Talking Points on House Republican Fiscal Note on House Bill 2150 (as Amended 5/1/12) – Delaware Loophole

- The Republican fiscal note states that *SIMILAR* language from the Multi-state Tax Commission **could result in increased revenue** of $70 to $90 million per year. HOWEVER, these estimates are **not based on the specific language** of HB 2150, which creates a new loophole, and therefore **those estimates do not apply to this bill**.
    - **Even if the add-back provision did generate $90 million** per year, revenue losses would still be more than $600 million per year in 2019, and the **8-year cumulative loss would be approximately $2.5 billion**.
- The **Republican fiscal note only refers to the first two fiscal years** and does not address the significant revenue loss through the end of the decade, which results from significant CNI rate decreases.
- When **Republicans claim that this will generate revenue**. **That claim is based on a hope and a prayer** that businesses might somehow come to love PA just because of a lower tax rate *and flock here in droves*, but **there is no guarantee that this will happen**.

House Bill 2150 PN 3447 Revenue Estimate - Based on House Republican Fiscal Note for Add-back Provision

Corporate Net Income Tax	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	8 Year Total
Rate Reduction (9.99% to 6.99% by 2019)	$ -	$ (27.4)	$ (129.9)	$ (263.6)	$ (377.2)	$ (483.6)	$ (577.5)	$ (627.3)	$ (2,486.5)
Single Sales Factor Change (90% to 100%)	$ (9.6)	$ (33.2)	$ (34.2)	$ (32.2)	$ (31.3)	$ (32.9)	$ (33.9)	$ (34.9)	$ (242.3)
Uncapping Net Operating Loss use by 2022	$ -	$ (3.7)	$ (35.1)	$ (60.8)	$ (79.0)	$ (90.3)	$ (115.8)	$ (155.2)	$ (539.8)
Total Revenue Loss	**$ (9.6)**	**$ (64.4)**	**$ (199.2)**	**$ (356.5)**	**$ (487.4)**	**$ (606.7)**	**$ (727.2)**	**$ (817.4)**	**$ (3,268.5)**
Revenue Gain									
Sales Tax Vendor Discount ($300/year cap)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Add-back Provision*	$ 90.0	$ 90.0	$ 90.0	$ 90.0	$ 90.0	$ 90.0	$ 90.0	$ 90.0	$ 720.0
Net Revenue Impact	**$ 80.4**	**$ 25.6**	**$ (109.2)**	**$ (266.5)**	**$ (397.4)**	**$ (516.7)**	**$ (637.2)**	**$ (727.4)**	**$ (2,548.5)**

* **Based on House Republican Fiscal Note.** There is no guarantee that the add-back provision and exceptions will generate any revenue. Estimates are based on SIMILAR language but not the actual language of HB 2150. House Democratic Appropriations Committee estimates maintain that the add-back provision will result in no revenue gain, however Republican estimates are shown to demonstrate the best-case scenario revenue losses in the out-years.

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5/2/2012

Talking Points on House Bill 2150 (<u>as Amended 5/1/12</u>) – Delaware Loophole

- *Closing the Delaware Loophole with House Bill 2150 is like asking a condemned man to tie his own hangman's noose. Chances are he's going to slip through.*
- **House Bill 2150 doesn't solve the Delaware Loophole** problem because it **opens another loophole** for corporations to avoid paying their fair share of taxes in Pennsylvania.
  - **A new loophole** is created within the bill because it allows businesses to take advantage of an exception to the "add-back" rule by claiming that an expense is directly related to a "valid business purpose."
  - The exception for valid business purposes is so broad that it is possible, and very likely, that all affected intangible expenses will be considered to be for "valid business purposes."
- Over the next eight years, **House Bill 2150** will **cost Pennsylvania at least $3.3 Billion in lost revenue** needed to pay for education and other core programs.
  - **NOTE:** The net loss of at least $3.3 billion is a combination of the revenue changes from the CNI reduction, Sales Factor change, and Net Operating Loss being uncapped.
- There is **NO Guarantee of any revenue increase** from the add-back provision. However, by drastically lowering the CNI rate there **IS a guarantee of significant revenue loss.**
- Anyone truly interested in closing the Delaware Loophole should consider Rep. Phyllis Mundy's legislation — House Bill 1396 — which uses the **combined reporting** method to calculate state business taxes.
  - House Bill 1396 would close a wide array of corporate tax avoidance schemes, including the Delaware Loophole, by requiring businesses and their subsidiaries to jointly file one tax return and pay taxes according to the amount of business activity conducted in Pennsylvania.
  - **23 other states use the combined reporting** method because it is the best and most comprehensive approach to ensure that all corporations in Pennsylvania pay their fair share of taxes.
- **House Bill 2150 does NOT close the Delaware Loophole <u>OR</u> deliver real tax fairness to Pennsylvania.**

- House Bill 2150 **gradually lowers the CNI tax rate starting in 2014**. In the first 8 years, this change will result in nearly $2.5 billion in lost revenue to Pennsylvania.
- The **Sales Factor Change** in House Bill 2150 favors companies that are located in PA and **the net revenue loss is between $9 and $35 million a year**.
- House Bill 2150 also **gradually uncaps the net operating loss** provision beginning in 2014 and it will be completely uncapped by 2022. The **estimated revenue loss in 2019-20 would be more than $155 million** and would continue to grow beyond that in the years thereafter.
- The **one area where House Bill 2150 could have actually increased state revenue** was amended OUT of the bill on second consideration (5/1/12).

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5/2/2012

Fact Sheet on House Bill 2150 (as Amended 5/1/12) – Delaware Loophole

House Bill 2150 falsely claims to close the Delaware loophole by creating an add-back provision for intangible expenses. The bill also reduces the corporate net income (CNI) tax rate, allows for single sales factor apportionment, and gradually uncaps net operating losses.

Net Fiscal Impact: There are significant revenue losses that would result from this bill. The **losses each year grow significantly** to **more than $700 million per year** in 2019-20. The net fiscal impact over the next eight years would add up to approximately **$3.3 billion in total revenue losses.** These revenue losses would result in budget cuts to programs and services.

- **Add-back Rule:** House Bill 2150 claims to close the Delaware Loophole by creating provisions that would require businesses to add back intangible expenses for royalties and trademarks to taxable income. **A new loophole is created within the bill** because it allows businesses to take advantage of an exception to the add-back rule if the expense is directly related to a "valid business purpose."
  - **Fiscal Impact:** **There is NO Guarantee of revenue gain, but revenue loss is guaranteed.** It is impossible to accurately estimate the portion of business expenses that might be added back to taxable income in PA since it would depend on the decisions and structure of each individual business. The exception for valid business purposes is so broad that it is possible, and very likely, that all affected intangible expenses will be considered to be for valid business purposes. Therefore our analysis is that the add-back provision will result in **no significant revenue increase**.

- **Rate Reduction:** The bill gradually lowers the CNI tax rate starting in 2014, with a new reduction each year through 2019 when the rate would be 6.99%.
  - **Fiscal Impact:** Because the rate reduction begins in 2014, there is no revenue loss for the next fiscal year (2012-13); However **revenue losses associated with this provision are significant** and accelerate quickly in the out-years. When the rate is fully phased down to 6.99%, revenue losses will be more than $627 million per year continually.
  - **Long-term Loss:** Over the next eight years as the rate phases down, **revenue losses will total nearly $2.5 billion**.

- **Sales Factor Change:** The sales factor is changed from 90% to 100%, or a single sales factor. This change favors companies that are located in PA (having proportionally more payroll and property than sales).
  - **Fiscal Impact:** The **revenue loss** associated with this provision is not significant, starting at $9.6 million in 2012-13 and then **$33 to $35 million each year** thereafter.

- **Net Operating Loss Uncapping:** This bill gradually uncaps the net operating loss provision beginning in 2014; it will be completely uncapped by 2022.
  - **Fiscal Impact:** The **revenue losses**, beginning in 2013-14, begin small but **escalate each year**. The estimated loss in 2019-20 would be more than $155 million and would continue to grow beyond that in the years thereafter.

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5/2/2012

House Bill 2150 PN 3447 (As Amended 5/1/12) Revenue Estimate									
Corporate Net Income Tax	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**8 Year Total**
Rate Reduction (9.99% to 6.99% by 2019)	$ -	$ (27.4)	$ (129.9)	$ (263.6)	$ (377.2)	$ (483.6)	$ (577.5)	$ (627.3)	$ (2,486.5)
Single Sales Factor Change (90% to 100%)	$ (9.6)	$ (33.2)	$ (34.2)	$ (32.2)	$ (31.3)	$ (32.9)	$ (33.9)	$ (34.9)	$ (242.3)
Uncapping Net Operating Loss use by 2022	$ -	$ (3.7)	$ (35.1)	$ (60.8)	$ (79.0)	$ (90.3)	$ (115.8)	$ (155.2)	$ (539.8)
Total Revenue Loss	**$ (9.6)**	**$ (64.4)**	**$ (199.2)**	**$ (356.5)**	**$ (487.4)**	**$ (606.7)**	**$ (727.2)**	**$ (817.4)**	**$ (3,268.5)**
Revenue Gain									
Add-back Provision*	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Net Revenue Impact	**$ (9.6)**	**$ (64.4)**	**$ (199.2)**	**$ (356.5)**	**$ (487.4)**	**$ (606.7)**	**$ (727.2)**	**$ (817.4)**	**$ (3,268.5)**

* **There is no way to guarantee any revenue gain from this provision**. It is impossible to accurately estimate the portion of business expenses that might be added back to taxable income in PA since it would depend on the decisions and structure of each individual business. The exception for valid business purposes is so broad that it is possible and very likely that all affected intangible expenses will be considered to be for valid business purposes. Therefore our analysis is that the add-back provision will result in no significant revenue increase.