



It's Time for Combined Reporting

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Prepared Statement of Marc Stier, Executive Director of the Pennsylvania Policy Center Before the Pennsylvania House Finance Committee

Introduction

Chairman Samuelson, Chairman Greiner, and members of the committee,

My name is Marc Stier. I'm the executive director of the Pennsylvania Policy Center, a new organization that does policy analysis and advocacy on state policy issues, including tax, budget, education, and safety net issues. I was previously the director of the Pennsylvania Budget and Policy Center where I started working on similar issues in December 2015.

I thank you for your invitation to speak on two of the three bills before you. Today, I'm going to start with some remarks on House Bill 1482, the legislation to accelerate the reduction in the Corporate Net Income Tax rate. Then I will speak a bit about House Bill 1462, the legislation to institute combined reporting.

Corporate Net Income Tax Rate

Last year, I authored a long paper and a few shorter pieces explaining why I opposed reductions in the Corporate Net Income Tax rate on the scale adopted by the General Assembly.¹ I have long believed that some reduction in our corporate tax rates is justified both as a matter of fairness and economic efficiency, since non-corporate business profits are taxed at the Personal Income Tax rate of 3.07%. But the right rate seemed to me to be about 6.5%, which is not only just a bit below the national average of 7% but is also the rate that I've proposed for non-corporate business taxes in the Fair Share Tax plan that the Pennsylvania Budget and Policy Center first developed five years ago.²

Given my opposition to reducing the CNIT rate to 5%, I oppose accelerating that reduction this year.

Discussions of the corporate tax rates can become complicated very quickly. So, the first thing I want do is remind you that Pennsylvania has drastically cut corporate income taxes in the last 21 years. State revenues have been reduced by \$4 billion per year and yet we, like other states that relied on

1. Marc Stier and Diana Polson, [Corporate Tax Cuts Without Combined Reporting Are Not Worth The Cost](#), Pennsylvania Budget and Policy center, June 13, 2022. Marc Stier, "[It's Not the Time or Way to Cut Corporate Taxes](#)," Pennsylvania Budget and Policy Center, June 13, 2022.

2. It is generally accepted that an ideal tax system would tax all business profits at the same rate, no matter whether the business is organized as a C-corp, S-corp, LLC, or in some other form. Ideally business efficiency, not tax considerations, should determine how a business is organized. The most recent version of our Fair Share Tax proposal is in: Marc Stier and Diana Polson, [How Can a Fair Share Tax Support Public Investment in Pennsylvania?](#) Pennsylvania Budget and Policy Center, March 21, 2023.

reducing corporate taxes to generate jobs and economic growth, have little to show for it.³

The second thing I want to do here is summarize two arguments I've made before. The written version of the testimony contains technical details as well as references to earlier papers.

Theory untethered to empirical analysis

Some economists and advocates support cutting taxes by embracing economic theory in a way that is not tethered to empirical analysis. The standard version of microeconomic theory tells us that if we tax some activity we will get less of it. So, advocates tell us that reducing tax rates on corporate profits will lead to more investment, which will create jobs.

This theory is correct. In most cases, taxing corporate profits reduces business investment to some degree.

The sticky question, however, is *how much?* Theory cannot answer that question. It cannot tell us how much business investment is deterred by a certain tax rate or how much investment would increase if that rate were lowered. We need to attend to empirical evidence to answer those questions.

Once we look at the best empirical evidence, it becomes clear that cutting taxes is a costly way of generating job growth. There are number of reasons this is true: most importantly, corporate taxes account for no more than 0.3%–0.4% of the costs to corporations of doing business, far less than the cost of labor, raw materials, offices, and factories, and almost any other cost of business.

Given that corporate taxes have such little impact on business income, it should not come as a surprise that the best overviews of the huge econometric literature on the relationship between taxes and job growth shows that a 10% reduction in **all** business taxes (not just corporate net income taxes) would increase business activity by about 2%–3% over a 10-year period.

Suppose we use these figures to do a back-of-the-envelope analysis of the impact of the reduction in the CNIT from where it was in the last fiscal year, 9.99%, to the 4.99% it is currently scheduled to reach in 2031 and that it would reach in 2026 under HB 1482.⁴ My calculation shows that such a reduction in tax rate would add roughly 97,500 jobs.

Now that sounds like a lot. But it comes at the cost of more than \$1 billion in tax revenues, which would require a reduction in spending by the same amount. The only parts of the state budget that can be reduced by that amount are education and infrastructure. We know from experience that the cost of a \$1 billion reduction in education spending is about 27,000 jobs. Taking into account the multiplier effect of government spending, the reduction in jobs is likely to be closer to 50,000. And we also know from research that about 80% of the jobs created by tax cuts for businesses go to people who move into the state because of shortages in the employees desired by expanding businesses. So, the net increase in jobs for Pennsylvanians would be only between 11,000 and 12,000.

Now 12,000 new jobs for Pennsylvanians are not unimportant. And one could argue that increasing the population of the state by 45,000 people would be beneficial as well. But the unanswered question

3. Stephen Herzenberg, Diana Polson, and Marc Stier, [Corporate Tax Cuts Since 2002 Now Cost PA \\$4.2 Billion Yearly: PA Should Pass Worldwide Combined Reporting](#), Pennsylvania Budget and Policy Center, January 27, 2020.

4. Full details of this analysis are in the appendix to this testimony. To simplify the analysis, I'm going to assume that the rate reduction takes place all at once and goes into effect for a full year starting in the next fiscal year.

is whether it is worth the cost of \$1 billion in lost revenues.

That brings me to a second point.

Alternative paths to economic growth

When we focus all our attention on cutting taxes as a way of generating economic growth and jobs, we often fail to consider the alternative, which is using tax revenue to invest in public goods, such as education and infrastructure, which also generate economic growth and create jobs. I'm focusing on education spending again though I think the conclusion I reach would be even stronger if I focused on infrastructure. Drawing on recent research on the economic impact of education spending, I calculate \$1 billion a year in new education spending would lead to a 2.2% increase in Pennsylvania wages, a reduction in the poverty rate of 1.1%, an increase in the state gross product of about \$900 million, and the generation of about 12,000 jobs for Pennsylvanians. Moreover, this research looks only at the direct impact of education spending, leaving aside the multiplier effect of such spending: that is the impact an increase in consumer spending has on creating other economic activity. Academic research on the multiplier effect of government spending tends to center around 1.5, which would mean that \$1 billion in state would generate \$1.5 billion in economic activity and perhaps 18,000 jobs for Pennsylvanians.

Choosing the right path toward economic growth.

The back-of-the-envelope calculations I'm presenting quickly today are all rough. I would not put much stock in them, not the least because there is a great deal of uncertainty and controversy about all the research on which I've drawn. My point is not to say that at this point in our state of economic knowledge, research can tell us what economic development strategy a state should undertake.

But if research can't tell us which economic strategy we should adopt, and our best guess is that the benefit in terms of economic growth and jobs for Pennsylvanians of a billion-dollar corporate net income tax cut is about the same as a billion-dollar investment in education, how should we choose between them. And does it matter which path should we choose?

I would answer that yes it matters, and it matters very much. For the key question is not just how much our state benefits in the aggregate from one or another economic development strategy but who benefits more from these different strategies. And here, the difference between the two strategies is clear.

An economic development strategy that is focused on cutting taxes for corporations will create some jobs for average Pennsylvanians. But it would also bring enormous benefits to the wealthy owners of corporations. It would make our already upside-down tax system—in which the top 1% pays taxes at half the rate of middle-income Pennsylvanians—even more unfair and would increase inequality in the state.

On the other hand, an economic development strategy that uses tax dollars from wealthy corporations to focus on educating and training Pennsylvanians, or investing in infrastructure, would provide far more benefit for low- and moderate-income Pennsylvanians. This would create greater equality of opportunity, reduce the disparity between rich and poor, save the state social safety net spending, and make our communities safer. It would, no doubt, benefit businesses as well by ensuring they have the educated and trained workers they need. I welcome economic policies that help our business community. But the benefit of an economic development strategy focused on education and training would be far more broadly shared than one focused on cutting taxes.

Combined Reporting

I turn now to the issue of *combined reporting*. I'm going to be brief because we have Don Griswold with us today, and this is a topic about which he has far more expertise than I do.

I just want to make four quick points.

First, it is long past time that Pennsylvania joins 28 states and the District of Columbia to adopt combined reporting rather than the separate reporting system that, as Don will explain, allows corporations, advised by clever lawyers and accountants, to shift profits from Pennsylvania to states and countries that have low or even no corporate net income taxes. It is scandalous and unfair that 73% of the corporations that do business in our state pay no corporate net income taxes even though those businesses take advantage of the workforce educated by Pennsylvania taxpayers as well as the roads and bridges Pennsylvania taxpayers pay for.

Second, as Don explains in more detail, the add-back provisions included in the corporate tax legislation enacted last year, will not block tax avoidance for long, if at all. Trying to close the Delaware loophole by blocking one tax avoidance scheme after another is a game of whack-a-mole that Pennsylvania taxpayers always lose.

Third, HB 1462 is a very good first step to closing what we colloquially call the *Delaware loophole*. It goes even farther in blocking some specific international tax havens, which are named in the legislation. But ultimately, we need to move from the approach in HB 1462 to worldwide combined reporting which would totally block tax shifting to other countries as well as other states. In other words, we need to close the Bahamas and Cayman Islands loopholes as well as the Delaware loophole.

Fourth, I want to share with you a very rough estimate of how much additional revenue this legislation would raise. My estimate draws on the Department of Revenue's 2018 projection that water's edge combined reporting would raise \$667 million in new revenue at the CNIT rate of 9.9%. What I have done in the table in my testimony is to adjust this number in two ways. First, I've made some calculations for different tax rates, which is a simple revision. Then I've adjusted for the growth in corporate profits based on the 42% increase in national corporate profits between 2018 and now. I estimate that at the current tax rate of 8.49%, combined reporting would bring in an additional \$887 million in tax revenue. At that tax rate for 2031 under current law—and proposed for 2026 under HB 1482—combined reporting would bring in an additional \$484 million.

Estimates of Additional 2023 Pennsylvania Tax Revenue Under Water's Edge Combined Reporting for various CNIT rates					
	2018 CNIT Rate	2023 CNIT rate	2024 CNIT rate under current law	2028 CNIT rate under current law	2031 tax rate under current law
	9.90%	8.99%	8.49%	6.49%	4.99%
Based on DOR Estimate for 2018 taxes	\$677,000,000	\$661,990,909	\$625,172,727	\$477,900,000	\$341,235,354
Based on 2023 adjustment for growth in corporate profits	\$961,340,000	\$940,027,091	\$887,745,273	\$678,618,000	\$484,554,202

Source: Penn Policy analysis of Amy Gill, Deputy Secretary of Tax Policy, Pennsylvania Department of Revenue, "Corporate Net Income Tax Combined Reporting Methodology," 2019; and National Income: Corporate profits before tax, Federal Reserve Economic Data (FRED), St. Louis Fed, <https://fred.stlouisfed.org/series/A053RC1Q027SBEA>.

As I discuss in detail in an appendix to this testimony, these estimates are quite rough for two reasons. First, the Department of Revenue's 2018 estimate was for legislation less comprehensive than HB 1462. Second, recent and future tax law changes in both the United States and in countries that adopt the OECD's new rules on corporate taxation—which may at some point including the United States—will have some impact on the allocation of multinational corporate income between one country and another.

Fifth, let me say that for many years my organization held that the reduction in the CNIT rate we supported should only be enacted in legislation that also included combined reporting. The corporate tax legislation reduced the CNIT rate but did not include combined reporting. This year the General Assembly should revisit this decision and enact legislation that accelerates the reduction of the CNIT rate along with enacting water's edge combined reporting. Despite my doubts about how far the CNIT rate will be lowered, I would strongly support this compromise legislation.

And finally, let me say that given the impact that new funding for education can have on creating opportunity for all—not to mention the constitutional mandate to fund our schools fully and fairly—we very much need the revenue that can be raised from instituting combined reporting.

Thank for the opportunity to speak to you on these issues.

Technical Appendix I: Calculation of Impact of Corporate Tax Cuts and Education Investment Strategies

In this first appendix I will, as we used to say in grade school, show my work and present the details and research that support my conclusions about the impact of corporate tax rates and education investment on economic growth and the creation of jobs.

Corporate tax cuts

The best research we have suggests that all state and local taxes account for only 2%-4% of total business costs. Corporate income taxes at the state and local levels amount to slightly less than 10% of that 1.9%,⁵ or 0.3%–0.4%, of the costs to corporations of doing business.⁶

The corporate tax bill enacted last year—as well as HB 1482—ultimately calls for reducing the CNIT from 9.99% to 4.99%, a tax rate reduction of 5 percentage points or 50%. The general academic

5. Peter Fisher argues that state and local taxes make up only 1.9% of total business costs in “State and Local Taxes Are Not Significant Determinants of Growth,” <http://www.gradingstates.org/the-problem-with-tax-cutting-as-economic-policy/>. This piece is an accessible overview and one-stop resource about the impact of tax policy on economic development. His research on the impact of state and local taxes on the cost of doing business is “based on data from 2001 through 2012 from two sources: U.S. Internal Revenue Service, Statistics of Income, Integrated Business Data for all U.S. Corporations, partnerships, and non-farm proprietorships, showing total deductions for business costs on tax returns, <https://www.irs.gov/statistics/soi-tax-stats-integrated-business-data> and the Council on State Taxation’s annual reports *Total State and Local Business Taxes*. (The 2016 edition is available at <http://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/fy16-state-and-local-business-tax-burden-study.pdf>.)”

Fisher’s estimate has been challenged in Joseph Crosby’s “Just How ‘Big’ Are State and Local Business Taxes?” *State Tax Notes*, June 20, 2005, Doc 2005-12415, or STT 117. Michael Mazerov and Katherine Lira responded in “Almost All Large Iowa Manufacturers Are Already Subject to Combined Reporting in Other States,” Center on Budget and Public Policy, April 3, 2008, where they conclude that “state and local taxes have a relatively small impact on corporate location decisions because they constitute only 2.3 percent or less of total corporate expenses and their potential influence is overwhelmed by interstate differences in labor, energy, transportation, and other costs of production that account for almost 98 percent of total corporate production expenses,” <https://www.cbpp.org/research/almost-all-large-iowa-manufacturers-are-already-subject-to-combined-reporting-in-other>,

6. The estimate that corporate taxes account for less than 10% of state and local taxes is from the Council on State Taxation (COST), *Total State and Local Business Taxes, State by State Estimates for FY 20*, October 2021, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/2108-3843085_50-state-tax-2021-final.pdf.

consensus—which of course, is not without its critics, holds that the elasticity of business activity relative to business taxes is 2%–3%.

But because the CNIT is only 10% of the taxes paid by businesses in the state, a 50% reduction in the CNIT rate is a total tax reduction for businesses of just 5%. Using the academic consensus on the impact of a 10% reduction of taxes, the proposed CNIT reduction would lead to an increase in business activity of just 1 to 1.5%. Let's call it 1.25%. And that is a one-time increase over several years, not a continuing increase. As there were around 7.8 million Pennsylvanians employed in 2020, a 5 percentage-point reduction in the CNIT would generate about 97,500 new jobs by the end of ten years. (I'm oversimplifying the analysis by assuming that the jobs are created all in one year, although much of the research suggests the full impact of the tax cut would not be felt for ten years.)

Now that is a lot of jobs. But it comes at the cost of more than \$1 billion in revenues in the first year and each subsequent year.⁷ And a \$1 billion reduction in state revenues would require a \$1 billion reduction in state spending—that would result in a loss of jobs in state government, local governments, and schools that would lose state support, and suppliers to the government. The kind of spending that is easiest to cut in the state is for education and infrastructure. So, let's assume all the job loss is in the public sector where the average salary is \$47,000. A loss of \$1 billion in state revenues would directly cost a bit over 21,000 jobs. And that fits with the evidence that the Corbett reduction of about \$1 billion in school spending cost the state about 27,000 jobs. So, the net increase in jobs is reduced to somewhere between 90,000 and 96,000.

But that doesn't mean 90,000 jobs for Pennsylvanians. because the academic consensus is that 80% of the jobs created by tax cuts or incentives go to people from outside the metropolitan area in which taxes are cut. That's likely to mean outside of Pennsylvania for a roughly similar share of new jobs created.⁸ So the increase in jobs for Pennsylvanians would be only roughly between 18,000 and 19,500.

Now that's still an impressive number. But it does not consider the long-term impact of state spending on the economy of the state and, even more importantly, on the future of Pennsylvanians. And here we know that the return on state spending, especially for education and workforce training, is dramatic.

Investment in education

The best recent research suggests that a 10% increase in per-pupil spending on education at all levels leads to 7.25% higher wages and a 3.67% reduction in the annual incidence of adult poverty—and the benefit is larger for families with low incomes.⁹ And another study suggests that every increase

7. I am aware that the \$1 billion in lost CNIT revenues would likely be somewhat offset by increases in Personal Income Tax and Sales Tax receipts. But, by the same token, a reduction in government spending of \$1 billion will reduce Personal Income and Sales Tax receipts. The two effects might cancel each other out. On the other hand, government spending on education (or infrastructure) goes to workers who will spend a large share of their incomes. On the other hand, some of the corporate tax cuts wind up in the pockets of very rich people who save a larger some portion of their income, reducing sales tax revenue.

8. Timothy J. Bartik, [*Solving the Problem of Economic Development Incentives*](#), W. E. Upjohn Institute for Employment Research, 2007, p. 108.

9. C. Kirabo Jackson, Rucker C. Johnson, and Claudia Persico, *The Effects of School Spending on Educational and Economic Outcomes: Evidence from School Finance Reforms*, National Bureau of Economic Research, Working Paper, 20847, January 2015.

in education expenditure equal to 1% of GDP increases economic activity by .2%–.3%.¹⁰ I used these studies to estimate the effect what the state would lose if it failed to spend an additional 1 billion education. Such spending would raise average wages by 2.2%, poverty would decline by 1.1%, the gross state product of Pennsylvania would increase by almost a billion dollars and 12,000 jobs would be created. Moreover, these calculations do not account for the multiplier effect of education spending. Academic research on the multiplier effect of government spending tends to center around 1.5 which would mean that \$1 billion in state funds would generate \$1.5 billion in economic activity and perhaps 18,000 jobs.¹¹ (The estimates of the elasticity of business tax cuts on economic activity on which I relied do consider multiplier effects.)

It is possible that targeted workforce development and training could bring even better results to Pennsylvania in all these areas.

And of course, investment in infrastructure has also been shown to contribute to economic growth and job creation. Infrastructure spending so dramatically raises the productivity of private capital that even conservative economists claim that “it pays for itself.”¹²

Appendix II: Uncertainties in the Estimation of the Revenue Generated by Combined Reporting

The latter adjustment is far less certain. It is straightforward to calculate the amount of additional revenues that would be raised in Pennsylvania in 2023 based on the increase in corporate profits in the United States. This estimate assumes that the share of multinational profits booked in Pennsylvania, and the United States as whole relative to the rest of the world, has not changed. To do that we adjust the 2018 figures by the percentage increase in corporate profits in the United States before tax between 2018 and 2023, which according to FRED is 42%.¹³ This is what we do in the second row in table 1.

But at present, what we can't adjust for is the impact of recent and future tax law changes on the allocation of multinational corporate income between one country and another. Two major changes in international corporate taxes have had, had or will have an impact on where multi-national corporations show profits. The first, the Tax Cut and Jobs Act of 2017 (TCJA) and especially the Global Intangible Low Tax Income (GILTI) provision, has likely already had some effect, but it's not yet clear what it is.¹⁴ The second, the adoption of OECD corporate tax rules, would have an effect in the future. Pillar One of the new OECD rules require, first, that corporations pay more taxes in

10. Sefa Awaworyi Churchill, Mehmet Ugur, and Slew Ling Yew, “Government Education Expenditure and Economic Growth,” the B. E. *Journal of Macroeconomics*, 2017, Vol. 17, pp. 1-17. Sefa Awaworyi Churchill, Mehmet Ugur, and Slew Ling Yew, *Effects of Government Education and Health Expenditures on Economic Growth: A Meta-Analysis*, Monash University Department of Economics, 2015.

11. Renee Haltom, [Econ Focus: Fiscal Multiplier](#), Federal Reserve Bank of Richmond, 2018; Maarten De Ridder, Simona M. Hannon, Dajman Pfajfar, The Multipiece Effect of Education Expenditure, “The Multiplier Effect of Education Expenditure,” Finance and Economics Discussion Series 2020-058. Washington: Board of Governors of the Federal Reserve System, <https://doi.org/10.17016/FEDS.2020.058>.

12. Jim Glassman, “How a Big Infrastructure Investment Could Pay Off,” JP Morgan, Markets and Economy, <https://www.jpmorgan.com/commercial-banking/insights/the-economic-case-for-infrastructure-spending>.

13. National Income: Corporate profits before tax, Federal Reserve Economic Data (FRED), St. Louis Fed, <https://fred.stlouisfed.org/series/A053RC1Q027SBEA>.

14. Matthew Gardner, “Guilty, Not GILTI: Unclear Whether Corps Continue to Lower Their Tax Bills Via Tax Haven Abuse,” Just Taxes Blog, ITEP, January 7, 2020 <https://itep.org/guilty-not-gilti-unclear-whether-corps-continue-to-lower-their-tax-bills-via-tax-haven-abuse/>.

countries where they have customers and less in countries where they have the headquarters, employees, and office or plants where they produce goods and services. Pillar Two of OECD rules set a global minimum corporate tax of 15%.¹⁵ The new OECD rules have not gone into effect but will soon, possibly as early as next year in the European Union. While President Biden has called for the US to adopt the global minimum corporate tax, it is not likely to do so soon. However, whether the US joins the treaty or not, the OECD rules will have some impact on allocation of corporate profits between countries. There are many theories about how the OECD rules will affect US federal and state tax revenues. Some observers think that Pillar Two will add to US tax revenues. Others think they will be reduced.

Changes in the global allocation of the profits of multi-national corporations are likely due to both the TCJA and new OECD rules. But it's not clear how much they would change future Pennsylvania tax revenues if water's edge combined reporting were adopted in our state. On the other hand, if worldwide combined reporting were to be adopted in our state, the impact of those laws is probably less important. From the point of view of our state, it does not matter much whether corporate profits that are generated by sales in Pennsylvania are booked in Delaware or the Cayman Islands. Either way, worldwide combined reporting would allow us tax revenue that should flow to Pennsylvania but currently does not.

15. For differing views of the proposed OECD rules, see Steve Wamhoff, “Unfinished Tax Reform Corporate Minimum Taxes,” ITEP, October 4, 2022, <https://itep.org/unfinished-tax-reform-corporate-minimum-taxes/> and Daniel Bunn and Sean Bray, “The Latest on the Global Tax Agreement,” Tax Foundation, June 13, 2023, <https://taxfoundation.org/global-tax-agreement/>.