

## Finance, Revenue and Bonding Committee JOINT FAVORABLE REPORT

**Bill No.:** SB-11

AN ACT CONCERNING CONNECTICUT'S RESPONSE TO FEDERAL TAX

**Title:** REFORM.

**Vote Date:** 4/5/2018

**Vote Action:** Joint Favorable Substitute

**PH Date:** 3/2/2018

**File No.:** 624

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### **SPONSORS OF BILL:**

Introduced by:

Sen. Martin M. Looney, 11th Dist.

Sen. Bob Duff, 25th Dist.

Rep. Joe Aresimowicz, 30th Dist.

Rep. Matthew Ritter, 1st Dist.

### **REASONS FOR BILL:**

To implement the Governor's budget recommendations in order to make modifications to Connecticut's tax statutes in response to the federal Tax Cuts and Jobs Act of 2017.

### **RESPONSE FROM ADMINISTRATION/AGENCY:**

#### **Benjamin Barnes, Secretary, Office of Policy and Management**

Secretary Barnes's testimony explained that this proposal makes modifications to Connecticut's tax statutes in response to the federal Tax Cuts and Jobs Act of 2017 (TCJA) that became law in December 2017. He goes on to point out that regrettably the TCJA targeted states like Connecticut by limiting the state and local tax deduction to no more than \$10,000. It has been estimated that this change will impact more than 170,000 residents claiming \$10.3 billion of deductions in Connecticut, according to a recent analysis by the Department of Revenue Services. This bill would introduce changes to ensure Connecticut remains competitive under the new federal tax regime.

#### **Comptroller Kevin Lembo, State of Connecticut**

The Comptroller explained that the new federal tax changes will have long-term consequences for states like Connecticut, impairing the ability of Connecticut state and local governments to afford essential investments in infrastructure, education and workforce training that are necessary to drive economic growth. These federal tax changes raise basic

questions of fairness for high-income states like Connecticut and fly in the face of the tax reform's stated goals. He notes that Connecticut has rightfully joined a multi-state coalition to fight this disparity. Comptroller Lembo commends state officials and the Finance Committee for their response to this and closes by stating that we must examine every avenue to achieve tax fairness for the people of Connecticut.

## **NATURE AND SOURCES OF SUPPORT:**

### **Connecticut Conference of Municipalities (CCM)**

CCM is generally supportive of SB 11 as a short term fix to address the federal tax reform law, but encourages the Committee members to continue its efforts on making Connecticut's towns and cities less reliant on the property tax. CCM Specifically commented on Sec. 10 of the proposal which allows municipalities to, upon approval by its legislative body, provide for a residential property tax credit. While CCM is appreciative of the Governor for thinking outside the box and looking to help residential property tax payers in light of the federal government capping the State and Local Tax deduction at \$10,000, they, as an organization, strongly support efforts to enact real property tax reform. Connecticut's property tax is uncompetitive nationally and the federal tax reform bill makes it even more so.

### **Eric Gjede Counsel, CBIA**

CBIA appreciates the proponent's goal of reviewing the state's tax code and making changes in response to federal tax reform that will allow Connecticut to remain a competitive, more predictable place to do business. In lieu of tax reductions, some of the proposals set forth in SB 11, if determined to be legally sufficient, could be a reasonable alternative. Mr. Gjede points out that Sections 1 to 9 of this bill propose a method of mitigating the impact of federal caps on deductibility of state and local taxes on personal income that will hit many pass-through businesses in the state. Pass-through entities will essentially pay a new business entity tax that will be offset by a credit in the equivalent amount on the personal income tax. If this proposal is legally sufficient to mitigate the impact of the federal cap, then it certainly merits further review. However, CIBA urges the committee to look at whether corporate partners should be required to pay this new tax, especially given that due to their structure and liability, corporate partners may be unable to realize the state tax credit. Sections 11 and 12 decouple the state from federal rules related to depreciation of capital assets. Simply put, when there are two different depreciation rates in effect, tax filings become more complicated and businesses spend more resources preparing them. Further, this decoupling is one more example of the state undermining the sense of fiscal predictability Connecticut businesses need to invest here with confidence. In closing CBIA encourages the committee to consider the impact any changes to the state tax code will have on our ability to remain competitive as a state, and pursue policies that promote economic growth and job creation.

### **National Federation of Independent Business (NFIB)**

NFIB appreciates the Governor's efforts and for putting forth this important proposal to try to ensure that small businesses do not lose the benefits of the tax cuts and reforms at the federal level. At this time, however, NFIB is still analyzing the specific implications of this proposal and vetting it amongst their small business owner members. Some immediate questions have arisen regarding the administration of this new business entity tax and corresponding income tax credit. Even assuming a true "break even" dollar for dollar scenario, small business owners need to be ensured that any such proposal will not increase their administrative burden or require additional paperwork, filings, or compliance measures.

Furthermore, assuming such a proposal is viable and allowable; the personal income tax credit must remain equivalent and intrinsically tied to any new entity-level tax assessment. Additionally, much of the rhetoric in Connecticut critical of the federal tax reform bill is confusing for our small business owners, because many if not the bulk will be realizing benefits. Finally, at a macro level, if state policymakers are concerned that the tax burden at the state level is too high, then that is where policy changes need to be focused and made.

**Francis Pickering, Western Connecticut Council of Governments (WestCOG)**

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. Mr. Pickering states that 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.

**Jeff Shaw, Director of Public Policy and Advocacy, The Alliance**

It is Mr. Shaw's hope that the General Assembly will consider the negative impacts federal tax reform will have on nonprofits as it forms its legislative response to these changes. The federal Tax Cuts and Jobs Act contains sweeping changes in corporate and individual tax rates, and an increase in the individual standard deduction. While the Alliance is pleased the law protected nonprofit nonpartisanship, the law creates uncertainty for nonprofits, both in the State's potential legislative action in response to the new \$10,000 cap on state and local taxes (SALT), which affect over 170,000 taxpayers (2015 data), as well as a likely reduction in charitable giving.

**Tom Swan, Executive Director, Connecticut Citizen Action Group**

Mr. Swan applauds the Governor for proposing SB 11 in response to the "Trump tax scam." He believes that the The Federal legislation is an abomination and was clearly designed to punish more enlightened states like Connecticut. Mr. Swan expects this proposal to be refined as it moves along and he hopes to be able to enthusiastically support its passage.

**Betsy Gara, Executive Director, Connecticut Council of Small Towns**

The Connecticut Council of Small Towns (COST) respectfully submits the following comments regarding SB-11: The \$10,000 cap on the State and Local Tax (SALT) deduction under the federal tax reform law recently enacted by Congress is putting tremendous pressure on towns to maintain or reduce property tax levels. COST appreciates the efforts of Governor Malloy to identify options for addressing this issue as outlined in Section 10 of the bill, which would effectively allow taxpayers to reclassify their property tax payments as charitable donations. COST is concerned, however, that there is a lot of uncertainty regarding how the Internal Revenue Service (IRS) will treat such donations. As such, they urge lawmakers to focus, instead, on assisting towns in controlling property tax levels by 1) diversifying local revenue options; 2) eliminating and refraining from adopting any new unfunded mandates; and 3) restoring critical sources of municipal aid, such as Town Aid Road and education funding.

**NATURE AND SOURCES OF OPPOSITION:**

**Joe Horvath, Director of Legislative Outreach, Yankee Institute for Public Policy**

Mr. Hovath's testimony states that this proposal contains a provision that would likely not pass legal muster. Specifically, the scheme creating tax credits exchanged for cash donations to support municipal services is, on its face, outside the parameters of the Internal Revenue Code as well as corresponding Treasury Regulations and existing case law. As for the proposed alteration to pass-through business entity treatment, it is an interesting concept, but Yankee Institute takes no position at this time. The Yankee Institute appreciates the difficult circumstances Connecticut faces. However, the tax policy proposals that are being considered would largely serve only to exacerbate, not alleviate, Connecticut's fiscal issues. Economic growth must be a fundamental part of fiscal recovery, and now is not the time for additional economic burdens.

**Horowitz, Barry- Nirenstein, Horowitz Associates**

Mr. Horowitz's testimony focused on the section of the proposal that addresses Connecticut's estate and gift tax. While he supports the section of the proposal that delays until 2023 full implantation of CT matching the federal estate and gift tax exemption of 11 million dollars, he feels that the proposal does not go far enough in curtailing what will be a needless and ineffective attempt to influence the decision of CT's wealthy residents to leave the state once they retire or stay.

**Ray Noonan, Connecticut Voices for Children**

Mr. Noonan's testimony states that the federal tax changes have pressured Connecticut to adjust its policies to remain competitive even though these changes mostly benefit the wealthy. The Governor's first proposal, allowing municipalities to set up local charitable funds, benefits only those who itemize to deduct state and local taxes (SALT) from their federal tax liability. Research shows that the wealthiest are much more likely to itemize than the middle class. The Governor's second proposal, shifting taxes for owners of passthrough businesses, only benefits those who receive income from a passthrough business. This income disproportionately goes to the wealthy. These changes would accrue to the very population that already disproportionately benefitted from the federal tax bill. As a result, the Governor's changes will widen inequalities in effective tax rates between the wealthiest and everyone else. To narrow these inequalities, Voices urges the legislature to consider pairing the Governor's changes with others that will ease burdens for low-income families, such as restoring the state Earned Income Tax Credit to 30 percent of the federal credit.

**Reported by: Tom Spinella**

**Date: 4/10/2018**