TAX CUT PLAN IS NOT REVENUE NEUTRAL

HB 440 will cost Pennsylvania over $700 million per year by 2025, shifting costs to individuals and local property taxpayers

PENNSYLVANIA
Budget and Policy Center

April 23, 2013

After a decade of business tax cuts that are costing Pennsylvania $3 billion this year alone, Governor Tom Corbett has proposed a brand new round of corporate tax cuts beginning in tax year 2014 that will continue to come at the expense of investments that really matter in our schools and communities. That proposal is moving forward in the Pennsylvania House of Representatives as House Bill 440. Supporters describe the bill as revenue-neutral tax reform, which closes the Delaware loophole to pay for the new business tax cuts. **In reality, the plan will cost the state hundreds of millions of dollars annually within just a few years.**

The bill attempts to prevent some corporations from unfairly shifting profits from Pennsylvania to Delaware and other low- or no-tax states by enacting a weak "addback rule," but **the cost of the bill far exceeds revenue gains from this and other provisions.** The result will be less money for the investments that boost Pennsylvania's economy, such as a strong education system, roads and bridges, and safe schools, streets, and communities. The bill will not close the Delaware loophole and leaves other loopholes untouched.

A Decade of Tax Cuts But No Jobs

The Governor's tax plan comes on the heels of a decade of tax cuts enacted by lawmakers in the hope of creating new jobs. Instead, the loss of tax revenue has contributed to cuts to critical services for families trying to manage in the recession and to the loss of 20,000 jobs in public schools and colleges since 2010. These job losses have contributed to Pennsylvania's unemployment rate, which since September 2012 has been above the U.S. average.

Expensive Tax Cuts

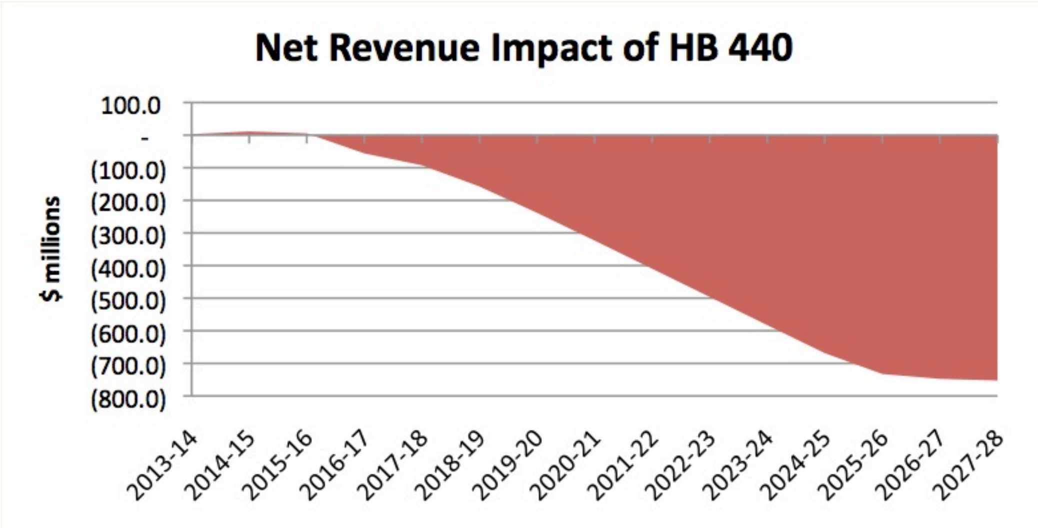
House Bill 440 implements new tax cuts for large, profitable corporations, reducing the corporate income tax rate by 30% over 10 years, beginning in 2015, and increasing the value of business losses from prior years that can offset current tax bills. **When fully phased in, the tax cuts in HB 440 will cost over $750 million annually.**[i]

By 2017-18, the plan loses almost $2 in tax collections for every $1 in new revenue it generates. This imbalance grows to a loss of $7 for every $1 in new revenue by 2025-26. This overall loss of revenue stems from the 30% cut to the corporate income tax rate, while an addback provisions may, at best, generate an additional 2% to 5% of corporate tax being collected.[ii] The addback mechanism in HB 440 would be the weakest in the nation; while we estimate a 2% revenue gain, it could raise far less.

Estimated Cost HB 440 – Including most of Gov.'s Plan (in millions)

	2013-14	2014-15	2015-16	2016-17	2017-18	2022-23	2027-28
Tax Cuts in HB 440	-$11	-$53	-$95	-$165	-$205	-$613	-$874
Revenue Increases (Including Addback)	$14	$65	$100	$109	$113	$117	$121
Net Revenue Gain or Loss of HB 440	**+$3**	**+$11**	**+$6**	**-$56**	**-$93**	**-$496**	**-$753**
Net Gain/Loss from Entire Gov.'s Plan Incl. Addback	**+$2**	**+$2**	**-$7**	**-$70**	**-$107**	**-$511**	**-$767**

Source. Pennsylvania Budget and Policy estimates, based in part on Pennsylvania Department of Revenue estimates on the cost of the Governor's tax plan and the Pennsylvania Independent Fiscal Office's estimates of how much revenue could be generated by creating an addback provision. Net cost of the Governor's plan includes the repeal of the corporate loans tax in 2014 (not included in HB 440, but would likely be enacted with HB 440 as part of the 2013-14 budget).



A Loophole Within a Loophole

The bill requires companies to add back expenses paid to related companies in other states to Pennsylvania taxable income. But it offers a broad exception for transactions "related to a valid business purpose." This means a company can easily skirt the law by claiming a valid business purpose. Most similar laws in other states are written to provide clear guidance and make it hard to avoid compliance.

The bill also grants a "valid business purpose" exemption for all transactions between related parties that are at market prices. This means that even if a company's intent was to reduce its Pennsylvania taxes, the Department of Revenue must allow the transaction as a long as it charges itself a going market rate for the interest or intangible expense.

There Are Better Approaches

- *Eliminate the broad exemption to the addback rule.* Requiring all income from intangible expenses and interest to be included, with only very limited exceptions, would stop more avoidance activities and raise significantly more money for investment in Pennsylvania's economy.

- *Require tax cuts to be voted on each year by the legislature.* Tax cuts should be treated like other spending and be subject to annual votes rather than being renewed automatically. The statutory phase out of the capital stock and franchise tax is a good example of the difficulties with an automatic approach. Since that tax was first voted to be phased out in 1999, the rate reduction has had to be suspended four times in 10 years because of economic downturns. This plan locks in rate cuts that will tie the hands of future governors and legislators.

- *Evaluate business tax cuts for impact, just like spending cuts.* Business taxes have been cut by almost 50% (close to $3 billion annually) without evidence that cuts have produced jobs or improved Pennsylvania's economy. The benefit to the public remains unproven.

Learn more about the Governor's tax plan at http://pennbpc.org/GovernorsTaxPlan.

The Pennsylvania Budget and Policy Center is a non-partisan policy research project that provides independent, credible analysis on state tax, budget and related policy matters, with attention to the impact of current or proposed policies on working families.

Endnotes

[i] The costs for HB 440 do not include the cost of the repeal of the corporate loans tax that the Governor proposed. The repeal of the loans tax is a separate bill, but is as likely to be enacted as the rest of the Governor's tax plan. Both the costs of HB 440 and the entire Governor's plan (including addback) are presented separately.

[ii] The Pennsylvania Independent Fiscal Office recently documented that addback rule may generate revenue gains ranging from 2% to 5% (http://www.ifo.state.pa.us/Resources/PDF/Corporate%20Tax%20Base%20Erosion%20-%20Analysis%20of%20Policy%20Options%20-%20March%202013.pdf).