CONNECTICUT STATE AND LOCAL TAX STUDY PANEL:
OVERVIEW AND RECOMMENDATIONS

NOTES TO ACCOMPANY TESTIMONY

BEFORE THE FINANCE, REVENUE AND BONDING COMMITTEE

JANUARY 29, 2016

Organization of Remarks

Organization of the Final Reports

Establishing the Policy Framework of the State/Local Revenue System

Findings and Recommendations Relating to State Taxation

Findings and Recommendations Relating to The Property Tax and Local Revenue Diversification

Establishing the Policy Framework for the Connecticut State & Local Revenue System

The Connecticut Economy

Overview of the Connecticut State and Local Revenue Systems

Municipal Fiscal Disparities

Fiscal Architecture: How Does Connecticut Compare?

Competitiveness

Fiscal Architecture: What Makes “Fiscal Sense” as Connecticut Approaches the 2020s?

The Connecticut Personal Income Tax

Recommendation 1. **Taxation of Retirement Income .** Other than federally excluded income, tax all retirement income including military and teacher retirement income similar to the state's treatment of social security income.

Recommendation 2. **Connecticut Definition of Adjusted Gross Income.**Retain the Connecticut definition of Adjusted Gross Income as the starting point for calculating the Connecticut Personal Income Tax.

Recommendation 3. **The Earned Income Tax Credit (EITC).** Retain the Earned Income Tax Credit. Increase the credit from an amount equal to 27.5% to 30% of the federal earned income tax credit (Current Connecticut law phases in this increase by FY 2017).

Recommendation **4. Net Capital Gains Income.** Retain the tax treatment of taxing net capital gains income at the same rate as all other income in the Connecticut income tax.

The Connecticut General Retail Sales Tax

Recommendation 1. **Remote Sales Transactions.** Remain aggressive in the taxation of remote purchases destined for Connecticut residents by pursuing opportunities to expand the definition of *nexus* through administrative procedures and, if needed, through legislation. As part of its enforcement the state should require sellers to collect and remit

Digital Downloads . Tax retail consumption of digitized versions of goods at the same standard retail sales tax rate as other goods. As part of the enforcement strategy the state should look to use sellers, wherever they are located, to collect and remit the sales tax.

Recommendation 3. **Shared Economy.** Ensure that the sharing economy is taxed similarly to the traditional economy. Recognizing that the sharing economy is still in its early stages of development, the General Assembly should provide legislative support to the Department of Revenue Services in its efforts to identify the size of the tax base as well as to capture the tax due at retail by requiring the sharing economy organizing business entity to collect and remit tax due.

Recommendation 4. General Application of Sales and Use Tax. Adopt the presumption that the Connecticut sales tax on final consumption be broadly applied to all goods and services sold at retail. If exclusions, exemptions or credits are to be allowed, the General Assembly must be explicit in its rationale for such treatment.

***Recommendation 5*.** **Eliminate Sales Tax Holidays.** Eliminate the practice of a sales tax holiday

General Business Taxation: Alternatives to the Corporate Net Income (Profits) Tax

Recommendation 1. **Alternatives to the Corporate Net Income Tax and Business Taxes.** The state shall undertake, through the Department of Revenue Services, a study of the structural impacts and tradeoffs of replacing the corporate net income tax with a broad based/low general business tax to be imposed uniformly on corporate and non-corporate businesses alike. A single-business tax analysis will include (i) eliminating the capital base system; (ii) phasing-out the proliferation of tax credits that can now be applied against the corporate net income tax; and (iii) phasing-in the exemption of business-to business transactions from the retail sales tax, and (iv) applying a less stringent ownership rule for business-to-business purchases when services are sold between a parent and a subsidiarity.

Relating to the Existing Corporate Net Income Tax

***Recommendation 2*. Capital Base System.** Eliminate the capital base (stock) tax that serves as an alternative method of calculating taxpayer corporate income tax liability.

***Recommendation 3*: Proliferation of Tax Credits.** Discontinue the practice of issuing new tax credits that erode the base of the corporate net income tax, and also evaluate existing credits as to whether they are achieving their intended objectives. If credits are intended to provide general tax reduction, then phase out the credits and lower the statutory rate. If credits are intended to promote economic development, then efforts are to be made to identify alternative and transparent policies that can promote economic growth at lower revenue costs to the state.

***Recommendation 4.* Mandatory Unitary Reporting.** Maintain mandatory combined reporting for business entitles that are part of a unitary business; require that unitary groups be broadly inclusive.

***Recommendation 5.* Apportionment of Multi-state Income.** Broadly adopt single sales apportionment factor based on market (destination) sourcing for the taxation of corporate and non-corporate business activities alike.

***Recommendation 6:* Claiming of Net Operating Loss.** Reinstate full use of Net Operating Losses.

The Connecticut Estate and Gift Tax

***Recommendation* 1**. **Basic Structure and Effect on Taxpayer Migration Effect.** For the present retain the current estate tax exemption level of $2 million of the adjusted estate. The State should then (i) further examine the option of phasing in the level of tax exemption in conformity with federal law and (ii) continue to monitor data for tax induced taxpayer migration flows.

***Recommendation* 2. Portability** .Provide "portability" of the Connecticut estate tax exemption between spouses such that the unused exemption of the first to die may be claimed by the second-to-die's estate as permitted for federal estate tax purposes.

***Recommendation* 3**. **Qualified Terminable Interest Property**. Review current practice to ensure the full implementation of a Connecticut Qualified Terminable Interest Property (QTIP) election regardless of whether a federal QTIP election is made and independent from a federal QTIP election such that married couples can defer state estate taxes until the second death.

***Recommendation* 4.**   **Gift Tax.** Repeal the Gift tax; continue to apply a rule that gifts made in contemplation of death are included in the value of the estate.

Recommendation 5. Estate Filing Dates to Conform to Federal Law. Replace the Connecticut deadline for filing an estate return from the current   practice of   six (6) months following the decedent's death to conform to the federal practice of nine (9) months

Probate Fees

***Recommendation* 6. Probate Fee Structure.** Revise the current formula of the probate fee for decedents' estates so that it reflects an appropriate level as a direct user fee for estate settlement rather than a vehicle for paying for essential judicial services unrelated to decedents' estates.

Context for Property Tax Reform and Local Revenue Diversification: The Connecticut Experience

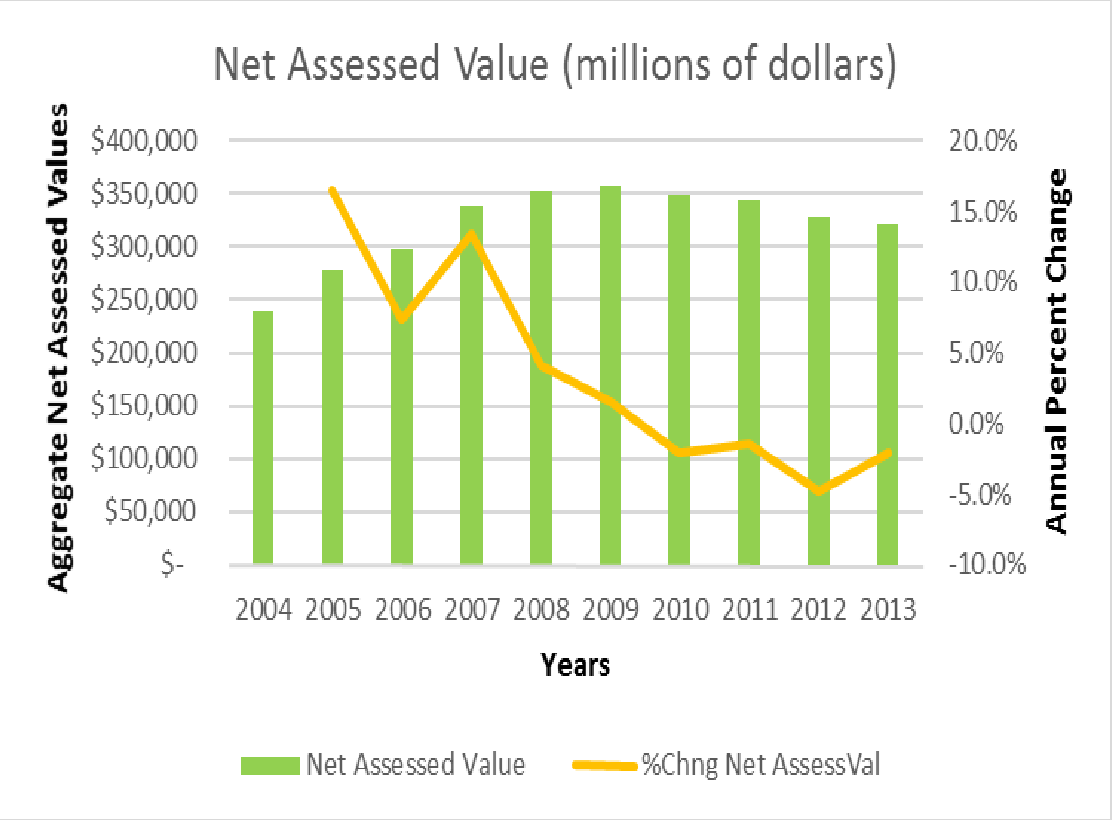
The property tax base in Connecticut is broader than the property tax base in many other states because it includes selected personal property and motor vehicles.

Both the Connecticut state and local revenue system, and local revenue systems are more dependent on property taxes than most other states.

Consequences of Falling Property Values and Increasing Property Tax Revenues

Fiscal Disparities Across Municipalities

Property Tax Values Falling While Property Tax Revenues Increasing



Increasing Property Tax Revenues in Connecticut		
Years	Property Tax Revenues (millions of dollars)	%change
2008	$ 8,123.39	
2009	$ 8,521.27	4.9%
2010	$ 8,700.69	2.1%
2011	$ 9,005.30	3.5%
2012	$ 9,222.58	2.4%
2013	$ 9,501.44	3.0%

Property Tax Administration

***Recommendation 1*: Fractional Assessment.**

Eliminate the 70 percent fractional assessment and define assessed value as 100 percent of estimated market value. When this transition is made, all municipalities must lower their property tax mill rate to raise the same amount of revenue as they raise currently.

***Recommendation 2*: Assessment Cycle**

Eliminate the 5-year reassessment cycle and institute annual reassessment. To ensure an accurate description of each property retain the 10-year physical inspection requirement. This recommendation should be implemented over a five-year period. The Tax Study Panel recognizes there may be some cost implications for municipalities and recommends ways to mitigate increased costs resulting from moving toward annual reassessments should be explored. For example, 74 municipalities have already joined together for regional revaluations.

Local Fiscal Disparities

***Recommendation 3*: Local Fiscal Disparities**

The Tax Study Panel's mandate is to review the state's overall state and local tax structure. The Panel affirmed at its May 2015 meeting it would not examine state and local expenditure policy. Accordingly, addressing the magnitude and design of state grants to local governments in Connecticut is beyond the Panel's scope of work.

However, in view of evidence presented to the Panel finds that there are significant differences in property tax capacity of municipalities (fiscal disparities) across municipalities, the Panel concludes that state grant policies should be re-examined in an effort to further relieve pressure on the property tax and to equalize fiscal disparities.

Tax Exempt Properties

Recommendation 4: Payments in Lieu of Taxes (PILOT)

The Panel recommends retention of Connecticut's existing statutory scheme for *payment-in-lieu-of-taxes* (PILOT) grants from the state to municipalities that is designed to recognize that state properties, hospitals, and colleges and universities serve regional and statewide communities. The Panel acknowledges that funding of this existing program is outside the scope of the Panel's charge, and it consequently makes no recommendation as to the funding of this program.

Direct Property Tax Relief

***Recommendation 5*: Low Income Tax Credit "Circuit Breaker"**

Eliminate the more than 100 state and local option partial property tax exemptions and replace them with a single unified state circuit breaker mechanism that provides property tax relief targeted to homeowners and renters whose property taxes are high relative to their household income.

Such a circuit breaker would be a single threshold type circuit breaker implemented as a refundable credit through the Connecticut state income tax to provide targeted relief, replacing the current property tax credit.

Agricultural Land: Use Valuation

Recommendation 6: **Agricultural Land**

Tighten up the implementation of the PA490 use value assessment program so the program is more aligned with the intended purpose of the program by

- Implementing an objective test of agricultural use in order to qualify for participation in the program (e.g., establish a *de minimis* level of gross income from agricultural production)
- Rationalizing use value assessment computation methods using more accurate income measures and more realistic capitalization rates
- Requiring forest land participating in the program to be adjacent parcels
- Allowing towns to remove land from the program if it has been rezoned for subdivision
- Expanding the time period which land must remain undeveloped from 10 to 15 years
- Increasing the penalties for early withdrawal from the program
- Moving away from general tax relief for agriculture broadly and move toward strategic use of use value assessment to protect and preserve land that provides ecosystem services that are a form of public good or generates positive externalities.

Local Revenue Diversification

***Recommendation 7*: Local Non-Property Taxation**.

Allow for a local sales tax of 1 percent to be implemented on a statewide basis with the revenue to be collected by the Department of Revenue Services (DRS), which will act as the collection agent for all local governments. The local tax will be piggybacked to the standard state sales tax rate. The funds shall be deposited in the Municipal Revenue Sharing Account and then distributed to municipalities in a manner that is fiscally equalizing

Personal Property Taxes

***Recommendation 8*: Taxation of Business Tangible Property**

Exempt the first $10,000 of personal property from taxation thereby eliminating 46 percent of personal property accounts. The Panel recognizes that for zero tax due accounts there must be a mechanism put in place so that each municipality will continue to be able to identify individual businesses located in their jurisdiction.

***Recommendation 9*: Personal Property Tax Revenue Administration/Implementation**

The Office of Policy and Management (OPM) or other research agency should revisit the implementation of the personal property tax by

Periodically examining depreciation schedules and the 30 percent residual value

Improving audit procedures and practices

Strengthening the role of OPM in overseeing uniformity of assessment administration

Requiring all municipalities to use the same OPM standard form for filing information

Periodically estimating economic and functional obsolescence in at least chemical products manufacturing and other industries where standard depreciation schedules are inadequate.

Motor Vehicle Tax

***Recommendation 10*: Motor Vehicles ("Car Tax")**

The Panel supports the changes in the motor vehicle tax made in 2015 and recommends that the impact of these changes on the equity, efficiency and administration costs of the motor vehicle tax should be evaluated after they have been in place for a period of no more than three years. This will also provide time to see how the Municipal Revenue Sharing Account works to hold harmless those municipalities that experience a decline in motor vehicle tax revenues because of the ceiling placed on the mill rate applied to motor vehicles.

***Recommendation* 11: Antique Vehicles**

The assessed value of antique vehicles should be set at current market value rather than the current assessment limit of $500, but shall not exceed a valuation of $50,000.

Conveyance and Controlling Interest Taxes

***Recommendation* 12. Conveyance and Controlling Interest Taxes**

To assure inter-community equity the local real estate conveyance (REC) tax rate shall be set at the same rate statewide as the targeted community rate (0.5 percent). The state rate shall remain unchanged.