Corporate Rate Reduction and Higher NOL Cap

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Act 53 of 2022 phased down the corporate net income tax (CNIT) rate from 9.99% in tax year 2022 to 4.99% by tax year 2031. The new state budget further reduces corporate tax liability by raising the net operating loss (NOL) deduction threshold. Net operating losses are unused tax losses carried forward from prior tax years that can be used to offset current year taxable income. Act 56 of 2024 raises the NOL deduction threshold from 40% of taxable income (the maximum offset) for tax year 2024 to 80% by tax year 2028, in 10 percentage point increments each tax year (see table). The higher thresholds only apply to NOLs generated after tax year 2024; older NOLs can only offset up to 40% of taxable income.

Corporate Rate Reduction and Higher NOL Deduction Threshold

Tax Year	2023	2024	2025	2026	2027	2028	2029
Rate Reduction	**8.99%**	**8.49%**	**7.99%**	**7.49%**	**6.99%**	**6.49%**	**5.99%**
Liability Impact	-$570	-$870	-$1,190	-$1,520	-$1,900	-$2,310	-$2,740
Raise NOL Threshold	**40%**	**40%**	**50%**	**60%**	**70%**	**80%**	**80%**
Liability Impact			$0	-$26	-$69	-$123	-$160

Note: Millions of dollars. Corporate rate declines to 4.99% for tax year 2031.

The table displays the IFO static estimates for the CNIT rate reduction and higher NOL deduction threshold by tax year. Both estimates assume that corporate profits expand by 3% per annum. Notable results include:

- The CNIT rate cut moves Pennsylvania from the state with the 2nd highest statutory tax rate in 2022 (after New Jersey) to 28th highest by 2029 (assumes other states do not reduce rates). The rate cut reduces tax liability by $2.7 billion for tax year 2029 relative to the original 9.99% rate.
- The higher NOL deduction threshold reduces the effective tax rate paid by corporations. Advocates note several benefits that include: (1) conformity with federal tax law, (2) reduced penalty on cyclical industries (that tend to generate more losses) and (3) a positive cash flow impact for new firms that generate losses in early years of operation. While the higher cap may allow some firms to claim NOLs that would effectively never be used, other firms can claim NOLs earlier than they would have otherwise.
- The rate cut and higher NOL threshold interact because tax losses that are carried forward have less tax benefit when claimed as a deduction under a lower tax rate. For example, a $100 NOL deduction in 2022 would have reduced taxes by $9.99. That same NOL claimed in 2027 would reduce taxes by $6.99.

It is noted that the figures in the table are static estimates, and do not reflect any dynamic response that could partially offset the negative revenue impact. Dynamic effects refer to the increase in private economic activity that should occur in response to lower tax burdens. A positive revenue offset should occur because (1) the lower tax rates (statutory and effective) encourage firms to locate or expand operations within the state and (2) there is less incentive to shift profits to other states. Regarding the tax incidence (i.e., the entities that ultimately pay the tax) of the provisions, the U.S. Congressional Budget Office and Joint Committee on Taxation both assume that 75% of the corporate income tax is borne by shareholders and 25% by workers. The Tax Foundation assumes an even split between shareholders and workers.