Corporate Taxes Cuts Without Combined Reporting Are Not Worth The Cost

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By Marc Stier June 13, 2022

Executive Summary

Governor Wolf and some Democrats in the General Assembly have proposed reducing the tax rate for Pennsylvania's corporate net income tax (CNIT) this year and in future years, while also adopting some limited reforms that would expand the tax base by requiring some multinational corporations that now pay no corporate taxes to pay something.[1] We believe that the governor's proposal would be a step backwards for the state, both because it would cut the CNIT tax rate too much and because the reforms he proposes are far weaker than necessary, and far weaker than the one he has proposed in previous years. Some reduction in the CNIT rate makes sense but only when coupled with reforms that shut the door on the Delaware and Cayman Islands loopholes completely.

On April 26, the House Republican leadership brought legislation to the floor to cut the CNIT rate by two percentage points without any reforms that would expand the tax base. The bill passed the House of Representatives by an overwhelming margin with only eight Democrats voting against it.

We spoke out against the House action on this bill immediately as it was doubly problematic. Cutting the corporate net income tax rate without expanding the tax base would cost the state substantial revenue. And they are not worth the cost. Research on the effect of corporate taxes on economic growth shows that cutting the corporate tax rates will not generate substantial jobs. The House proposal to cut the tax rate by 2 points will initially cost the state $600 million in revenues per year, an amount that will grow over time. We estimate that a 2-point reduction in the corporate tax rate will over ten years generate only 23,067 new jobs of which only 20%, or 4,613, would go to current Pennsylvanians. These jobs come at a huge 10-year cost of more than $6 billion in lost state revenues or almost $270,000 per job. The cost for every job secured by a current Pennsylvania resident is $1.3 million. (And the costs don't stop after ten years.)

Investing the same amount of state funds in K-12 or higher education or in rebuilding our infrastructure is likely to generate far jobs than a cut in corporate taxes.

While the state is currently flush with cash, it may not remain so in the future. Previous reductions in corporate taxes are one reason that the state had so much trouble balancing its budget in the ten years before the COVID epidemic. Cutting corporate taxes with the expectation that it will create jobs make no sense at all.

There is only one justification for reducing the corporate tax rate—to be fair to small, Pennsylvania-based corporations that pay at a high rate. But fairness in taxation—and the need to sustain state revenues over the long term—also demands that we close the Delaware and Cayman Islands loopholes which allow 73% of corporations in the state, including the most highly profitable multinational corporations, to pay no corporate taxes to our state at all.

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[1] Thanks to Michael Mazerov, senior fellow at the Center on Budget and Public Policy, for his guidance in writing this paper and his extremely helpful comments on an earlier draft.

At a time when Pennsylvanians need help from their state, as well as the federal government, to deal with post-pandemic economic difficulties—including the rise in prices for housing, child care, and gas—it is obscene that the Republican leadership seeks to cut the corporate tax rate while blocking legislation that would deal with those problems. Republicans keep asserting that the state needs to save funds for the future. Then they hypocritically bring forward a corporate tax reduction bill that will cost the state over $600 million a year and provide unnecessary benefits to billionaires, many of whom who have seen their wealth double or triple during the pandemic, while doing nothing for most Pennsylvanians.

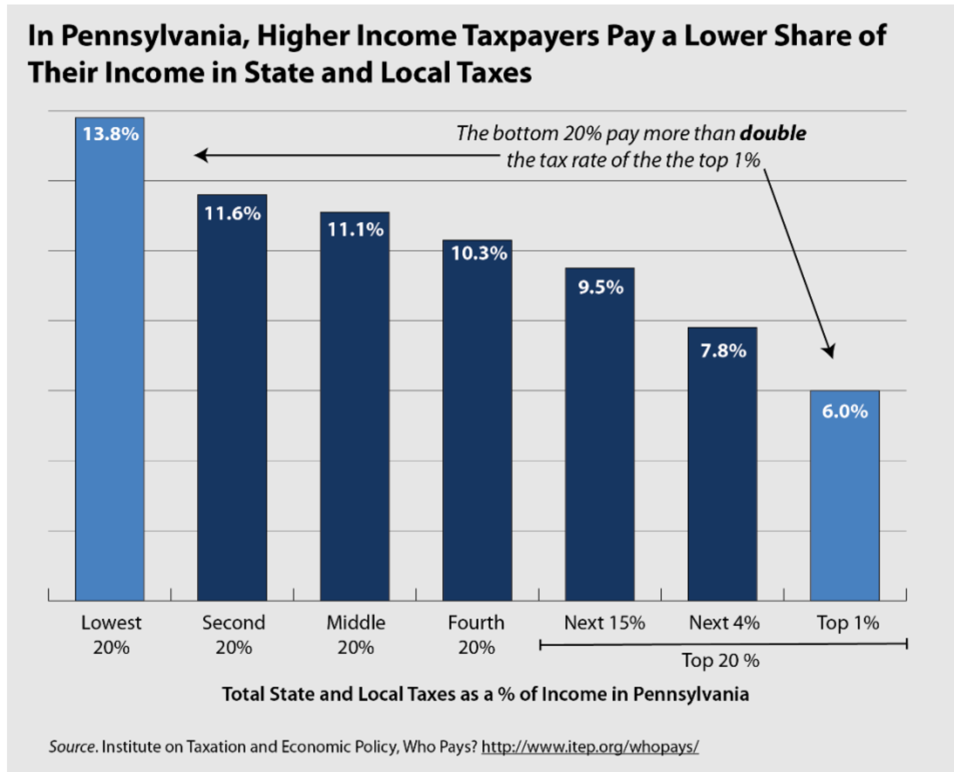
We are troubled that Democrats voted for this bill, and we attribute that vote to a political miscalculation after the legislation moved to the floor with almost no warning. We are gratified that Governor Wolf has made clear he will veto the bill and House Democrats have said they will sustain this veto. But it is also important that the governor and members of the General Assembly in both parties recognize that the only sound way to reduce the CNIT rate is by instituting combined reporting at the same time to ensure that wealthy multinational corporations pay what they owe Pennsylvania.

Pennsylvania's Corporate Net Income Tax In Context

Before turning specifically to the details of the corporate net income tax (CNIT) and Governor Wolf's proposals, we should put the CNIT into context.

The most important context is that of the state's tax system as a whole. For years, it has been upside down in that it takes a larger share of the income of low- and moderate-income Pennsylvania families than that of the top 1% as shown in figure 1. Families in the bottom 20%, with an annual income of less than $21,000, pay 13.8% of that income in taxes compared to the top 1% of income earners, with annual incomes above $540,000 and an average annual income of $1.6 million, who pay only 6% of their income in these same taxes.

Figure 1



One reason the state's tax system is so regressive is that corporate taxes have been drastically reduced in the last fifty years. As figure 2 shows below, the share that General Fund revenues that come from corporate taxes has been declining since the 1970s. In 1972, corporate taxes contribute 30% of our General Fund revenues, but today these taxes contribute only 15%.[2] One corporate tax—the capital stock and franchise tax (CSFT)—was once a stable source of revenue for the state and taxed wealthy multistate and multinational corporations. But rates were gradually reduced until in 2016 the tax was eliminated. The elimination of the CSFT, together with changes to the basis of the corporate net income tax (CNIT), costs the state more than $4 billion per year in revenues.[3] And as we explain in more detail below, we have seen little or no economic benefit from these corporate tax reductions.

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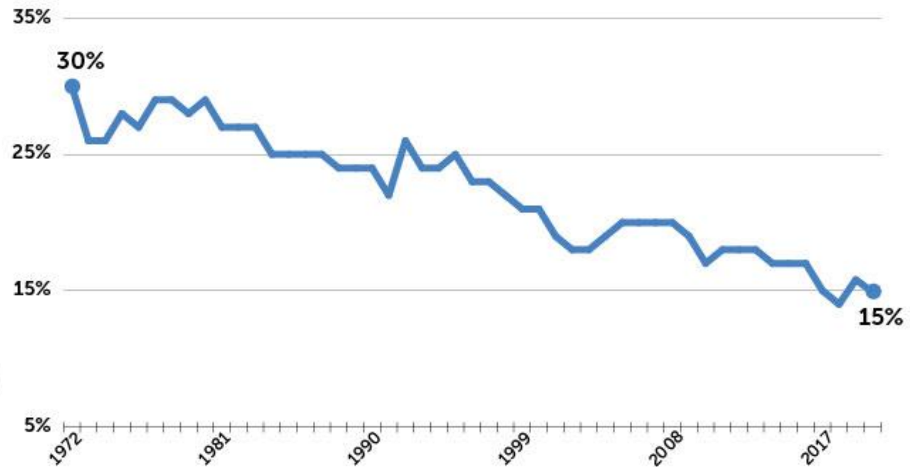
[2] To be fair, some of the decline has been due to businesses organizing themselves as S-corporations, LLCs, or partnerships so that their profits pass through to the owners who pay taxes at the lower personal income tax rate. As we point out below, we think that the CNIT rate should ideally be the same as the rate on the income from wealth, including that from businesses, so that tax considerations do not determine the organizational form of businesses.

[3] Stephen Herzenberg, Diana Polson, Marc Stier, "Corporate Tax Cuts Since 2002 Now Cost PA $4.2 Billion Yearly: Pennsylvania Should Pass Worldwide Combined Reporting," KRC-PBPC, https://krc-pbpc.org/wp-content/uploads/Corporate_Tax_Paper_Final.pdf.

Figure 2

Corporate Taxes Are Providing a Smaller Share of General Fund Revenue Over Time

Corporate taxes, as a share of General Fund revenue, account for nearly half (15%) today of what it did in 1972 (30%)



The corporate net income tax in Pennsylvania is a bit higher than other states. Of the 46 states that have a corporate income tax, our rate of 9.9% is the second-highest rate in the country after New Jersey's rate of 11.5%. But Pennsylvania's tax rate is not extraordinarily high—both the average and median top corporate tax rates in the country is 7%. It is true, however, that small corporations in many other states pay less than the top rate because those states have graduated corporate tax rates, something which is prohibited by the uniformity clause of the Pennsylvanian constitution.

Perhaps the most important context for thinking about the Pennsylvania corporate net profit tax is that 73% of corporations that operate in Pennsylvania pay the state no taxes at all because of what we call the Delaware and Cayman Islands loopholes. And while the Department of Revenue (DOR) cannot legally identify them, we are quite confident in our inference that they include most of the multistate and multinational corporations that are based out of state but operate subsidiaries or affiliates in our state. Many highly profitable multinational corporations pay no federal corporate taxes, so we find it unlikely that they pay Pennsylvania's CNIT.[4] As we shall see below, both the (DOR) and the Institute of Taxation and Economic Policy (ITEP) have very high estimates of how much revenue would be raised by closing the Delaware and Cayman Islands loopholes—and there is no other source of revenues of this magnitude except from multinational corporations. Our inference that these corporations pay little in corporate taxes is further confirmed by the opposition of their chief representative in the state, the Pennsylvania Chamber of Business and Industry, to closing the loopholes in the CNIT.

How wealthy corporations escape taxation—and how we can make them pay

Wealthy corporations escape from paying Pennsylvania's corporate tax by setting up subsidiaries or affiliates in the state that show little or no profits and thus pay no taxes here. Corporations use the magic of internal accounting to take advantage of tax laws that only tax corporations on the profit earned by their Pennsylvania subsidiaries. And by reducing the profits of local subsidiaries, multinational corporations can escape taxation entirely.

[4] Institute on Taxation and Economic Policy, "Corporate Tax Avoidance in the First Year of the Trump Tax Law," December 16, 2019, https://itep.org/corporate-tax-avoidance-in-the-first-year-of-the-trump-tax-law/.

If, for example, the wholesale price for goods sold in Pennsylvania but produced in other states or abroad are marked up high enough, the profits of the Pennsylvania subsidiary will be reduced. If the affiliated company based in another state charges the Pennsylvania subsidiary for a share of its national advertising or for management fees or administrative overhead costs, the profits earned in Pennsylvania will be reduced. And if the parent company charges the Pennsylvania subsidiary a high amount for the right to use its trademark or for the good will associated with its brand, the Pennsylvania subsidiary will show little or no profits and report this to the Pennsylvania Department of Revenue.

Because many of the corporate affiliates that are used to limit the impact of Pennsylvania's corporate net income tax are based in Delaware, PBPC and others have long called this method of avoiding Pennsylvania taxes, the Delaware loophole. In recent years however, many of those affiliates have been now based outside the United States entirely, so we call this practice the "Cayman Islands loophole."

Combined Reporting

The way to end the Delaware and Cayman Islands loopholes is to institute combined reporting. Under this system, all corporations that operate in Pennsylvania would report their U.S. profits to the state no matter where those profits were earned. The corporation would then pay taxes on a share of those profits equal to the share of sales made in the state. In this scenario, if a national company sells 25% of its goods or services in our state, it must pay Pennsylvania taxes on 25% of its combined profits.

Combined reporting makes it harder for multistate companies to avoid taxes by manipulating their reported income in states like Pennsylvania with a relatively high CNIT rate. Combined reporting would thus enable our CNIT to generate much higher revenues. And that would also make it possible to lower taxes for all corporations while still bringing in more revenue. Some of the benefits of a lower corporate tax rate would flow to smaller, in-state corporations. The Pennsylvania Department of Revenue estimated in 2019 that without a change in tax rates, water's edge combined reporting—which would require corporations to pay taxes on the Pennsylvania share of profits earned in the United States—would raise $677.1 million in additional revenue from Pennsylvania's CNIT.[5] Worldwide combined reporting, which taxes corporations on the Pennsylvania share of the profits corporations make worldwide, would raise even more. The Institute on Taxation and Economic Policy estimates that without a change in tax rates Pennsylvania would secure $729 million in new revenues each year by instituting worldwide combined reporting.[6] Of that amount, $469 million would come from taxing profits that are shifted from Pennsylvania to other states (less than the amount above that the Pennsylvania Department of Revenue estimates) with the rest coming from taxing profits that are shifted abroad from Pennsylvania.

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[5]Amy Gill, Deputy Secretary of Tax Policy, Pennsylvania Department of Revenue, "Corporate Net Income Tax Combined Reporting Methodology," 2019. The Department also estimates that the revenue neutral CNI rate—i.e., the rate at which combined reporting would bring in the same revenue as the current CNI with separate company reporting—is 7.76%. Less revenue would result if net operating losses were uncapped or sharing of NOLs within corporate groups were allowed under combined reporting. We point this out as a warning to legislators to pay attention to those provisions in any combined reporting bill.

[6] Richard Phillips and 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), https://itep.org/a-simple-fix-for-a-17-billion-loophole/.

Combined reporting is not some new-fangled or radical idea. Twenty-eight states with corporate income taxes, plus the District of Columbia, have enacted water's edge combined reporting. As the map in figure 3 shows below, Pennsylvania is one of 17 primarily midwestern and southern states that have a corporate income tax but have NOT implemented combined reporting.

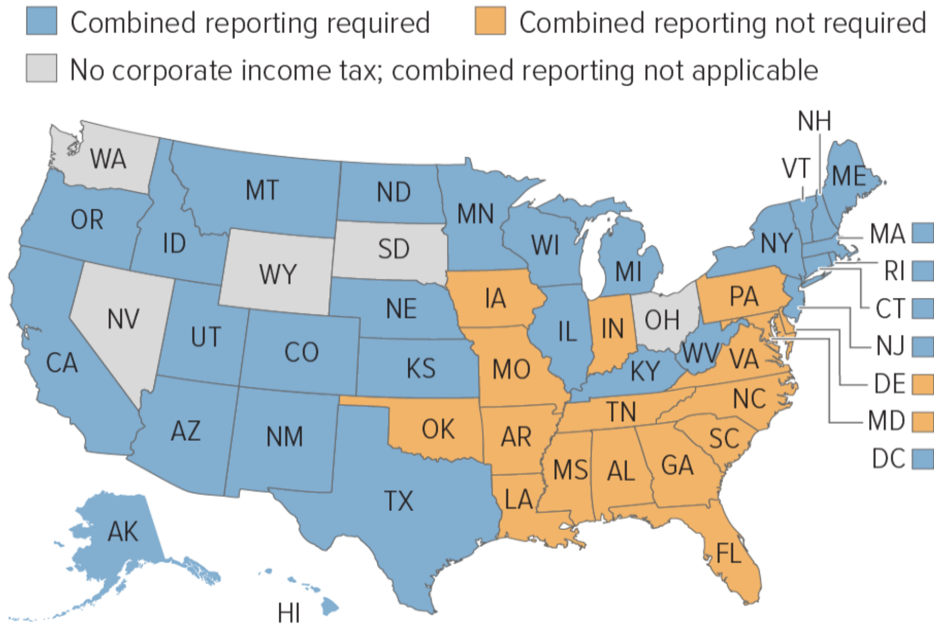
Nor does combined reporting drive businesses out of the state. A report from the Center on Budget and Policy Priorities showed that many large corporations operate in one or more states with combined reporting. And between 1990 and 2007, seven of the only eight states with that saw an increase in the number of jobs had combined reporting in place. Pennsylvania is one of the largest states and has one of the biggest markets in the country. Corporations may complain about combined reporting because they don't want to pay more in taxes. But they will not give up the Pennsylvania market or move away and give up the advantages of being located in the state.[7]

Indeed, if taxes have an impact on where businesses locate, there is reason to think that combined reporting would encourage corporations to locate more facilities in our state to service our large market. The argument that says corporations would be more likely to move to the state if we reduce our corporate tax rate has things *exactly backwards*. If it were true that differences in corporate tax have a great effect on where corporations decide to move or expand their operations, closing the Delaware and Cayman Island loopholes would be more of an incentive for businesses to move here than cutting our corporate tax rate. Even if they generate substantial sales in the state multinational corporations now have every incentive to limit their operations here in order to avoid Pennsylvania taxes. If corporations based outside the state were required to pay taxes based on their share of sales in our state, that disincentive would be removed. They would thus move more of their operations to Pennsylvania.

[7] Michael Mazerov and Katherine Lira, "Almost all Iowa Manufacturers Are Already Subject to Combined Reporting in Other States," Center on Budget and Policy Priorities, April 3, 2008, https://www.cbpp.org/research/almost-all-large-iowa-manufacturers-are-already-subject-to-combined-reporting-in-other.

Figure 3

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.

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Corporate Taxes and Democracy

That corporations based solely in Pennsylvania pay a relatively high corporate tax rate, while multistate and multinational corporations can exploit loopholes that enable some of them to pay little or nothing is an indictment of our political system as a whole. One would think that the representatives and senators elected by the people of Pennsylvania to serve in the General Assembly would put their constituents' interests above all. And doing that would mean taxing out-of-state corporations as much as—or even more than—corporations based in Pennsylvania. Yet even though Governor Wolf has called for it year after year, the Republican-led General Assembly has consistently refused to adopt combined reporting and use some of the revenues it would generate to cut taxes on Pennsylvania-based corporations. Opponents of Governor Wolf's plan claim to be concerned about creating economic growth and jobs in Pennsylvania, but by allowing some corporations based outside the state to pay nothing, they harm the small, local businesses that create most of our jobs.

When critics of American democracy point to the oligarchical nature of our government—its tendency to do what benefits the corporate elite, not the people—this is exactly the kind of public policy they are talking about.

What To Do About Our Corporate Tax Rates

Some reduction in the tax rate is justified

If our state were to introduce combined reporting, it would be possible to lower corporate net income tax rates on corporations based in Pennsylvania while still generating new revenues. This is what Governor Wolf proposed every year of his administration—until this one.

We at the Pennsylvania Budget and Policy Center have long believed that some reduction in the corporate tax rate might be justified—but not because there is any evidence that reducing our corporate tax rate would significantly aid the state's economy. Rather, we are concerned about the fairness of a high tax rate for small businesses when, thanks to the Pennsylvania Constitution's uniformity clause, we cannot institute graduated tax rates and when businesses organized as S-corporations, limited liability companies, or partnerships pay at the personal income tax (PIT) rate of 3.07%. In our Fair Share Tax plan, we propose raising the tax rate on non-corporate business profits to 6.5% We think that the corporate tax rate be set at the same rate. If corporate and non-corporate business profits were taxed at the same rate tax law would play no role in determining the legal structure businesses choose for themselves. We agree with what most economists believe—that an ideal tax regime for a state should not favor one or another form of business organization or status but should allow business owners to pick the form that makes the most sense for their goals and operations.

Corporate tax cuts don't generate economic growth and job creation

Research on the impact of taxes on business activity shows that cutting corporate tax rates in Pennsylvania is highly unlikely to generate a great deal of economic growth or new jobs.

Before we turn to the research on the impact of corporate tax cuts on job creation, we want to make six preliminary points that cast doubt on the notion that cutting the corporate tax rate would generate economic activity and jobs.

First, one reason corporate taxes have little impact on economic growth job creation is that taxes are a much smaller cost of doing business than labor costs and the cost to manufacturers of energy and raw materials. Access to low-cost energy and raw materials are determined by things such as geographic location and transportation costs. And access to plentiful and skilled labor is determined by the quality of training and education found in a geographic location and by the costs of regional transportation for educated and trained workers. The best research we have suggests that, together, 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%,[8] or 0.3%–0.4%, of the costs to corporations of doing business. [9]

The recent scramble by the nation's cities to offer Amazon huge tax subsidies shows us how limited in importance those subsidies can be. Amazon chose two metro areas, Washington, DC, and New York, even though New York has one of the highest state and local tax burdens in the country and their tax subsidy packages were far less aggressive than that of other cities. And when New Yorkers rejected the deal, Amazon still decided to expand there.[10] Obviously, many other factors, and especially the availability of skilled workers, were far more important to Amazon than taxes.

Second, a large majority of new jobs do not come from businesses' decisions to move or expand production. A Center on Budget and Policy Priorities analysis of states' job creation strategies found two key conclusions about the source of new jobs.[11]

> **The vast majority of jobs are created by businesses that start up or are already present in a state — not by out-of-state first relocating to a state or branching into it.** Jobs that move into one state from another typically represent only 1 to 4 percent of total job creation each year, depending on the state. Jobs created by out-of-state businesses expanding into a state through the opening of new branches represent less than one-sixth of total job creation. In other words, "home-grown" jobs contribute more than 80 percent of total job creation in every state.

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[8] 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,

[9] 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.

[10] Ben Fox Rubin and Sean Keane, "Amazon continues expansion in New York City even after HQ2 debacle," CNET, August 18, 2020, https://www.cnet.com/tech/services-and-software/amazon-continues-expansion-in-new-york-city-even-after-hq2-debacle/.

[11] Michael Mazerov and Michael Leachman, "State Job Creation Strategies Often Off Base," Center on Budget & Policy Priorities (CBPP), February 3, 2016, https://www.cbpp.org/research/state-budget-and-tax/state-job-creation-strategies-often-off-base.

During periods of healthy economic growth, start-ups and young, fast-growing companies are responsible for most new jobs. During the Internet-driven boom of the late 1990s and early 2000s, for example, start-up firms (those less than one year old) and high-growth firms — which are likely to be young — accounted for about 70 percent of all new jobs in the U.S. economy.[12] From 1990 to 2009, these enterprises were responsible for about 3 million jobs per year, with a little over 2 million jobs created consistently after the first five years of operations. In Pennsylvania, almost 86% of new jobs created between 1995 and 2013 were "home-grown jobs" created by start-ups and the expansion of in-state businesses.[13]

Third, a cut in the corporate net income tax is especially unlikely to encourage businesses to move operations into the state because Pennsylvania is a "single sales factor" apportionment state in which the share of taxes paid to Pennsylvania is determined by the share of sales made in the state. As a result, if a corporation sites a new plant or additional employees in Pennsylvania but make sales outside of the state, it pays no additional taxes. So, changing the CNIT rate should have no impact at all on whether multistate or multinational corporations want to locate in our state or somewhere else.[14]

And fourth, whatever businesses save when state corporate tax rates are cut is off-set in part by the loss of their deduction of state corporate taxes from their federal corporate taxes. At the current federal corporate tax rate of 21%, if the state reduces corporate tax revenues by $600 million, Pennsylvania corporations would only receive $474 million in benefits.

Fifth, when Pennsylvania-based corporations get a business tax cut, they won't necessarily invest that money in new productive capacity. That depends on general business conditions and whether there is a demand for what they're producing. We have seen that the Trump business tax cuts at the federal level have not led to substantial new investment because until the recent recovery there wasn't enough consumer demand to justify that investment.[15] (At the time the Trump tax cuts were passed, the cost of capital was extremely low with very high stock prices and low interest rates.) That is why reducing taxes for working people or providing support for people struggling to pay for housing or child care from the ARP or General Fund surpluses, is far more likely to lead to new business activity and jobs than a cut in business taxes.

And sixth, even if Pennsylvania-based corporations do invest more in productive capacity as a result of a tax cut, some of their spending for raw materials or intermediate goods will flow out of state. Indeed, given that the pandemic influenced an increase in the use of remote work, it's possible that many of the additional workers hired by Pennsylvania-based corporations aren't even

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[12] Ibid.

[13] Center on Budget and Policy Priorities, Chart: "Most New Jobs Come From Businesses Already in a State," 2016. Source: National Establishment Time-Series (NETS) database (Walls and Associates) provided under contract by the Business Dynamics Research Consortium: a project of the University of Wisconsin – Extension Division for Business and Entrepreneurship, https://www.cbpp.org/most-new-jobs-come-from-businesses-already-in-a-state-0.

[14] See Michael Mazerov, "Cutting State Corporate Incomes Taxes is Unlikely to Create Many Jobs, Center on Budget and Policy Priorities," September 14, 2020, https://www.cbpp.org/research/cutting-state-corporate-income-taxes-is-unlikely-to-create-many-jobs.

[15] A good overview of the failure of the Trump tax cut to lead to new investment is Jane G. Gravelle and Donald J. Marples, The Economic Effects of the 2017 Tax Revision: Preliminary Observations, Congressional Research Service May 22, 2019,
https://www.everycrsreport.com/files/20190522_R45736_8a1214e903ee2b719e00731791d60f26d75d35f4.pdf.

Pennsylvanians. Again, the revenues lost to a Pennsylvania corporate tax would not benefit the people of our state.

These conclusions give us more reason to doubt that business tax cuts are a useful tool to stimulate economic growth and job creation. Taxes on business profits are likely to have little impact on where jobs are created because new start-ups typically do not show any profits for their first few years in business.

Given these considerations on the relationship between business taxes and economic development in the states, it should be no surprise that the large body of statistical and empirical evidence that academics have developed in the last few decades casts doubt on the strength of the relationship between taxes and job growth.

There is a vast literature on this issue—so vast that we will cite a number of works that essentially summarize that literature, not the primary works themselves.[16] [17] There is now a rough consensus about the impact of taxes on economic growth in cities and states: the elasticity of business activity relative to business taxes is 2%–3%. That means that a 10% reduction in business taxes would increase business activity by about 2%–3%. Now there are several important qualifications to this claim:

- It assumes that all business taxes in a jurisdiction are cut commensurately. That means that all local and state business tax rates would have to be reduced by the same percentage. The corporate income tax is only one way that businesses are taxed by the state. S-corporations, LLCs, family-owned unincorporated businesses, and others are "pass-through businesses." The owners of these businesses pay taxes on the firm's profits at the personal income tax rate. There are also taxes that fall on utilities and insurance companies. And businesses also pay real estate and income taxes to municipal and county governments. The best evidence we have suggests that a bit less than 10% of the taxes paid by businesses in Pennsylvania are raised by the corporate net income tax.[18] So a reduction in the CNIT does absolutely nothing for the

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[16] See Michael Mazerov and Michael Leachman, "State Job Creation Strategies Often Off Base," Center on Budget & Policy Priorities (CBPP), February 3, 2016, https://www.cbpp.org/research/state-budget-and-tax/state-job-creation-strategies-often-off-base; Timothy J. Bartik, "Solving the Problems of Economic Development Incentives," *Growth and Change*, Vol. 25, No 2 (Spring 2005); Timothy J. Bartik, "Who Benefits From Economic Development Incentives? How Incentive Effects on Local Incomes and the Income Distribution Vary with Different Assumptions about Incentive Policy and the Local Economy," Upjohn Institute Technical Reports, https://doi.org/10.17848/tr18-034; Peter Fisher, "State and Local Business Taxes Are Not Significant Determinants of Growth," http://www.gradingstates.org/the-problem-with-tax-cutting-as-economic-policy/state-and-local-business-taxes-are-not-significant-determinants-of-growth/.

[17] In addition to the overview of the literature in the previous note, there are a number of powerful case studies of states that have adopted sharp tax cuts as a way of stimulating their economies only to see those policies fail. See for example: Tracy M. Turner and Brandon Blagg, "The Short-Term Effects of the Kansas Income Tax Cuts on Employment Growth," *Public Finance Review*, March 29, 2017, https://journals.sagepub.com/doi/abs/10.1177/1091142117699274. Also, Michael Mazerov, "Kansas Provides Compelling Evidence of Failure of 'Supply Side' Tax Cuts," Center on Budget and Policy Priorities, January 22, 2018, https://www.cbpp.org/sites/default/files/atoms/files/1-22-18sfp.pdf: "During the Brownback administration the personal income tax rate was cut and passthrough business taxes were temporarily repealed in Kansas. The cuts did not noticeably help the state economy. The state's bond rating was downgraded. Kansas underperformed in job creation and economic growth as compared to neighboring states."

[18] Council on State Taxation, *Total State and Local Business Taxes, State by State Estimates for FY 20.*

vast majority of businesses in the state and very little for almost all small businesses since they usually are not organized as C-corporations which are subject to the CNIT.

- It assumes that public spending is not reduced to offset the cost of cutting business taxes. Cutting public spending would have negative short- and long-term consequences on business activity. In the short term, any reduction in spending would lead to a direct loss in public sector jobs and an indirect loss due to the reduction in consumption due to the loss of those jobs. The longer-term consequences are more serious. We know, for example, that K-12 education—and even more so, early childhood education—has dramatic effects on children's long-term educational and economic success and thus contributes to the local economy. Similarly, we know that investments in roads and bridges and public transportation have enormous economic benefits. Reducing spending in these and other public services to pay for business tax cuts would be totally self-defeating over the long term. Keep in mind that the $4 billion in yearly business tax cuts already in place are largely responsible for Pennsylvania's persistent budget problems over the last ten years. Those cuts are also behind the deep reduction in the state's funding for K-12 schools and higher education, as well as the failure of the state to keep up with the repair of our roads and bridges, which have all undermined our state's economy.[19]
- It does not presume that all new jobs would go to current Pennsylvanians. Recent studies suggest that, over the long term, as many as 80% of the jobs created by tax cuts and subsidies to individual businesses are filled by newcomers to a state.[20]
- It does not consider the public sector costs of bringing new workers into the state such as new classrooms and teachers for their children and streets and water/sewer infrastructure for the new subdivisions or apartment buildings where they'd likely live.

Are corporate tax cuts worth it? A back-of-the-envelope analysis.

Taking all of this into consideration, a back-of-the-envelope calculation suggests that deep cuts to the corporate net income tax would not be worth the cost.[21] Say we reduce the CNIT by 2 percentage points from the current 9.99% to 7.99%. That is a 20% reduction in the rate. But, as we mentioned above, businesses pay many other taxes to state and local government, including property taxes and sales tax, on the equipment they use. And the profits of businesses not organized as C-corporations

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[19] We showed that corporate tax reductions cost the state at least $4 billion in revenues: Stephen Herzenberg, Diana Polson, Marc Stier, "Corporate Tax Cuts Since 2002 Now Cost PA $4.2 Billion Yearly: Pennsylvania Should Pass Worldwide Combined Reporting," KRC-PBPC, Corporate Tax Cuts Since 2002 Now Cost PA $4.2 Billion Yearly: Pennsylvania Should Pass Worldwide Combined Reporting (krc-pbpc.org). Our annual analyses of the PA Budget in the last five years have repeatedly pointed to the shortfall in state funding of K-12 education, higher education, environmental protection, and infrastructure. See most recently, Diana Polson and Marc Stier's "Analysis of Pennsylvania's 2022-2023 Executive Budget," https://krc-pbpc.org/research_publication/analysis-of-pennsylvanias-2022-executive-budget/.

[20] See most recently, Diana Polson and Marc Stier, Analysis of Pennsylvania's 2022-2023 Executive Budget and Timothy J. Bartik's "Solving the Problems of Economic Development Incentives."

[21] Our approach here follows that of Timothy J. Bartik in "Taking Preschool Education Seriously as an Economic Development Program: Effects on Jobs and Earnings of State Residents Compared to Traditional Economic Development Programs," unpublished working paper, W.E. Upjohn Institute for Employment Research, March 30, 2006.

are subject to the personal income tax. So, the CNIT is only 10% of the total taxes that businesses pay to state and local governments in Pennsylvania. As a result, a 2-point cut in the CNIT rate is an overall reduction in state business taxes of only 2.5%. Assuming an elasticity of 2.5% in the relationship between tax rates and business activity—which we saw above is the academic consensus—a 2% reduction in the state business taxes would lead to a job increase of only .63%. As there were around 7.8 million Pennsylvanians employed in 2020, a 2 percentage-point reduction in the CNIT would generate about 36,408 new jobs by the end of ten years. But that would come at the cost of approximately $630 million in state revenues in one year and more than $6.3 billion over ten years. The average public sector worker in Pennsylvania makes about $47,000 annually. If we assume that the loss in revenue reduces the number of public sector employees roughly in proportion to the average wage of public employees, the loss is about 13,000 jobs. That means that at the end of ten years, the net increase in jobs in the state from a 2-point reduction in the Pennsylvania CNIT would be only 23,067 jobs of which only 20%, or 4,613, would go to current Pennsylvanians. Those jobs come at a huge 10-year cost of almost $6 billion in state revenues or almost $270,000 per job. The cost for every job secured by a current Pennsylvania resident is $1.3 million. (And the costs don't stop after ten years.)

Even if we are talking about all jobs, not just those secured by current Pennsylvanians, the cost of creating one job is enormous. And so far, we are only talking about the direct costs. We have not even mentioned what Pennsylvania and its residents lose by failing to invest $630 million in K-12 education and higher education, or in repairing our road and bridges. $630 million a year in new education funding would take us about two-thirds of the way to paying for the PA Promise plan to make state colleges and certificate-providing worker training and apprentice programs free for every family with an income of $115,000 or less. It would take us one-seventh of the way to giving every student in the state an adequate education by current state standards. It would take us one-fifteenth of the way to providing enough annual funding to bring our roads and bridges up to a state of good repair.

The lost revenues created by a 2-point reduction in the CNIT is not enough to solve the state public investment deficit. But it could make a dent in the infrastructure deficit and an even bigger dent in the K-12 funding deficit, which would get us a long way in providing higher education opportunities to young people. And we know that the long-term benefits of K-12 education, higher education, and investment in roads and bridges is enormous. Research about the effects of pre-K and K-12 education, higher education, and roads and bridges continues to show that their long-term impact on people's well-being and on their communities' economic prospects is strong. Infrastructure spending so dramatically raises the productivity of private capital that even conservative economists claim that "it pays for itself."[22]

Look more closely at just one aspect of state spending—education—and it will be clear that the costs of reducing spending to pay for tax cuts are likely to be far greater than the benefits. A relatively conservative estimate of the impact of education on the economy shows that an average additional year of schooling increases economic growth by .37% a year after inflation.[23] That may not seem like

[22] 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.

[23] See Eric Hanushek, "Education and Economic Growth: It's not just going to school, but learning something while there that matters," Education Next, Hoover Institution, Spring 2008, 62-70: "…we found that, across 50 countries, each

much. But between 2010 and 2019, GDP increased in PA by only 1.6% a year after inflation. An increase of .37 percentage points, or a 23% increase in the average growth rate over those years, would have added $10.8 billion to the Pennsylvania economy by 2019.[24] While K-12 education is critical, its importance to economic growth is in large part because it prepares young people for higher education: "For advanced economies especially, a strong K-12 sector is a necessary but hardly a sufficient condition for continued economic growth in the competitive global marketplace. The real payoff of improvements in K-12, at least for advanced economies, appears to come primarily at the level of tertiary and higher education."[25] The importance of higher education to economic growth is recognized across the world—a recent study of the ASEAN-5 countries (Thailand, Indonesia, Malaysia, Singapore, and the Philippines) concluded that "higher education is the key to future growth and sustainability."[26] Sadly, many people in our country, which pioneered equal access to both K-12 and higher education to generate economic growth and technological progress, have lost faith in it.

Public investment in Pennsylvania strongly contributes to the well-being of our current residents. So, our conclusion is that a substantial cut to business taxes would be a mistake because it would require deep cuts in the public investments that most contribute to the long-term economic prospects of our state.

In addition, when we consider who benefits from a reduction in the CNIT paid for by a reduction in spending, it is likely that this policy would increase inequality in our state. Corporate tax cuts no doubt flow to stockholders with high incomes who are disproportionately white. And education spending, especially if it is used to reduce the deep inequity in the way we fund our schools, benefits those with low incomes who are disproportionately Black and Hispanic.

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additional year of average schooling increased the average 40-year growth rate in GDP by about .37 points. That may not seem like much—but consider the fact that since World War II, the world economic growth rate has been around 2 to 3 percent. Lifting it by .37 percentage points is a boost to annual growth rates of more than 10 percent of what would otherwise have occurred, a significant amount." Note the subtitle of this article: while years of schooling are important, the impact of schooling on quality of cognitive skills may be even more important. That is, among other things, an argument for improving the quality of schooling in the school districts that are the least well-funded so that young people develop the cognitive skills to go on to higher education. And it also is an argument for investment in pre-K education, which has been shown to help children initially develop the cognitive skills that enable them to take better advantage of K-12 and higher education. Other estimates of the importance of higher education to economic growth are higher. In "Estimating the Social Return to Higher Education: Evidence from Longitudinal and Repeated Cross-Sectional Data," Journal of Econometrics, Vol. 121, 2004, 175-212, Enrico Moretti shows us that an additional year of schooling in a community increases economic activity per capita by 17.4% and wages per capita by 17.8% in "Estimating the Social Return to Higher Education: Evidence from Longitudinal and Repeated Cross-Sectional Data," *Journal of Econometrics*, Vol. 121, 2004 175-212.

[24] And if jobs increased by the same rate, it would have added 234,354 jobs in the state. Now we do not know how much a difference of $600 million per year spent on higher education would make to the average educational attainment of Pennsylvanians. (We will be doing some work on this soon.) But when the state funding for PASSHE is less than that, it's not inconceivable that the impact would be substantial. Even if $600 million per year only raised the average years of schooling of all Pennsylvanians by only two months, the number of jobs generated by that spending would more than the number of new jobs generated by cutting the CNIT by 2 percentage points. And we would have the other benefits of more educated population as well—including the head start that college-educated parents give their children.

[25] Tom Wood, Higher Education and Economic Growth, National Association of Scholars, September 23, 2009, https://www.nas.org/blogs/article/higher_education_and_economic_growth.

[26] Parvee Maneejuk and Woraphon Yamaka, "The Impact of Higher Education on Economic Growth in ASEAN-5 Countries," *Sustainability* 2022, 13, 520, https://www.mdpi.com/2071-1050/13/2/520.

We should emphasize that what we have presented here is not a thorough econometric analysis. A full account would have to make more precise estimates of how many jobs would be created over a 10-year period, would have to consider the rising wages of state employees of those 10 years, and the growing revenue loss over time due to both economic growth and inflation. It would have to more precisely estimate what spending would be forgone due to the loss of CNIT revenues and the consequences for productivity growth and wages of reduced spending in critical areas of government including education at all levels and repair of road and bridges. It would have to estimate the lost wages of students who are denied a good K-12 or higher education[27] and the additional costs to Pennsylvanians of a higher "pot hole tax"—that is the repairs to the struts and shocks of cars damaged by pot holes in our roads and bridges. It would have to estimate the cost of providing public services to an additional 12,000 residents; it would have to estimate the additional state and local taxes paid by an additional 21,000 workers—and so on.

And keep in mind that our calculation assumes that a cut in the CNIT rate would have the effect on jobs generally found in the literature. Given what we said above about how corporate tax cuts are likely to have far less effect in a state with a single-sales, factor-based corporate tax, we think the estimate of job creation we report here is likely to be high.

But while our analysis is not complete, we have shown that the benefits of cut taxes for corporations are small and the costs large. When one thinks clearly about how much government spending, especially on infrastructure and education, increases productivity, business profits, and wages over the long term, especially for people with lower incomes, it becomes impossible to think that corporate tax cuts will pay for themselves. It is far more likely that they'll create a burden for the people of Pennsylvania, and especially on Pennsylvanians with low incomes.

We conclude then that there is no economic case to be made for reducing the CNIT rate in Pennsylvania. A small reduction may be justified in terms of fairness to businesses that choose to organize themselves in forms that make them subject to the CNIT. But that is the only justification.

Governor Wolf's proposal for 2022-2023

[27] Brad Hershbein and Melissa S. Kearney, "Major Decisions: What Graduates Earn Over Their Lifetimes," The Hamilton Project, September 29, 2004, https://www.hamiltonproject.org/papers/major_decisions_what_graduates_earn_over_their_lifetimes. The average lifetime earnings of a typical holder of a bachelor's degree total $1.2 million—about $600,000 more than the average lifetime earnings of someone with a high school diploma. It is over $300,000 more than what's earned by those who hold an associate degree. To be sure, lifetime incomes are not totally determined by educational attainments. There are many people who do not have a college degree but make high incomes in the building trades or other technical fields. And there are some with bachelor's degrees who have low or moderate lifetime incomes. However, the stereotype of the impoverished English major is misleading. Over a lifetime, an English major would earn just about $1,000,000, not far below average and thus $400,000 more than the average earning of someone with just a high school diploma. Also, keep in mind that those with only a high school degree who have high earnings often received post-secondary training that is also subsidized by the state. The averages are telling. So long as businesses and others believe that holding at least a college degree—or higher degrees for which a bachelor's degree is necessary—then it is critical both to our economy and to the economic well-being of future Pennsylvanians that we give Pennsylvania high school graduates access to a college education or other post-secondary training.

The Corporate Net Income Tax Rate

This year, however, Governor Wolf proposes to reduce Pennsylvania's corporate net income tax rate over several years, from 9.99% to 5.99% in 2027. Moreover, the governor's proposed Executive Budget suggests that these reductions should put the state on a path to a corporate tax rate of 4.99%.

A reduction in the corporate tax rate even to 5.99%, let alone 4.99%, is deeply problematic, not just because it would reduce state revenues, which over the last ten years have barely supported our current level of spending, let alone the level of spending that would be necessary to close our public investment deficit in K-12 education, higher education, human services, environmental protection and the avoidance of climate change, and transportation infrastructure. Moreover, a reduction in the corporate net income tax would, at least rhetorically, make it hard to raise the tax on business profit in our Fair Share Tax.

Governor Wolf's plan does too little to close corporate tax loopholes

While we have supported some reduction in the CNIT, our support for this policy—like the governor's until this year—has been predicated on a simultaneous decision to enact combined reporting, thus closing the loopholes that are one reason that 73% of the corporations doing business in the state pay nothing in corporate taxes. Governor Wolf has embraced this policy in the last six years.

Frustrated by the failure of the Republican majority to support combined reporting along with a reduction in the corporate net income tax rate, this year Governor Wolf has proposed an alternative policy that has three elements. While we support two of those elements, we believe his substitute for combined reporting is utterly inadequate.

Clarifying the nexus for taxation under Pennsylvania's corporate net income tax

The governor's plan first proposes to codify in law the rule embodied in Department of Revenue Corporation Tax Bulletin 2019-04. That rule clarifies the "nexus" or economic connection a corporation must have to Pennsylvania in order to be subject to corporate taxation in the state. What counts as a sufficient nexus has been the subject of disputes in the federal courts. Corporations seeking to avoid state taxation have claimed that a corporation had to have a physical presence in a state to be subject to corporate taxation. Thus, for example, if Netflix's business activity solely consists of streaming movies to the TV sets of Pennsylvanians, it might claim it was not subject to our corporate net income tax. However, a recent decision by the Supreme Court, in Wayfair v. South Dakota, 138 S. Ct. 2080, 201 L. Ed. 2d 403 (2018) held that a physical presence is not necessary for nexus. Rather a nexus exists if a corporation is taking advantage of the economic marketplace of a state above some minimum threshold of activity. And while the Wayfair decision addressed sales taxation, it likely applies to companies like Netflix as well.[28]

In light of this ruling, the Department of Revenue has proposed a rule presuming that "corporations without physical presence in the state, but having $500,000 or more of gross receipts sourced to Pennsylvania per year pursuant to the sales factor rules contained in 72 P.S. § 7401, have a filing requirement with the Commonwealth for purposes of the corporate net income tax for income generated by

[28] A federal law, Public Law 86-272 (1959), requires a physical presence for state corporate income tax nexus when a corporation is selling physical goods. The governor's proposal clarifies the nexus for companies providing services or earning income from intangible assets to which Public Law 86-272 does not apply.

1. the sale, rental, lease, or licensing of tangible personal property.
2. the sale of services.
3. the sale or licensing of intangibles, including franchise agreements.
4. interest and other intangibles not included above.

This part of the governor's proposal certainly makes sense. It clarifies in an effective way the basis upon which multinational and multistate corporations can be legitimately taxed under Pennsylvania's corporate net income tax rules.

Making the Apportionment Rules Consistent

A second part of the governor's proposal modifies how the state apportions a corporation's income between Pennsylvania and other states. As a "single sales factor" state, Pennsylvania uses sales to divide up what share of a company's national profits is subject to tax here. Our current rules say that when it comes to sales of goods or services, that apportionment is based on where the customer for those goods is located. If the customer is located in Pennsylvania, then those sales have to be included in determining the fraction of total sales that take place in Pennsylvania. But when it comes to sales of intangible goods—such as the profits made on the sale of rights to use patents, software, trademarks, and copyrights; ownership interests in a pass-through corporation; profits made on loans to purchase goods in the state; and others—the state currently apportions profits based on where the intangible good was produced, not where the sale of the intangible good takes place. This allows corporations to move profits made in Pennsylvania to other states. And since other states may not tax the profits made on the sale of intangible goods, they may become "nowhere profits," which are not taxed anywhere.

The governor proposes to change the rules for how sales of intangible property are defined as taxable income under the corporate net income tax so that they are brought into conformity with the rules for tangible property and services. That is, sales will be apportioned to Pennsylvania if the customer for intangible goods are located here.

Again, this a proposal that make sense. It will ensure that some profits that are made by corporations operating in Pennsylvania are taxed by the CNIT.

Add-Backs

Finally, the governor proposes a number of "add-backs" that address particular ways in which corporations seek to shift profits from their Pennsylvania subsidiaries to out-of-state corporate parents and affiliates. These proposals are called "add-backs" because they require that, for the purpose of calculating their Pennsylvania profits, corporations that are subsidiaries or affiliates of multistate or multinational corporations must add back deductions that they are allowed to take on their federal tax returns.

The governor proposes that three types of payments from Pennsylvania subsidiaries to national affiliates—management fees, intercompany royalties, and intercompany interest—be added back to the profits shown by Pennsylvania corporations.

There is no question that these add-backs would require Pennsylvania corporate affiliates of multistate or multinational corporations to pay more in taxes. But there are other ways in which these corporations can reduce their profits through the magic of internal accounting. They can deduct payments to their out-of-state affiliates for marketing, branding, advertising, and strategic planning,

and none of these would be added back into the profits of the Pennsylvania affiliate and taxed under our corporate net income tax. Nor would payments to those same out-of-state affiliates for inventory resales.

The fundamental flaw of the effort to stop Pennsylvania affiliates from moving their profits out of state—and out of the reach of the PA corporate net income tax—is obvious. Corporations have multiple ways to shift profits, and can always invent new ones, so shutting off one way only invites them to find others.

We can think of deductions from state corporate profits—which we are trying to tax in Pennsylvania—like cats we're trying to keep from entering another room. People who own cats know that there are a lot of ways to do that. You can put up a two-foot barrier—perhaps make a wood frame holding plastic mesh—between one room and another. That might keep cats from crossing from one room to another for a time. But clever cats will ultimately figure out how to claw through the mesh, jump onto and over the barrier, or push the barrier down or ajar. There are ways to fix barriers of this kind for a time. But over the long term, they do not work. Cats are clever and motivated to go where we don't want them to go. And sooner or later they will find a way to do that. If we want to stop a cat from entering a room, the best solution is to close—and if your cat is especially clever—lock the door.

Similarly, we can block a number of ways that corporations shift profits from Pennsylvania to other states. But corporations, like cats, are clever and motivated, and if we block one path for moving out of state they will find another.

If we are serious about stopping giant, wealthy corporations from evading their responsibility to pay their fair share of taxes to the Commonwealth, we need to address the problem at its root. We need to close the door on interstate profit shifting. And that means making it impossible for them to attribute profits earned in Pennsylvania to their out-of-state entities.

The only way to achieve that goal is with *combined reporting*.

Corporations and their representatives in Pennsylvania—the Chamber of Commerce, other business lobbyists, and their in-state affiliates in the PA General Assembly—don't like combined reporting. The problem for them is not that combined reporting is unknown or a radical idea. Twenty-eight states have combined reporting. Nor is the problem that combined reporting makes doing taxes more complicated or difficult for them. It is far less complicated than calculating multiple add-backs into their taxes, especially since almost every corporation that would pay Pennsylvania's corporate net income tax already do most of the work in determining what they owe the 28 states that already have combined reporting.

The Chamber of Commerce and the large, multinational corporations they represent don't like combined reporting for one and only one reason: because they would pay Pennsylvania far more in taxes than they do now or would do under Governor Wolf's proposed reforms to our corporate net income tax. And that should tell us all we need to know about any reforms that fall short of combined reporting. They are inadequate because they would continue to allow huge, wealthy corporations to pay less than they owe to our state.

The Costs of Corporate Tax Reform

Table 1, below, shows the consequences of Governor Wolf's proposal for General Fund revenues. The second row shows how much more revenue would be raised by the governor's three reform proposals—assuming that the tax rate remains unchanged. The fourth row shows how much revenue would be lost because of the cut in the corporate tax rate. The final row shows the net effect of changes in the tax and the reduction of the rate.

We find the net effect of the governor's proposals troubling. Over five years, the state would lose almost $13 billion dollars. And by the fifth year, the state would lose almost $650 million in General Fund revenues *each year*. That amount would increase over time, especially if the General Assembly accepts the governor's suggestion that the rate ultimately be lowered to 4.99%.

Table 1

Impact of Governor Wolf's Corporate Tax Proposals on Pennsyvania General Fund Revenues					
($ millions)	22-23	23-24	24-25	25-26	26-27
Base Expansion (@ 9.99%)	$176	$629	$695	$709	$707
Proposed rate on January 1	7.99%	7.99%	7.99%	6.99%	5.99%
Rate Cut (based on expanded base)	-$255	-$770	-$836	-$979	-$1,352
Net	-$79	-$141	-$141	-$271	-$645

This loss of revenue is deeply troubling for three reasons. First, as we have documented year after year—and as our analysis of the governor's proposed budget reaffirms—Pennsylvania suffers from a deep public investment deficit. Our failure to invest in education at all levels has led us to have some of the most unequal K-12 school funding in the country and the most expensive public colleges and universities relative to our median income than any other state and not enough non-college training opportunities. The result is that too many of our people do not have an equal opportunity to take advantage of their natural talents to get ahead in life—and our businesses and economy as a whole suffer from an inadequately trained work force. Our roads and bridges and public transit funds are woefully underfunded, leading to delays in people getting to work, in raw materials getting to manufacturers, and in products getting to the market. That undermines our economy. It also adds to the costs of every family as we all pay a higher pothole tax to auto mechanics. We also do not spend enough on protecting our environment and reducing the production of greenhouse gases in our state, with devastating consequences to our health and, over the long term, the habitability of our planet.

With all the needs the state still has, we need every cent of revenue we can raise. Reducing the unfairness of our corporate taxes to Pennsylvania-based corporations makes sense, but not at the cost of the revenue we need to reduce our public investment deficit.

Second, corporate tax reduction will make it harder to pay for what the state already provides the citizens of our state. The recent influx of federal funds, thanks to President Biden and the Democratic Congress, and the unexpectedly quick recovery from the pandemic recession have led to higher revenues that will give the state an accumulated surplus of more than $10 billion by the end of June. However, over a number of years, that surplus is bound to decline and then ultimately reverse. And we will be back in the situation we were between 2010 and 2020 when year after year the state struggled to close budget deficits and the General Assembly passed budgets that were balanced on paper only with the use of one-time funds, transfers from special funds, underestimating of Medical Assistance caseloads and, one year, more than a billion dollars in borrowing. Those budget difficulties were caused by previous cuts in corporate taxes, including the elimination of the capital stock and

franchise tax, and the narrowing of the corporate net income tax base. Corporate tax cuts continue to cost the state more than $4 billion in revenue every year. And as figure 2 above shows, the share of General Fund revenues that come from corporate taxes has fallen sharply since 1972. Right now the state is flush with cash, thanks to the ARP and the rapid economic recovery it helped create. We can use some of those funds to address current problems and reduce accumulated investment deficit. We should not be using those funds to pay for a corporate tax reform that will do little to help the state's economy while creating long term deficits that make it impossible to those things that really do create long term prosperity—education at all levels and infrastructure.

Third, even if we could count on state surpluses continuing, is spending them on corporate tax reductions our top priority, given all the needs the state has? And if we want to reduce taxes, why don't we start by cutting income or sales taxes that mostly fall on working people or instituting a state earned income tax credit that would help families with low incomes. As we have documented in the past, and as figure 1 of this paper shows, Pennsylvania has one of the most upside-down tax systems in the entire country, in which the those with the lowest incomes pay at far higher rates than those with the highest incomes. Cutting the corporate net income tax, without combined reporting, would exacerbate the inequality of our tax system, putting the poor and working people at a greater disadvantage. It is frankly outrageous that cutting the CNIT rate is a higher priority than making the tax system, as a whole, fairer for Pennsylvanians.

It Is quite possible that even Governor Wolf's compromise proposal will be rejected by the Republican majority in the General Assembly because those they appear to care about most, wealthy multinational corporations, do not want to pay our state *any* taxes at all if they can help it. And we recently saw the Republican-led House pass a 2-point cut in the CNIT without any of the tepid reforms Governor Wolf has proposed.

Governor Wolf has said that if the Senate also passes this reduction in the CNIT he would veto it. We strongly urge him to go further and withdraw the proposal in his budget and again insist on combined reporting as the price for any reduction in the CNIT rate. And we urge him to limit that reduction to 6.5%.

We know Governor Wolf has long wanted to have a reduction of the CNIT as one legacy of his two terms as governor. But the price the Republican majority in General Assembly is asking is far too high. Sometimes the best legacy for a governor is to block irresponsible public policy that may look good in the short term but make life—and budgetary problems—increasingly difficult for his successor.

Conclusion

PBPC has long called for reforms in Pennsylvania's corporate net income tax that would close the Delaware and Cayman Island loopholes which allow wealthy, multinational corporations to escape taxation, and slightly reduce the rate to make the tax fairer to Pennsylvania-based businesses. Doing so would generate new revenues while allowing us to make a small reduction in the CNIT rate, which is justified not because it would create new economic activity or create jobs but because it would set the tax rate on C-corporations where we think it should be set for all businesses.

This however is the only kind of corporate tax reform we believe is morally and practically justifiable. While Governor Wolf's new proposal to reduce the CNIT while broadening the tax base has some good elements and is a step in the right direction, the add-backs he proposes are far inferior to combined reporting as a means of closing the Delaware and Cayman Island loopholes.

For the last six years, Governor Wolf and House and Senate Democrats have stood behind the idea of expanding the corporate net income tax base by instituting combined reporting while also lowering the CNIT rate by a few points. They should stand there still. And public polls show that the people of Pennsylvania will stand with them.