Putting Connecticut into Context

Presented to the
Institute for Municipal and Regional Policy
Sponsored by
Central Connecticut State University

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CURRENT TAX STRUCTURE
Sales and Income Taxes Dominate State Revenues

Percentage Distribution of U.S. Tax Collections, 2003

- General sales: 33.8%
- Individual Income: 33.3%
- Selective Sales: 16.0%
- Corporate: 8.1%
- Licenses: 3.7%
- Other: 3.4%
- Property: 1.8%
Tax Structures Differ Significantly

State Individual Income Taxes as a Percent of Total Taxes, 2003

Less than 33.3% --16--
33.3% to 40.0% --15--
Greater than 40% --12--
Not Levied --7--

U.S. = 33.3%
CT = 38.3%
Tax Structures Differ Significantly
state General Sales Taxes as a Percent of Total Taxes, 2003

U.S. = 33.8%
CT = 32.2%
State Sales Tax Bases Differ Widely
Base as percent of personal income, 2002

Greater than 50%
40% to 50%
Less than 40%
No sales tax

--11--
--20--
--14--
--5--
Connecticut Tax Collections 2003

- General sales: 32.2%
- Selective Sales: 18.1%
- Individual Income: 38.3%
- Corporate: 4.9%
- Licenses: 2.8%
- Other: 3.7%
- Property: 0.0%
Total State and Local Taxes as a Percent of Personal Income, NE States, 2002

U.S. and CT = 10.4%
(US Rank)
Total State Taxes as a Percent of Personal Income, NE States, 2003

U.S. = 6.2%
CT = 6.5%
State Taxes as a Percent of Total Taxes (State + Local), Northeast States 2002

U.S. = 54.9%
CT = 61.9%
GROWTH OF REVENUES
State Tax Revenues as a Share of Personal Income

- **US Average**
- **Connecticut**

Graph showing the percentage of state tax revenues as a share of personal income from 1988 to 2003.
2001 to 2003 was Unique for State Revenues Revenue Growth Rates
Only the CT Personal Income Tax has Grown Faster, 1992-2003

Compound Annual Growth, 92-03

- Income
- Sales
- Total
- Corporate

US  CT
Revenue Growth has Improved Dramatically

Growth in Total Tax Collections, July to March 2003 and 2004

- U.S. = 6.8%
- Less than 6.8% --28--
- 6.8% to 9.0% --11--
- Greater than 9.0% --11--
Personal Income Tax Growth
Growth in Personal Income Tax Collections, July to March 2003 and 2004

U.S. = 7.1%

- NA --9--
- Less than 4.0% --16--
- 4.0% to 7.1% --16--
- Greater than 7.1% --9--
KEY STATE TAX ISSUES
Federal Legislation Continues to Affect State Options

Ongoing State Policy Issues
- Internet Tax Freedom Act
- Streamlined Sales Tax Project
- Business Activity Tax

Recent Issues
- 6th Circuit (Ohio) – Tax Incentives
SALES AND CORPORATE TAX BASE EROSION
State Corporate Tax Bases Also Eroding

Corporate Profits Tax as a Percent of Corporate Profits
Eroding Corporate Income Tax Base

- **Federal Base**
- **Legislated Decisions**
  - Tax concessions
  - Weighting the sales factor for apportionment
  - Voluntary combined reporting
- **Tax Planning**
P.L. 86-272

- Federal law that prohibits a state from taxing the profits of a corporation if that entity's only activity in the state is to make sales (i.e. sets the minimum nexus standard for income tax).
- Sales are often not taxed in the home state because the sales are sitused to the sales state.
- Therefore, if a corporation has no property or payroll in a state, the sales to that state are generally untaxed.
ABC Incorporated and Subsidiaries [Revised March 11, 2002]
## Well-Known Companies Using the PIC Strategy

<table>
<thead>
<tr>
<th>Aaron Rents</th>
<th>Con Agra Foods</th>
<th>Kohl’s</th>
<th>Stanley Works</th>
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<tr>
<td>Burger King</td>
<td>Gap</td>
<td>The Limited</td>
<td>Staples</td>
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<td>Circuit City</td>
<td>Home Depot</td>
<td>Radio Shack</td>
<td>Toys “R” Us</td>
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<tr>
<td>Comp USA</td>
<td>Kmart</td>
<td>Sherwin-Williams</td>
<td>Tyson Foods</td>
</tr>
</tbody>
</table>

Source: WSJ 8/9/02
State Responses to Corporate Base Erosion

- **Interstate Tax Planning**
  - Combined Reporting - 15 states
  - Addback for royalty payments TN, MA, CT
  - Argue nexus – Geoffrey & SC
  - Argue that lack of economic substance – MD

- **Pass-through firms such as LLCs**
  - Impose entity level tax
  - Align tax structures

- **Throwback Rules?**
Sales Tax Bases Are Narrowing

Base as Percent of Personal Income, 1988-2003
Eroding Sales Tax Base

- Growing remote transactions
- New technologies
- Legislated exemptions
- Changing purchasing patterns
- Tax planning
E-Commerce Continues to Reduce State and Local Tax Revenue

Source: Donald Bruce and William F. Fox
# Changes in Consumption Patterns Reduce Sales Tax Revenues

<table>
<thead>
<tr>
<th></th>
<th>1979 Percent</th>
<th>2002 Percent</th>
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<tbody>
<tr>
<td>Total Expenditure</td>
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<td>Durable Goods</td>
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<td>Autos</td>
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<td>Furn &amp; Household</td>
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<td>Other Durables</td>
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<tr>
<td>Nondurable Goods</td>
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<tr>
<td>Food and Beverage</td>
<td>39.1</td>
<td>29.0</td>
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<td>Services</td>
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<td></td>
<td>47.4</td>
<td>59.1</td>
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State Responses to Sales Tax Base Erosion

- Streamlined Sales Tax Project
- Broaden the base to carefully selected services
- Avoid concessions and exemptions
- Raise Tax Rates