An Evaluation of Connecticut's Corporate Income Tax

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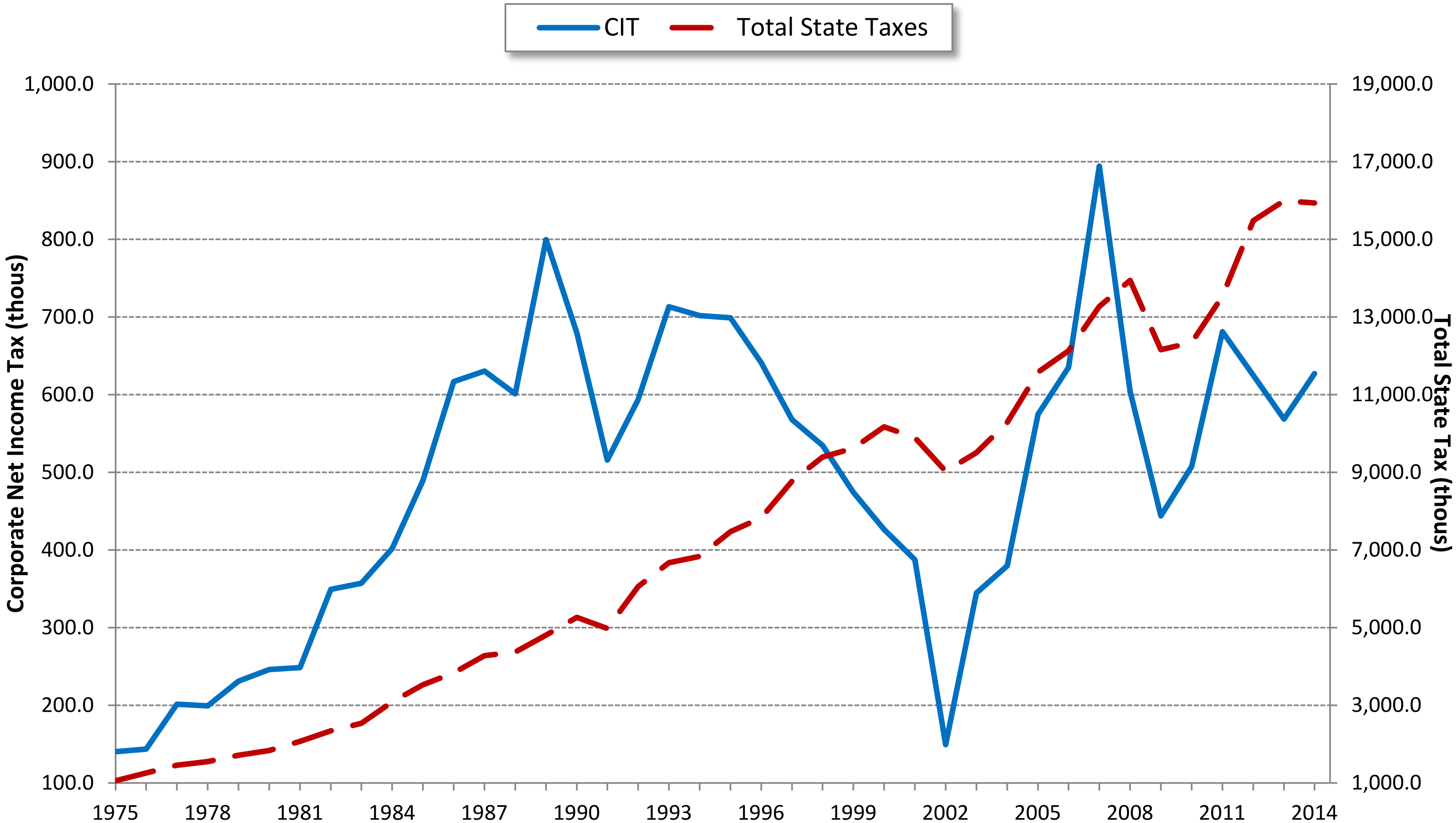
Overview

- Brief Discussion of Current CIT regime
- Corporate Tax Revenue Performance
- Tax Credits
- Suggestions for Improving Corporate Income tax
- Options Beyond Corporate Income Tax: Structural Reform

Summary of Existing Tax Regime

- Top CIT rates (7.5%, 9% with surcharge) competitive with regional rates that vary from 7.1% in NY to 10% in PA.
- Business income tax levied only on C Corps.
  - Profits from businesses organized as S Corps, LLCs etc. and Sole Proprietorships captured by individual income tax
- For multistate businesses, income is apportioned using both single factor sales and three factor formula.
- Services sourced to CT using cost of performance rules.
- Mandatory combined reporting begins in 2016.

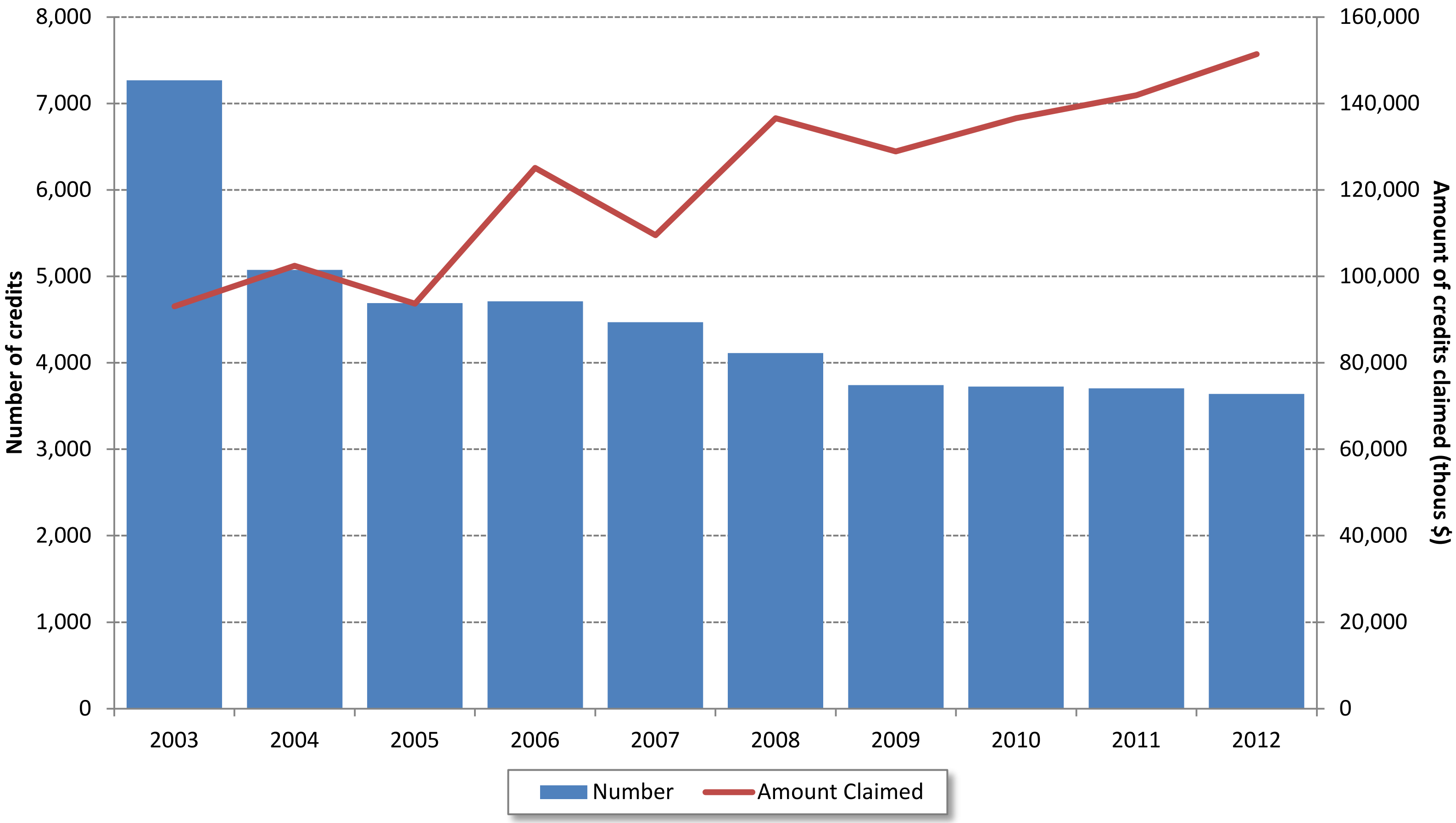
Revenue Performance CIT versus Total Taxes



Revenue Performance

- CIT represents only 3.9% of total tax collections in CT.
- Lower share of total taxes than regional competing states. NY – 6.3%. Delaware – 8.8%. New Jersey – 8.0%.
- CIT is highly volatile, ranging from a recent high of $900 million in 2007 to $450 million in 2009 during the recession. Currently running about $600 million / year.
- Nominal collections on long term downward trend, despite several 'fixes' to CIT regime to keep revenues propped up.
  - Temporary surtax in effect since 2003.
  - Increase in the maximum preference tax in 2003
  - Limits on credits (now 50.01% of pre-credit income)

Tax Credits


8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
Number of credits
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
Amount of credits claimed (thous $)
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
Number
Amount Claimed

Tax Credits by Type

Type of Credit	Credits: Number	Credits: Share of Total	Credits Claimed: Amount	Credits Claimed: Share of Total	Average Credit Claimed
Apprenticeship Training	9	0.2%	146,089	0.1%	16,232
Computer Donation	1	0.0%	702	0.0%	702
Digital Animation	2	0.1%	684,235	0.5%	342,118
Donation of Land	3	0.1%	5,929	0.0%	1,976
Electronic Data Processing	1,128	31.0%	10,725,356	7.1%	9,508
Film Production	27	0.7%	25,796,631	17.0%	955,431
Film Production Infrastructure	3	0.1%	1,477,765	1.0%	492,588
Financial Institutions	2	0.1%	2,341	0.0%	1,171
Fixed Capital	1,727	47.5%	63,125,737	41.7%	36,552
Historic Homes Rehabilitation	3	0.1%	24,648	0.0%	8,216
Housing Program Contribution	4	0.1%	377,550	0.2%	94,388
Human Capital	116	3.2%	1,869,913	1.2%	16,120
Job Expansion	111	3.1%	2,223,373	1.5%	20,030
Machinery and Equipment	62	1.7%	439,783	0.3%	7,093
Manufacturing Facility in Targeted Investment Community or Enterprise Zone	16	0.4%	847,382	0.6%	52,961
Neighborhood Assistance	72	2.0%	2,284,116	1.5%	31,724
New Jobs Creation	6	0.2%	754,792	0.5%	125,799
Qualified Small Business Job Creation	5	0.1%	21,329	0.0%	4,266
Research & Development	145	4.0%	5,392,832	3.6%	37,192
Research & Development Grants to Institutions of Higher Education	2	0.1%	123,469	0.1%	61,735
Research & Experimental Expenditures	180	4.9%	20,681,089	13.7%	114,895
Small Business Guaranty Fee	1	0.0%	148	0.0%	148
Urban and Industrial Site Reinvestment	14	0.4%	14,371,333	9.5%	1,026,524
Total	**3,639**	**100.0%**	**151,376,542**	**100.0%**	**41,598**

Tax Credits

- In 2012, about 3,600 taxpayer claimed credits totaling $151 million
- The number of taxpayers claiming credits has declined in recent years, but the dollar amount claimed has continued to grow.
- The 11 firms in the top quintile of pre-credit liabilities claimed about 35% of all credits.
- Value of credits carried forward to 2013 was $2.5 *billion*, or about four times the total corporate income tax collections in 2014.
- Elimination of all credits in 2012 would have allowed a revenue neutral tax rate reduction of 0.9%.
- To limit revenue losses, credits were limited to 50.01% of tax liability for years before after 2014, down from 70% for years prior to 2015.

Recommendations: Corporate Income Tax

- Eliminate the capital base system.
- Clarify the corporate tax rate via elimination of the corporate surtax.
- Eliminate the proliferation of tax credits.
- Evaluate whether tax credits are achieving their objective.
- Enact market-based sourcing in lieu of the current cost of performance rule for apportionment of sales factor for service providers.
- Unitary groups for combined reporting should be as inclusive as possible.
- Broaden addback statutes by including management fees.
- Eliminate the election to report combined reporting on a water's edge, worldwide, or federal affiliated bases.
- Impose single factor sales apportionment for all taxpayers.

Broad

	Taxonomy of Business Taxes	
Tax Base	**Examples**	**Description**
Gross Receipts Tax	Ohio CAT, Washington B&O, Nevada	
Margins Tax	Texas, Kentucky	Gross receipts – labor 70% of gross receipts Gross receipts – COGS
Subtraction Method Vat	Proposed in California	Gross receipts minus purchases from other firms
Credit Invoice VAT	Europe	Gross receipts minus labor, depreciation, interest, purchases from other firms
Corporate Income Tax	Imposed on U.S. C corps in 45 states	Gross receipts minus labor, depreciation, interest, purchases from other firms, other operating exp.

Narrow

Gross Receipts Tax

- Tax on all gross receipts.
- Tax return fits on a post card.
- Very broad base and low rates.
- Imposed on every firm doing business in the state without regard to nexus.
- Tax on turnover, so can pyramid in the production and distribution cycle. However, low rates mitigate this problem.
- Also disadvantages high volume, low margin businesses such as grocery, wholesaler, discount retailers, etc.

Value Added Taxes

- Most commonly proposed business tax version in the U.S. is the subtraction VAT.
- Gross Receipts minus all purchases from other businesses (but not in-house labor).
- Income variant capital assets treated similarly to the traditional income tax – capitalized and deducted when sold (inventory) or depreciated (capital assets).
- Consumption variant – all items fully deductible in the year purchased, no inventory, no depreciation deductions.

Corporate Tax Rates and Revenue Neutral VAT and GRT Rates

	2007	2008	2009	2010	2011	2012
VAT Tax Rate	0.589%	0.531%	0.571%	0.633%	0.618%	0.640%
GRT Tax Rate	0.215%	0.172%	0.190%	0.242%	0.226%	0.221%
CIT Tax Rate*	7.500%	7.500%	8.250%	8.250%	8.250%	9.000%

*Includes surcharge tax rate.