Western Connecticut
COUNCIL OF GOVERNMENTS

March 2, 2018

Esteemed Chairs Fonfara, Frantz, and Rojas,
Esteemed members of the Finance, Revenue and Bonding Committee:

The Western Connecticut Council of Governments (WestCOG) is pleased to share its comments on *Bill 11, An Act Concerning Connecticut's Response to Federal Tax Reform.*

WestCOG **supports** the purpose of this bill, which is to mitigate the impact of federal tax reform. This reform would dramatically raise the federal tax liability on Connecticut residents, exacerbating the financial imbalance between our states and others—we already pay more to the federal government than we receive in return—and further increasing the cost of living and doing business in the state. The result, we are concerned, may be an acceleration in the loss of financial and human capital from the state and deterioration in tax revenues and state and local budgets.

Given the urgency of the threat, WestCOG has made mitigating the impact of federal tax reforms its top legislative priority this year. We are gratified to see that the state's leadership takes the threat as seriously as we do. With that said, we remain concerned that **the solutions proposed, while necessary, may not be sufficient fully to eliminate significant adverse impacts on the state's residents and businesses. These impacts may not only result from federal tax changes, but also from the responses of neighboring states to that changes.**

Like most discussion on the subject, Senate Bill 11 does not appear adequately to consider the cross-border interactions that state tax changes may produce. For instance, **should New York replace its state income tax with a payroll tax, Connecticut residents who work in New York could have to pay a New York payroll tax *in addition to* Connecticut and federal income taxes.** Income tax credits granted for out-of-state payroll tax contributions could avoid this situation. However, they could produce large revenue losses for Connecticut, as commuters into New York, who have historically paid Connecticut income tax fully, and paid only New York the difference between their and our rates, now would solely pay New York via the payroll tax.

Given the large potential costs, we urge you to coordinate with our neighbors on state tax changes and/or to anticipate and prevent adverse interactions with changes in neighboring states. A letter to the Commission on Fiscal Stability and Economic Competitiveness with more detail is attached, but should you have questions, please do not hesitate to contact me.

Sincerely,

Francis R. Pickering
Executive Director

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February 20, 2018

Robert Patricelli, Co-Chair
James Smith, Co-Chair
Commission of Fiscal Stability and Economic Growth
Legislative Office Building, Room 3700
300 Capitol Avenue
Hartford, CT 06106

Esteemed Co-Chairs Patricelli and Smith,
Distinguished Members of the Commission on Fiscal Stability and Economic Growth:

The Western Connecticut Council of Governments (WestCOG) thanks you for your service to the state and for giving us the opportunity to comment on the issues that face us all as residents and taxpayers in Connecticut.

Our top priority as a COG this year is the implementation of an effective state response to the recent federal tax reform. We urge you to put this at the top of your agenda as well, even if it means putting it ahead of structural fixes. These fixes are badly needed and overdue; however, unlike the changes to federal tax law, failure to deal with them *now* will not create an emergency.

We do not use the term emergency lightly. But consider the following points, which illustrate the gravity of the predicament in which we find ourselves:

1. The capping of the SALT deduction hit Connecticut hard. The impact of this change been estimated as high as $9 billion statewide annually, **an amount equivalent to a doubling of the state income tax**.
2. Unlike state income tax revenues, which are largely spent in Connecticut and thus feed back into the local economy, a smaller fraction of the taxes that the state's residents and businesses contribute to the federal government is spent here. (In recent years, Connecticut has received approximately 80¢ for every dollar it sends to Washington.)
3. Western Connecticut is impacted most severely of all regions in Connecticut. On average, households in the region have the highest property tax burden in the state, in dollar terms (median of over $7,000 annually) and as a percent of household income (over 5% of income). **The federal tax reform will increase this burden further.**
4. Many Connecticut residents work out of state. This is especially true in Western Connecticut, which accounts for 26% of state income tax revenues.
5. Neighboring states are pursuing strategies to avoid new federal tax liability. Should those states replace an income tax, which is based on the place of residence, with one that that is assessed at the place of work (e.g., a payroll tax), and Connecticut not do the same, **commuters to jobs out of state may face triple taxation**: first, a neighbor state payroll tax, second, the Connecticut income tax, and third, federal income tax on state and local taxes paid in Connecticut.

6. Even if Connecticut replaces the income tax with a payroll tax, the state may lose revenue insofar as the earnings of Connecticut residents who work out of state exceeds the earnings of residents of other states who commute into Connecticut.

Absent an adequate and timely restructuring of the state tax code, those households which contribute disproportionately to state revenues may face a one-two punch of a hike in effective state and local tax rates *and* duplicate taxation of their income by two states. We expect **the result would be an acceleration in the departures of high-income households from the state and a deterioration in the economy, with negative impacts on home values, businesses, and municipal government.** Such developments would exacerbate the state's budget situation.

Connecticut has prospered in part due to the advantage of having lower taxes than its neighbors. Tax reform by the federal government and our neighbors without corresponding action in Hartford could upend that, putting Connecticut at a severe economic disadvantage and potentially driving the state into a recession and fiscal crisis. With consequences like this, **if we can only complete one reform this year, responding to federal tax reform should be it**.

Our members are exploring granting property tax credits for donations to charitable foundations. While such an option may offset new federal tax liability, it may not fully eliminate it, nor does it address the dual taxation that commuters out-of-state may face. In addition, this option may not be available at the same time, to the same extent, or at all in every city or town. Local efforts may give relief (and, in conjunction with state reforms, a higher standard deduction, and changes to the AMT, could theoretically result in lower tax burdens under the federal tax reform than before it), but they cannot replace action on the state income tax.

One solution may be a graduated payroll tax for wage income, with non-wage income subject to an income tax. Such an arrangement could obviate the need for many or most workers to file taxes. However, designing a tax and rate structure that is legal, revenue-neutral, and does not yield unintended consequences (e.g., burden shifting) is complex. Just as our members have brought on experts to guide local tax reform, **restructuring state taxes will require professional assistance**.

Unlike structural challenges, which can emerge over decades, the impact of tax reform will be felt next year, so **we urge you to advise the state to engage the necessary talent as soon as possible.**

Should you have questions, please do not hesitate to get in touch.

Sincerely,

Francis R. Pickering
Executive Director