromises. 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 increased revenues by about $200 million annually.

Pro-growth Tax Reform
The PA Chamber is urging lawmakers to continue rallying around tax policy that enjoys the kind of bipartisan support we have seen for business tax improvements and avoid any poison pills, such as combined reporting, that have historically derailed meaningful tax reform.