Testimony on Combined Reporting
Senate Democratic Policy Committee
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Matthew Knittel, Independent Fiscal Office

Good afternoon Chair Boscola and members of the committee, thank you for the opportunity to testify. For my remarks, I will provide some brief comments on combined reporting, the use of the filing method by other states and the IFO's perspective on the potential revenue impact.

Background

Under mandatory combined reporting, multi-state firms that form a unitary group are required to file a combined return as if the related entities were a single corporation. The combined return reflects the net income or loss associated with the business operations of all members of the unitary group, and income is apportioned to the taxing jurisdiction based on the activity of the combined group within that jurisdiction.

Those who support combined reporting note that:

- the filing method reduces a firm's ability to shift profits to low or no tax states through related-party transactions and is subject to less manipulation by firms;
- it will "level the playing field" because Pennsylvania-only firms cannot shift profits to other states; and
- it should not prove burdensome because firms already use this method in many other states.

Those who oppose combined reporting note that:

- the filing method will subject profits to state tax that have little or no economic connection to the state;
- it will make the state less attractive to firms and will constrain economic growth; and
- it will introduce significant administrative complexity.

It is well known that determination of the unitary group is a crucial component of combined reporting and is generally based on the ownership of the group, as well as the relationships between the entities within the group. Estimating the revenue impact from combined reporting is subject to uncertainty, largely because taxing authorities lack full information regarding the characteristics of potential unitary groups. Despite the uncertainty, combined reporting is generally assumed to increase tax collections in high rate states due to the various methods that can be used to shift profits to low or no tax states.

Use by Other States

The attached table provides a comparison of (1) state corporate net income tax (CNIT) rates and (2) the applicable filing method used by states with a CNIT. Highlights of the comparison include:

- Forty-four states currently levy a CNIT, with the highest statutory rate (12.00 percent) levied by Iowa followed by New Jersey (10.50 percent) and Pennsylvania (9.99 percent).
- Fourteen states use a graduated rate structure, while 30 levy a flat rate. Since 2008, 17 states have reduced their top corporate tax rate.
- As of 2020, 27 states and the District of Columbia require combined reporting for firms that meet unitary group standards. The most recent states to enact combined reporting are Kentucky and New Jersey (both in 2018) and New Mexico (effective January 1, 2020).
- The remaining 17 states that levy a CNIT require separate company reporting.

Because nearly two-thirds of states with a CNIT use combined reporting, it is likely that large, multistate firms that would be affected by the enactment of combined reporting in Pennsylvania already use this method in at least one other state and are generally familiar with it. Regarding administrative complexity, the IFO defers to the Department of Revenue for the additional resources required to administer and enforce the proposed filing regime.

Revenue Impact

For the purpose of estimating the potential revenue impact from combined reporting proposed in last year's *Executive Budget*, the IFO surveyed reports, fiscal notes and other documents from states that enacted combined reporting in the past decade. Overall, that research suggested a consensus that combined reporting could increase revenues from 5 to 15 percent. An outlier state was Rhode Island, which originally estimated that combined reporting could increase revenues by approximately 20 percent, and in a report from March 2018, revised that estimate to 28 percent.

In addition to the survey, the IFO performed an analysis that used a simple statistical test to quantify the potential impact of combined reporting for Pennsylvania. The test compared the difference in average growth rates for state economic growth (as measured by state private GDP) and CNIT revenues from 2005 to 2018 for six states that enacted combined reporting within that time period, and 10 control states that did not. This comparison suggested that new combined reporting states did in fact realize higher average CNIT growth than would have been expected otherwise. The extra growth translated into a revenue gain of roughly 11 percent relative to the control states that did not enact combined reporting. The IFO updated that analysis using a more recent year of data, and the results are largely unchanged. For Pennsylvania, an 11 percent base expansion implies a potential revenue gain of $375 million at current tax rates. It is likely that the full revenue gain would take several years to occur due to administrative issues and legal challenges to the new unitary groups.

In closing, I would note that the impact from combined reporting will vary significantly across firms. Many firms will be unaffected, some will have a lower tax bill, while others realize a significant tax increase. For this final group of firms, it is likely they will respond in some fashion, and to the extent they are able, it is reasonable to assume they will adjust their operations again to minimize their overall tax bill across all states in which they operate. For this reason, we generally do not observe a 20 or 30 percent increase in revenues in states that have enacted combined reporting. Rather, we observe gains that appear to range from 5 to 15 percent. Those net gains reflect actions taken by firms over several years in response to combined reporting to minimize their overall state tax bill.

States with Corporate Net Income Tax

State	Tax Rate	Method	State	Tax Rate	Method
Alabama	6.50%	Separate	Minnesota	9.80%	Combined
Alaska	0.00 - 9.40%	Combined	Mississippi	3.00 - 5.00%	Multiple
Arizona	4.90%	Combined	Missouri	4.00%	Separate
Arkansas	1.00 - 6.50%	Separate	Montana	6.75%	Combined
California	8.84%	Combined	Nebraska	5.58 - 7.81%	Combined
Colorado	4.63%	Combined	New Hampshire	7.70%	Combined
Connecticut	7.50%	Combined	New Jersey	6.5 -10.5%	Combined
Delaware	8.70%	Separate	New Mexico	4.80 - 5.90%	Combined
Florida	4.46%	Separate	New York	6.50%	Combined
Georgia	5.75%	Separate	North Carolina	2.50%	Multiple
Hawaii	4.40 - 6.40%	Combined	North Dakota	1.41 - 4.31%	Combined
Idaho	6.93%	Combined	Oklahoma	6.00%	Separate
Illinois	9.50%	Combined	Oregon	6.60 - 7.60%	Combined
Indiana	5.50%	Multiple	**Pennsylvania**	**9.99%**	**Separate**
Iowa	6.00 - 12.00%	Separate	Rhode Island	7.00%	Combined
Kansas	4.00 - 7.00%	Combined	South Carolina	5.00%	Multiple
Kentucky	5.0%	Combined	Tennessee	6.50%	Multiple
Louisiana	4.00 - 8.00%	Separate	Utah	4.95%	Combined
Maine	3.50 - 8.93%	Combined	Vermont	6.00 - 8.50%	Combined
Maryland	8.25%	Separate	Virginia	6.00%	Multiple
Massachusetts	8.00%	Combined	West Virginia	6.50%	Combined
Michigan	6.00%	Combined	Wisconsin	7.90%	Combined

Note: States designated as "multiple" generally require separate reporting, but either allow taxpayers to elect another form of reporting, or may require combined reporting based on audits. Indiana's rate decreases to 5.25% on July 1, 2020.

Source: CCH State Tax SmartCharts (January 2020).