CONNECTICUT VOICES FOR CHILDREN

The Connecticut Corporation Business Tax: Frequently Asked Questions[1]

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Why should corporations pay tax at all?

- **Corporate status is a legally created privilege that carries many benefits; corporations are "persons" under the law.** Doing business as a corporation is a privilege for several reasons: corporations exist only because the law allows them to exist; they can attract more capital and make higher profits than might be possible for an individual; and corporations shield their owners (stockholders) from individual liability for corporate acts.
- **The business community benefits significantly from state-funded services**. Like individuals, corporations use and benefit from state supported infrastructure and services, including: police and fire services, roads, railways, airports, and harbors, the judicial system and the state's school system that produces an educated workforce and helps attract qualified employees.
- **"Taxes are the dues we pay for the privileges of membership in an organized society."**[2] The basic premise underlying all forms of taxation is that members of society – be they individuals or corporate entities – should help pay for the government-provided services and infrastructure that allow them and others to function – and indeed thrive – in society.

What is CT's corporation business tax?

- **The corporation business tax is a "tax on the privilege of carrying on a business in a corporate capacity in Connecticut."** It imposes a 7½% tax on the Connecticut net income of corporations subject to the tax (unless the amount of tax due under the alternative capital base method is higher). If the amount of tax due under both calculation methods is less than $250, the corporation must pay the Alternative Minimum Tax (AMT) of $250.

Are all CT corporations subject to the corporation business tax?

- **No. An increasing number of corporations, including many smaller ones, are exempt.** Of the four types of corporate entities in CT, only C– corporations (which include many of the publicly-traded and largest businesses) are subject to the tax. Subchapter S-corporations, limited liability corporations and limited liability partnerships – which together include most of the smaller, "mom and pop" businesses and 18 of Connecticut's largest businesses – do not pay this tax at all, but only a $250 "entity" tax. In addition, state law exempts certain specific types of C-corporations from the corporate tax.[3] Since 2001 pass-through entities have grown by approximately 30% while C-corporations have declined by 10%.[4]

Do all CT corporations that are subject to the tax pay the 7½ % rate?

No. Most of them pay far less, and some have been paying nothing at all. The recent Legislative Program Review and Investigations Committee study of Connecticut's tax system found that in 2003, 18 of the largest 100 corporations headquartered in Connecticut paid only $250 in corporate income taxes,

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[1] For more detailed information and the sources of data in this fact sheet, please see S.Geballe, *CT's Corporation Business Tax: It's Time for Repair* (CT Voices for Children, July 2003), available at www.ctkidslink.org.

[2] Franklin Delano Roosevelt.

[3] See 2002-2003 DRS Annual Report p. 16, available at: http://www.ct.gov/drs/cwp/view.asp?a=1442&Q=266020&drsPNavCtr-#40901

[4] *Connecticut's Tax System*, Legislative Program Review and Investigations Committee, January 19, 2006, p. 51.

and only one corporate filer paid more than $1 million in corporate income tax after credits.[5] In addition, at least half of the 44,277 C-corporations in Connecticut paid only the $250 minimum tax.[6]

How is this possible?

- **Since the early 1990s, CT has enacted wide-ranging corporation business tax exemptions, deductions and credits that reduce dramatically the tax liability of many CT corporations.** In 2005, CT will lose an estimated $425 million due to these and other business "tax expenditures." These reductions are *in addition to* a reduction in the tax rate from 13.8% in FY 90 (a rate that was too high) to 7.5% in FY 02 (a rate at about the national average) and a change in the apportionment formula for multi-state and multi-national corporations in some specific industries (which also reduced revenue to Connecticut).

Where does CT stand compared to other states on Corporation Business Tax Revenues?

- **CT ranks 28th among the 46 states with a corporation tax in the proportion of state tax revenues from corporation business taxes**. In 2003, 3.6% of Connecticut's total state tax revenues came from its various corporation business taxes. This was less than in New Hampshire (20%), New Jersey (12%), Massachusetts (7.6%), and New York (5.2%).
- **State revenues from the CT corporation business tax have declined significantly since the early 1990s,** and as a share of total General Fund revenues the corporation business tax dropped from 11.5% in FY 92 to 3.6% in FY 03. Between FY 83 and FY 06 (projected), total business tax revenues have declined from 24% to just 7% of total General Fund revenues.[7]

Why is the CT corporation business tax sometimes called a "voluntary" tax?

- **In addition to the tax exemptions, credits and deductions that have so dramatically reduced corporation business tax liability, there are ways to shelter corporate income so that there is virtually no taxable income in Connecticut.**
- **Tax sheltering results in significant lost revenue.** The Multistate Tax Commission reported that *three-quarters* of the decline in the effective rates of state corporate taxes resulted from tax sheltering. In FY 01, while CT was collecting about $413 million in state corporate income taxes, CT was *losing* about half this amount because of national and international tax sheltering.[8]

Do CT corporations pay other taxes?

- **Like individuals, corporations pay other taxes (like sales, property and real estate conveyance taxes).** As with the corporation business tax, however, corporations enjoy various credits and exemptions that reduce their liability for these other taxes. Corporations may also pay taxes that are unique to businesses, such as the unemployment benefit tax.
- **There is no state-specific data on the amount and share of these other taxes actually paid by businesses in CT.** Importantly, these are not new taxes. They existed in 1990, and since then they have been reduced through credits and exemptions, just as the corporation business tax has been reduced. These changes, like the reductions in the corporation business tax, result in a shift in financing state government from corporations to individuals.
- **Businesses can pass on certain costs of taxation in the price of their products.** That is, who it is that actually bears the burden of taxes imposed on businesses (the business, its shareholder or the businesses' customers, and in what proportion) is not known and would vary by business.
- **A January 2004 study prepared by Ernst & Young for the Council on State Taxation (COST) – a business-funded trade organization – found that CT was one of only three states in which *overall***

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[5] *Connecticut's Tax System*, Legislative Program Review and Investigations Committee, January 19, 2006, p. 51.

6 A change in the law since that time limits tax liability reduction to 70% of the amount of tax due prior to the application of the credit. In other words, corporations must pay 30% of what their tax liability would be without tax credits or the alternative minimum tax of $250. Conn. Gen. Stat. §§ 12-217zz., 12-219.

[7] *Where Does the Money Come From? Where Does the Money Go? An Overview of the State's Revenues and Expenditures*, Office of Fiscal Analysis, February 6, 2006.

[8] Multistate Tax Commission, *Corporate Tax Sheltering and the Impact on State Corporate Income Tax Revenue Collections* (July 2003)(Table 1).

state and local business taxes declined in the previous 3 years. The study also found that CT ranked in the bottom 10 of states on three out of four measures of *overall* state and local tax burden.[9]

Aren't corporation business tax credits and exemptions a benefit to CT's economy and important to attract and keep business in CT?

- **Some may be, but no one knows which ones benefit the state and which merely divert resources from more productive uses.** These "tax expenditures" are generally not reviewed once they are enacted and there is no periodic evaluation of their benefit or detriment to the state. They become "entitlements." Indeed, policymakers don't know *which* corporations are receiving *which* benefits, so it is impossible to know if the tax expenditures benefit our economy or if they provide a valuable return on investment.
- **Another troubling aspect of tax expenditures is that they grow, unchecked.** That is, a tax credit projected to cost the state a certain amount in the year enacted can cost many times that much as more corporations take advantage of it. Credits against the corporation business tax alone will cost the state $175.3 million in FY 2005 – up from $2.7 million in 1987.
- **Research on corporate location decisions shows that taxes are only one of many (and generally not one of the most important) factors in the decision-making process.** According to the New York Times, the initial findings of a survey of more than 200 multinational corporations reveal that lower labor costs in emerging markets are not the major reason for hiring researchers overseas, though they are a consideration, and that tax incentives do not matter much. Instead, the report finds that "multinational corporations were global shoppers for talent."[10]

If CT repairs its corporation business tax, won't we become less competitive?

- **No. New Jersey's case is illustrative.** NJ adopted a multi-pronged corporation business tax reform in 2002 despite claims that it "would trigger a mass exodus of employers and jobs from NJ." A year later, NJ's State Treasurer announced that "new investment is spreading across all corners of our state."
- **On key economic measures, New Jersey fared better than CT following its tax reforms:** In 2002 and 2004, New Jersey enacted an increase in the state's corporation business tax and an increase in the personal income tax, respectively. *Since the 2001 national recession and withstanding these tax changes, New Jersey gained 72,100 jobs between January 2001 and November 2005, while Connecticut lost 16,800 jobs during the same time period.* As noted in *The Connecticut Economy*, "The data make it hard to argue that the main source of sluggish job growth is business taxes."[11]

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[9] A. Wright, "Connecticut Business Taxes in Perspective," *The Connecticut Economy: A University of Connecticut Quarterly Review* (Spring 2006).

[10] A recent New York Times article by Steve Lohr entitled, "Outsourcing is Climbing Skills Latter," February 16, 2006 cited the findings of an upcoming report by Jerry and Marie Thursby entitled, Here or There? A Survey on the Factors on Multinational R&D Location and IP Protection." The initial findings of the survey were presented to the National Academies on February 16, 2006.

[11] A. Wright, "Connecticut Business Taxes in Perspective," *The Connecticut Economy: A University of Connecticut Quarterly Review* (Spring 2006).