PENNSYLVANIA Budget and Policy Center

January 29, 2020

BEFORE THE SENATE DEMOCRATIC
POLICY COMMITTEE OF THE PENNSYLVANIA LEGISLATURE

Testimony of Stephen Herzenberg, Executive Director, Keystone Research Center

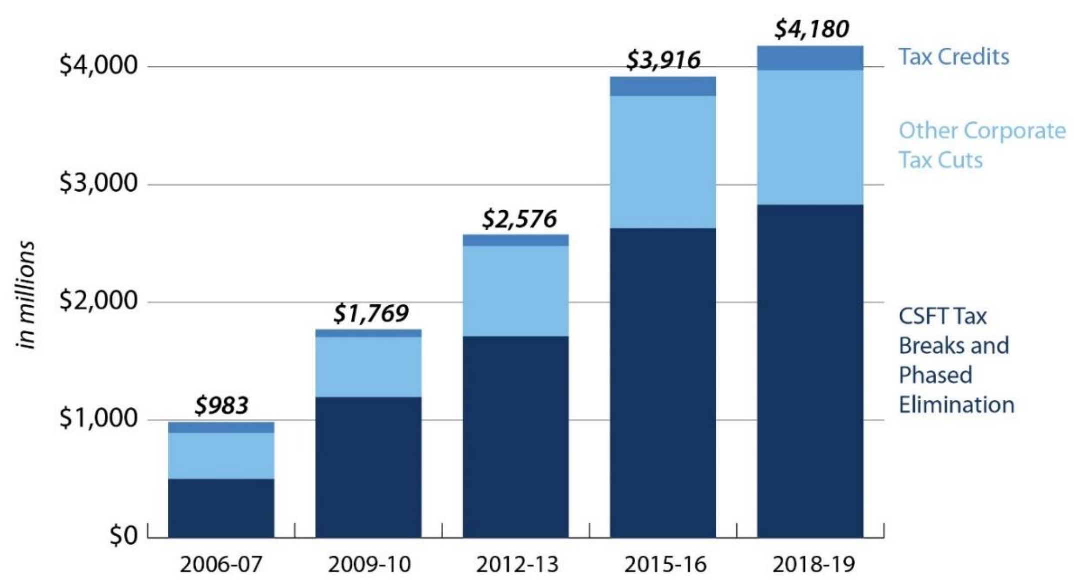
Chairwoman Boscola and Members of the Committee:

My name is Stephen Herzenberg and I am the executive director of Keystone Research Center and hold a PhD in economics from MIT. KRC publishes its tax and budget work under our Pennsylvania Budget and Policy Center, which is led by my colleague Marc Stier. Thank you for the opportunity to piggyback on my Marc's comments.

The Cost of Corporate Tax Cuts Since 2002

The corporate tax policies that Pennsylvania has pursued since 2002 illustrate the power of the narrative in our state that the path to prosperity is paved by tax cuts for corporations. The first bar chart in our policy brief tells the overall story. The annual cost of corporate tax cuts since 2002 now equals an estimated $4.2 billion (Figure 1).

Annual Cost of Corporate Tax Cuts Implemented Since 2002



Source: Table A1. CSFT tax breaks and phased elimination includes the first two rows of Table A1; other corporate tax cuts the next four rows; and tax credits the remaining rows.

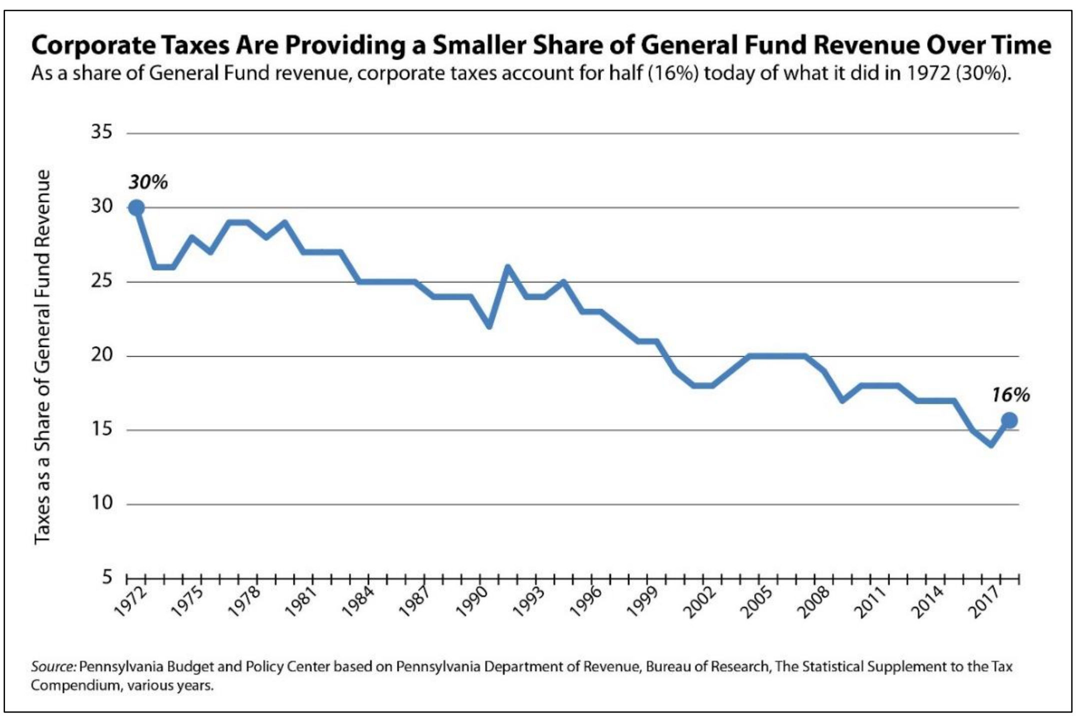
The biggest corporate tax cut since the early 2000s was the phase out of the Capital Stock and Franchise Tax (CSFT) imposed in part on the value of the capital stock of corporations operating in Pennsylvania. If this tax were still in place at the 2002 rate it would have raised about $2.8 billion in 2018-19. Revenues from this tax were more stable than those from the corporate net income taxes over the business cycle just as revenues from residential property taxes are more stable those from the personal income tax. The CSFT was also less open to exploitation of corporate tax loopholes because the value of capital stock in Pennsylvania cannot be manipulated as easily as reported net income.

The next largest group of tax cuts in our chart includes changes that modify and lower the taxes paid by many large Pennsylvania corporations. The most important of changed the reported income subject to the Corporate Net Income tax with a combined cost of over $1 billion.

Pennsylvania has also expanded a wide range of tax credits—those we include in our tally are listed in Appendix Table A1 in our brief. Our estimates of the cost of tax credits are conservative because we don’t include tax credits unless they are for individual businesses with the express goal of increasing job creation.

Corporate Taxes Are a Much Smaller Share of General Fund Revenues Over Time

When you cut corporate taxes it drives down these taxes contribution to General Fund revenues. As Marc has emphasized, it also drives up the share of General Fund revenues that has to be paid for by other taxes, including those paid by middle- and low-income families. If the corporate share of General Fund revenues still equaled the average for the 1970s (which is similar to the rate in 1992), corporations would contribute another $4.1 billion—very close to our $4.2 million estimate above based on adding up the cost of each individual tax cut.



No Payoff from Business Tax Cuts

The story told by proponents of corporate tax cuts is that these cuts stimulate investment and job growth. The reality—that pesky thing documented by real world experience and real research—shows that corporate tax cuts don't stimulate investment and job growth.

Ohio in the 2000s eliminated the state tax on corporate profits, slashed the individual income tax, and phased out a major business property tax. Ohio "lost relatively more jobs, and more manufacturing jobs, than the country as a whole….output and new investment have lagged, while personal income hasn't kept up."[1] Pennsylvania followed similar policies with similar results.

The large and rigorous peer-refereed research literature—drawing on a wider range of state experience—highlights two reasons corporate tax cuts don't boost growth. First, state and local corporate taxes represent too small a share of corporate costs to have a significant effect on business location. Second, because of state balanced-budget requirements, cuts in corporate tax rates often lead to spending cuts, which reduce overall demand. Especially when those spending cuts lower critical public investments—in, for example, education and infrastructure—the net effect can be to reduce economic growth.

Worldwide Combined Reporting

Since zombie cutting of corporate tax cuts doesn't work, we, like others in this hearing, recommend reversing course. Specifically, since we have but one major corporation tax left that many of the largest corporations operating in Pennsylvania are supposed to pay, the Corporate Net Income (CNI) tax, we suggest a policy reform to make sure more companies do pay something rather than being able to cook their books to eliminate their reported net income in Pennsylvania. Currently, 73% of C corporations registered in Pennsylvania pay no CNI tax, in part because of the rampant exploitation of corporate tax loopholes and corporate tax avoidance. We recommend closing tax loopholes that allow income shifting across national as well as state boundaries—through worldwide combined report. The PA Department of Revenue estimates that closining tax loopholes within the US would raise $677 million in additional revenue from Pennsylvania's CNI tax.[2] ITEP estimates worldwide combined reporting would raise $260 million more than just closing tax loopholes that allow income shifting across state lines.[3]

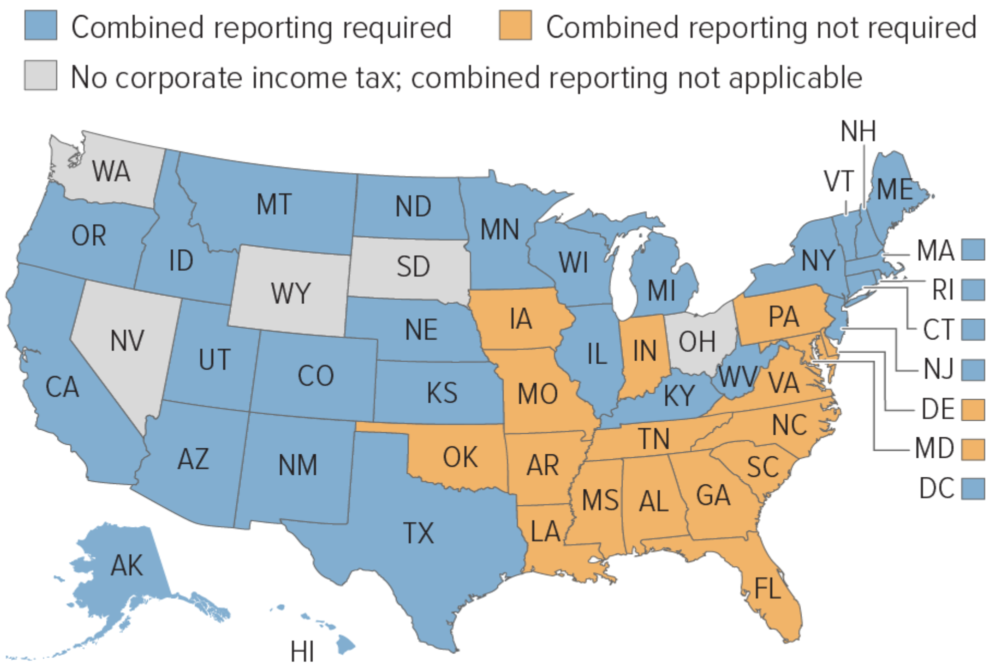
Twenty-eight states with corporate income taxes, plus the District of Columbia, have enacted combined reporting. Pennsylvania is one of 17 primarily midwestern and southern states that have a corporate income tax but have NOT implemented combined reporting.

[1] Zach Schiller, "Revisit Ohio's Tax Cuts" Toledo Blade, September 12, 2010.

[2] Amy Gill, Deputy Secretary of Tax Policy, Pennsylvania Department of Revenue, "Corporate Net Income Tax Combined Reporting Methodology," 2019.

[3] Richard Phillips, Nathan Proctor. "A Simple Fix for a $17 Billion Loophole: How States Can Reclaim Revenue Lost to Tax Havens." ITEP, U.S. PIRG Education Fund, SalesFactor.org and American Sustainable Business Council (ASBC). Accessed at: https://itep.org/a-simple-fix-for-a-17-billion-loophole/.

28 States Plus DC Require Combined Reporting for the State Corporate Income Tax



Source: John C. Healy and Michael S. Schadewald, "2019 Multistate Corporate Tax Guide, Vol. 1," Kentucky HB 487 (2018), effective January 1, 2019; New Jersey AB 4262 (2018), effective July 1, 2019; New Mexico, HB 6 (2019), effective January 1, 2020.

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

I want to close with a story about the business community's acknowledgment nearly 20 years ago that having no CSFT and a porous Corporate Net Income tax is a bit greedy. At that time, the business community thought—wrongly—that a new Democratic Governor might balance the budget on the backs of corporations. So major business organizations joined with labor unions in a business-labor tax project. The business organizations' tax-cutting wish list in 2002-03 was topped by changes implemented over the next decade without any concessions from corporations in exchanange: specifically, eliminate the CSFT and modify, and lower, the compution of net income subject to the CNI. Not knowing then they would get their wish list for nothing, the business groups endorsed a reform package that would have required coroporations to pay a new net worth tax to replace the CSFT if that new net worth tax raised more than the CNI—i.e., more than zero in many cases.[4] The new net worth tax business groups

[4] In exchange for immediate CSFT elimination and for changes to the computation of taxable income subject to Pennsylvania's CNI, the reform package of the PA21 Business-Labor Tax Project included a new net worth tax at 2.5 mills. Under the proposal, companies would have paid the larger of the Net Worth Tax or the CNI at a rate of 7.99%. The Net Worth Tax would have raised an estimated $250 million in 2003, about $360 million in today's dollars. See Pennsylvania 21st Century Consultants (Ernst & Young LLP, Keystone Research Center and Pennsylvania Economy League, Inc. *Pennsylvania 21st Century Tax Policy Project Moving Pennsylvania's Tax System Into the 21st Century*, December 3.) The governing board of the PA21 project included representatives of the

endorsed then would have raised $360 million in today's dollars—not $4.2 billion but not nothing. In sum, the corporate tax-cutting frenzy has cut too deep for long. It's time for corporations to contribute their fair share and help address our state's pressing investment deficit—in education, higher education, roads and bridges, health care, and social services.

Pennsylvania AFL-CIO, the Pennsylvania Business Roundtable, the Pennsylvania State Education Association, and the Allegheny Conference on Community Development.