COST
COUNCIL ON STATE TAXATION

Ferdinand Hogroian
Senior Tax & Legislative Counsel
(202) 484-5228
fhogroian@cost.org

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Connecticut General Assembly
Appropriations, Commerce, Finance, Revenue & Bonding, and Planning and Development Committees

Re: Recommendations of the Commission on Fiscal Stability and Economic Growth

Dear Members of the Appropriations, Commerce, Finance, Revenue & Bonding, and Planning and Development Committees:

Thank you for the opportunity to address the Committees concerning the final report of the Connecticut Commission on Fiscal Stability and Economic Growth. The Council On State Taxation (COST) represents approximately 550 corporations engaged in interstate and international business, many conducting significant business operations in Connecticut. The Commission's final report cites COST's research, in particular our annual Business Tax Burden Study (a joint study with COST's State Tax Research Institute, or STRI), as support for raising taxes on businesses. We believe this is a misinterpretation of our research and that the final report fails to account for anticompetitive aspects of existing Connecticut business taxes. Therefore, the final report's recommendations may harm, rather than enhance, prospects for economic growth in the State.

The COST Business Tax Burden Study. Each year, Ernst & Young LLP estimates the total state and local business taxes paid by business in each state (the COST Business Tax Burden Study).[1] The study provides a valuable tool for policymakers to evaluate the contribution of various business taxes to total state and local revenues. These metrics can provide the basis of comparison between the states, but it is important to note the factors that can contribute to a state appearing on the low or high end of a given comparison.

For example, when comparing business tax revenues as a percentage of total revenues in the states, we note that while Connecticut and Maryland generate the smallest share of their overall tax receipts from business taxes, "In both states, the structure of the states' economies plays a significant role in generating this result. In Connecticut, significant income earned by high-income taxpayers contributes to individual income tax receipts that outweigh business collections."

[1] *See, e.g.*, "Total state and local business taxes: State-by-state estimates for fiscal year 2016" (August 2017), available at: http://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/fy16-state-and-local-business-tax-burden-study.pdf.

While indeed the State's reliance on individual income tax receipts (particularly from high-income taxpayers) contributes to revenue volatility, as noted in the Commission's final report, this does not support a conclusion that business taxes are too low or that their characteristics are competitive. It also does not support a decision that lowering individual income tax rates and replacing that revenue loss with a new, anti-competitive payroll tax on all businesses would help the State's economy. **A payroll tax would have the effect of increasing the costs of locating business investment in Connecticut, discouraging job creation and depressing wages.** Connecticut also would be the only state, to our knowledge, to impose a statewide general business tax on payroll.

As explained in our Study, the Total Effective Business Tax Rate (TEBTR) is measured as the ratio of state and local business taxes to private-sector gross state product (GSP), the total value of a state's annual production of goods and services by the private sector. The average TEBTR across all states is 4.5%. Connecticut had the lowest TEBTR at 3.47%. Connecticut is home to several high-output industries, such as insurance, financial services and aerospace, which generate a large amount of GSP for the state. Business taxes per dollar of GSP are significantly below the national average for this reason. Additionally, Connecticut relies on individual income taxes for a significant share of its total state and local taxes, which are mostly paid by households.

Thus, the Commission should have focused on the elements of Connecticut's business taxes that are anticompetitive, rather than citing the TEBTR which for Connecticut reflects differences in industry makeup and its concentration of high net worth and high income individuals. If it had, the Commission would not have called for a blanket 14% reduction in "exemptions" to produce $750 million annually in "additional sales tax and other revenues." Our study shows that businesses pay a substantial amount of sales and use taxes, including approximately $1.5 billion in Connecticut, whereas a properly designed retail sales tax would exempt business inputs.[2] **Artificially meeting a target elimination of sales tax exemptions risks further taxation of business inputs (*e.g.*, pyramiding of the tax) and exacerbating the already anticompetitive effects of Connecticut's sales tax laws.**

We also note that "Connecticut had the highest growth rate [in the country] for business property tax revenue, increasing 12.6%." We can assume that property taxes for households likewise had a significantly high growth rate, again likely outweighing the business property tax burden. That, of course, does not mean that the business property taxation in Connecticut is competitive. The Commission's final report, however, fails to note that Connecticut had the highest growth in property taxes of any state in the country in fiscal year 2016.

Conclusion. I hope that this explanation of COST's Business Tax Burden Study helps the Committees understand the study's intended use and how it might be used to analyze Connecticut's state and local tax systems. Please contact me with any questions regarding this testimony or COST's research.

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[2] *See also* COST's study on taxation of business inputs, "What's Wrong with Taxing Business Services: Adverse Effects from Existing and Proposed Sales Taxation of Business Investment and Services" (April 2013), available at: http://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/sales-taxation-of-services-and-business-inputs-study.pdf. COST and STRI are currently in the process of updating this study and also will soon release a new "Scorecard" on sales tax administration incorporating updated data on sales taxation of business inputs.

Respectfully,

Ferdinand Hogroian

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director