CONNECTICUT
BUSINESS & INDUSTRY
ASSOCIATION

Testimony of
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Before the
Finance, Revenue & Bonding Committee
Hartford, CT
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Good Afternoon. My name is Bonnie Stewart and I am Vice President of Government and Public Affairs & General Counsel for the Connecticut Business and Industry Association (CBIA). CBIA represents more than 10,000 job creators throughout the state of Connecticut ranging from one-person businesses to large corporations. The majority of our members have fewer than 25 employees.

Although we recognize the difficult challenges facing the Governor and the legislature in closing budget deficits, we shouldn't close gaps by inhibiting investments by the very companies that drive our economy. The best way to grow revenues is to grow our economy. Yet in the proposal before you today, **SB 946** An Act Concerning Revenue Items to Implement the Governor's Budget, key investment incentives are reduced substantially and previously scheduled tax reductions are eliminated or extended. This will strike a serious blow to the business confidence in our economic recovery. Therefore we ask you reject the proposals to:

- Reducing the use of earned investment incentives for research and development, capital purchases, and other key economic drivers;
- Limiting the use of the net operating loss carry-forward, an important tax mechanism to encourage investment in Connecticut;
- Making permanent the 20% corporate surcharge that was scheduled to be illuminated this year; and
- Continuing the credit reduction for the insurance tax that was scheduled to be illuminated this year.

What Are Tax Credits

Tax credits are important incentives identified and passed by the Connecticut General Assembly to encourage companies to make certain investments in Connecticut. Two important examples of these include the:

- R&D credit – e.g. pay salaries and buy equipment for research and experimentation in Connecticut (1%-6% credit); and the
- Fixed capital investment credit – e.g. install machinery & equipment in Connecticut (5% credit)

Only investments made in Connecticut can earn tax credits. There is no cost to the state until after a Connecticut investment is made, and in fact, the revenues generated as a result of the investment far out exceeds the credit earned.

Why Tax Credits Matter

Investment incentives matter greatly to Connecticut because they can afford us the opportunity to be competitive. Credits are part of a company's locational decision – i.e., where are we going to make this investment. They are an important mechanism for offsetting costs where Connecticut is not competitive. Nearly all state and foreign jurisdictions offer credits, and only 3 states have permanent limitations on use of credits

It's also important to note that limiting credits raises taxes ***only*** upon Connecticut companies. Not those companies that use Connecticut as a market, but don't have a physical presence in the state. Furthermore, the proposal before you retroactively increases taxes upon those companies that already made the investments in Connecticut specifically sought by the General Assembly.

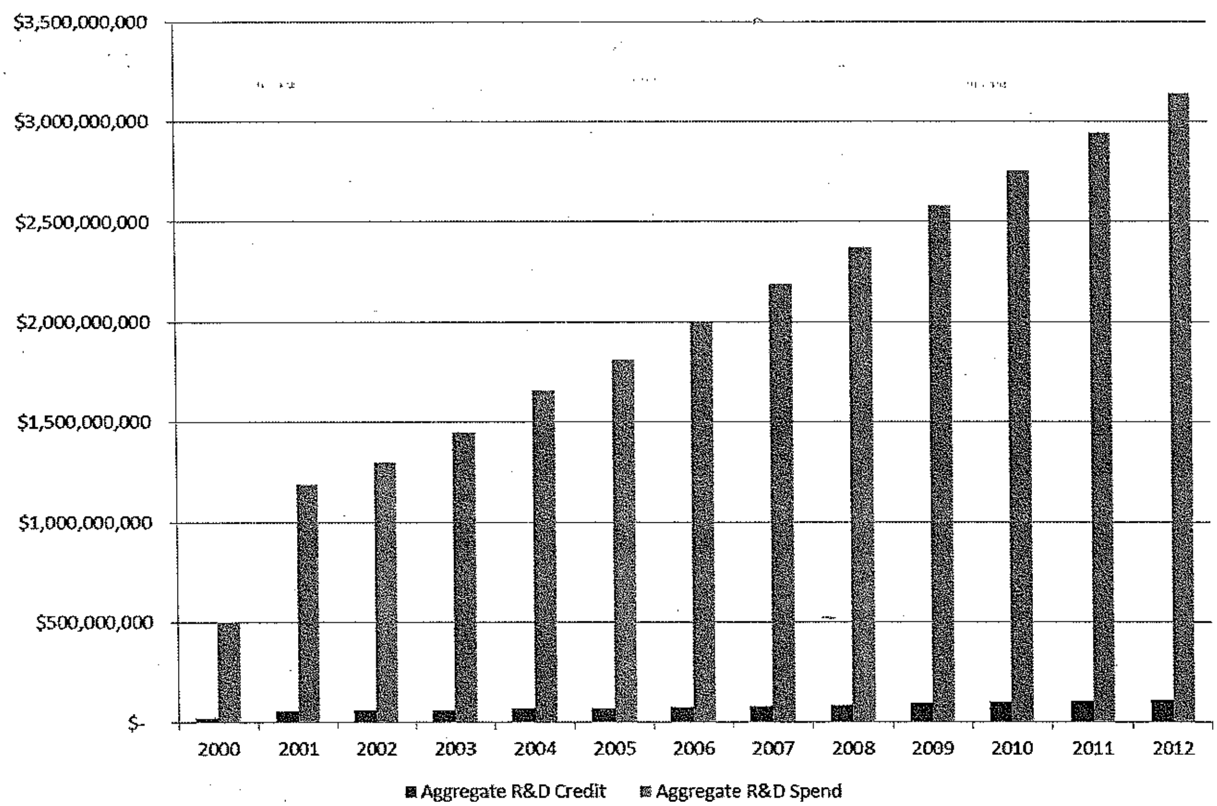
Having investment incentives that anchor businesses to Connecticut is a good thing, but only if companies believe that if they make the desired investment that they will be able to claim the credit they earned. Remember, a company only gets value for credits (currently and carryforward) if they continue producing income in Connecticut. The types of investment incentives Connecticut offers generally require significant time for utilizing credits and therefore should match the length of the business/product cycles. These are great for Connecticut because they create long-term jobs as well as other economic activity.

Connecticut Industries	Connecticut R&D Cycle	Connecticut Manufacturing Cycle
Pharmaceuticals	7-15 years	7-8 years
Aerospace	5-20 years	30+ years
Submarines	7-10 years	30+ years

Comparison: Connecticut Investment to Tax Credits Earned

Tax credits have been **revenue generators** for Connecticut for years. Since its adoption in Connecticut, $109.2 million of R&D tax credit has resulted in $3.14 billion dollars of investments in Connecticut. What a multiplier effect!

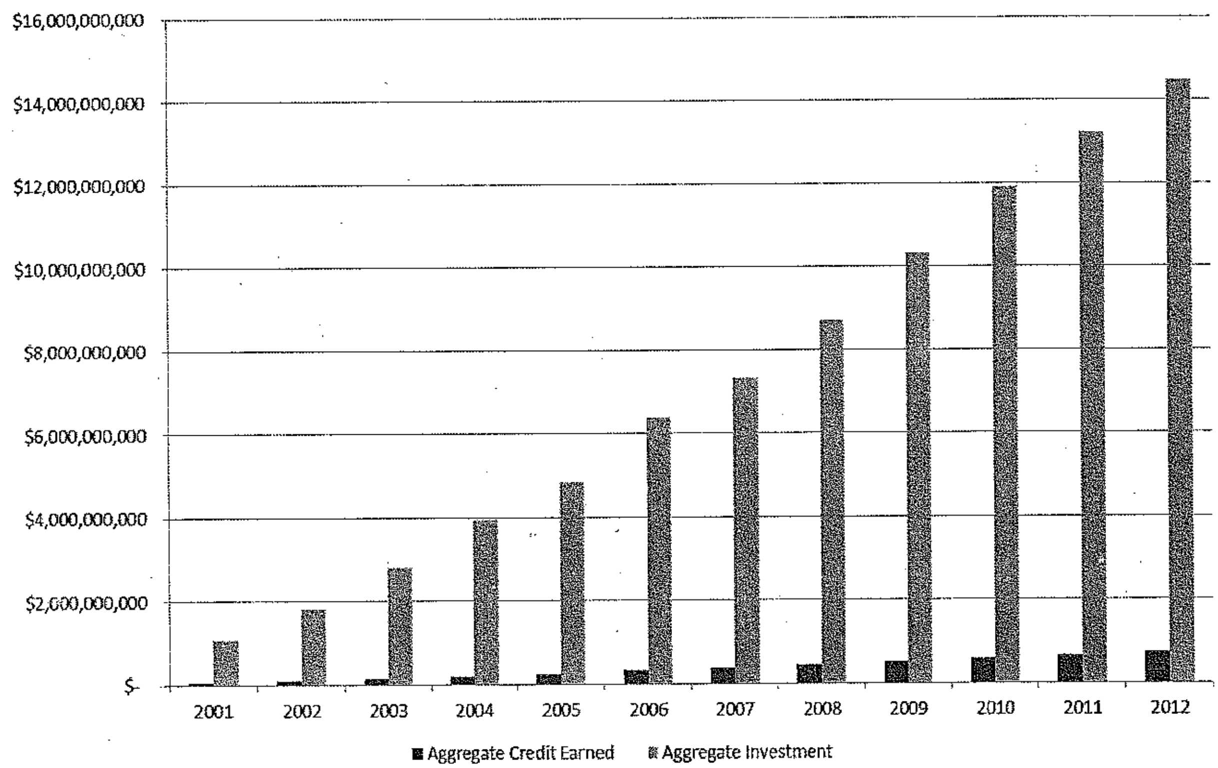
R&D Tax Credit - Sec. 12-217n



$3.14 Billion of in-state investments since 2001 to generate $109.2 Million of credits

Another excellent example of how tax credits have been **revenue generators** for Connecticut for years is the Fixed Capital credit. Since 2001 $724 Million of Fixed Capital credits have resulted in $14.5 Billion of in-state investments. That $14.5 Billion of investments doesn't include the additional economic activity that results from the investments.

Fixed Capital Credit - Sec. 12-217w



$14.5 Billion of in-state investments since 2001 to generate $724 Million of credits

Tax Credits Are Revenue Generators

As evidenced above, tax credits are an incentive for companies to perform certain and significant economic activity in Connecticut. Given that cutting back tax credits is likely to significantly reduce investments made in Connecticut, as well as the other economic activity that results from that activity, <u>we urge you to reject limiting corporate business tax credits further and from extending the insurance premium credit cap for two more years</u>.

What Are Net Operating Losses

Net operating losses ("NOLs") carryforwads are an important mechanism for attracting long term investment in a state. The purpose of a NOL carryforward is to allow companies to either offset losses in the year thy're incurred, or in a future year. This allows companies that are developing products, or those who are struggling, to overcome a mismatch between a business cycle and a tax year. Expenses are incurred up front but income is not realized until later in the business cycle (e.g., product hits market). Allowing NOLs to be deducted against future profits more closely corresponds to a business's investment horizon than would a strict annual accounting and attracts companies with long-term investment opportunities.

Three scenarios that commonly create NOLs include: Start-up businesses, New product development, and Economic downturn.

Why Net Operating Losses Matter

Connecticut must remain competitive. All states with an income tax allow NOLs and only two states have permanent limitations on NOL carryforwards. Any limitation makes Connecticut much less attractive for businesses with significant upfront investments and therefore will reduce Connecticut's economic competitiveness.

Imposing a limit on NOLs in Connecticut as it will discourage Connecticut start-ups, retroactively increase taxes for those taxpayers whose Connecticut losses will now expire due to the limitation, and significantly harm businesses' ability to recover after downturns.

There should be no limitation on the use of NOLs. They promote and protect economic development and retention in Connecticut.

<u>We urge you to reject limitation of Connecticut's NOL carryforward.</u>

Permanent Rate Surcharge

Connecticut's corporate business tax rate was set at 7.5% years ago in an attempt to make Connecticut more competitive. The rate has remained there for years with an occasional surcharge being imposed. The proposal before the committee today would make that surcharge permanent and bring Connecticut's corporate business tax rate to an uncompetitive

9%. Only 5 states have a higher income tax rate. We urge you to reject the proposal to raise Connecticut's Corporate Business tax permanently to 9%.

Elimination of the Business Entity Tax

The Business Entity Tax (BET) has been a nuisance tax since its creation. It is not based on revenues, but smply a tax for existing. CBIA supports elimination the BET.

Consistency, clarity, and fairness in state tax policy are both achievable and critically important goals. We urge you to reject the Governor's increased revenue proposals, eliminate the Business Entity Tax and encourage your colleagues on the Appropriations Committee to develop a budget that reduces costs and improves outcomes by adopting the recommendation of the Connecticut Institute for the 21st Century. Doing so will help create a more predictable, fairer tax environment and a more competitive Connecticut economy. Connecticut can be a top destination for job creators, but we need to encourage rather than discourage investment that leads to job creation.

Thank you for your consideration.