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Testimony Concerning SB 400, An Act Eliminating the Business Entity Tax

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Commerce Committee
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Dear Senator LeBeau, Representative Berger, and distinguished Members of the Commerce Committee:

I am President of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to promote the well-being of Connecticut's children, youth and families.

CT Voices opposes the *total elimination* of the $250/year Business Entity Tax as a way to help "small business" because:

- **Many business entities subject to the Business Entity Tax are not small businesses.** 18 of Connecticut's 100 largest corporations (by sales) in 2003 were organized as LLCs or other legal entities that pay this $250/year tax, rather than the corporation business tax, for the privilege of doing business in Connecticut.[1] Three-quarters of the "production" companies claiming "film production" tax credits (36 of the 49 production companies) are LLCs, so also pay this $250/year tax, although – in total – they now are claiming $51 million in transferable (i.e., saleable) tax credits. The many S corporations that now pay the Business Entity Tax once were subject to the corporation business tax; many paid much more than $250/year minimum corporation business tax for the privilege of doing business in Connecticut. Some Connecticut estates now are held by LLCs to protect the personal assets of their individual wealthy owners; no business is being conducted at all. So, total repeal is overbroad. If the goal is to help truly small, operating businesses, exempting from the Business Entity Tax those operating businesses with less than a certain amount in gross receipts or net income -- or a certain amount in assets -- would more precisely target relief, and thereby reduce the more than $30 million/year revenue loss that outright repeal would cause.

- **Even for genuinely small operating businesses, a tax equal to $20.83/month is not necessarily excessive.** Any business operating in the state benefits from the public investment Connecticut makes in its infrastructure – its roads, its courts, its workforce, etc. Because Connecticut requires a balanced budget, a reduction in one group of taxpayers' taxes results in an increase in some other taxpayers' taxes, a reduction in state-funded services, or both. Requiring even smaller businesses to make such a modest contribution to the costs of maintaining the infrastructure essential to their success is not necessarily excessive.

- **Connecticut's Business Entity Tax is not anti-competitive; it is more modest than comparable taxes in neighboring states.**[2] For example, New York imposes a tax on each *member* or *partner* of the entity, so for any business with multiple members/partners the total tax would exceed a single tax on the entity itself.[3] New Jersey and New Hampshire's entity tax is based on the net income of the entity.[4]

Rhode Island, like Connecticut, imposes a business entity tax, but Rhode Island's tax is twice ours at $500/year.

- **If Connecticut wants to target help to small businesses, it would be fairer to create graduated tax rates in the Business Entity Tax than a total exemption.** Entities with less than $50,000/year in gross business receipts or with less than $100,000 in assets, for example, could pay a smaller tax than $250/year for the privilege of operating a business in Connecticut, while very profitable firms could be required to pay more. This could assure that *all* business entities contribute *something* to the costs of maintaining the infrastructure that supports their businesses or investments, but in a revenue-neutral way.

- **Broader reform of Connecticut's business tax code is needed to assure a more level playing field among *all* Connecticut businesses.** Changes in apportionment formulas (that allow certain large, multi-state firms to shift income out of state) and the enactment of new tax credits, exemptions and deductions have narrowed Connecticut's business tax base and created distortions in the market. There is a need to create greater equity among Connecticut's businesses – both between businesses operating wholly in Connecticut and Connecticut's multi-state/multi-national corporations and also between Connecticut's large profitable corporations and its small start ups. Such greater equity could be achieved by requiring unified combined reporting, extending the business tax to *all* businesses (regardless of legal form), repealing preferential tax expenditures, and then adopting a progressive rate structure that imposes higher taxes on larger, more profitable firms than on smaller and start-up companies. By so broadening the base of the tax, the business tax rate could be reduced -- making Connecticut more competitive for *all* businesses.

  This is the type of fundamental reform that was proposed by the December 28, 2007 Final Report of the Commonwealth of Massachusetts' Study Commission on Corporate Taxation. It recommended, *inter alia,* a mandatory combined reporting system combined with a reduction in corporate tax rate to "provide a material tax benefit to all corporate taxpayers, including smaller taxpayers, taxpayers wholly in Massachusetts, and other taxpayers who cannot or do not benefit from income-shifting or other tax planning techniques that have been utilized by large multistate taxpayers."[5]

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[1] Connecticut General Assembly, Program Review and Investigations Committee, *Connecticut's Tax System* (2006), p. 202.
[2] See B. Ely, S. Grisson, and M. Houser, *State Tax Treatment of Limited Liability Companies and Limited Liability Partnerships.* 2007 STT 142-2 (State Tax Notes, Tax Analysts, 2007).
[3] New York imposes a tax of $100 per year on each *member* or *partner* in an LLP or LLC, with a cap on the tax paid by the entity of $25,000/year.
[4] In New Jersey, LLCs and LLPs pay 6.37% of New Jersey net income allocated to all nonresident, non-corporate members/partners and 9% of New Jersey net income for all nonresident corporate members/partners (as well as a $150/year tax on each member/partner in any LLC or LLP with three or more members/partners). New Hampshire imposes a 5% tax on dividends and interest exceeding $2,400, an 8.5% tax on business profits (only for LLCs and LLPs with more than $50,000 in gross business income), and a 0.75% tax on the "business enterprise value tax base" of the LLC/LLP (with a dollar-for-dollar credit against the business profits tax for the amount of business enterprise tax paid).
[5] Commonwealth of Massachusetts, Final Report of the Study Commission on Corporate Taxation (December 28, 2007), p. 9. Available at: www.mass.gov/Ador/docs/dor/Publ/PDFS/Study%20Commission%20on%20Corporate%20Taxation%20-%20Final%20Report.pdf.