CONNECTICUT VOICES FOR CHILDREN

Making Sense of the Rankings: Where Connecticut Stands on Business Taxes

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In recent months, there has been a steady stream of reports about state business taxation. The Council on State Taxation (COST), a trade association of large corporations, released its annual ranking of state and local business taxes, naming Connecticut the lowest-tax state in America. Then, Good Jobs First graded states on accountability provisions in their corporate subsidy programs, and the Institute on Taxation and Economic Policy (ITEP) and Citizens for Tax Justice (CTJ) released a list of the greatest avoiders of state corporate income taxes. Connecticut, it turns out, is home to both below-average accountability and some of the country's biggest tax avoiders.

Yet despite low taxes, subsidies with few strings attached, and considerable tax avoidance by major corporations, Connecticut has a reputation as a state unfriendly to business. What accounts for this? According to COST, our state and local business taxes take up only 3.3% of private sector economic activity[1]: overall, they simply do not represent a large burden on companies. Business costs other than taxes, such as the cost of energy, the cost of healthcare, and the cost of working with aging infrastructure, may be more important contributors to the cost of doing business in Connecticut.

However, while business taxes make up only a few percent of the state's economy, they make up a large percent of state tax revenues—35%.[2] Thus, these reports have significant ramifications for Connecticut's fiscal health, particularly in light of the recent downturn. Just as companies laid off over 100,000 Connecticuters and led many families to turn to the state for food, heating oil, and medical care, the state found its ability to meet their needs diminished. Now, as Connecticut plans investments to create jobs and build a stronger economy, we remain strapped, facing a sluggish recovery and daunting long-term debts. In such an environment, we should put every tax dollar to best use.

Yet, these reports suggest that Connecticut companies avoid millions in taxes through creative accounting and tax credits. It is unlikely that every one of these millions of dollars represents the optimal use of our resources. Too often, we do not ask whether subsidy dollars are well spent, and other times, we are aware of large tax loopholes but fail to close them. While the COST study establishes the low average tax burden on Connecticut companies, the Good Jobs First and ITEP/CTJ reports make clear the need for greater accountability in corporate subsidies and for loophole-closing reforms like mandatory combined reporting. In times like these, we must make every dollar count.

A. Council on State Taxation (COST)

According to COST,[3] Connecticut's overall business taxes are the lowest in the Nation.[4] In fiscal year 2010, state and local taxes on business comprised only 3.3% of private sector economic activity (gross state product, GSP), compared to the national average of 5.0%.[5] And this finding has been consistent: COST has placed Connecticut at or near the bottom for the last seven years.[6]

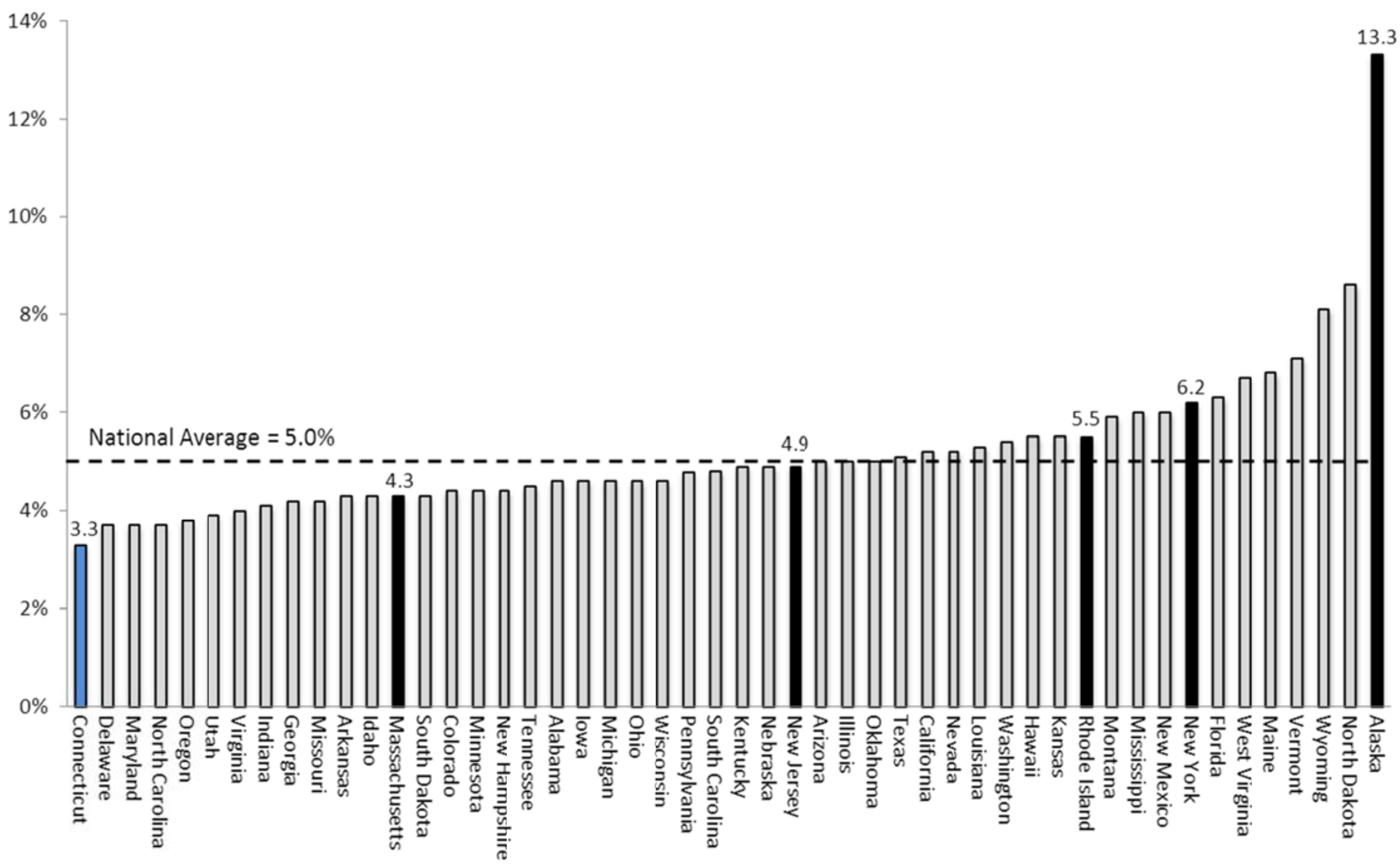
New Haven Office: 33 Whitney Ave. • New Haven CT 06510 • Phone: 203.498.4240 • Fax: 203.498.4242 | **Web Site:** www.ctkidslink.org
Hartford Office: 53 Oak St. Suite 15 • Hartford CT 06106 • Phone: 860.548.1661 • Fax: 860.548.1783 | **E-mail:** voices@ctkidslink.org

As in years past, Ernst & Young conducted this study for COST, creating a measure of what businesses actually pay in taxes, rather than relying on statutory rates, which are peppered with loopholes and difficult to compare across states. The Ernst & Young metric is also comprehensive, including not just the corporation business tax, but the other taxes that fall on businesses as well: property taxes on business property; general sales taxes on business inputs; unemployment insurance taxes; business and corporate license fees; public utility taxes; personal income taxes on pass-through business income; excise taxes; insurance premium taxes; and other miscellaneous taxes.[7]

This broad sweep is crucial, since most state and local taxation of businesses does not occur through the corporation business tax (CBT). In Connecticut, the CBT generates just 7.3% of business tax revenues. Property taxes constitute 33.5%, followed by sales taxes (22.3%), excise and gross receipts taxes (12.3%), unemployment insurance taxes (9.3%), license fees (4.4%), and personal income taxes on the income of pass-through entities (10.8%).[8]

Despite this broad sweep, the COST figures only tell the story of the *average* Connecticut business. Whether our business taxes are optimally distributed is a separate question—does our tax structure, for instance, favor big, mature businesses over fast-growing young companies? Or, does it especially burden new investment? The incidence of our business taxes is a crucial issue, and one that the state should monitor more closely. In the interim, however, the big picture is clear: no state taxes businesses less than Connecticut.

Figure 1. State and Local Business Taxes as Share of Private Sector Economic Activity, FY 2010



B. Good Jobs First

According to a new report by Good Jobs First on states' accountability procedures for corporate subsidies,[9] Connecticut ranks poorly, at 36th in the Nation. Good Jobs First scored the 50 states and District of Columbia on the extent to which they hold subsidy recipients accountable for creating "good" jobs: most of the scoring rubric focused on requirements for adequate healthcare benefits, market-based wages, and other aspects of quality employment. Thirty-five states had stronger requirements than Connecticut.[10]

Good Jobs First's state rankings do not break down on traditional conservative-liberal lines, however. Some of the highest scoring states are conservative: Tennessee, Oklahoma, and North Carolina are all in the ten best, while California, Massachusetts, and New York fall among the ten worst. Some of the fastest growing state economies (e.g., Texas, Virginia) have stricter requirements than Connecticut.[11]

Good Jobs First's report underlines a key point about corporate subsidies: while creating jobs is good, creating quality jobs is better. Particularly in Connecticut with our high cost of living, it is crucial the jobs we create allow workers to afford housing, education, and healthcare and contribute to the economy by shopping at local stores and consuming local services. Every dollar spent on subsidies has a cost: it could go, for instance, to paying down our looming long-term debts. For a subsidy to be worthwhile, it must be better than just leaving the dollars be.

C. Institute on Taxation and Economic Policy and Citizens for Tax Justice (ITEP/CTJ)

According to a new report by ITEP and CTJ on tax behavior among America's 500 largest businesses,[12] some of the Nation's greatest tax avoiders hail from Connecticut. General Electric, for instance, paid no state corporate income taxes in 2010 (and enjoyed a negative 45.3% federal tax rate from 2008-2010[13]), while Travelers paid none in 2009. Over 2008 to 2010, both companies paid less than 1% in state corporate income taxes.[14]

Since corporations do not tend to break out tax payments for each state, ITEP/CTJ reported the 50-state tax rates for companies, rather than the individual-state tax rates. Nonetheless, in light of a legislative report several years ago that at least half of the state's corporations pay only the minimum tax of $250,[15] it seems many Connecticut companies bring their tax avoidance skills to bear against our state as they do others.

ITEP and CTJ based their analysis on companies' annual reports and 10-K's, looking only at Fortune 500 companies that had been profitable from 2008-2010 (as the corporate income tax is levied on profits). For the 265 profitable Fortune 500 companies that fully disclosed state income taxes, they divided current state income taxes by domestic pre-tax profits to determine the effective state income tax rate.[16]

In the main, this report raises serious issues of tax fairness and efficiency: similarly situated companies should not owe different taxes simply because one has cleverer tax attorneys. Not only is it unfair, it is economically inefficient. Imagine if, instead of hiring 975 tax mavens,[17] General Electric hired 975 top-flight scientists and engineers to invent better products. Presumably, the inventers would provide more value to our country.

Much of companies like GE's tax avoidance stems from their optimization, even manipulation, of corporate tax credits and loopholes. More rigorous transparency and accountability for tax expenditures, coupled with elimination of wasteful credits, would reduce the potential for avoidance. So too would instituting mandatory combined reporting and the throwback rule, two rules that many other states use to close corporate tax loopholes—rules in fact, that ITEP and CTJ's recent report suggested for Connecticut.

[1] Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2010*, July 2011, available at http://www.cost.org/StateTaxLibrary.aspx?id=17768.
[2] Calculated by dividing business-paid state taxes by total state taxes. *Id.*
[3] COST is "a nonprofit trade association consisting of over 600 multistate corporations engaged in interstate and international business. […] COST was formed in 1969 by a handful of companies under the aegis of [the] Council of State Chambers of Commerce, […] precipitated by the need of corporate taxpayers to be represented by a united voice on state tax issues." Council on State Taxation, *About COST*, available at http://www.cost.org/AboutCost.aspx. Among COST's members are Aetna, CIGNA, General Electric, Pitney Bowes, and United Technologies Corporation. Council on State Taxation, *Council on State Taxation Company Membership*, January 2010, available from the Oregon Center for Public Policy at www.ocpp.org/2010/COSTcompany_list20100126.pdf.
[4] COST reports average figures: some companies may pay more; others may pay less.
[5] Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2010*, July 2011.
[6] Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2009*, and the same reports for FY 2004-2008.
[7] Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2010.
[8] *Id.*
[9] Good Jobs First is "a national policy resource center for grassroots groups and public officials, promoting corporate and government accountability in economic development and smart growth for working families." Good Jobs First, *About Us,* available at http://www.goodjobsfirst.org/about-us.
[10] Philip Mattera, Thomas Cafcas, Leigh McIlvaine, Andrew Seifter, and Kasia Tarczynska, *Money for Something: Job Creation and Job Quality Standards in State Economic Development Subsidy Programs,* Good Jobs First, December 2011, available at http://www.goodjobsfirst.org/moneyforsomething.
[11] *Id.*
[12] Founded in 1980, ITEP is "a non-profit, non-partisan research organization that works on federal, state, and local tax policy issues. ITEP's mission is to ensure that elected officials, the media, and the general public have access to accurate, timely, and straightforward information that allows them to understand the effects of current and proposed tax policies." Institute on Taxation and Economic Policy, *Background and History*, available at http://itepnet.org/about/about.php. ITEP's sister organization CTJ, founded in 1979, is "a 501 (c)(4) public interest research and advocacy organization focusing on federal, state and local tax policies and their impact upon our nation. CTJ's mission is to give ordinary people a greater voice in the development of tax laws." Citizens for Tax Justice, *Background and History*, available at http://www.ctj.org/about/background.php.
[13]Robert McIntyre, Matthew Gardner, Rebecca Wilkins, and Richard Phillips, *Corporate Taxpayers and Corporate Tax Dodgers,* Citizens for Tax Justice / Institute on Taxation and Economic Policy, November 2011, available at http://itepnet.org/policy_briefs/multistate_reports.php.
[14] Citizens for Tax Justice / Institute on Taxation and Economic Policy, *Corporate Tax Dodging in the Fifty States, 2008-2010,* December 2011, available at http://ctj.org/ctjreports/2011/12/corporate_tax_dodging_in_the_fifty_states_2008-2010.php.
[15] Legislative Program Review and Investigations Committee, Connecticut General Assembly, *Connecticut's Tax System*, January 2006, available at http://www.cga.ct.gov/pri/2005.asp.
[16] Corporate Tax Dodging in the Fifty States, 2008-2010.
[17] David Kocieniewski, "G.E.'s Strategies Let It Avoid Taxes Altogether," *New York Times*, March 24, 2011, available at http://www.nytimes.com/2011/03/25/business/economy/25tax.html?pagewanted=all.