

# **Sales Taxation in Connecticut**

## **Connecticut State Tax Panel**

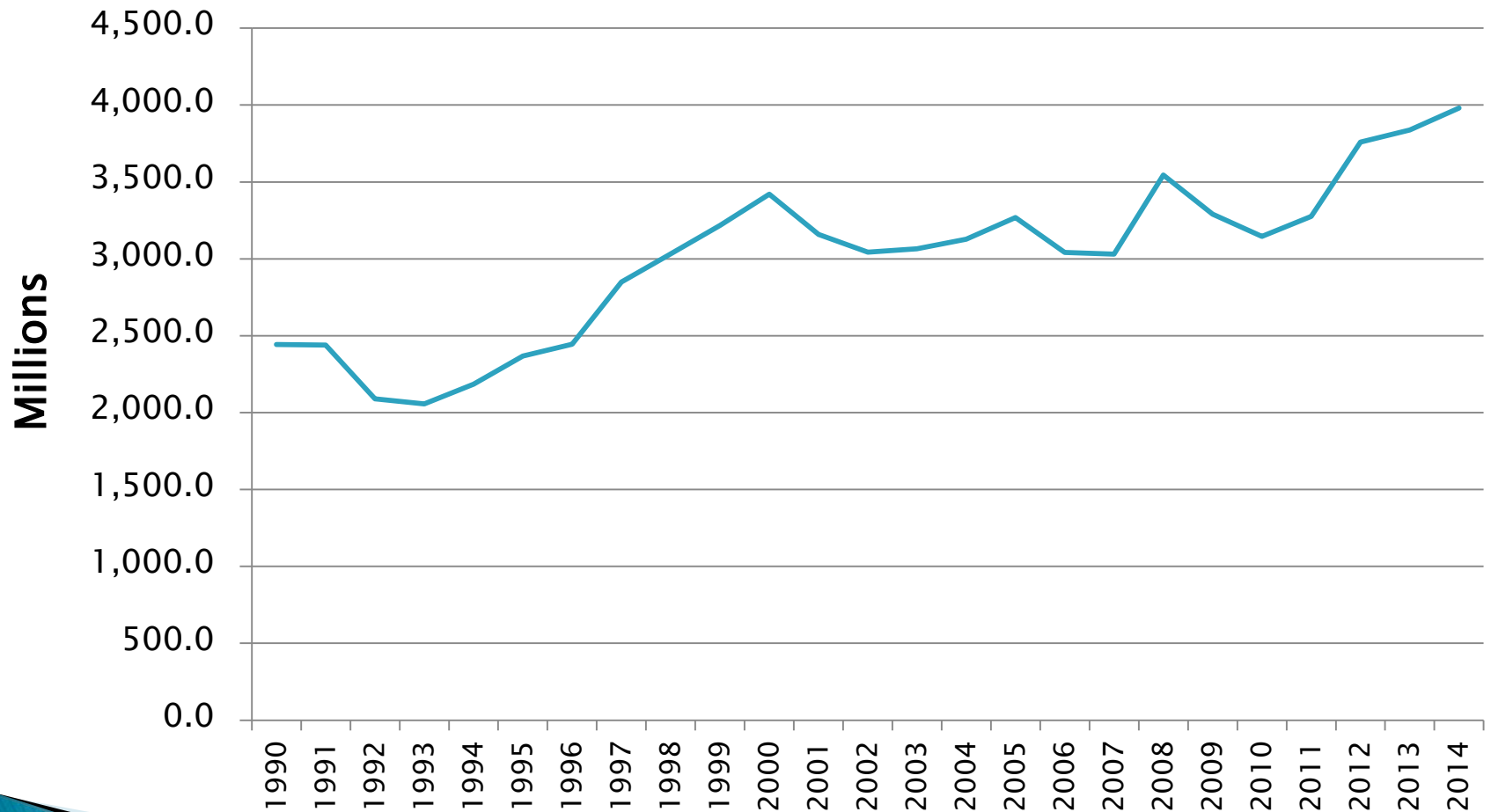
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# Sales Tax Characteristics

- ▶ Revenue elasticity has been very low over the past 15 years (0.22), low over the past decade (0.57) and has been negative for three of those years.

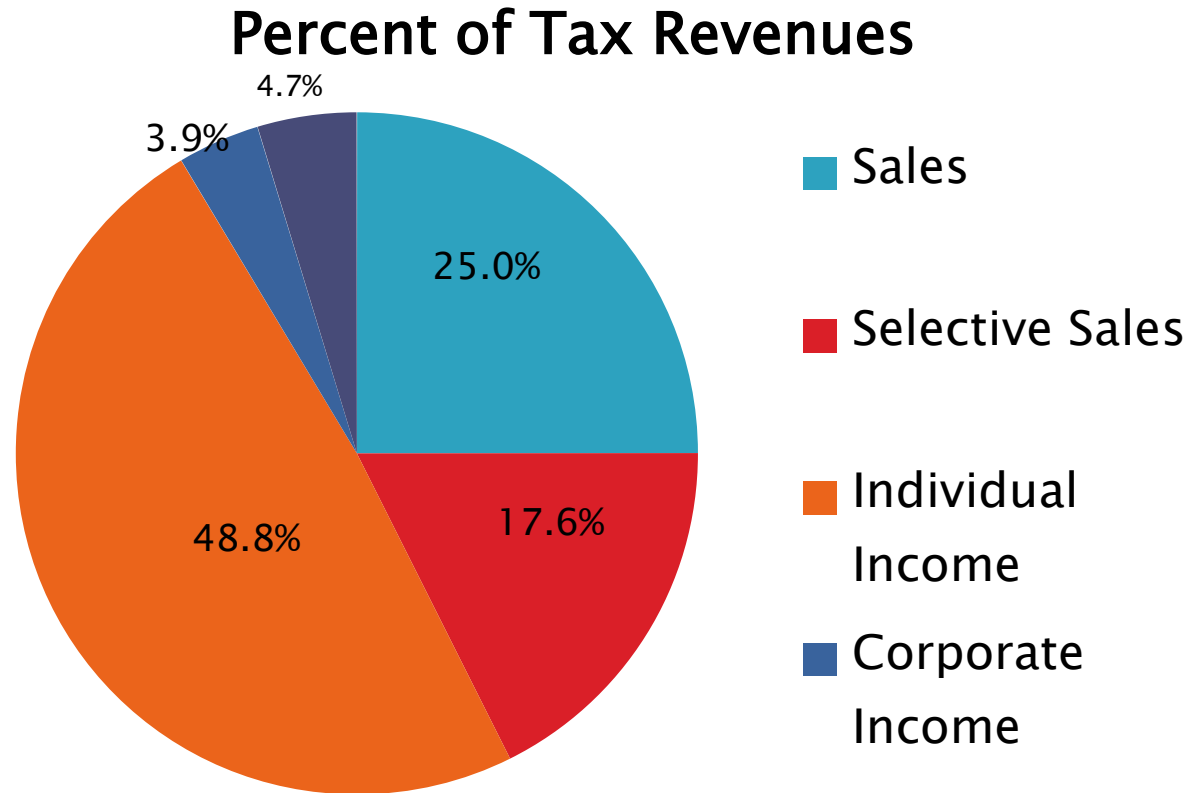
# Sales Tax Revenue, 1990–2014



# Sales Tax Characteristics

- ▶ Revenue elasticity has been very low over the past 15 years (0.22), low over the past decade (0.57) and has been negative for three of those years.
- ▶ Generates 25% of state tax revenues – low on national standards

# Figure 1: Percent Distribution of Connecticut State Tax Revenues, 2014

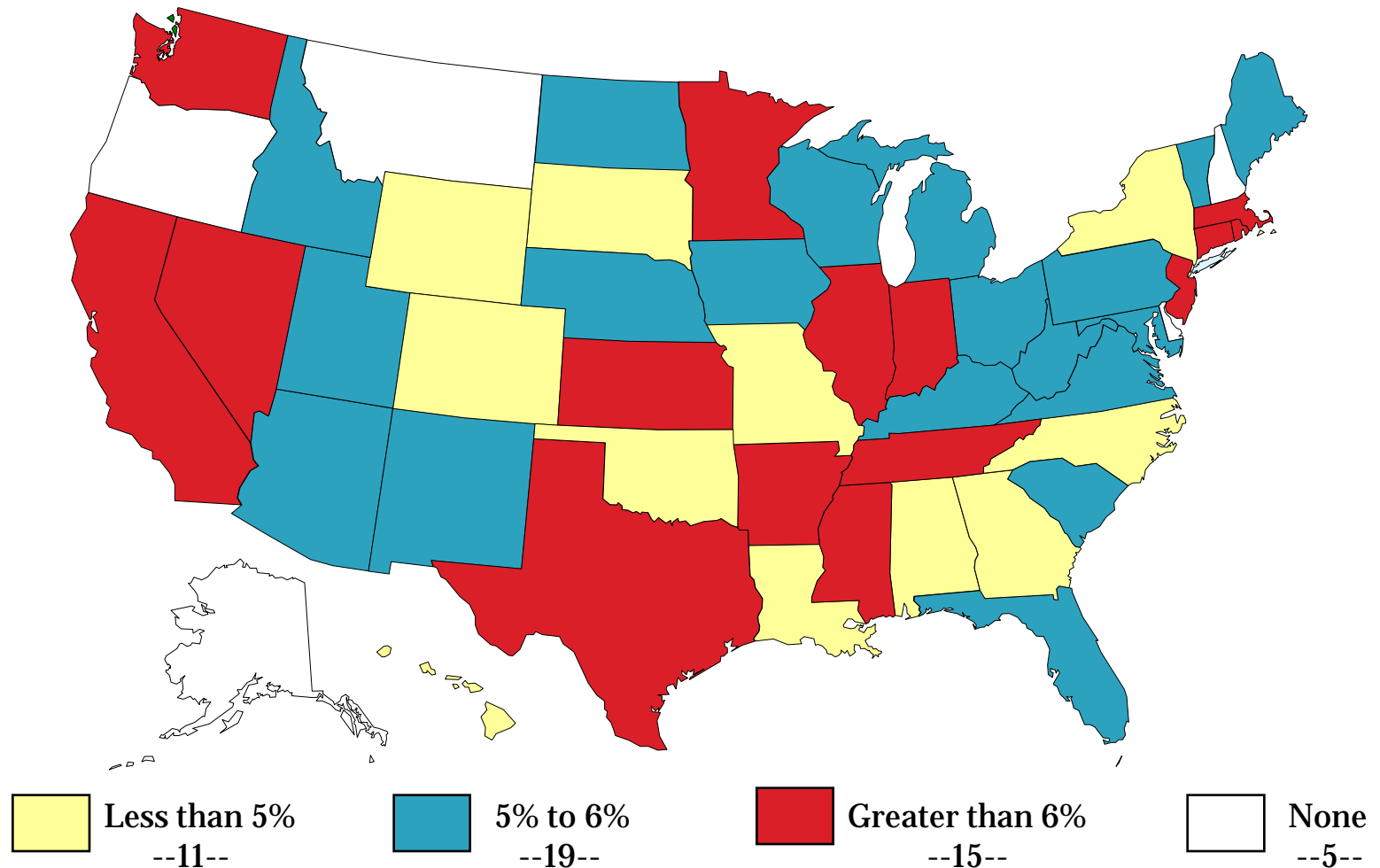


Source: <http://taxadmin.org/fta/rate/14taxdis.html>

# Sales Tax Characteristics

- ▶ 6.35% standard tax rate – below national 6.9 state/local median rate
  - Connecticut imposes 7 sales tax rates, which is high on national standards

# Figure 3: STATE SALES TAX RATES as of Jan. 1, 2015

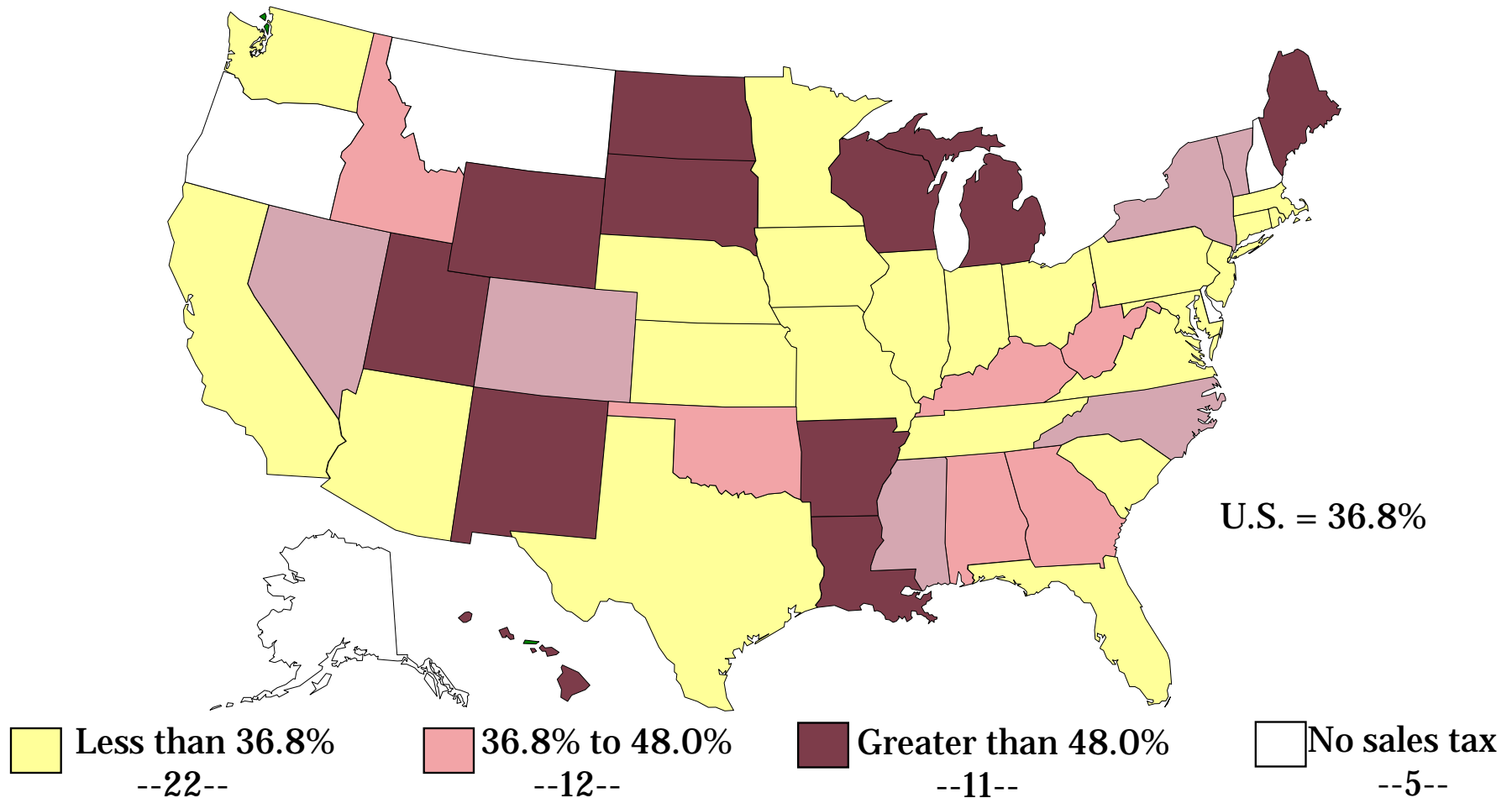


# Sales Tax Characteristics

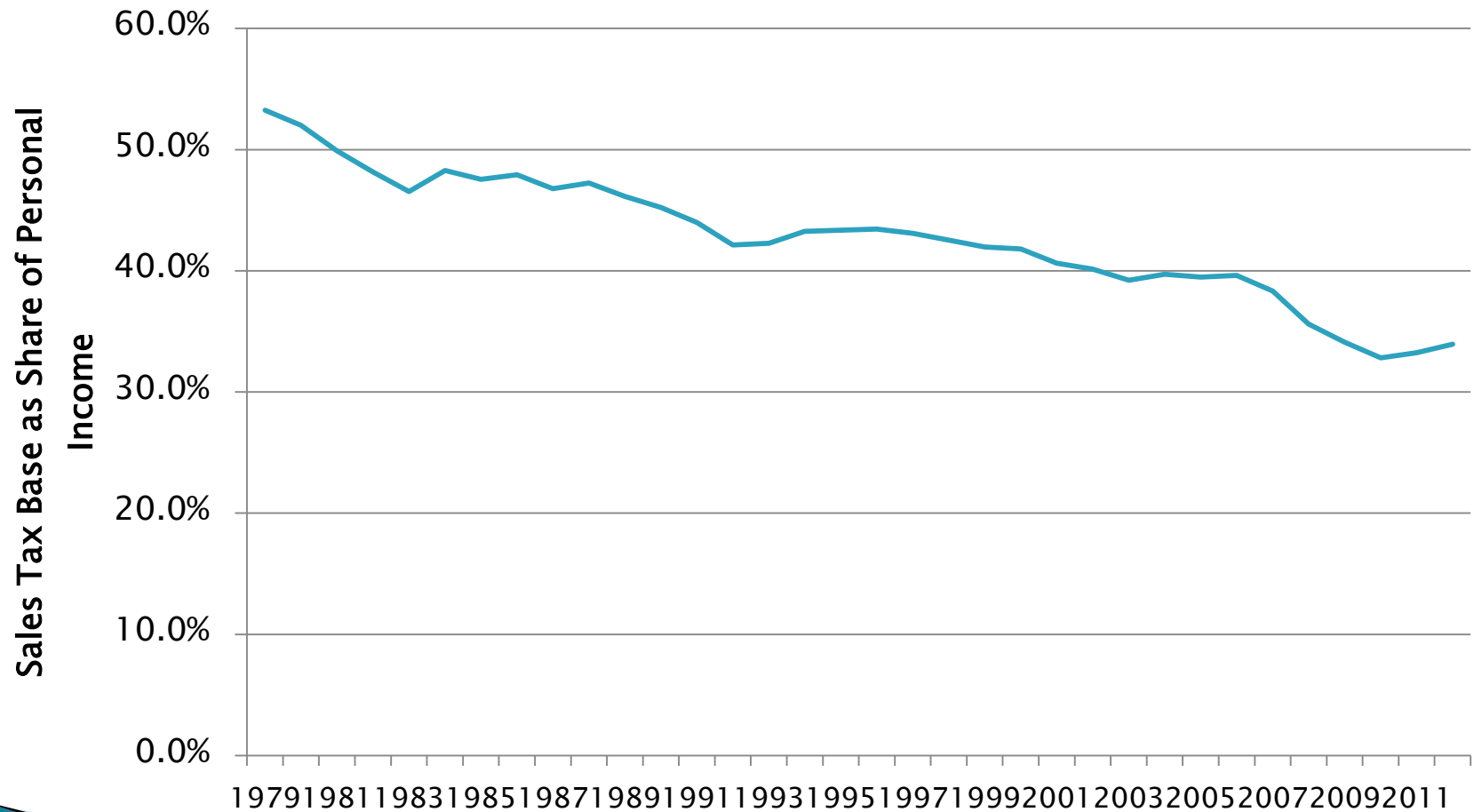
- ▶ 6.35% standard tax rate – below national 6.9 state/local median rate
  - Connecticut imposes 7 sales tax rates, which is high on national standards
- ▶ Connecticut's collected sales tax base (27.9%) is narrow relative to national standards (36.8%), but only Maine is broader among northeast states.
- ▶ Taxation of services is relatively broad



# Figure 4: STATE SALES TAX BASE AS A PERCENT OF PERSONAL INCOME, 2012



# Sales Tax Base as Percentage of Personal Income, 1979–2012



# Sales taxes are evaluated as consumption taxes

- ▶ Tax all household purchases, regardless
  - How obtained
  - Where obtained
  - Who is the seller
- ▶ Exempt business purchases
- ▶ Destination tax
  - Tax out-of-state purchases, including e-commerce, cross border shopping, etc.,
  - Exempt out-of-state sales

# Sales taxes are evaluated as consumption taxes

- ▶ CT provides 49 exemptions, many of which are intended to move the sales tax from a tax on all transactions to a tax on consumption.
- ▶ \$243.6 billion total value of exemptions
- ▶ 72% of exemptions are for intermediate purchases and out-of-state sales
- ▶ But, the exemptions mean that tax can depend on who buys, what they buy, who they buy from, where they buy, and how they buy

# Tax consumption broadly

- ▶ Distributes tax burden proportionally to consumption
- ▶ Allows a lower revenue neutral tax rate
- ▶ Enhances horizontal equity
- ▶ Limits effects of the sales tax on behavior

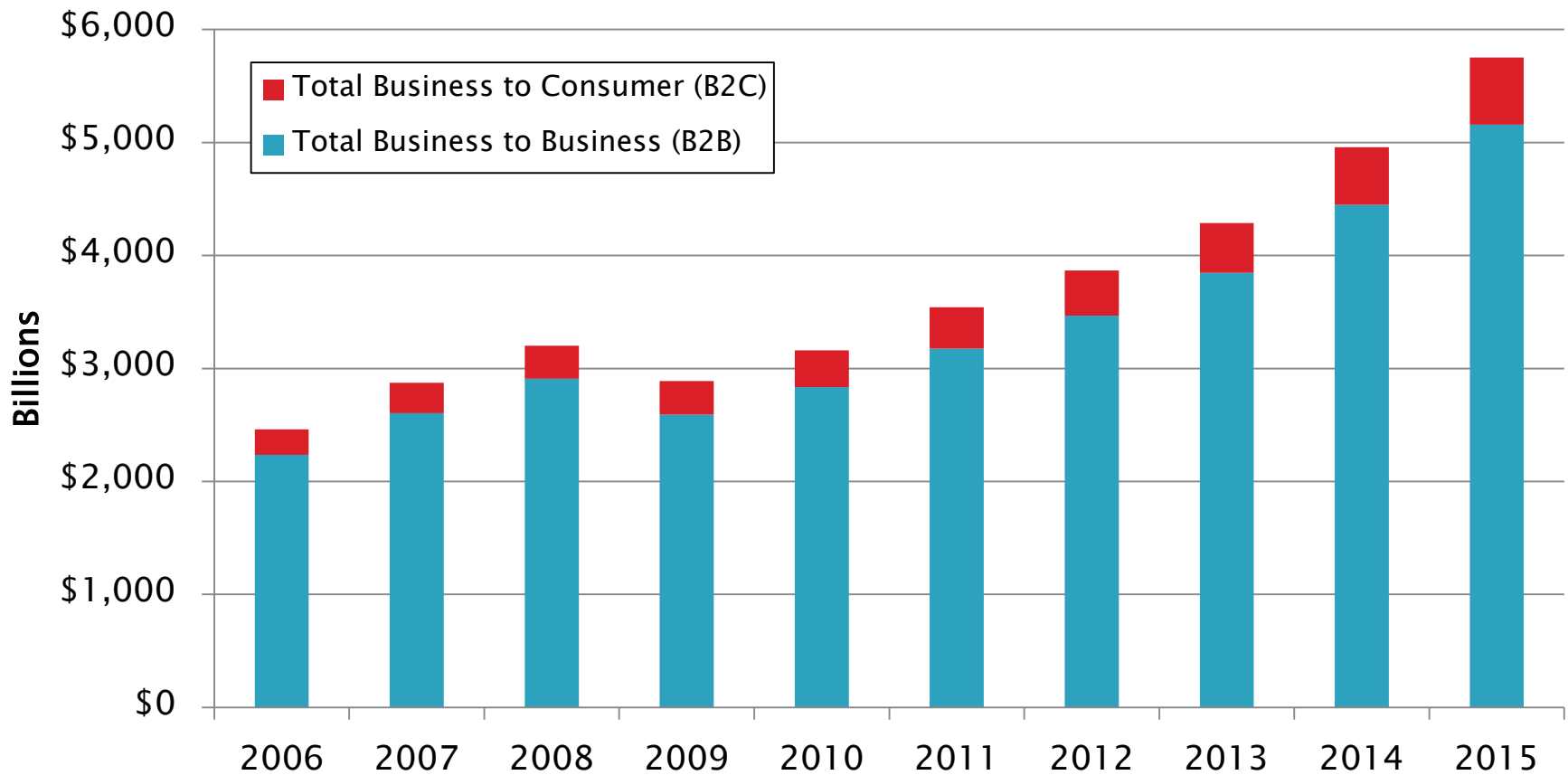
BUT

- ▶ May tax purchases that are not taxable in other nearby states, and creates problems for some in-state businesses
- ▶ Vertical equity? DRS indicates
  - 5.81% burden for lowest decile
  - 0.17% for highest decile

# Challenges of changing consumption patterns and options

- ▶ Fast growing service consumption, and particularly health care
- ▶ E-commerce – tax consumption the same regardless of how acquired
  - SSTGB
  - More expansive nexus definitions
  - Work with others in challenge of Quill
- ▶ Tax digitized media

# Figure 7: ESTIMATED TOTAL E-COMMERCE SALES



\*Sales-taxing states only.

# Why exempt intermediate purchases?

- ▶ Perhaps 35% of CT sales tax on business purchases, which is low on national standards
- ▶ Case for exemption:
  - Taxes production, and could discourage firm locations/production
  - Encourages vertical integration
  - Harms small business
  - Cascades into higher product prices
- ▶ But if exempt:
  - Bases tax on purchaser and can raise compliance costs and fraud
  - Requires a higher tax rate – over 8 percent



# Policy Options

- ▶ ***Policy Option 1:*** Reduce the number of sales tax rates. One rate is preferred, though the state may want to levy separate taxes on items purchased heavily by tourists, such as a hotel or rental car tax.

# Broaden the base

- ▶ Tax additional goods
  - Food other than meals
  - Tax holidays
- ▶ Tax additional services
  - Residential utilities
  - Residential repairs and renovations

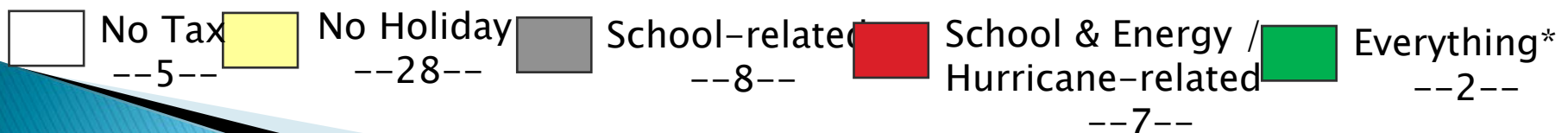
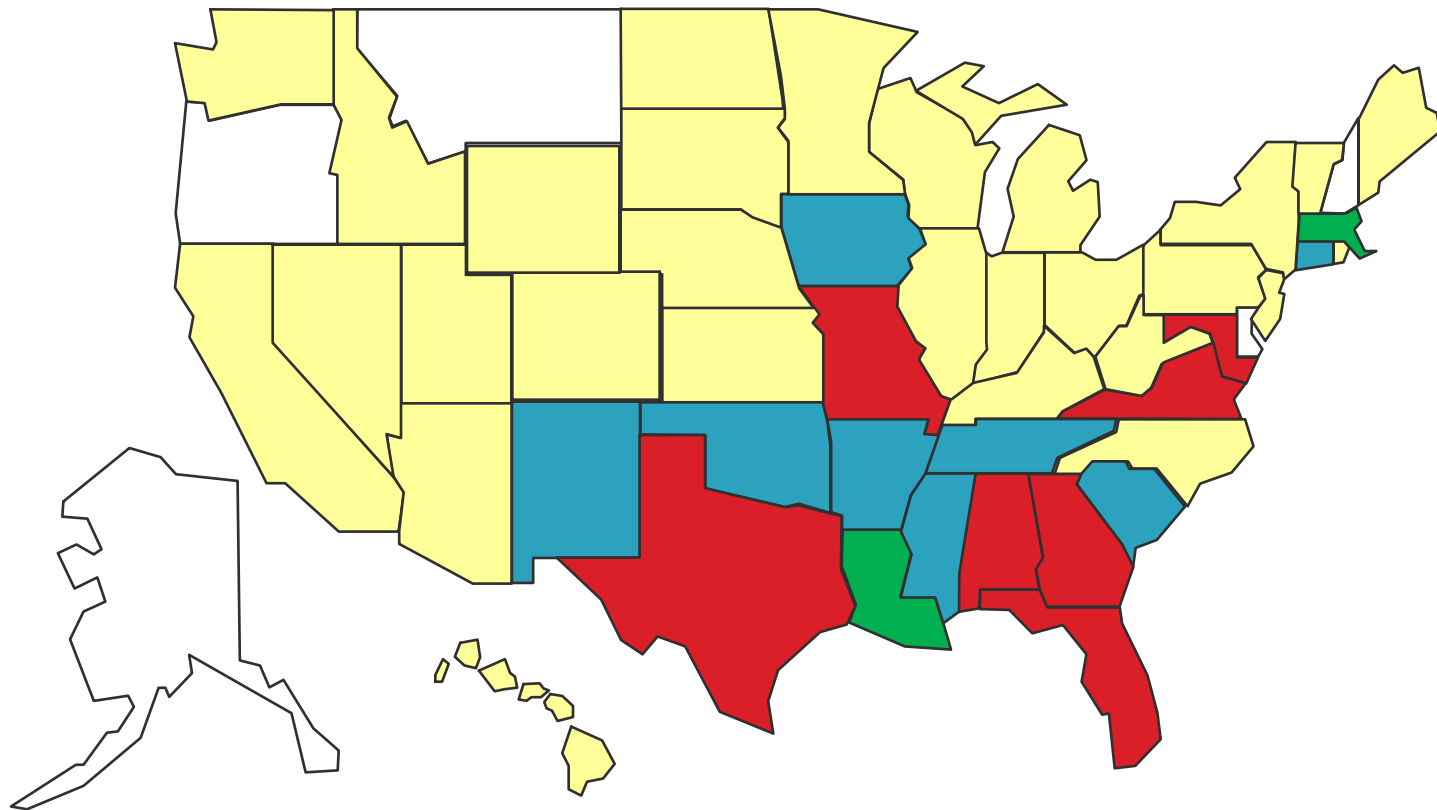
# Policy Options

- ▶ ***Policy Option 2:*** Impose the sales tax on all food purchases, regardless of whether regarded as part of a meal. Purchases made with food stamps would remain exempt under any policy change.

# Policy Options

- ▶ ***Policy Option 3:*** Eliminate the sales tax holiday.

# Figure 6: States with Sales Tax Holidays, 2014



Louisiana has 3 holidays: i) hurricane prep; ii) hunting supplies; and iii) all tangible personal property.

# Policy Options

- ▶ ***Policy Option 4:*** Broaden the sales tax to more services used by consumers, including residential utilities and repairs to residential real property.

# Keep sales tax current with business practices, for example

- ▶ Exemption for transactions between wholly owned subs and parent
- ▶ Other business services
  - Employment/training services
  - Computer services
  - Lobbying and consulting
  - Business analysis

# Policy Options

- ▶ ***Policy Option 5:*** Reduce taxation of intermediate services and particularly employment and computer services.



# Policy Options

- ▶ ***Policy Option 6:*** Legislate a less stringent ownership rule for exemption when services are sold between a parent and a subsidiary.

# Policy Options

- ▶ ***Policy Option 7:*** Eliminate the exemption for sales to not-for-profit organizations except when the purchases are used to produce goods and services that are sales taxed when provided to beneficiaries, or add a requirement that the not-for-profit organizations meet certain criteria evidencing that their work is in the public interest.

# Exempt organizations

- ▶ Not-for-profits
  - Distinguish between philanthropic and service providing?
  - Provide the same exemptions for intermediate goods that other businesses face
- ▶ Governments – why exempt sales to or sales by governments?

# Policy Options

- ▶ ***Policy Option 8:*** Impose the sales tax on sales to government entities.

# Policy Options

- ▶ ***Policy Option 9:*** Levy the sales tax on sales by government in cases where the public activities compete with the private sector, such as parking.

# Policy Options

- ▶ ***Policy Option 10:*** Join the Streamlined Sales Tax Governing Board.

# Policy Options

- ▶ ***Policy Option 11:*** Connecticut should continue to investigate and where possible legislate a more expansive definition of nexus.

# Policy Options

- ▶ ***Policy Option 13:*** Tax digitized downloads for consumption, such as books, video and music at 6.35%.



# Challenges of changing consumption patterns and purchasing options

- ▶ Sharing economy
  - Tax consumption
  - Similar taxation, particularly for highly substitutable items
  - Sector changing rapidly, which means must move cautiously into new legislation
  - Use the organizing company to comply with the tax

# Policy Options

- ▶ ***Policy Option 12:*** Use companies organizing the sharing economy for enforcement and remittance of the sales tax.

# Policy Options

- ▶ ***Policy Option 14:*** Ask the Department of Revenue Services to carefully review the sharing economy to ensure that consistent taxation is occurring between the sharing and digitized economies and traditional economy. Enact legislation where necessary to ensure that neutral taxation is occurring.