Tax Credits

Because of Connecticut's high costs for wages, health care benefits, and energy, tax credits and other incentives that help reduce business costs are essential to the state's tax structure.

As policymakers look for solutions to the state's fiscal crisis, it's important to understand how good tax policy drives state revenues by expanding economic activity and establishing the predictability that instills business confidence.

Predictability is the key factor in an effective tax credit system. The kind of activities tax credits are designed to incent in Connecticut—capital investment, research and development, job creation, investment in urban areas, and many others—require long-range planning. No company is going to invest resources in, say, planning a new research and development facility in the state if there is doubt about whether the R & D tax credit will be available. When lawmakers constantly tinker with tax credits or threaten to limit their use, they undermine the system's predictability and make it impossible for companies to rely on it, which could have an adverse impact on a company's financial statement and stock price.

> These credits provide incentives to companies to invest in Connecticut. These incentives work. A limit or moratorium on these credits will hurt the very companies that invest in the buildings, equipment, and people of our state.
>
> **Hank Teskey,** director of taxes, Electric Boat Corp., Groton

Policy-driven

Tax credits are policy-driven—designed to encourage certain business activities viewed as valuable to the state by policymakers. Businesses can't take advantage of tax credits unless they stay in the state and engage in whatever activity the credits are designed to incent.

Consequently, suspending the use of tax credits, capping the amount of credits that can be claimed, or otherwise limiting their use will result in less (or no) activity in the areas policymakers had intended to bolster.

> We have accrued tax credits that will help us survive the current downturn. Losing those credits would cripple us going forward.
>
> **Kate Hampford Donahue,** president, Hampford Research Inc., Stratford

Tax credits generate revenue

Tax credits have catalyzed the kind of business activity that produces millions of dollars in tax revenue for the state every year. Curtailing the use of credits in the interest of short-term revenue gains would effectively eliminate a major source of long-term revenue for the state. Businesses would simply choose not to locate or expand here— or they would move to states with more favorable growth incentives. The end result would be an uncompetitive Connecticut and a significantly less robust tax base as investment and jobs flowed to other states. Given current economic conditions, many states would welcome the opportunity to siphon off business activity and tax revenue from Connecticut.

> Stripping business of incentives would negatively impact research and development, slow Connecticut's economic recovery, and do nothing to keep good jobs in the state.
>
> **Jim O'Brien,** operations lead, Monsanto Mystic Research Center, Mystic

For more information, contact CBIA's Bonnie Stewart at 860-244-1925 or bonnie.stewart@cbia.com.

Good Tax Policy Drives State Revenues

Much talk at the Capitol has focused on so-called "tax expenditures" and their impact on state revenues in Connecticut. As policymakers look for solutions to the state's fiscal crisis, it's important to understand how good tax policy drives, not deprives, state revenues.

Without a strategic tax policy—including prudent use of credits and exemptions—Connecticut would be a very different, and much poorer, place.

Connecticut used tax policy to help stimulate the growth of research and development cluster industries in the state, and good things happened–more R&D facilities were built and more jobs created—and the state gained additional revenues.

When Connecticut used tax policy to help ignite the state's "FIRE" (financial insurance and real estate) cluster, more good things happened—companies and jobs stayed here, others moved in—and the state gained additional revenues.

And when state tax policy was used to help manufacturers, the state became more competitive for jobs, keeping many companies here and encouraging new, cutting-edge businesses to start.

Take away those basic tax policy decisions to grow our economy and Connecticut would have much fewer jobs, a much weaker economy and much less in tax revenue.

Without the strategic use of tax policy, many of the businesses and industries we're depending on to grow us out of the recovery would have left the state years ago.

Tax policy with a vision understands the reality that businesses are now competing not just with those in our neighboring states, but in a vast new global marketplace.

And it's the kind of focus that has directly promoted areas that can grow and lift Connecticut's economy again.

Now, as the state grapples with how to grow its way out of the recession, one part of the solution should be obvious: Stay with the strategies that work—both for the results they bring and the stability they demonstrate to the business community.

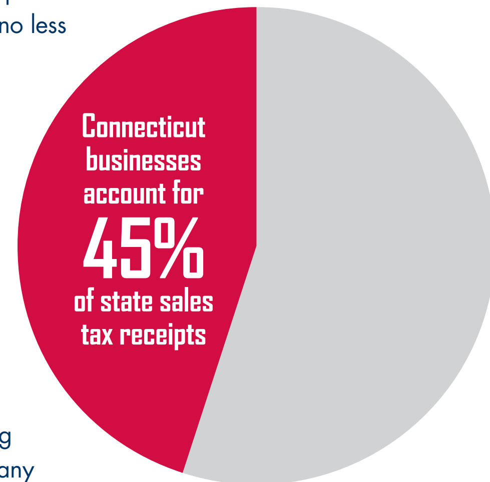
This Government Affairs Report supplement describes how tax credits and exemptions work to keep Connecticut's economy competitive.

CBIA encourages policymakers to look at the whole picture of tax policy before making decisions that could in fact deprive the state of the revenue it needs.

For more information, contact CBIA's Bonnie Stewart at 860-244-1925 or bonnie.stewart@cbia.com.

Sales and Use Taxes

As consumers themselves, Connecticut businesses already account for nearly half of all the state's sales tax receipts. So, an across-the-board sales tax increase would be no less onerous to businesses than it would be to individuals.



More troubling to Connecticut employers and damaging to the state's economy, however, are structural changes in our tax system that discourage capital investment, business expansion, and job creation.

One such change now being considered would extend the state sales tax to all professional and business services. Such services include legal, advertising, accounting, and investment advisory services.

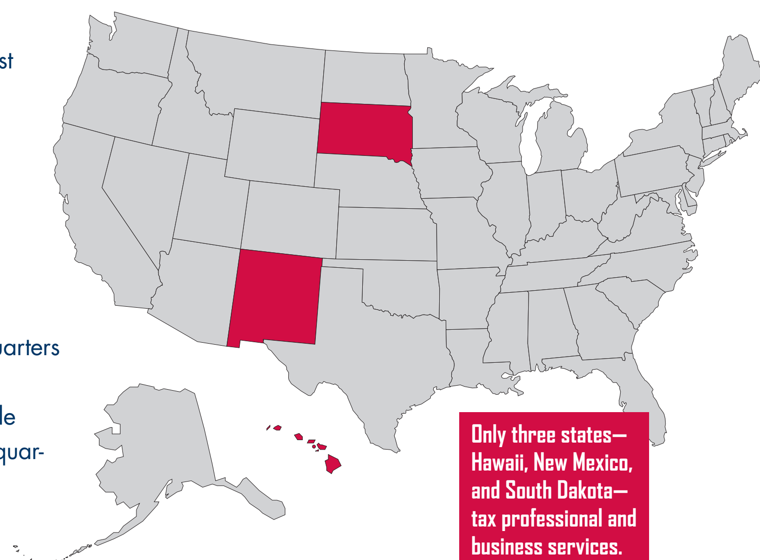
Another change would eliminate exemptions to the state's sales tax, including exemptions for business inputs, resulting in multiple taxation. (Business inputs are items that a company purchases for its own use in producing a final product or operating its business. These include manufacturing machinery, equipment, raw materials, tools, and fuel.)

Both of those changes would seriously hinder Connecticut's ability to compete with other states for business and investment.

Extension of the sales tax to all professional and business services

Connecticut already taxes business and professional services more broadly than almost any other state in the country. Expanding this tax will have an immediate negative impact on companies here—costing many of them millions of dollars a year—and will instantly make Connecticut an undesirable business location relative to most other states.

Extending the sales tax to professional and business services especially penalizes headquarters companies in Connecticut by taxing services entirely in Connecticut that may benefit multiple locations. For example, if a corporation headquartered in Connecticut hired an accountant in New York City to consult with the company, the corporation would be required to pay Connecticut sales tax on that service.



Only three states—Hawaii, New Mexico, and South Dakota—tax professional and business services.

Elimination of sales tax exemptions

Virtually every state that wants to keep manufacturing jobs exempts machinery, equipment, and other business inputs from sales tax. In Connecticut, as in other states, such exemptions are policy-driven, put in place along industry clusters to spur growth in certain areas, such as aerospace and biopharmaceutical. Eliminating exemptions, therefore, affects not just one or two companies but entire industries, causing monumental tax increases, more business shutdowns, and more job losses.

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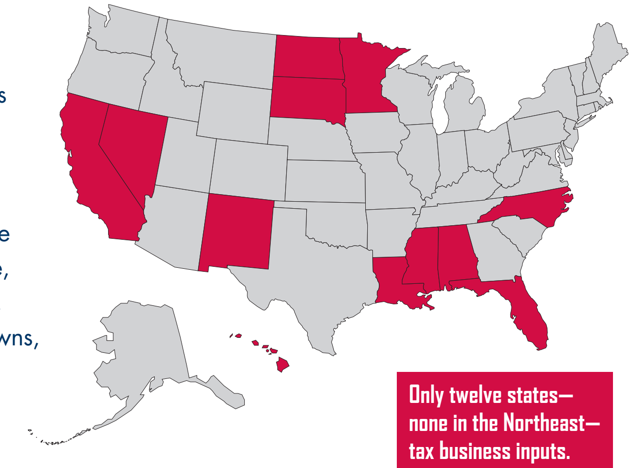
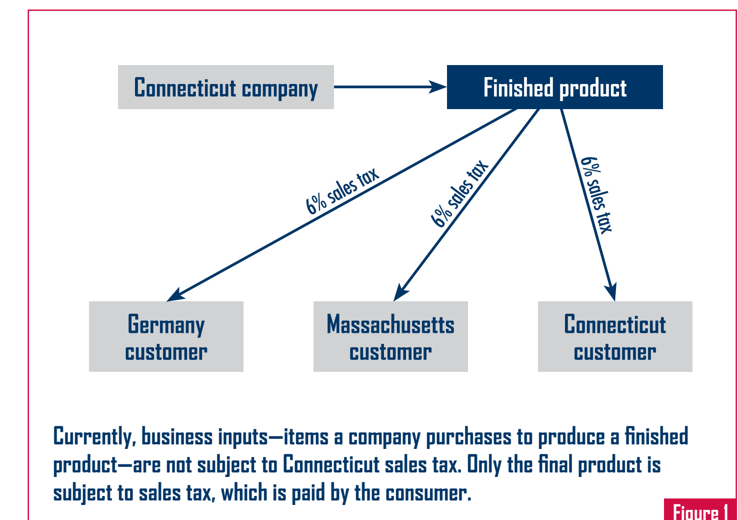


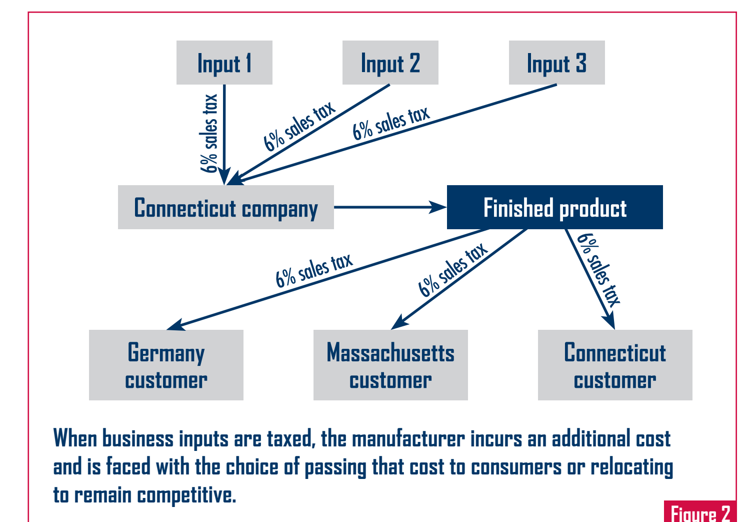
Only twelve states—none in the Northeast—tax business inputs.

> A sales tax on business inputs violates several tax policy principles—economic growth, equity, simplicity, and efficiency—and causes a number of economic distortions. Notably, these distortions result from pyramiding, where a tax is imposed at multiple levels [for example, along a supply chain], such that the effective tax rate exceeds the retail sales tax rate. Companies are forced to either pass these increased costs on to consumers or reduce their economic activity in the state in order to remain competitive with other producers who do not bear the burden of such taxes.
>
> **Joseph R. Crosby**, COO & Senior Director, Policy, Council on State Taxation



Currently, business inputs—items a company purchases to produce a finished product—are not subject to Connecticut sales tax. Only the final product is subject to sales tax, which is paid by the consumer.

Figure 1



When business inputs are taxed, the manufacturer incurs an additional cost and is faced with the choice of passing that cost to consumers or relocating to remain competitive.

Figure 2