



Testimony

Submitted on behalf of the
Pennsylvania Chamber of Business and Industry

Informational Meeting

Before the:

House Finance Committee

Presented by:

Thomas A. Bowen, Esq., CPA
Shareholder, Stevens & Lee
Chair, PA Chamber Tax Executive Workgroup

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417 Walnut Street
Harrisburg, PA 17101-1902
717.720.5580 phone
<http://www.pachamber.org>

Introduction

Chairman Benninghoff, Chairwoman Mindy and members of the committee, thank you for the opportunity to testify before you today regarding issues facing the business community that fall under the jurisdiction of the House Finance Committee. My name is Tom Bowen and I serve as Chair of the PA Chamber's Tax Executive Workgroup. The Chamber is the largest, broad-based business advocacy association in the Commonwealth. We represent business of all sizes ranging from Fortune 100 companies to sole proprietors crossing all industry sectors. Our membership comprises nearly fifty percent of the private workforce.

Importance of competitive business tax structure

Few issues draw as much attention as state business taxes for businesses seeking to locate or expand operations. Despite positive changes to the Commonwealth's business taxes over the last few years, the economic boom of the mid-to-late 1990s and increased international competition allowed most of Pennsylvania's competitors to reduce their business tax burdens significantly. As a result, the Commonwealth's business tax structure continues to have some of the highest rates in the nation and is more burdensome than most others. While the progress on business taxes in Pennsylvania was constructive, it did little to improve our overall competitiveness in the nation and around the world.

Tax policy should not discourage corporate headquarters locating in Pennsylvania

Sadly, we have seen a growing number of PA-based companies being acquired by out-of-state or foreign-based corporations. While there are other factors involved in these corporate takeovers, tax policy should not be a barrier to locating global and regional corporate headquarters operations in Pennsylvania.

PA can no longer afford to have the nation's highest effective corporate tax rate

Pennsylvania businesses have to make tough choices in order to compete successfully in a global economy. The top US federal income tax rate on corporations at 35%, is already among the highest globally, so any additional rate by states needs to be carefully considered, and PA has the highest effective rate (9.99%) among all 50 states¹. CNI tax rates are the most straightforward measure that businesses use when comparing states' business climates. While a reduction of just one percentage point to 8.99 percent would improve Pennsylvania's ranking by eight places, the Commonwealth still would remain well above the national average of 6.80 percent.

Mandatory unitary combined reporting will further erode PA's attractiveness

The PA Chamber opposes proposals to collect the CNI on a unitary combined basis because it is a potentially significant tax increase that would also 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.

NOL cap should be removed

Pennsylvania is one of only five states that impose a cap on Net Operating Losses (NOLs)². In 2010 the cap was increased to the higher of \$3 million or 20 percent of a company's net income. While

¹ Although Iowa has a higher nominal rate (12.0% on income exceeding \$250,000), unlike Pennsylvania and most other states, it provides a deduction of 50% of the U.S. federal income tax. Accordingly, Iowa's highest effective corporate rate is 9.96% (corporations subject to the 34% U.S. rate; the effective rate drops to 9.90% for corporations subject to the top 35% US rate).

² New Hampshire has a \$1 million NOL cap. The NOL caps in the other three states are temporary: Colorado has a \$250 thousand NOL cap through 2013, California has suspended its NOL deduction through this year, and Illinois has suspended its NOL deduction through 2013.

these changes were a welcomed improvement, the ongoing cap still represents a barrier to start-up companies looking to locate in Pennsylvania and a burden on cyclical companies looking to maintain existing operations.

By way of background, the vast majority of new start-up companies today are companies employing 100 or fewer employees. Due to the various components of start-up costs, these businesses tend to record significant losses in the first few years of operation. Likewise, cyclical businesses face regular fluctuations in income as part of their business operations. An NOL deduction that is free of any uncompetitive restrictions is an important way to help start-up companies and balance the effect of volatile economic conditions on cyclical businesses.

CNI apportionment should be fully market-based

The Corporate Net Income tax liability of a multi-state company is determined by an apportionment formula. In the 1990s, the legislature began the process of shifting to a formula that is based on a single sales factor. In 2010, the apportionment formula was changed to one that is based on 5 percent property, 5 percent payroll and 90 percent sales.

A 100 percent sales factor, or single sales factor, would help companies that have a significant investment of property and payroll in Pennsylvania. In practice, a corporation that increases its Pennsylvania holdings and the number of employees in Pennsylvania would not be penalized under a SSF because property and payroll would no longer be considered as part of the tax calculation.

The sales factor for services is currently based on the state where they are performed. To reverse this to have services performed in the Commonwealth, Pennsylvania should adopt a customer-base

sourcing. This market-based sourcing has been the rule in Maryland for several years and is being adopted in a growing number of states³ to keep and grow their service jobs. This would be consistent with the destination-based sourcing used for product sales.

Capital Stock/Franchise Tax should continue to be phased-out on schedule

In May of 2000, the General Assembly recognized that Pennsylvania's Capital Stock and Franchise Tax (CSFT) represented an unfair, burdensome tax on Pennsylvania businesses. Subsequently, in May of 2000, the General Assembly initiated a 10-year phase-out of the CSFT. Since 2000, the CSFT phase-out was delayed three times in order to generate more revenue for the Commonwealth's General Fund. Under the original phase-out plan, the CSFT was to be eliminated by January 2009, but the changes have delayed the elimination of the tax until January 2014.

Most states do not impose a franchise tax based on capital stock value. There are only 9 other states⁴ that charge both an income tax and an uncapped capital-based franchise tax. Complicating matters, Pennsylvania businesses must pay the CSFT regardless of whether the business earned a profit. This is particularly burdensome for new business ventures and companies that may be struggling in a slow economy. In effect, the CSFT is a tariff on every dollar invested in Pennsylvania. Continuing the original phase-out, as proposed in Governor Corbett's most recent budget proposal, would re-inject stability and predictability for Pennsylvania businesses that count on sound fiscal policies as they locate and expand their operations.

³ 10 other states besides Maryland have adopted market-based sourcing of service sales: California (effective this year), Georgia, Iowa, Illinois (2009), Maine (2007), Michigan (2008), Minnesota, Oklahoma (2010), Utah (2009) and Wisconsin.
⁴ Arkansas, Louisiana, Massachusetts, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee and West Virginia.

PA Chamber supports property tax assessment reform

On the local tax front, the PA Chamber supports property tax assessment reform. How properties are valued for tax purposes affects local tax fairness for individuals and businesses, and the assessment process that sets these values directly affects uniformity and fairness. Businesses raise concerns about the infrequency with which reassessment occurs in Pennsylvania, which may mean assessments are no longer fair and that some properties end up paying more and others less than they should. If reassessment occurred more regularly, property values would be set more uniformly and the real property tax would be fairer. The Chamber believes in mandatory reassessment and assessment reform that provides clear, consistent and standardized assessment standards.

Local gross receipts tax should not apply without base of operations

As the local governmental tax base has eroded in recent years, pressure has been building for authorities to develop independent sources of revenue. Although the rates and adoption of the local tax on business gross receipts (commonly known as the “Business Privilege and Mercantile Tax”) has been frozen since 1988, a state Supreme Court ruling in late 2007 opened up the possibility that a municipality could apply it where a business had a temporary base of operations, such as a job trailer. This ruling left many business owners with unanswered questions. Legislation that provides clarity to the current interpretation of the law must be enacted. The Chamber supports legislation that states the tax can only be imposed if the “privilege” of doing business is exercised through a “base of operations” in the local taxing jurisdiction and that engaging in transactions within a taxing jurisdiction does not constitute the “privilege of doing business.”

Sales tax returns should be limited to no more than once monthly

Of immediate importance, the PA Chamber supports legislation that would replace the onerous semi-monthly sales tax return requirement established by Act 48 of 2009 with a single monthly return that includes both an estimated tax for the current month based on the previous year's remittance and a true-up payment for the prior month tax. This new process would alleviate the costly and burdensome method created by Act 48, which made Pennsylvania the only state in the country to require two sales tax returns per month.

Under Act 48, the semi-monthly sales tax return system will take effect on May 21, 2011. If semi-monthly filing is implemented, Pennsylvania businesses will have the shortest deadline of any state to file and remit sales tax, just 10 days to file each return. Further, the Department of Revenue and businesses will perform double the work to process semi-monthly returns. Lastly, larger companies will incur substantial expenses to create new data retrieval and reporting systems just for their Pennsylvania operations.

Conclusion

The PA Chamber recognizes that the Commonwealth is facing record budgetary deficits and any change in the corporate tax structure may have a negative effect on short-term revenues. However, Pennsylvania needs to be increasingly competitive, for both jobs and capital. Companies and investors have choices, both globally and among the states, to place their investments and we want businesses to remain here, invest here and grow here.

Again, thank you for giving me the opportunity to present remarks on behalf of the PA Chamber. I am happy to answer any questions you may have at this time.