POLICY BRIEF

Sales Factor Increase Would Bring Little Benefit To Pennsylvania

June 23, 2008

Several proposals under consideration by the Pennsylvania General Assembly would change the way companies calculate their corporate tax liability. Currently, the Commonwealth uses a formula that looks at a company's payroll, property, and sales in Pennsylvania, counting sales at 70% and payroll and property each at 15%. The Senate proposal would increase the sales factor weight from 70% to 85%, while the House proposal would count sales at 80%, and payroll and property each at 10%. The bills being considered would benefit corporations with facilities and employees in Pennsylvania, and a higher proportion of sales outside the state. Before enacting these bills, the General Assembly should carefully scrutinize proponents' claims and should consider the many drawbacks associated with these changes.

1. Increasing the weight of the sales factor has not been an effective economic development device—in Pennsylvania or in other states.

As of 2001, eight states had changed from an equally weighted formula to a 100% or single sales factor (SSF) apportionment formula (Connecticut, Illinois, Iowa, Maryland, Massachusetts, Missouri, Nebraska, and Texas).[1] From 2001 to 2007, all eight states lost manufacturing jobs, with five of the states losing more than the national average. Only four states in the US during this period saw increases in manufacturing jobs, and none of these used a single sales factor method of apportionment.[2] If weighting the sales factor is stimulating to manufacturing, the evidence is not readily apparent. (See Table 1, page 4.)

Pennsylvania has already increased its sales factor weight—with no discernible positive effect on manufacturing. In 1999, Pennsylvania began shifting the weighting of the sales factor from 50% to 60%.[3] In 2007, the weight on the sales factor was increased further, from 60% to 70%.

While the 1999 change reduced the taxation of corporations having more payroll and property than sales in Pennsylvania, it had no visible positive impact on the number of manufacturing workers or operations in Pennsylvania. Since 2001 (the earliest year available in the current industry classification system), both the number of manufacturers and the number of manufacturing jobs have declined in Pennsylvania.[4] (Figure 1, page 2.)

Evidence suggests that investment and location decisions are primarily driven by factors other than state tax law in general or the weight of the sales factor in particular. Companies move facilities and jobs from states using a single sales factor to states where they do not—defying the logic behind heavily weighting the sales factor. For example, Nike, headquartered in Oregon, was a major force in lobbying for the enactment of SSF

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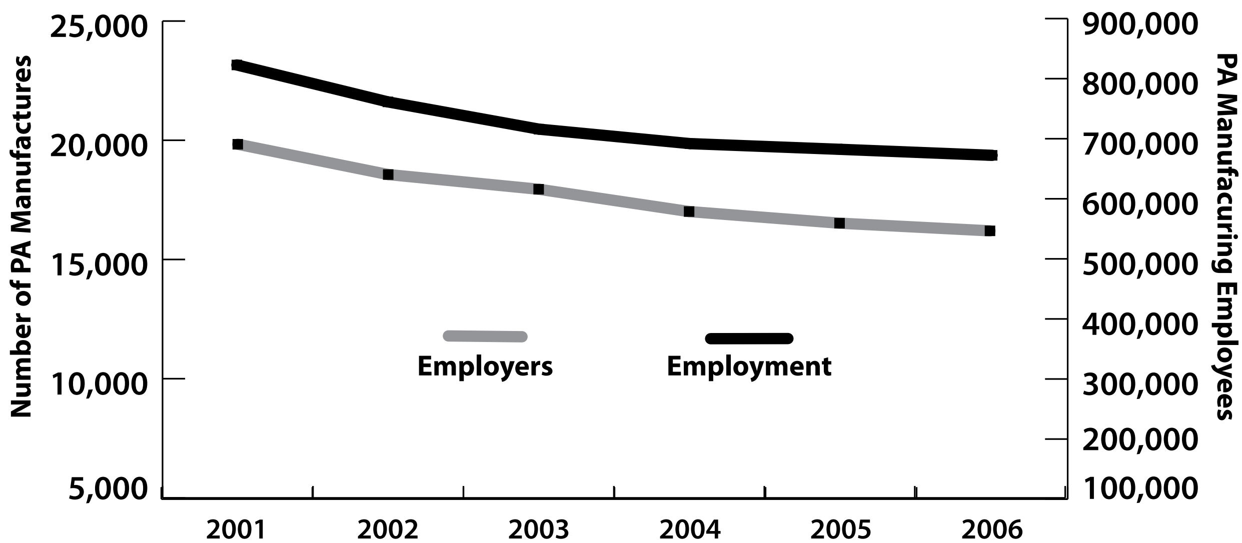
1. "Single sales factor" means that profit is apportioned to a state based solely on their sales in that state compared to sales in the US. Under this system, property and payroll are not counted in the apportionment formula. In Connecticut and Maryland, the single sales factor is limited to manufacturers. In Massachusetts, the single sales factor is limited to manufacturers, defense contractors, and mutual funds. In the other states, the single sales factor applies to all industries.
2. Michael Mazerov, "Stop the giveaway," *Pittsburgh Tribune Review*, February 15, 2008.
3. Prior to 1999, Pennsylvania "double weighted" the sales factor compared to the other two factors, property and payroll. The sales factor counted for 50% of apportionment, while property and payroll each counted 25%. In 1999, the sales factor was increased to 60% of the total apportionment value, with the property and payroll factors dropping to 20% each.
4. US Bureau of Labor Statistics. Annual private manufacturing establishments and employees (NAICS 31-33)

in Oregon. In September 2006, Nike announced it would consolidate its shoe shipping operation by moving 232 jobs from Oregon to Tennessee, a non-SSF state.[5] Rubbermaid closed its Centerville, Iowa, plant in 2006 to move production to a plant in Kansas.[6] Iowa uses a single sales factor, while Kansas uses an equally weighted formula.

In 2002, Black and Decker moved 450 jobs overseas from Maryland, single sales factor state. Responding to questions about the move, the company replied, "The decision to transfer certain production from our Easton plan to Mexico is part of a comprehensive restructuring of our entire global manufacturing network, and thus, is based *on a range of considerations well beyond Maryland tax law*" (italics added).[7]

Figure 1. PA Manufacturing Jobs Declining Despite Heavily Weighted Sales Factor



Source. **US Bureau of Labor Statistics. Annual private manufacturing establishments and employees (NAICS 31-33)**

2. Changing the sales factor could be a tax windfall for multistate corporations.

If the bills are enacted multistate corporations could receive a significant reduction in taxes without their creating a single job or making any further investment in Pennsylvania. The corporations can do what they choose with the proceeds—whether it be dividends for worldwide investors or building new facilities in China, Vietnam, or Mexico. These decisions are driven by rates of return of the investment—not by state tax policy. Multistate corporations could even reduce their footprint in Pennsylvania (by firing employees and closing facilities) and still be eligible for the tax bonus.[8]

5. John Scruggs, "Nike will consolidate distribution centers in Memphis," *Memphis Business Journal*, September 19,2006 http://memphis.bizjournals.com/memphis/stories/2006/09/18/daily19.html.
6. "Centerville Rubbermaid Factory to Close," *Sioux City Journal*, July 15, 2006 http://www.siouxcityjournal.com/articles/2006/06/15/news/latest_news/7f54f58c06e55c5f8625718e004ac85b.txt
7. Dan Rodricks, "A 'teachable moment' in corporate taxes world," *Baltimore Sun*, February 15, 2002
8. For example, a company has two plants, both in Pennsylvania. These plants employ 90% of the company's employees in the US (property and payroll factors are 90%). The company has sales across the US with only 10% of those sales in Pennsylvania (sales factor is 10%). If the company moves facilities, it can still benefit from the sales factor weighting. As long as the company has higher Pennsylvania property or payroll factors (say 11%, after moving most of its employees and property out of state) than its 10% sales factor, it still receives a tax benefit from the heavily weighted sales factor.

3. Increasing the sales factor would be unfair to smaller local and regional businesses.

This tax change would disproportionately benefit corporations having high out-of-state sales, mostly large, multinational corporations. Many smaller or regional corporations that have all or much of their sales in Pennsylvania do not receive this tax benefit—despite heavy investment in Pennsylvania. Some businesses (those with modest investments in Pennsylvania but a larger percentage of sales in Pennsylvania) will have their taxes *increase*. The intentional favoring of certain businesses over others is unfair.
This policy violates one of the basic principles that fiscal experts rely on to evaluate good vs. bad tax policy—the benefit principle, which states that entities benefitting from public investments and other spending financed with tax revenue should contribute to those investments. Companies with large numbers of facilities and employees in Pennsylvania depend on Pennsylvania's education system, roads, bridges, airports, and other public investments, and they should help pay for what they use.

4. The Pennsylvania Business Tax Commission offered a better solution to fix the business tax system.

Business groups claim that Pennsylvania's corporate tax system reduces our competitiveness, typically citing its 9.99% Corporate Net Income Tax rate as a deterrent to investment, and suggesting a rate reduction and other changes to fix the system.[9] To address these concerns, the Pennsylvania Business Tax Reform Commission was established, convening business and government officials to examine the issue and to make recommendations. In 2004, the Commission offered a fair plan to reduce the tax rate for all corporations, including apportionment and other changes, without jeopardizing overall state revenues. The Commission recommended that the Commonwealth finance the plan by adopting combined reporting, which closes many corporate loopholes and makes the system more fair for corporations that do not apportion. Adopting the Commission's recommendations makes the tax system more fair, reduces the tax rate, and can be paid for without increasing personal income taxes or cutting services.

5. If Pennsylvania businesses pay less, Pennsylvania citizens will end up paying more.

Businesses and individuals benefit from government services, and both share a responsibility to pay for them. Yet, over the past 20 years the tax load has been increasingly borne by individuals. Businesses have received over $1 billion in tax cuts in this decade. The Capital Stock and Franchise Tax is being phased out and has left a hole in the state's budget that must be filled with other tax revenue. The amount of General Fund spending financed from Corporate Net Income Tax has declined from 14% in 1972 to 9% in 2007. Apparently, businesses have better lobbyists than working people do.

As a society, we have agreed on a group of functions and services performed by state government. If businesses continue to pay less of the freight, the difference will have to come from somewhere—and the likely group is individuals.

Increasing the sales factor is the wrong answer at the wrong time for the citizens of Pennsylvania.

9. "Improving Business Taxes," *Pittsburgh's Future* http://www.pittsburghfuture.com/businessclimate/businesstaxes.html

Table 1. % Change in Manufacturing Employment, Dec. 2001–Dec. 2007. *States With Single Sales Factor Apportionment Throughout Period in Bold*

State	%change	
Alaska	13.3%	
Utah*	10.2%	
North Dakota	*9.3%*	■
Iowa	**-0.3%**	
Idaho	-0.5%	
Oregon	-1.0%	
Montana	*-1.4%*	■
Kansas	*-2.4%*	■
Louisiana	-3.1%	
Texas	**-4.9%**	
Hawaii	*-5.0%*	■
Nebraska	**-5.7%**	
Arizona	-5.8%	
Alabama	*-6.7%*	■
New Mexico	-7.2%	
Minnesota	-7.4%	
Indiana	-7.6%	
Wisconsin	-7.9%	
Oklahoma	*-8.8%*	■
Delaware	*-10.4%*	■
Kentucky	-11.0%	
Missouri	**-11.1%**	
Florida	-11.2%	median state
Georgia	-12.1%	
Mississippi	-12.4%	
New Hampshire	-12.6%	
Connecticut	**-13.0%**	
Illinois	**-13.3%**	
Tennessee	-13.9%	
California	-14.0%	
Colorado	-14.3%	
Arkansas	-15.0%	
Ohio	-15.8%	
Maine	-16.6%	
Virginia	-16.9%	
South Carolina	-17.0%	
West Virginia	-17.0%	
Pennsylvania	-17.2%	
Vermont	*-17.8%*	■
New Jersey	-18.9%	
Maryland	**-19.0%**	
New York	-19.4%	
North Carolina	-19.8%	
Massachusetts	**-20.2%**	
Rhode Island	-23.1%	

States shown in *italics* with ■ are equally-weighted three-factor formula states. Since 2001 another 11 states have enacted sales factor changes.

*Utah was an equally-weighted three-factor formula state until 1/1/06.

Source. Center on Budget and Policy Priorities, May 2008