CBIA CONNECTICUT BUSINESS & INDUSTRY ASSOCIATION

TESTIMONY OF
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BEFORE THE
GOVERNOR'S BUSINESS TAX POLICY REVIEW TASK FORCE
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Good afternoon. My name is John Rathgeber and I'm the president and CEO of CBIA. I would like to thank the Governor for putting this group together and thank the task force members for inviting me to share our thoughts on business tax policy here in Connecticut.

I think the threshold question for this task force is, how can we best align our tax policy with the state's economic goals? In other words, how can we encourage the types of investments we want that will create wealth, grow our economy and help create good, stable, high-paying jobs?

The state of Connecticut must focus on economic-base industries – those that export goods and services beyond our borders, import wealth to the state, and create the underpinnings of a strong local economy. These economic-base industries can encompass many different types of entities, even not-for-profits. Yale University, for example, creates the type of economic activity that can help grow an economy. Regarding for-profit businesses, it does not matter if you are a large or small company, whether you are a C corporation or a pass-through entity. What does matter is that you are not just trading the same dollar between different companies but that you are growing the economic pie by exporting product and importing wealth.

We are blessed with many world-class businesses in key economic-base industries such as advanced manufacturing, insurance, financial services, biopharmaceutical and other types of Research &Development. Governor Malloy is correct in his efforts to make strategic investments in these industries and, more importantly, to encourage private sector investment in Connecticut. True economic growth comes from investors – whether they are large, midsize or small businesses or single entrepreneurs – having confidence that they can invest their dollars in our state and make a reasonable return on their investments.

The focal point of our tax policy must be on how that policy relates to those types of entities that we are trying to retain and grow in Connecticut or to relocate to the state.

Not every type of company can be successful here. We are a high-cost state – our labor, energy and healthcare costs are among the highest in the country. To be successful in Connecticut you have to be a high value-added, highly productive company that can export products and services at a competitive price point.

One of the keys to having companies successful is a competitive tax structure. It is somewhat difficult to determine exactly what makes a competitive tax system because there are some any variables. I have three tax studies with me today, all done by the same accounting firm. One shows Connecticut's business taxes a being low when compared to gross state product. Another puts us in the middle of the states when measured by the services businesses get for their tax dollars. The last shows us more expensive than most states when looking at the tax burden on new investments. So we should consider a variety of factors in determining competitiveness, not just a single study.

When companies are looking to make investment decisions, among other things they look at costs, the predictability and stability of tax policy, the timeliness of decisions on contested matters, and the complexity of compliance with tax laws and regulations. These are all areas where Connecticut can do a better job so those people who are making investment decisions have confidence that they will be subject to fair, understandable and competitive taxes.

We do have some positive things in our tax code that do align with an economic strategy that encourages investments by economic-base industries. I'm somewhat reluctant to talk about them because others will characterize them as loopholes and work to eliminate them. But because we have a diversity of economic-base industries, if we do things right we can have a great future. We just have to re-energize our economy and give confidence to decision-makers that Connecticut is the right place to invest and grow.

Some of these positives include the apportionment rules under our corporate tax for manufacturers and financial service firms. The rules actually incent people to invest and put payroll in Connecticut, while putting more of the burden on companies that sell into the state but do not have significant investments here. We should, however, have apportionment rules that are similar for C corporations and pass-through entities.

We also have some good tax credits – R&D, electronic data processing, fixed capital and digital animation among them. In addition, we attempt to treat manufacturing favorably under our sales and use tax but unfortunately our laws are antiquated and often not reflective of manufacturing in the 21st Century.

However, we also have some negatives. I think the biggest single negative is that although we have started to do some things right, I'm not sure we have the fortitude to continue to do them right down the road. The largest challenge is the unfunded liabilities of the state. Decision makers will not have confidence that our tax structure won't change significantly if we don't address the dark cloud of unfunded liabilities on the horizon.

Will we continue to move forward with GAAP accounting? Will we continue to lean government operations? Will we address our unfunded liabilities? Are we going to make the right fiscal decisions to avoid significant tax increases in the future? These are questions that have to be answered in the affirmative if we are going to maintain a competitive tax policy.

Another negative is the annual call by some people for a complete review and overhaul of our tax structure. This works against the predictability that is such an important factor in having a good tax system. We saw this several years ago when the state reduced the value of tax credits after companies had made the necessary investments to qualify for the credits. That change harmed Connecticut's reputation quite a bit.

There are changes we can adopt to make the state more competitive. One is in the treatment of pass-through entities to ensure they are on a level playing field. Another is the modernization and improvement of the sales and use tax as applied to manufacturers. Commissioner Smith is leading an effort of the National Governors Association on advanced manufacturing here in Connecticut. I have attached some specific examples of what we can do to modernize our tax code for this critical industry.

Finally, we have to analyze the costs of changes to tax policy in a more dynamic fashion so we recognize the economic impacts as well as the costs. And the debate in the legislature has to be about how both sides can win instead of if one side wins, the other loses.

Thank you for the opportunity to present this testimony.

ATTACHMENT

1. Make the 50% Manufacturing Recovery Act exemption a 100% exemption. Remove the distinction between property used "directly" in manufacturing, which is 100% exempt, and property used "indirectly" in manufacturing, which under the MRA is only 50% exempt. Modern manufacturing is an integrated process, and so-called indirect activities, such as research and development, and the manufacture and repair of tools and tooling, should not be disfavored under the tax system.

2. Recognize that a manufacturing plant need not be used primarily for manufacturing. If manufacturing is taking place in a mixed use facility, manufacturing activities in that portion of the facility should still qualify for the exemptions available to manufacturers, regardless of how else the remaining facility is used.

3. Exempt the acquisition of technology. All computer equipment and software used by a manufacturer, other than for office or administrative functions, should be exempt to encourage investment in the technology needed to compete.

4. Clarify that the installation of a product by a manufacturer does not negate otherwise qualified manufacturing status. The General Assembly specifically clarified that asphalt manufacturers are considered manufacturers, notwithstanding that they install the product they manufacture. This concept should extend to all manufacturers.

5. Exempt the repair of property used in manufacturing. The purchase of new property used in manufacturing long has been exempt. It does not make sense to create a disincentive to repair property by subjecting it to tax.

6. Clarify that the production of prototypes constitutes manufacturing, even if the prototype is not ultimately sold. The development of prototypes is a valuable economic activity in and of itself, and a necessary precursor to manufacturing, and should be exempt.