



FINANCE COMMITTEE TESTIMONY
COMMISSIONER KEVIN SULLIVAN
DEPARTMENT OF REVENUE SERVICES

MARCH 18, 2016

Chairman Fonfara, Chairman Berger, Senator Frantz, Representative Davis and members of the Committee, thank you for this opportunity to review our 2016 agency legislative proposals.

Before briefly describing our two bills, let me underscore what you have already heard from OPM Secretary Barnes. At DRS, we see Connecticut's new economic reality in tax collections each day. Our state economy is in recovery but it is slow and fragile. Connecticut is also undergoing a major shift from our traditional economic base to emerging areas of growth that will take time to mature. As in most other states, revenue growth remains well below peak pre-recession levels and below growth in legislative spending levels.

But this is *not* a revenue crisis. Connecticut already has a very progressive state tax structure. Our reliance on top income tax levels is evident in the volatility we experience. Yes, we do need tax policies that better align with the new economy we need to build for our state. But it also means affordable, sustainable budgeting based on core state functions.

Last special session, you produced important progress in tax policy. This year, Governor Malloy's commitment to *no new or increased taxes* and our agency proposals will continue those positive steps.

SB 448 includes the following initiatives:

- **Destination sourcing.** With unitary reporting and single sales factor apportionment already enacted, destination sourcing completes the trifecta of corporate tax reform. Together, these changes lessen the tax burden on businesses based here and more fairly allocate taxes to businesses outside the state that do lots of business here. No wonder this legislation is also one of CBIA's top pro-growth priorities. We do seek one bit of fine-tuning in the bill and have submitted substitute language today based on further review of the impact on some unique in-state market characteristics.

Business parity. As you know, most business growth is not in the form of traditional C corporations. SB 448 will bring parity by extending corporate tax reforms to the taxation of other business income.

- **Sales tax fairness.** Like Amazon, more on-line retailers are now collecting and remitting sales taxes just like all other retailers. However, a significant, anti-competitive gap remains in the taxation of out-of-state, on-line retail sellers until federal protectionism is ended and there is a level economic playing field. One estimate of our state tax gap certainly still exceeds \$100 million annually. Congress failed to act so it is up to the states to do what we can. Our proposed legislation offers two important changes:
 - Out-of-state retailers really have no less substantial presence for purposes of constitutional nexus when measured by the volume and purposefulness of commercial activity directed at Connecticut than by assets like buildings, inventories or agents. Our legislation will make it clear that Connecticut is an *economic* nexus state for sales tax purposes just as we already are for corporate income tax purposes.
 - SB 448 would also align Connecticut with Colorado's informational regulation of remote sales recently upheld in U.S. Court of Appeals for the 10th Circuit. As a condition of doing business in Connecticut, on-line retailers that do not collect and remit sales tax would, by 2017, be required to (1) inform Connecticut buyers of their existing use tax obligations and (2) annually report to DRS the destination and amount (but not the nature) of untaxed retail sales to Connecticut buyers for existing use tax collection. This is not a new or expanded state tax. Representative Perone, who is a member of the committee advocating this for the National Council of State Legislators, can also provide you with more information. I do appreciate that this may be a more significant step than the Committee may want to take this session. If so, it will still be very helpful to bring forward the economic nexus provisions.
- **Other provisions.** The other provisions of this bill are technical, corporate income tax corrections – one with respect to captive real estate investment trusts and the other in conformance with a federal filing date change.

Our second bill, SB 451, also includes several initiatives:

- **Sales tax permits & tobacco product licenses.** A few years ago you supported our initiative to end routine renewal of permits and licenses when final tax deficiencies are owed. As a result, collections of taxes due have increased annually by more than \$10 million. Two additional changes will help even more. Too many businesses still get in too much trouble because the 5 year renewal period is too long. There is no charge for renewal, so going to 2 year renewal will only further improve collections and compliance. Similarly, permit and license renewals would no longer be renewed until businesses correct any failure to file.

Speaking of sales tax compliance, a word of caution. Apparently, there are folks who are once again peddling sales tax collection magic. These schemes have two things in common – added costs for already compliant retail taxpayers and no impact on those sellers most responsible for non-compliance. You will recall that when one of these approaches was tested in Connecticut, no one was interested. If, however, you do want to focus on improving compliance, there are now a growing number of *legitimate* third-party, certified processors that truly *deficient* retail taxpayers could be mandated to use for purposes of tax calculation, collection and remittance.

- **Tobacco tax records.** Since organizing our new tobacco enforcement unit, DRS has really stepped up criminal enforcement. Several major busts have stopped millions of dollars in illegal sales and tax evasion. State law already requires that tax records must be maintained for three years. But too often the records are just not there. Seizing tax records on site is key to prosecution. Otherwise, there is no assurance that true and actual records will be produced. Our proposed legislation adds a penalty for failure to produce the records on site immediately.
- **Dry cleaner “drop stores.”** Here again, recent legislation has helped DRS and DECD get a better handle on remediation fee non-compliance. For many years, that was a concern to dry cleaners that met their obligation to support the fund while others did not and limited available remediation assistance. The proposed legislation simply makes clear that locations that are *only* drop off stores performing no dry-cleaning are not subject to the fee.
- **SATV gross earnings tax compliance.** SB 451 will simply make it clear that all receipts related to cable and satellite TV operations in Connecticut are subject to the gross earnings tax.
- **Other provisions.** The other provisions of this bill are needed to (1) make all forms of income tax withholding data due at the end of January as you did for employer wage withholding this year; and (2) eliminate unnecessary regulations.

Finally, a thought about tax credits. Many of the state's major tax credits, like those supporting R&D investments, really work. But so much else is a patchwork of tax expenditures with less than compelling evidence of any real return on investment. This would be a good year for a moratorium on new or expanded business or individual state tax credits. More tax credits *narrowly* driven by business type, taxpayer type, transaction type or location will deliver no demonstrable, substantial or sustained economic benefit. At the very least, ask DECD to do the REMI analysis on such legislative proposals first.

Thank you for your consideration. As always, I am happy to take questions and provide any further information you may need.

Proposed substitute language to SB 448, AAC State Tax Policy.

Please add the following to Section 2:

(8) If a taxpayer concludes that it cannot reasonably determine the assignment of its receipts in accordance with subdivisions (1) through (7), such taxpayer may petition the Commissioner for approval to use a methodology that reasonably approximates the assignment of such receipts. The petition must be submitted not later than sixty days prior to the due date of the return for the first income year to which the petition applies, determined with regard to any extension of time for filing such return, and the Commissioner shall grant or deny such petition before said due date.

Please add the following to section 7:

(H) If a taxpayer concludes that it cannot reasonably determine where its gross receipts are earned in accordance with subdivisions (A) through (G), such taxpayer may petition the Commissioner for approval to use a methodology that reasonably approximates where such receipts are earned. The petition must be submitted not later than sixty days prior to the due date of the return for the first taxable year to which the petition applies, determined with regard to any extension of time for filing such return, and the Commissioner shall grant or deny such petition before said due date.