

# **Better Choices for Connecticut**

## **2012 Legislative Agenda**



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## Introduction

Connecticut residents value our high quality of life and depend on a vibrant public sector to maintain it. Public services – good schools, safe roads, and quality healthcare – are central to preserving our quality of life and ensuring Connecticut's economic vitality. State revenues – taxes, fees, and other income – are the collective investments we make to support these services and uphold the high standards we all expect.

While we expect high standards, for the communities in which all but the wealthiest live, we are far from achieving them. Over 40% of Hartford children live in poverty, as do 1 in 8 kids statewide; even towns like Branford and Bristol have substantial rates of poverty.<sup>1</sup> In the richest state in America, we can and must do more to ensure opportunity for all, instead of just a privileged few.

While positive changes were made last year, for the most part Connecticut's revenue system remains imbalanced, inadequate, and inequitable. Despite modest gains, the state's immediate needs and long-term debts still far outstrip our system's ability to meet them. Pragmatic reforms should be made to render our tax system more transparent, stable, adequate, fair, and efficient. To sustain our quality of life; to meet the needs of our families; and to protect the future of our children, our elderly, and our workforce, we must reexamine the state's system of taxation and make better choices about how to improve it.

We recognize that important revenue changes are seldom made during short legislative sessions. Nevertheless, the 2012 session is an opportunity to address some smaller, specific reforms which will provide the public and General Assembly the information and mechanisms they need to make larger reforms in the longer 2013 session.

### Our Mission

***Better Choices for Connecticut*** is a community coalition working to help Connecticut make smarter choices to improve the state's imbalanced revenue system so that it:

- Advances opportunity for all Connecticut residents
- Preserves services for children, families, and the elderly
- Creates and sustains good jobs
- Reinvests in the middle class and our communities

## Cuts to Public Services: A Poor Choice for Connecticut

While Connecticut made some better choices in 2011, serious challenges remain, in large part because we have not fixed fundamental problems in our ability to generate revenues, like rapidly growing corporate tax loopholes and a tax code that has not kept pace with the changing economy. Many public services still face the threat of damaging cuts in fiscal year 2013, and are virtually certain to face devastating cuts in future years unless reforms are made. State agencies have been asked to propose reductions to their programs, and both public and private providers have had to leave positions vacant. These reductions mean fewer families in need will have access to vital services in the most trying of economic times.

By cutting public expenditures, we would also reduce employment and demand by purchasing fewer goods and services from businesses across the state. Meanwhile, any reduction in public support programs – like health benefits, rental assistance, and fuel aid – would pull money from the hands of the people most likely to spend it. Rather than carrying out additional painful cuts, Connecticut must solve its budget problems with methods that will be the least harmful to our economy and the least painful for our families.

Economists tell us that Connecticut's prosperity relies on the public structures we have created. Individual effort, expertise, and entrepreneurship can only succeed when critical structures are in place to enable those energies – from highways to high-speed rail, from courts that set the rules of fair play to regulations that keep our environment clean. And building new public structures to meet emerging needs – from early childhood education to affordable public college systems – is necessary if we are to keep our state vital and competitive.

As Connecticut addresses our budget challenges, carefully crafted revenue enhancements will benefit the state economy more than cuts to vital services. These enhancements can be focused on people and businesses with the greatest ability to pay, while maintaining or lowering the rates for those who are most vulnerable and for the small businesses key to job creation. Better Choices also urges the state to increase budget transparency, improve coordination of services, and find other ways to spend smarter. The benefits of smarter government, however, have limits: at best, these efficiency gains will merely allow Connecticut to keep pace with the growing demand for public services. To achieve broadly shared prosperity, the state will need pragmatic, comprehensive revenue solutions.

## **Better Choices for Connecticut**

Connecticut must make better choices. Despite some positive changes last year, our system of taxation remains imbalanced, inadequate, and inequitable. Connecticut's revenue problem requires a revenue solution. The present economic challenges offer us the opportunity to improve the structure of our revenue system substantially. In the long term, changes will also help build the resources necessary to tackle longstanding problems, such as the need for property tax reform.

The following choices represent the beginning of a comprehensive effort to improve Connecticut's tax system. Better Choices for Connecticut believes that the adoption of the proposals in this paper will promote the bedrock principles of fair taxation and good government:

- **Adequacy.** The tax system should provide sufficient revenue to fund essential public services, which include not only current services but also presently unmet essential needs.
- **Fairness.** The tax system should be fair, demanding the least of those least able to pay, and the most of those most able—as a percentage of income and wealth, not dollar amounts that simply reflect the depth of inequality in our state.
- **Stability.** Since demand for public services rises when the economy sinks, a tax system should be resistant to cyclical economic changes.
- **Accountability.** The tax system, including business tax credits and exemptions, should promote job creation and broad-based economic growth.

- **Optimization.** The tax system should optimize the benefits of the federal system (e.g., take into account which state taxes are deductible on the federal income tax). The tax system also should be regularly reviewed and adjusted to adapt to changing circumstances.
- **Practicality.** Major alterations to the current tax system should be carefully phased in over time.
- **Responsibility.** The tax system must reflect the state's responsibility to municipalities and localities.
- **Cohesion.** A tax system should be cohesive: its parts should interact in a manner that reflects and advances these other principles.
- **Transparency.** The tax system should be transparent and allow all stakeholders, including the public and elected officials, to know which companies benefit from tax breaks and loopholes.

The proposals suggested below are achievable in the short session and will allow the General Assembly to begin the 2013 legislative session armed with the information and mechanisms necessary to make progress for all of Connecticut's families and communities.

**1. Institute regular reporting of income and wealth inequality and of what people and businesses at different incomes and sizes actually pay in state and local taxes.**

Connecticut is one of the most unequal states in America. Over 350,000 Connecticut residents—and over 100,000 children—live in poverty,<sup>2</sup> yet we are also home to some of the world's wealthiest corporations and individuals: Greenwich alone has 8 billionaires.<sup>3</sup> The richest 1% in Connecticut average over \$3 million per year in income, but they pay less than half the proportion of income in taxes as the poorest 20%.<sup>4</sup> Not only is Connecticut unequal, our tax code makes it worse.

Precisely how much worse is unclear—the state does not track it. Since the last comprehensive review of our tax code, Connecticut has made over 50 changes to the personal income tax, 230 to the sales and use tax, and 140 to the corporation business tax, as well as multiple changes to or repeal of other taxes.<sup>5</sup> Yet, we have not examined how these modifications affect people, or businesses', actual tax liabilities.

By initiating regular analysis of income and wealth inequality as well as how much individuals and businesses across the income and business-size spectrum pay in state and local taxes, we can see how well our economy does for most of our people, as well as whether our tax code makes things better or worse.

**2. Improve business tax credit transparency and accountability by ensuring the new business tax credit review commissions have teeth.**

The cost of Connecticut business tax subsidies has grown tremendously over the last generation, yet despite a 27-fold increase from 1987 to 2008, there was zero net job growth.<sup>6</sup> Clearly, we are not getting maximum bang for our buck. Some credits are ineffective, even damaging, while all credits erode the tax base, often in hard-to-predict ways. Business tax credits are a large part of our economic development efforts, yet they often exist apart from our overall strategy. And not only is there a lack of coordination,

there is a lack of transparency and accountability—we cannot be sure which credits work, which credits do not, or whether credits fit into our overall economic plan.

Fortunately, the state now has two mechanisms that can bring transparency and accountability—and with them greater coordination and efficacy—to Connecticut business tax credits. The Governor recently announced the formation of a business tax credit policy and review commission, not long after the Comptroller helped revive a similar legislative business tax credit review committee. Such commissions must be permanent fixtures, with sufficient access to corporate tax data, and a mandate to maximize efficiency through real transparency and rigorous accountability.

### **3. Implement a “throwback rule” to close corporate tax loopholes and improve fairness towards smaller businesses.**

Each year, millions of dollars in corporate tax revenues fall through the cracks of our tax system: the rules for assigning multi-state corporations’ income across the various states simply are not able to capture every dollar. Some income, so-called “nowhere income,” is not booked in any state and thus goes untaxed. On balance, this means larger Connecticut corporations, with more out-of-state revenues, are able to pay lower taxes than smaller businesses, with fewer such revenues. The throwback rule, which about half of states with corporate income taxes already have,<sup>7</sup> would catch much of this revenue by making sure “nowhere income” is taxed at Connecticut companies, closing the loophole and removing the unfairness towards small businesses. The rule could generate \$20 million annually.<sup>8</sup>

### **4. Require combined reporting to close corporate tax loopholes and improve fairness towards smaller businesses.**

Connecticut’s tax system currently allows large multi-state corporations with clever tax attorneys to shift profits artificially to subsidiaries in states with lower or nonexistent corporate income taxes. When larger corporations avoid their fair share of taxes, it costs the state millions of dollars, shifts the responsibility onto local businesses and families, and places small businesses that compete against large corporations at a disadvantage.

Under mandatory combined reporting, Connecticut would require companies with separate entities that are the functional equivalent of divisions to file a single, combined tax return for the whole business. This would give the state the ability to identify tax-avoiding interstate transfers and thus tax the entire enterprise appropriately, based on economic reality rather than legal fiction.

Twenty-three states have already adopted mandatory combined reporting to combat intentional corporate tax avoidance.<sup>9</sup> Because it is so widespread, combined reporting is already familiar to most of Connecticut’s top employers and reform will not impose difficult, new administrative burdens. Mandatory combined reporting could generate \$70 to \$120 million annually.<sup>10</sup>

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- <sup>1</sup> Connecticut Voices for Children, *Poverty, Income, and Health Insurance in Connecticut Cities and Towns: Summary of 2008-2010 Data from the American Community Survey*, November 2011, [http://ctkidslink.org/pub\\_detail\\_568.html](http://ctkidslink.org/pub_detail_568.html).
- <sup>2</sup> Connecticut Voices for Children, *Poverty, Median Income, and Health Insurance in Connecticut: Summary of 2010 American Community Survey Census Data*, September 2011, [http://ctkidslink.org/pub\\_detail\\_564.html](http://ctkidslink.org/pub_detail_564.html).
- <sup>3</sup> Stamford Advocate, *Eight Greenwich Residents among World's Billionaires*, March 10, 2011, <http://www.stamfordadvocate.com/business/article/8-Greenwich-residents-among-world-s-billionaires-1066602.php>.
- <sup>4</sup> Wade Gibson, *Taking Stock: Four Decades of State Revenues, Expenditures, and Deficits*, Connecticut Voices for Children, January 2012, [http://ctkidslink.org/pub\\_detail\\_576.html](http://ctkidslink.org/pub_detail_576.html).
- <sup>5</sup> Eric Mitzenmacher, *A Revenue Accountability Commission: The Right Step toward Securing Connecticut's Fiscal Future*, Connecticut Voices for Children, March 2010, [http://www.ctkidslink.org/pub\\_detail\\_505.html](http://www.ctkidslink.org/pub_detail_505.html).
- <sup>6</sup> Wade Gibson, *Are CT Business Tax Credits Creating Jobs? Would We Know if They Weren't?* Connecticut Voices for Children, October 2011, [http://www.ctkidslink.org/pub\\_detail\\_565.html](http://www.ctkidslink.org/pub_detail_565.html).
- <sup>7</sup> Institute on Taxation and Economic Policy, *"Nowhere Income" and the Throwback Rule*, August 2011, <http://www.itepnet.org/pdf/pb39throw.pdf>.
- <sup>8</sup> Eric Mitzenmacher and Sarah Kopman-Fried, *Complementary Approaches to Corporate Tax Reform: Throwback Rule and Combined Reporting*, Connecticut Voices for Children, March 2011, [http://ctkidslink.org/pub\\_detail\\_538.html](http://ctkidslink.org/pub_detail_538.html).
- <sup>9</sup> Institute on Taxation and Economic Policy, *Corporate Tax Dodging in the Fifty States, 2008-2010*, December 2011, <http://www.itepnet.org/pdf/CorporateTaxDodgers50StatesReport.pdf>.
- <sup>10</sup> Complementary Approaches to Corporate Tax Reform: Throwback Rule and Combined Reporting.