Officers, 2016-2017

Amy Thomas Laub
Chair
Nationwide Insurance Company

Arthur J. Parham, Jr.
Vice Chair
Entergy Services, Inc.

Robert J. Tuinstra, Jr.
Secretary & Treasurer
E.I. DuPont De Nemours and Company

Theodore H. Ghiz, Jr.
Past Chair
The Coca-Cola Company

John J. Pydyszewski
Past Chair
Johnson & Johnson

Robert F. Montellione
Past Chair
Prudential Financial

Douglas L. Lindholm
President
Council On State Taxation

Directors

Barbara Barton Weiszhaar
HP Inc.

Deborah R. Bierbaum
AT&T

C. Benjamin Bright
HCA Holdings, Inc.

Paul A. Broman
BP America Inc.

Michael F. Carchia
Capital One Services, LLC

Tony J. Chirico
Medtronic, Inc.

Susan Courson-Smith
Pfizer Inc.

Meredith H. Garwood
Charter Communications

Denise J. Helmken
General Mills

Beth Ann Kendzierski
Apria Healthcare, Inc.

Kurt Lamp
Amazon.Com

Mollie L. Miller
Fresenius Medical Care North America

Rebecca J. Paulsen
U.S. Bancorp

John H. Paraskevas
Exxon Mobil Corporation

Frances B. Sewell
NextEra Energy, Inc.

Warren D. Townsend
Wal-Mart Stores, Inc.

Ferdinand Hogroian
Senior Tax & Legislative Counsel
(202) 484-5228
fhogroian@cost.org

May 23, 2017

State of Rhode Island General Assembly
House Committee on Finance

Via E-mail

Re: COST's Opposition to "CEO-to-Median-Wage Ratio Surtax," House Bill 5141

Dear Chairman Abney and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am writing to oppose legislation (H.B. 5141) that would impose either a 10 percent or 20 percent surtax on the corporate income tax liabilities of publicly traded companies based on their CEO-to-median-wage ratio reported to the U.S. Securities and Exchange Commission (SEC). The proposal is based on reporting requirements to the SEC that may never take effect, yet would immediately impact the estimated tax reporting requirements of publicly traded corporations doing business in Rhode Island. In addition to creating difficult (and potentially insurmountable) compliance and administration issues, this measure creates an artificial tax classification between publicly traded and private companies and would likely be subject to constitutional challenges. Further, Rhode Island would be the only state to enact such a measure. For all of these reasons, COST strongly urges the Committee to reject H.B. 5141.

About COST

COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST members are significant contributors to economic development and employment in Rhode Island.

Audit and Compliance Problems Under H.B. 5141

The use of the SEC CEO-to-median-wage ratio to determine a state tax is misguided and unworkable for several reasons. First, the SEC has stated that it does not intend to audit the ratio reported by subject companies. Thus, it is unclear how a state or local government expects to enforce such a provision in the absence of federal oversight. Second, the Dodd-Frank Act has been targeted for repeal by the current administration. If the Act is successfully repealed, pay ratio disclosure will likely be discontinued and the basis for applying and calculating the tax would no longer exist. Finally, using the SEC pay ratio as a basis for calculating a tax creates uncertainty and severe forecasting and financial reporting difficulties for companies whose pay ratio may fluctuate above and below the targeted ratio.

Differential Treatment Represents Unsound Tax Policy

A CEO-to-median-wage ratio tax, such as the surtax proposed in H.B. 5141, is only applicable to publicly traded companies subject to the SEC reporting requirements. A fair and neutral tax treats similarly situated taxpayers similarly. Publicly traded companies comprise less than one percent of U.S. companies, and there is no reasonable basis to treat public companies differently than private companies. Further, the SEC has provided companies that are required to report with a large degree of flexibility to determine this ratio, creating additional disparities among impacted companies. Finally, the imposition of a CEO-to-median-wage ratio tax will almost certainly have no influence on pay disparity—the supposed rationale for such measures. Like all taxes, a pay ratio tax would be borne in some combination by workers (through lower wages), by consumers (through higher prices), or by the businesses (through lower returns for investors and shareholders).

Constitutionally Suspect

CEO-to-median-wage ratio taxes raise significant state and U.S. Constitutional issues:

- State Uniformity Clause and U.S. Equal Protection Issues. Many states' "Uniformity Clause" provisions require that similarly situated taxpayers be taxed in the same manner and at the same rate. CEO-to-median-wage ratio taxes create differing tax treatment of similarly situated companies (*i.e.,* publicly traded versus private) with no rational basis. Further, two publicly traded companies may use different methods to calculate their respective ratios, both of which would be valid under the SEC rules even if, for example, they include the use of drastically different wage information. This all raises both Uniformity Clause concerns under state constitutions as well as Equal Protection Clause concerns under the U.S. Constitution.[1]

- U.S. Due Process and Commerce Clause Issues. The group of affiliated companies used to determine the SEC pay ratio encompasses all corporate entities worldwide and is based on a 50 percent ownership threshold. Under the US Constitution, states are prohibited by the Commerce Clause from taxing any entity that lacks "substantial nexus" with the taxing jurisdiction. Thus, the affiliated group of companies with nexus to the state or local jurisdiction imposing the tax will almost certainly be composed of different entities than those used to calculate the SEC pay ratio. In addition, a CEO-to-median-wage ratio tax impermissibly attempts to impose a tax that is based on activities with no connection to the taxing jurisdiction. For example, in most cases neither a company's CEO nor most of its employees (from which the wage ratio is derived) will be physically located in the taxing jurisdiction. These issues raise significant concerns under both the Due Process and Commerce Clauses of the U.S. Constitution.[2]

For all of these reasons, COST believes that H.B. 5141 represents unsound tax policy that would be counterproductive towards the bill's stated goals while creating an unworkable administrative and compliance regime. Please contact me with any questions regarding this testimony or COST's research in this area.

---

[1] *Metropolitan Life Insurance Co.* (470 U.S. 869 (1985)).
[2] *See Complete Auto* (430 U.S. 274 (1977)) and *Jefferson Lines* (514 U.S. 175 (1995)).

Respectfully,

Ferdinand Hogroian

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director