

CONNECTICUT TAXES



Commission on Fiscal Stability & Economic Growth

Commissioner Kevin B. Sullivan

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*Taxes...are dues that we pay for the
privileges of membership in an organized society.*

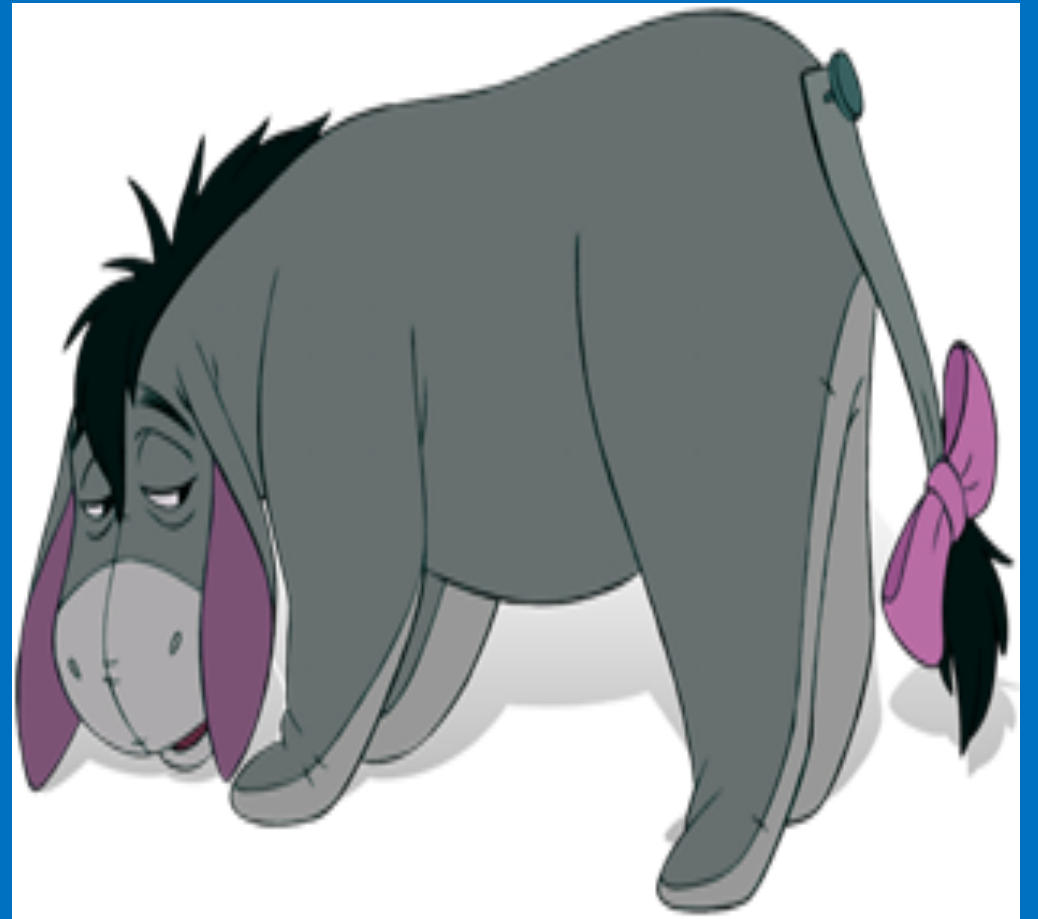
President Franklin Roosevelt

I shall never use profanity except in discussing taxes.

Mark Twain



ATTITUDE ADJUSTMENT



CHANGING STATE TAX PROFILE

| | FY 1984 | FY 1994 | FY 2004 | Current |
|-------------------|---------|---------|---------|---------|
| Income (PIT) | 0% | 37% | 48% | 52% |
| Sales & Use (SUT) | 46% | 32% | 30% | 25% |
| Corporate | 14% | 10% | 5% | 6% |
| Motor Fuels | 7% | 6% | 4% | 3% |
| Cigarette | 3% | 2% | 3% | 2% |
| All Other Taxes | 30%* | 13% | 10% | 12% |

* Includes taxes on capital gains, dividends & interest

STATE TAX COLLECTION

Total Revenue Less Refunds





TAX LEGACY



OLD WORLD

- Production economy
- Wage earners
- Geographic boundaries
- Physical presence
- Separate entities
- Cost of performance
- C corporations
- Domestic

NEW WORLD

- Service economy
- Mobile & contingent workforce
- Global economy
- E-commerce
- Transfer pricing
- Market-based sourcing
- Pass-through entities
- Off-shore

TAX POLICY ?

pol·i·cy *n.* 1. A plan, guiding principle or course of action designed to influence and determine decisions and actions.

~~2. Appropriations~~

~~3. Special interests~~



TAX POLITICS

“Much of what I learned surprised me, especially the degree to which the sound bites...bear as much connection to the reality of the tax system as my...grandson’s belief in Santa....[A] quarter century of tax cuts has produced not trickle down economics, but a Niagara up....”

- Johnston, *Perfectly Legal* (2005)

“Nowhere are vested interests, through their political action committees, more omnipresent than in tax writing.”

- Birnbaum & Murray, *Showdown at Gucci Gulch* (1987)

“Tax reform that will make America great again....”

- Trump (2017)



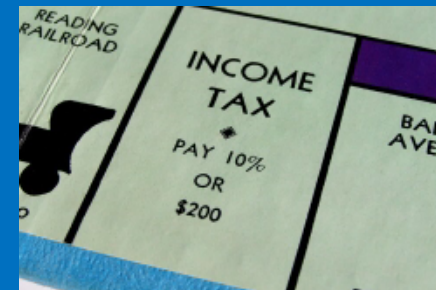
TAX PRINCIPLES

- Nexus
 - Due Process
 - Commerce clause
- Equity
- Cost of compliance (complexity)
- Volatility
- Efficiency
- Accountability
- Competitiveness



PERSONAL INCOME TAX

- Federal AGI based (before deductions & credits)
 - Few state modifications & credits
- Relatively simple rates & brackets (high end recapture)
- Efficient withholding & estimated payment
- CEITC refundable
- ERISA pension preemption
- Domicile evasion
- Volatility: Net negative biennial trend on high end increases



SALES & USE TAX

- Permits (renewable)
- Goods (tangible & intangible) & services (including business to business)
- Tax expenditures
 - Exclusion (services)
 - Enumeration (sales)
- E-commerce
 - Federal commerce clause nexus?
 - Digital downloads/Internet preemption
- Tax gap: Stronger analytics (segmentation & scoring)



BUSINESS TAXES

- Corporate income tax
 - Surcharge
 - Reform trifecta: Unitary, single factor (sales) & market sourcing
 - Net operating loss (NOL)
- Pass-through entities: Income tax
- Business entity “tax”
- Other: Healthcare (Medicaid), insurance, public service companies, admissions
- Transfer pricing, offshoring



OTHER STATE TAXES

- Unified gift & estate
- Motor fuel & petroleum products
 - No tolls
- Liquor & tobacco
- Real estate conveyance



LOCAL PROPERTY TAX

- Residential, commercial, personal property & motor vehicles
- Mostly uniform valuation & assessment
 - Homestead-like 30% of value exempt
 - State motor vehicle cap or standard rate
 - Commercial market-adjusted
- Wide base variation = wide AENGL adjusted variation per median family or per capita income
- Asset, not income tested
- PILOT payments
- Property tax relief



TAX EXPENDITURES

- Multiple tax types: Total annual “cost” \$6.5 billion
 - Sales & use tax: \$2.9 billion annually
 - Business R&D/R&E: \$12 million average annually
- Policy: Strategic economic drivers?
- Incentives or rewards?
- Entitlement, competitive, contractual
- Tax shifting and cost shifting
- Performance accountability
- Off budget & \$2.2 billion unfunded credit liability
- Amazon HQ2 challenge: Raising the bar



TAX INCIDENCE

- **Income Tax:** Progressive, 33% total taxes, not exported, high volatility.
- **Corporate Income Tax:** Moderately regressive (ultimate consumers), 1% of total taxes, 56% exported, low volatility.
- **Sales Tax:** Moderately regressive, 15% of total taxes , 24% exported, moderate volatility.
- **Property Tax:** Regressive, biggest tax bite at 40% of total taxes 23% exported, low volatility but for state aid.

TOTAL TAX RANKING PER CAPITA

| | <u>State</u> | <u>State & Local</u> |
|----|--------------|--------------------------|
| CT | 5 (\$4,438) | 4 (\$7,249) |
| MA | 7 (\$3,976) | 6 (\$6,014) |
| NJ | 11 (\$3,524) | 5 (\$6,448) |
| NY | 8 (\$3,952) | 2 (\$8,410) |
| SC | 43 (\$1,967) | 48 (\$3,220) |
| US | (\$2,694) | (\$4,675) |

Source: Tax Foundation (2017)

TAX RANKING

PER CAPITA

| | <u>INCOME*</u> | <u>SALES *</u> | <u>CORPORATE</u> | <u>PROPERTY</u> |
|----|----------------|----------------|------------------|-----------------|
| CT | 1 (\$2,279) | 8 (\$1,137) | 13 (\$ 192) | 3 (\$2,774) |
| MA | 3 (\$2,133) | 27 (\$ 854) | 3 (\$ 328) | 8 (\$2,181) |
| NJ | 7 (\$1,479) | 16 (\$1,021) | 6 (\$ 288) | 1 (\$3,065) |
| NY | 2 (\$2,208) | 37 (\$ 662) | 8 (\$ 257) | 5 (\$2,581) |
| SC | 35 (\$ 764) | 32 (\$ 729) | 41 (\$ 77) | 32 (\$1,080) |
| US | (\$ 967) | (\$ 844) | (\$ 144) | (\$1,462) |

Source: Tax Foundation (2017)

*Excludes local & county taxes

STATE BUSINESS TAXES

COUNCIL ON STATE TAXATION (COST)

- Still *lowest* total effective state & local business as a percent of gross state product (3.5%)
- Still *lowest* business *share* of total state & local taxes (30%)
- 24th ranked in Business taxes per employee (\$5,400)
- FY15-16 change: -1.3% (*only* actual reduction in Northeast)



WHAT WE KNOW ABOUT TAXES

(GOVERNOR MALLOY'S BUSINESS TAX TASK FORCE, 2012)

- Relatively *modest* factor in business location decisions but *important* in specific cases.
- Fiscal stability and tax predictability are far more important to business climate, business operations and economic growth.
- Every tax creates economic incentives and disincentives as well as the risk of unintended consequences in a complex, global economy.
- Tax policy should be aligned with longer term, strategic and dynamic fiscal, economic and social policies (not driven by short term expenditure needs and demands).
- Connecticut should not try to compete with low wage, low benefit or low public investment states but needs to be more competitive within the Northeast region.

ISSUES

General policy

- Economic & fiscal policy drive tax policy.
- Independent dynamic scoring for tax estimation.
- Legislative action on taxes before appropriations.
- Budget tax expenditures & report unfunded liability.
- Periodic evaluation of each tax.
- Periodic tax incidence analysis.

Health Care

- State coverage “penalty” fee intercepted to Health Care Access Fund.

Administration

- Biennial Taxes 101.
- Tougher civil & criminal penalties for tax crime.
- Replace & upgrade tax management information system (including advanced analytics).

Transportation

- Increase motor fuels tax indexed to price & reduce after tolls.
- Intercept revenue to Transportation Fund lock box.

ISSUES

Personal income tax

- Relative stability of federal AGI.
- Progressivity but diminishing return from high end adaptive behavior.
- Reduce modification & exemptions: Income is income.
- Shift to payroll tax or charitable donation to preserve federal deductibility.
- “Snow bird” parity.

Uniform gift & estate tax

- Phase in re-couple with federal but eliminate gift tax.

Sales & use tax

- Broader base (all goods & services except business-to-business), lower rate & simplification.
- E-commerce economic nexus with small business exemption.

Local taxes

- Reduce exempt value.
- Annual statistical revaluation.
- Supplemental state mill rate & revenue intercept for TRB share
- Non-profit exemption only for actual places of worship & no PILOT.
- Full fund state PILOT.

ISSUES

Business taxes

- Replace BET with SOTS fee.
- Decouple from federal changes & add partial “sponge” surtax intercepted to reduce state unfunded liabilities.
- Pass-through business parity (rate & credits).
- Repurpose & expand resale of “stranded” credits.
- Revise & reduce tax expenditures per 5-year state economic strategy with clear performance standards.
- Modified gross receipts business activity tax: Broader base, lower rate.