HOUSE COMMITTEE ON APPROPRIATIONS

FISCAL NOTE

HOUSE BILL NO. 2150 **PRINTERS NO**. 3447 **PRIME SPONSOR**: Reed

COST / (SAVINGS)

FUND	**FY 2011/12**	**FY 2012/13**
General Fund	**$0**	**See Fiscal Impact**

SUMMARY: House Bill 2150, Printer's Number 3447, amends the Tax Reform Code, in corporate net income, further providing for definitions and for imposition of tax.

ANALYSIS: This legislation makes changes to the corporate net income tax providing (1) for an add-back provision for intangible expenses and interest associated with the intangible expenses; (2) providing for apportionment of income to Pennsylvania; (3) providing for net operating loss deductions; and (4) providing for the rate of taxation.

For taxable years 2013 and thereafter, no deduction shall be allowed for an intangible expense or cost, or an interest expense or cost, paid, accrued or incurred directly or indirectly in connection with one or more transactions with an affiliated entity. An intangible expense or cost is any royalties, licenses or fees paid for the acquisition, use, maintenance, management, ownership, sale, exchange or other disposition of patents, patent applications, trade names, trademarks, service marks, copyrights, mask works or other similar expenses or costs and any interest expense or cost associated with the intangible expense or cost that is a deduction allowed under section 163 of the Internal Revenue Code.

The add-back of this expense or cost will not apply to the following: (1) a transaction that was directly related to a valid business purpose; (2) a transaction between a taxpayer and an affiliated entity domiciled in a foreign nation which has in force a comprehensive income tax treaty with the United States for the prevention of double taxation and the sharing of information; and (3) a transaction where an affiliated entity directly or indirectly paid, accrued or incurred a payment to a person who is not an affiliated entity, if the payment is paid, accrued or incurred on the intangible expense or cost, or interest expense or cost and is equal to or less than the proportional share of the transaction.

When a taxpayer is engaged in one or more transactions with an affiliated entity that was subject to tax in this Commonwealth or another state or possession of the United States on a tax base that included the intangible expense or cost or interest expense or cost, the taxpayer shall receive a credit against the tax due in this Commonwealth in an amount equal to the apportionment factor of the taxpayer multiplied by the taxes paid or the owed to the other state or possession of the United States. Any credit issued shall not exceed the taxpayer's liability in the Commonwealth attributable to the net income taxes as a result of the add-back adjustment.

For taxable years 2013 and thereafter, all business income shall be apportioned to Pennsylvania by multiplying the income by the sales factor. This implements a 100% sales factor apportionment. Currently income is apportioned to Pennsylvania using a 90% sales, 5% property and 5% payroll apportionment formula.

Currently, net operating loss deductions are capped at the greater of $3 million or 20% of taxable income. This legislation provides the following schedule to phase-out the net operating loss deduction cap:

Taxable year 2014	Greater of $4 million or 33% of taxable income
Taxable year 2015	Greater of $5 million or 45% of taxable income
Taxable year 2016	Greater of $6 million or 56% of taxable income
Taxable year 2017	Greater of $7 million or 66% of taxable income
Taxable year 2018	Greater of $8 million or 75% of taxable income
Taxable year 2019	Greater of $9 million or 83% of taxable income
Taxable year 2020	Greater of $10 million or 90% of taxable income
Taxable year 2021	Greater of $11 million or 96% of taxable income
Taxable year 2022 and after	No Cap on net operating loss deduction

Finally, this legislation provides a phase-down schedule of the corporate net income tax rate from 9.99% to 6.99% as follows:

Taxable year 2014	9.49%
Taxable year 2015	8.75%
Taxable year 2016	8.25%
Taxable year 2017	7.75%
Taxable year 2018	7.25%
Taxable year 2019 and after	6.99%

The act shall take effect immediately.

FISCAL IMPACT: Enactment of this legislation will result in no adverse fiscal impact on Commonwealth funds in fiscal years 2012-13 and 2013-14. It is estimated that the additional revenues generated from the add-back provision contained in the bill will be offset by the tax reductions provided in the bill in the first two fiscal years of enactment.

A Multistate Tax Commission (MTC) report done in 2003 estimated that revenues lost to the Commonwealth from all types of tax sheltering to other states ranged from a low of $209 million to a high of $449 million. The estimates produced by the MTC report included many more transactions to be treated as add-backs. Some of these transactions involve interest transactions, day-to-day treasury transactions, factoring transactions and discounting transactions which many believe are necessary for the cash flow management of businesses. The provisions of this legislation limit the add-back of intangible expenses to royalties paid for patents, trademarks, copyrights and other similar expenses, including the interest associated with such transactions, and other states have adopted similar provisions as those contained in the bill.

Based on the experience of other states with similar provisions it is estimated that the add-back provisions contained in this legislation will generate an additional amount of tax revenue for the General Fund in the range of $70 million to $90 million in any taxable year.

According to estimates provided by the Department of Revenue, the changes to the provisions for the sales factor apportionment, the phase-in to elimination of the net operating loss deduction and the phase-down of the corporate net income tax rate to 6.99% will result in combined lost tax revenues over the two taxable years 2013 and 2014 estimated to be $165 million to the General Fund.

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House Appropriations Committee (R)

DATE: May 2, 2012

Estimates are calculated using the best information available. Actual costs and revenue impact incurred may vary from estimates.