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June 26, 2017

Commonwealth of Massachusetts  
Joint Committee on Revenue

*Via E-mail*

**Re: COST’s Opposition to the act related to excessive executive compensation—S. 1555**

Dear Co-Chairs Brady and Kaufman and Members of the Joint Committee:

On behalf of the Council On State Taxation (COST), I am writing to oppose legislation (S. 1555) that would impose an additional 2 percent of tax on financial institutions and publicly traded companies based on a ratio of the business’s CEO pay to the median-wage. In addition to creating difficult (and potentially insurmountable) compliance and administration issues, this measure creates an artificial tax classification between financial institutions and publicly traded companies versus other private companies and would likely be subject to constitutional challenges. Further, Massachusetts would be the only state to enact such a measure. For these reasons, COST strongly urges the Committee to reject S. 1555.

**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 Massachusetts.

**Policy Against CEO-to-Median-Wage Ratio Taxes**

The COST Board of Directors has adopted a formal policy position regarding CEO-to-median-wage ratio taxes and surtaxes.<sup>1</sup> That policy position states:

*Predicating a state or local tax on a CEO-to-median-wage pay ratio has no basis in sound tax policy. Such measures create an artificial tax classification between publicly traded and private companies and create difficult compliance issues. Further, these taxes are constitutionally suspect because they measure and increase*

<sup>1</sup>[http://cost.org/uploadedFiles/About\\_COST/Policy\\_Statement/CEO%20to%20average%20wage%20ratio%20surtax%20FINAL.pdf](http://cost.org/uploadedFiles/About_COST/Policy_Statement/CEO%20to%20average%20wage%20ratio%20surtax%20FINAL.pdf)

*taxes based on business activities that typically take place outside of the jurisdiction imposing the tax.*

### **Audit and Compliance Problems Under S. 1555**

As drafted, S. 1555 requires financial institutions and publicly traded companies to determine a “compensation ratio,” which compares the business’s CEO or highest paid employee for a calendar year to the “median compensation of all employees employed by the business . . . within the U.S.” for that same calendar year, without any additional guidance. If S. 1555 were passed, Massachusetts would be the only state to require such a calculation, and this calculation differs significantly from the CEO-to-median-wage ratio, which a business may be required to calculate for its SEC filings. Further, the “compensation ratio” as defined by S. 1555 would likely include wage information for employees beyond those contained in the Massachusetts unitary combined filing group, adding an additional layer of complexity to a taxpayer’s compliance burden. In addition to the significant compliance burden for taxpayers, it is unclear how the Massachusetts Department of Revenue would audit a taxpayer’s ratio. Finally, using a “compensation 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**

The additional tax based on the CEO-to-median-wage ratio as proposed in S. 1555 is only applicable to financial institutions and publicly traded companies. A fair and neutral tax treats similarly situated taxpayers similarly. There is no reasonable basis to treat financial institutions and public companies differently than private companies. Such a tax is an arbitrary assessment on a limited number of companies doing business in Massachusetts. 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 U.S. Constitutional issues:

- 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 Massachusetts 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.<sup>2</sup>

For all of these reasons, COST believes that S. 1555 represents unsound tax policy that would be counterproductive towards the bill's stated goals while increasing compliance burdens for taxpayers as well as the state. Please contact me with any questions regarding this testimony or COST's research in this area.

Respectfully,

A handwritten signature in cursive script that reads "Karl Frieden".

Karl Frieden

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

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<sup>2</sup> See *Complete Auto* (430 U.S. 274 (1977)) and *Jefferson Lines* (514 U.S. 175 (1995)).