

**FINANCE, REVENUE & BONDING COMMITTEE
PUBLIC HEARING
MARCH 13, 2014**

**TESTIMONY OF COMMISSIONER KEVIN B. SULLIVAN
DEPARTMENT OF REVENUE SERVICES (DRS)**

Good morning and thank you for this opportunity to testify in support of our agency initiatives for this session.

Before getting to the three bills requested by DRS, let me comment briefly on some other proposals we have worked on with Governor Malloy:

HB 5465 - AAC the Connecticut Aerospace Reinvestment Act. From a tax standpoint, this is a creative and effective way to make stranded R&D tax credits work even harder for Connecticut. As you know from your hearing earlier this week, this initiative takes investment credits already earned and leverages them for additional reinvestment by a lead global business that will continue to grow here, at home in Connecticut. Probably every single community in this state will benefit from the jobs, supply chain and innovation that HB 5465 assures.

SB 28 - AAC Revenue Items to Implement the Governor's Budget. Connecticut has come a long way in less than four years. Rather than deficits and tax increases, Governor Malloy's singular focus on fiscal stabilization and the tough decisions made by this committee are why Connecticut is now in a position to share the benefits with our taxpayers. Governor Malloy's proposed tax refund is one of those taxpayer dividends. Reversing the taxation of over-the-counter medications is good tax policy, good economic policy and good health policy that already has bipartisan support. The proposed treatment of teacher pensions will address a longstanding inequity. And the proposed changes to the Angel Investor tax credit will help realize the full potential of this economic investment tool.

This brings me to the three agency bills that we thank the committee for raising:

SB 369 - AAC Changes to the Department of Revenue Services Statutes.

Sections 1 and 2 actually grow out of *your* initiatives last session to focus on sales tax delinquencies and our February report on sales tax collection initiatives. For all the reasons we shared with you at the time, the specific pilot program enacted last session proved unworkable and unnecessary. While the facts seem to elude at least one of the vendors out there, truth is that no federal taxing jurisdiction is even considering that approach. But your legislation did challenge us to do better and we have:

- By no longer renewing tax permits for delinquent taxpayers, hundreds of taxpayers are coming into compliance, remaining in compliance because of conditional renewals and paying what will continue for several years to be \$3-5 million annually in back taxes.
- Section 1 of SB 369 will give us another tool by allowing periodic publication of businesses in the state known to be operating without tax permits.
- Section 2, developed in consultation with the Connecticut Retail Merchants Association, will expedite all collections in line with other states and put delinquent taxpayers on a weekly electronic filing discipline using the existing DRS Taxpayer Service Center (TSC).

Section 3, based on successful experience in North Carolina and developed in consultation with the Connecticut Banker's Association, will be fairer to taxpayers, improve collection and reduce costs for financial institutions and DRS. Rather than the current process that requires full execution of a warrant before even determining if assets are available, this legislation will permit banks to screen accounts before DRS determines whether to proceed with collection.

As a matter of fairness, **Section 4** provides trusts and estates taxpayers the same income modification for qualified plan lump sum distributions that is already given to individual income taxpayers.

Section 5 strengthens our position in dealing with off-shore hedge fund income that should be sourced to Connecticut for non-residents performing services properly attributable to performance in the state. Even with federal repatriation of certain off-shore income, this and other forms of transfer payments are an area where Connecticut needs to step up its game in combating tax evasion.

Section 6 makes two changes. The first addresses a matter of fairness for Connecticut taxpayers by mirroring New York's sourcing of income for non-residents selling or exchanging an interest in an entity owning real property in Connecticut. The second change is long overdue in reversing an old, flawed DRS regulation that treats business pass-through income unfairly compared to corporate income. Instead, sales by pass-through entities will be sourced to Connecticut based on the location of the customer rather than the current rule sourcing pass-through entity income based on the origin of the sale. The importance of this proposal in improving our state's competitive economic position is evidenced by strong support from the Connecticut Business & Industry Association (CBIA). Please note that our analysis indicates this will be revenue neutral at worst.

Section 7 is purely a change added by LCO.

HB 5466 – AAC Department of Revenue Services' Procedures for Background Checks for Job Applicants, Applicability of the Estate Tax and Taxation of Motor Fuel in Gaseous Form.

Now, if you have not all drifted off, **Section 1** of this bill allows DRS the same access as other state agencies to federal criminal history records – in this case for employee security screening.

Section 2 is truly technical and corrects a drafting error in last session's legislation on the applicability of the estate tax.

Section 3, consistent with Connecticut's incentives for lower cost alternative fuels, simply requires DRS, in consultation with the Department of Energy and Environmental Protection (DEEP), to set annually the state rate for conversion of natural gas and propane to liquid gallons under the motor vehicle fuel tax consistent with the federal rate.

SB 390 – AAC Concerning Changes to Cigarette Regulation to Implement the Nonparticipating Manufacturer Adjustment Settlement Agreement.

Finally, you will recall that Connecticut wisely chose to accept settlement in the most recently completed federal cigarette Master Settlement Agreement (MSA) arbitration. Unlike other states, we protected our state share of annual MSA dollars, gained a one-time payment and now have \$13 million in reserve for enhanced enforcement by DRS and the Attorney General. SB 390 conforms state law to the settlement and commits us to an even greater focus on the interdiction of illegal, untaxed cigarette sales. DRS will shortly complete our strategic planning for this initiative, seek release of first year funding and then crack down even more effectively on illicit sales that evade taxation and unfairly compete with distributors and retailers.

Thank you for your consideration and we are, as always, looking forward to working with the committee.