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Growing From Zero

By Ken Girardin with
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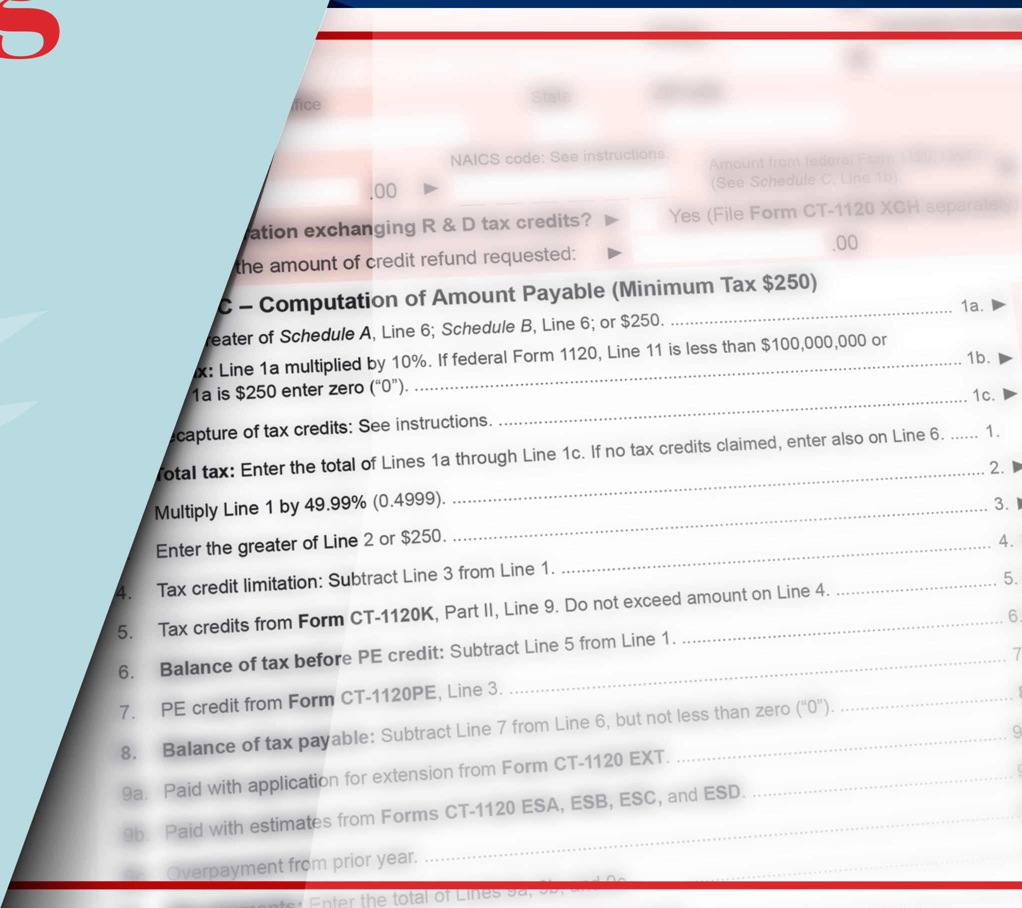

YANKEE INSTITUTE
For Public Policy

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Executive Summary

Connecticut missed out on much of a decade-long national economic expansion. The state added essentially zero private-sector jobs between 2017 and 2019, its population was essentially flat during the decade, and it has hemorrhaged corporate headquarters and major employers.

The post-COVID era presents both a threat and an opportunity for Connecticut's fraught jobs situation.

Employers are re-evaluating their physical office needs as professionals have shifted, many permanently, to working remotely. As leases expire, Connecticut risks bearing an outsized share of cuts to both office space and jobs as multistate employers face the same policies from Hartford that suppressed growth here in the leadup to the pandemic. On the other hand, this reshuffling event gives us the chance to snag more nimble operations, and jobs, from neighboring states and beyond—if state officials make it worth employers' while.

But this will require a major departure from Hartford's current approach of gifting tax credits, grants, and loans to preferred companies without improving the overall business climate. Instead, Connecticut should pursue transformative policy change that benefits new and existing businesses uniformly—and sends a powerful signal that we're open for business. There is no better target than the corporation business tax (CBT), the state's 7.5 percent assessment on corporate income (revenues after expenses).

The CBT is a relic from a time before Connecticut had even a general sales tax. The first version of the tax was enacted in 1915 to capture a portion of "corporate excess" and shift the tax burden away from property taxes, on which state operations were partially supported.
In the century since, academic research has shown that corporate income taxes are a greater hindrance to job creation than personal income, sales, or property taxes. Countries, other states, and even Connecticut itself has moved away from the CBT in recent decades. What's worse, the CBT has morphed over time to benefit companies that could cajole the General Assembly to give them tax credits and exemptions. Now riddled with credits, the state collects only about 84 percent of the intended revenue as favored corporations can slice their liability by up to half. And the pool of accrued credits is now more than the state hopes to collect in the next two years.

Connecticut can and should repeal the CBT because:

- CBT rate cuts in the late 1990s created jobs at a lower cost per job than many of the state's existing job-creation subsidy programs.
- It's designed to confer special benefits on larger corporations, leaving smaller businesses paying a higher effective rate. What's more, the state has already exempted some businesses entirely.
- Repealing the CBT would be worth more to Connecticut's private sector than it would cost state coffers, since it would end not only each company's bottom-line liability but also what are routine overpayments and considerable compliance costs. Administering the tax, which involves determining the extent to which business activity is taking place in Connecticut, is increasingly impractical in the global economy.
- Corporate income tax hikes in New York and New Jersey have widened the potential benefit for relocating to Connecticut under a zero-CBT regime.
- Rekindling Connecticut's population growth will help offset the lost revenue from repealing the CBT. Merely matching the Northeast growth rate over the past 30 years would have pushed state personal income and sales tax receipts almost half a billion dollars higher during 2020.

The CBT brings in only about 5 percent of Connecticut's general fund tax receipts, averaging $834 million over the past five years. By comparison, the just-adopted state budget put nearly $1 billion into the state's already-brimming rainy day fund during fiscal 2022 and nearly $800 million more in fiscal 2023.

The state can further finance CBT repeal by eliminating grants, loans, and sales, and income tax incentives used for economic development, some of which have already been identified by state agencies as costing taxpayers more than they generate. State accounting practices don't give a reliable read of the total cost of economic development programs, but a partial state accounting indicates $1.4 billion in state "investments" under management—which likely would have translated into more private-sector jobs had funds instead been used to reduce or eliminate the CBT.

Most importantly, CBT repeal would send an invaluable signal to the country and the world that Connecticut is open for business and draw new taxpayers and taxable sales—and most importantly, jobs.

Connecticut politicians have for decades framed the state as a victim of economic circumstances, from the end of the Cold War defense buildup to globalization to Wall Street volatility. The result has been an outmigration of people and capital, and stagnation for those left behind.

Hartford must instead navigate the landscape proactively and capitalize on changing circumstances instead of blaming them. Reform won't be easy. State officials will have to give up their ability to reward specific activities through the tax code. At a time when Connecticut has a jobs problem, not a revenue problem, repealing the corporation business tax offers a proven and equitable way to get Connecticut working again.

Background: Sick And Getting Sicker

Connecticut's economy entered the SARS-CoV-2 pandemic with a severe pre-existing condition.

The Connecticut economy did not keep pace with, let alone exceed, national private-sector job creation in any six-month period between January 2011 and the beginning of the pandemic in early 2020. (figure 1)

If Connecticut had only kept pace with the national rate during the prior decade, there would have been nearly 13 percent more private-sector jobs in February 2020. Put another way, the state would have had 186,800 more private-sector jobs.

And the state's employment picture was essentially flat from early 2017 until the beginning of the pandemic—meaning the state went almost three years (figure 2) with virtually zero private-sector job creation.

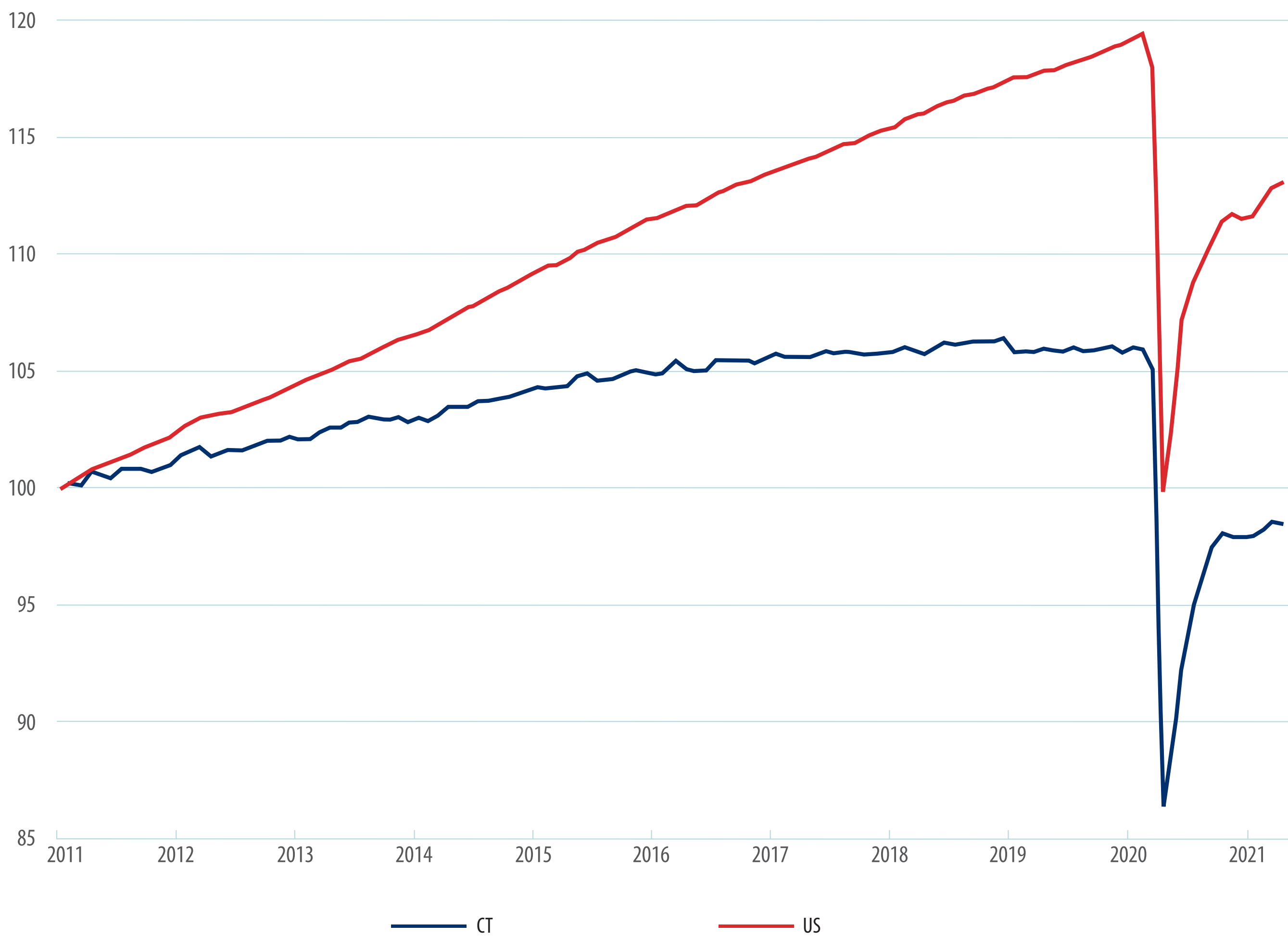
The same factors that smothered job creation ahead of the 2020 lockdowns remain today, causing Connecticut to also lag in regaining its COVID-related job losses.

Looking at the drop in employment from February to April 2020, Connecticut has recovered 62 percent of the lost jobs, compared to 67 percent nationally.[1] Between poor pre-COVID job growth, and a slow if not stalled recovery, Connecticut's economy in April 2021 had fewer private-sector jobs than at any point since the first half of 2010, while the US economy as a whole had recovered to mid-2016 levels.

If Connecticut's recovery continues at the rate it has averaged since last fall, the state is unlikely to return to pre-COVID private-sector employment before 2024. Connecticut's total wages and salaries have also lagged its neighbors significantly, growing at less than half the pace of Massachusetts since 2011.[2] (figure 3)

Figure 1

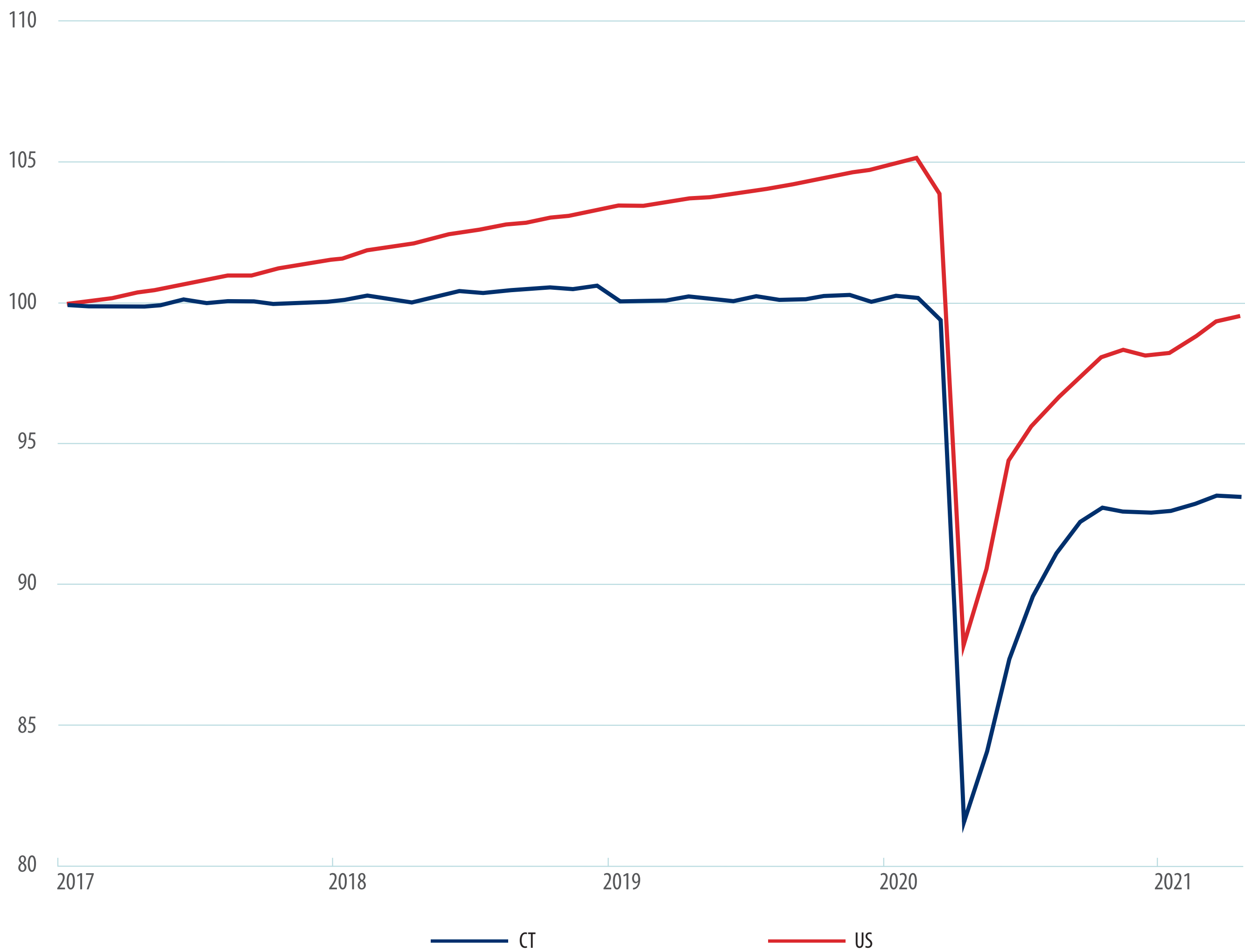
Private-Sector Jobs - US and CT (January 2011 Level = 100)



Source: US Bureau of Labor Statistics, CT Department of Labor

Figure 2

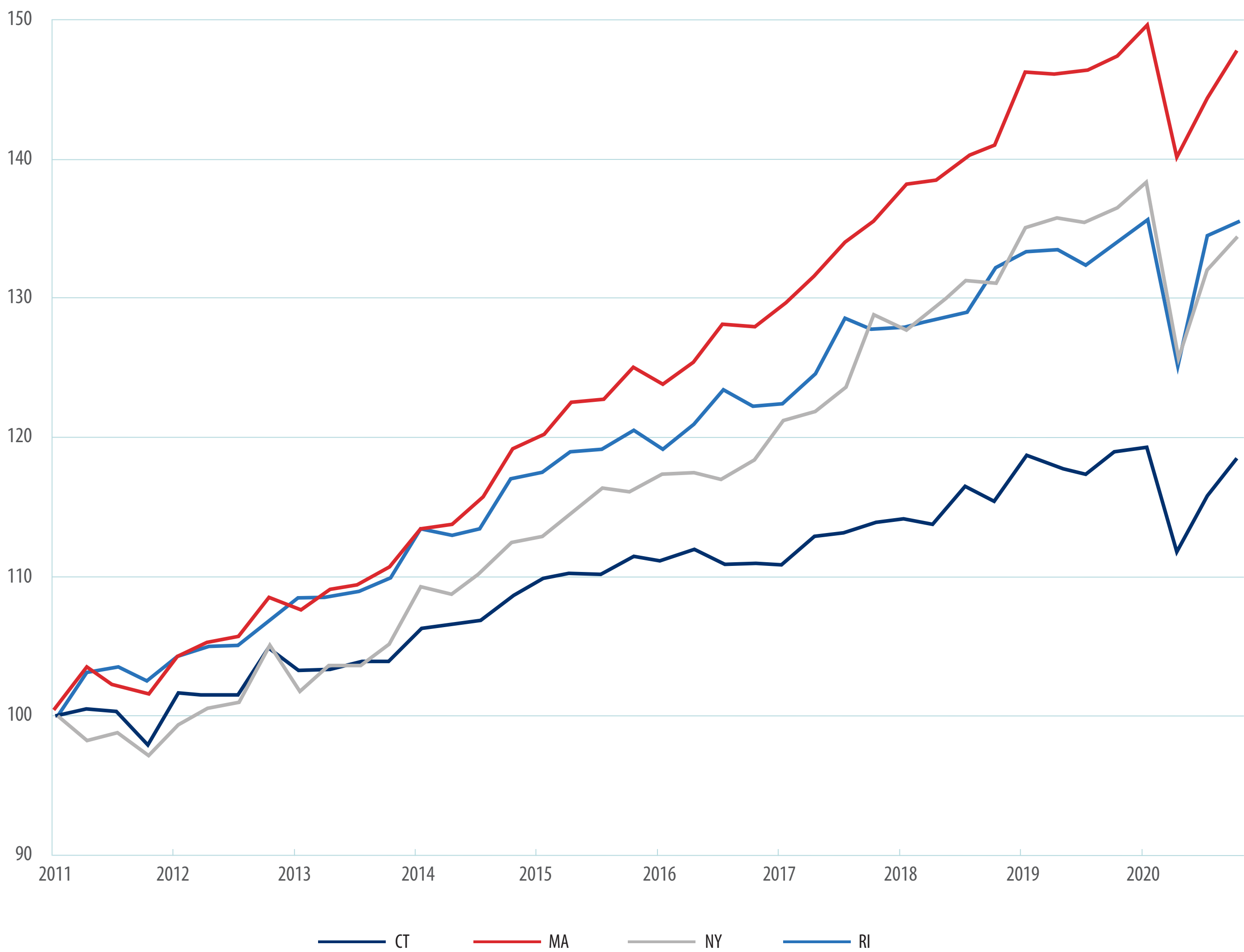
Private-Sector Jobs - US and CT (January 2017 Level = 100)



Source: US Bureau of Labor Statistics, CT Department of Labor

Figure 3

Total Wages & Salaries - CT and its Neighbors (2011 Q1 = 100)



Source: U.S. Bureau of Economic Analysis via Federal Reserve Bank of St. Louis

Connecticut's weak job and pay numbers come after a decades-long diaspora of corporate headquarters and research labs departing the state. A partial list follows:

- United Technologies merged with Raytheon Corporation in 2019, shifting its headquarters to Boston.[3]
- Pfizer, which had about 5,000 Connecticut employees [4] in 2009, has only about half as many here today.[5]
- Bristol-Myers Squibb closed its Wallingford site, which had about 1,300 employees just six years ago.[6]
- Aetna was purchased by Rhode Island-based CVS. An agreement with state regulators to preserve about 5,300 jobs in Connecticut expires in late November 2022.[7]
- General Electric in 2015 warned it would "seriously consider whether it makes any sense to continue to be located in this state" as Hartford contemplated and ultimately implemented another round of tax increases.[8] Seven months later, the company announced its 800-employee global headquarters were decamping from Fairfield for Boston.[9]

In 1985, 24 Fortune 500 companies were based in Fairfield County, the greatest concentration after only New York City (69) and Chicago (27).[10]

Today there are just 14 listed companies in the entire state of Connecticut, down from 22 in 1996.[11]

There are several other warning signs coming from the state economy.

- Employment in the higher-paying financial activities sector has sunk to under 120,000 jobs, its lowest point in at least 30 years.[12]
- The 2020 census found Connecticut's population grew less than 1 percent in the last decade, compared to 4.1 percent growth across the entire Northeast.[13] Connecticut has 121,100 fewer residents than it would have had if it had only kept up with the region's average growth rate over the past 30 years.
- Massachusetts is poised to overtake Connecticut as the wealthiest state, as measured by U.S. Bureau of Labor Statistics per-capita personal income levels, by 2022.
- Connecticut has fewer residents and households with earnings over $2 million than it did before the Great Recession.[14]
- Office vacancy rates in Hartford, its suburbs, and Fairfield County remain above 2019 levels, with Fairfield hitting nearly 25 percent in 2021 Q1.[15]

No single factor or policy is responsible. Connecticut's private sector faces a range of self-inflicted disadvantages:

- Commercial and industrial electricity users pay some of the highest rates in the continental US, thanks in part to state surcharges and mandates.[16]
- Three rounds of state personal income tax hikes between 2009 and 2015 pushed the top rate from 5 percent to 6.99 percent.
- Connecticut employers paid 0.76 percent of payroll toward unemployment insurance in 2019, compared to 0.47 percent nationally.[17]
- Our workers' compensation insurance premiums are the country's sixth-highest.[18]
- The minimum wage—set to hit $13 in August—will be more than 79 percent above the federal minimum, which sets the wage floor in states as near as Pennsylvania and New Hampshire.[19] The wage is scheduled to reach $15 in 2023.

By the same token, no single "silver bullet" policy change can reverse all these drawbacks. Cultivating a better business climate will require careful scrutiny of every tax, regulation, and other obstacle constructed by Hartford—and the political will to change it. But state officials should be looking for those policies that both make it easier to operate here and signal that Connecticut is serious about improving its business climate.

The Great COVID Shuffle

Although Connecticut can't immediately reverse the effects of decades of bad policy, it can take advantage of changing circumstances in the global economy to improve its fortunes going forward.

The pandemic prompted American businesses to make a massive shift toward remote work from which many operations may never return.

- Two of Connecticut's largest employers have already announced plans to reduce their physical footprints. Raytheon Corporation, which merged with United Technologies, plans to shed 8 million square feet of office space, about 25 percent of its total.[20] CVS, which merged with Hartford-based Aetna, plans to reduce 30 percent of its total office space.[21]
- Nationally, many white-collar employees have worked remotely for over a year, and a sizable share hope to continue permanently.[22]
- Initialized Capital, a San Francisco venture capital firm, reported 42 percent of company founders said a remote or distributed operation would be the "most beneficial place" to found their company today, up from 6 percent in 2020.[23]

These footprint and behavior changes will determine how many jobs with national and global corporations remain in Connecticut. It represents a serious threat, especially to the state's downtowns.

Fortunately, Connecticut is not experiencing this in a vacuum. Businesses everywhere are making the same re-evaluations about their space needs as leases come up for renewal in coming years.

This reshuffling means Connecticut can either lose out to other states seeking to consolidate in more favorable business climates—or make a calculated effort to come out ahead.

A Matter Of Place

Connecticut hasn't owed its historical prosperity to a particular natural advantage. It doesn't have abundant hydroelectric potential or natural gas reserves or mineral deposits. It isn't a major destination for tourists or international commerce.

Instead, the state for generations has benefited from having an attractive business climate. For more than a half-century after neighboring Massachusetts and New York adopted personal income taxes, Connecticut had none.[24] Connecticut was, as former state Senator L. Scott Frantz termed it, "the Switzerland of the Northeast."[25]

Some of Connecticut's prosperity, of course, has stemmed from circumstances outside Hartford's control. Federal defense spending toward the end of the Cold War, for one thing, boosted employment and tax revenues. And what's arguably the state's greatest asset isn't even within its borders. The City of New York, the seat of global finance, lies within commuting distance of the southwest Connecticut suburbs. Connecticut's economy has long benefited from the city's financial output and demographic churn. The state's comparative safety, lack of a state income tax, and lower density drew workers and wealth for a considerable part of the 20th century.

That trend waned in recent years as urban crime dipped and younger people flocked to cities, but as the COVID-driven diaspora from New York City has shown, plenty of people are still eager to make Connecticut their home.

But will they make it their headquarters? As corporate offices departed the state over the past decade, the *Hartford Courant* editorial page offered a grim moniker for Connecticut—"the strong presence state," reflecting the phrase often used in such departures to describe employees who would sometimes remain.[26]

Other states offer examples for Connecticut to follow if it hopes to capitalize on the momentary mobility of American businesses.

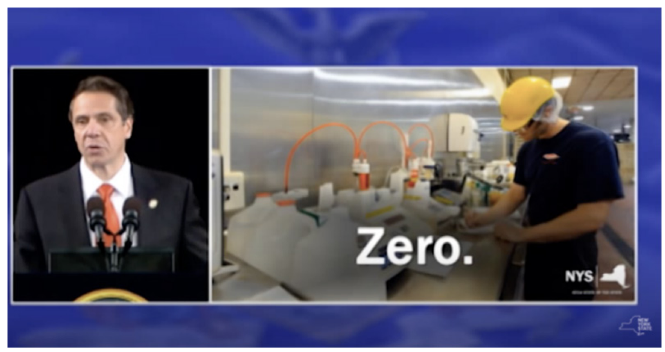
Delaware became a haven for financial corporations due to its corporate income tax structure and its dispute-resolution mechanisms. Officials in the Granite State, meanwhile, defend what they've come to call "the New Hampshire Advantage." The term, coined by former New Hampshire Governor (and Connecticut native) Steve Merrill, is a reference to New Hampshire levying neither a personal income tax or a general sales tax and having New England's lowest per-capita tax burden.[27]

Connecticut has the potential to make itself competitive again and escape the economic doldrums.

And Connecticut can take a visible and meaningful step: it can stop taxing corporate income—because for many of its businesses, it already has.

New York Governor Andrew Cuomo in 2014 summarized the benefits of such a move as he proposed exempting certain manufacturers from the Empire State's tax on corporate income.

"Let's cut the corporate tax in upstate New York to zero," Cuomo said. "Why? Because you cannot beat zero my friends, and it is a competition."[28]



Source: YouTube

CT'S CBT: An Overview

In addition to paying the federal corporate income tax, any C corporation "carrying on or doing business" in Connecticut must also pay the state's corporation business tax, or CBT.

All but two states—South Dakota and Wyoming—tax the gross or net income of business operations.[29]

Connecticut's CBT is assessed on three bases. Businesses must pay the greatest between:

- 7.5 percent of corporate income, essentially its revenues less ordinary expenses and other deductions;
- 0.31 percent tax of their capital base (the average value of the company's stock, certain cash holdings, and other capital); or
- a $250 minimum tax.

In 2018 (the most recent year for which data have been published), 32,105 businesses paid the CBT (table 1). Nearly half (15,271) paid the minimum tax.

Table 1

Tax Due Before Credits	Number of Returns	Tax Due Before Tax Credits	Business Tax Credits	Tax Due After Business Tax Credits
Exempt	3,864	$0	$0	$0
$250 or less	16,259	$4,054,595	$0	$4,054,595
$251 to $999	5,239	$2,910,091	$77,721	$2,832,370
$1,000 to $24,999	8,250	$45,495,247	$2,677,172	$42,818,075
$25,000 to $49,999	789	$28,248,411	$2,437,532	$25,810,879
$50,000 to $99,999	550	$38,740,254	$3,161,787	$35,578,467
$100,000 to $249,999	463	$73,514,083	$6,832,741	$66,681,342
$250,000 to $499,999	229	$80,051,362	$9,260,851	$70,790,511
$500,000 to $999,999	157	$108,518,871	$12,062,790	$96,456,081
$1M to $2M	91	$117,835,385	$15,439,039	$102,396,346
$2M to $5M	53	$166,288,069	$31,452,834	$134,835,235
$5M+	25	$265,010,479	$63,824,211	$201,186,268
	35,969	**$930,666,847**	**$147,226,678**	**$783,440,169**

Source: CT Dept. of Revenue Services FY20 Annual Report

For a company doing business in multiple states, their CBT bill is generally based on the share of sales occurring in Connecticut.

Businesses that show their Connecticut operation lost money in a year can deduct that net operating loss from their income over the next 20 years and can apply it to reduce their net income by as much as half in a year.

Businesses can also reduce their liability by up to half through tax credits. (Until recently filers could use them to slice as much as 70 percent off their bills.)[30] By 2018, businesses had accrued for future use almost $2.9 billion in credits—more than triple what Connecticut collects from the CBT annually.[31]

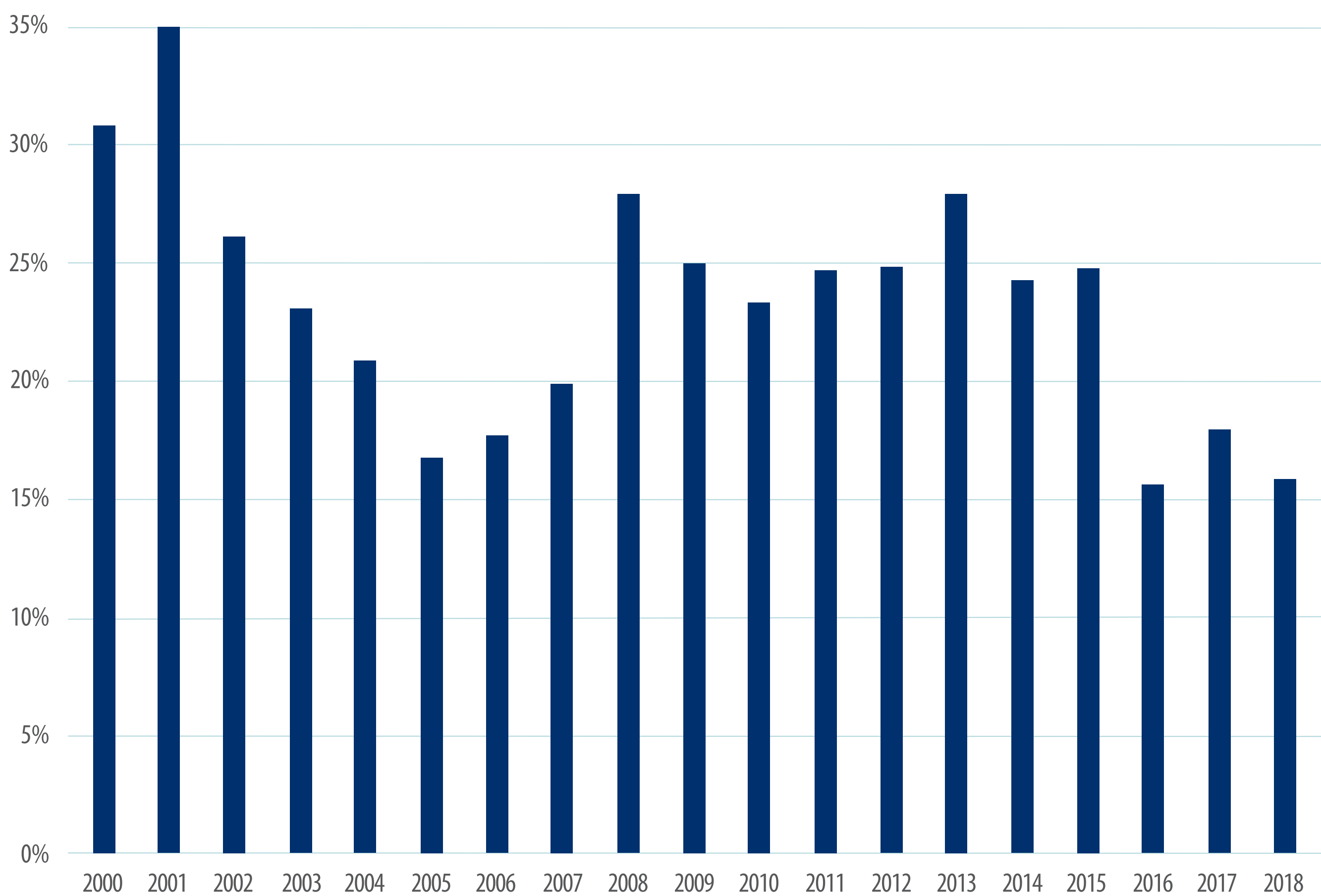
Connecticut in 2018 credited $147 million off a pre-credit liability of $931 million. Close to half went toward one of two purposes: fixed capital investments, for which the state credit is worth 5 percent, and research and development expenditures (R&D), on which the state gives 20 percent.[32]

In the case of R&D, the state lets those businesses accrue and then claim credits for the spending over a 15-year period, and lets them collect cash instead of credits at a discounted rate of 65 cents on the dollar.[33]

The CBT has been distorted, especially in recent decades, as governors and the General Assembly have used it to reward specific business activities and to entice companies to remain in Connecticut. But it began as a much simpler proposition.

Figure 4

Percentage of CBT Liability Credited



Source: US Bureau of Labor Statistics, CT Department of Labor

Farms Versus Factories

Connecticut's corporation business tax originated the same way its personal income would more than 75 years later: state government had spent too much money and officials in Hartford needed to plug a gap.

The General Assembly had years earlier levied targeted taxes on railroads, insurance companies, and certain utilities. The budget swelled as revenues flooded in, and over the course of a decade beginning around 1907, the state budget nearly tripled. But this spending left state officials facing a deficit in 1915 of about $250 million in today's dollars. And corporate tax advocates, who had been pushing since 1909 to put an assessment on "miscellaneous corporations," saw their opportunity.

The legislative hearings at which proposed corporate income taxes were reviewed pitted factory owners against farmers.

Among those arguing for the tax were the leadership of the Connecticut State Grange, which represented thousands of farmers. For Grangers, a tax on corporate profits was desirable because state government was partially financed with a "state tax," an assessment on each town and city that was passed on to landowners in the form of higher property taxes. And under this arrangement, the state's manufacturers were sometimes portrayed as paying less than their fair share.

"There is no excess of farmers' property," one granger argued in a March 1915 hearing. "This tax, therefore, is to apply to tax upon property not now taxed. The farmer doesn't ask and wouldn't favor any inequality of taxation, does not favor it as applied to himself or ask it for corporations, he simply askes that the burden of this revenue should be fairly distributed and he thinks this corporation excess will come nearer to more fairly distributing the burden."[34]

The manufacturers pointed out that the pressure to create a new tax had come from the state's overspending. They were joined by former House speaker and senator Michael Kenealy of Stamford:

> *The truth of the matter is this - a few years ago owing to the general prosperity of the state and the corporations, we were in the position of receiving more money than we had use for. A few years ago anyone could come up here and get an appropriation for his town which was not needed. I know what I am speaking about. We were so lavish with the money we were allowed to spend it went largely perhaps into things that were not required.*[35]

Horace B. Cheney, the silk manufacturer from Manchester, argued that a tax on corporate profits would be too narrow:

> *[M]oney that comes out of a corporation seems like finding money, whereas if the tax is fixed to some degree upon everybody, everybody will be interested in how it is spent.*

The General Assembly went on to adopt a 2 percent tax on "corporate excess." The tax neared its current form with the adoption of the Corporation Business Tax of 1935.

The CBT became a preferred tool for governors and lawmakers in budget crunches in the following decades.

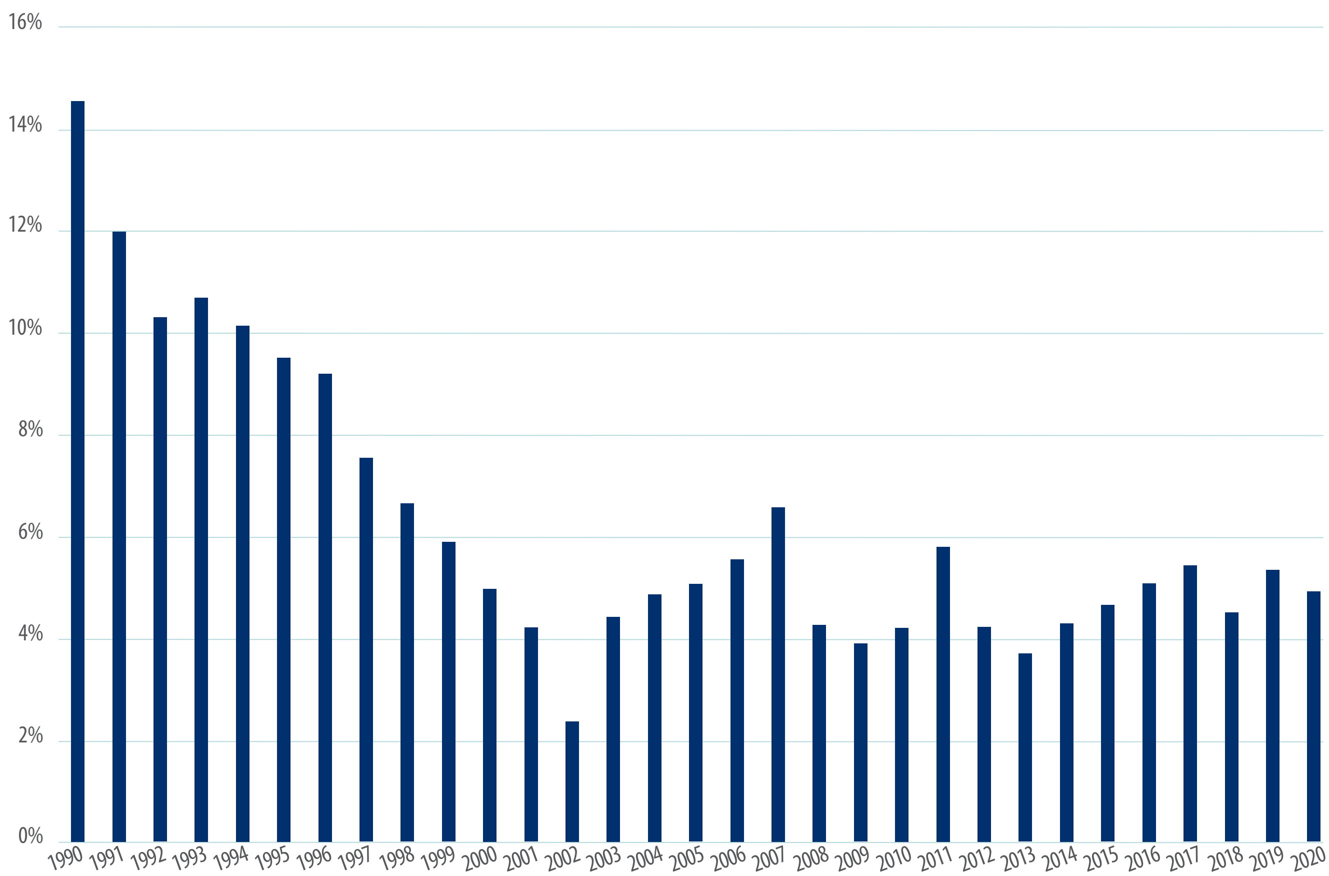
Governor Ella Grasso hiked the CBT income tax rate from 8 percent to 10 percent in 1976 as the state grappled with a deficit, in part to uphold her pledge to never impose a state income tax. The rate was again increased, to 11.5 percent in 1983, by Grasso's successor, Governor Bill O'Neill—who had made the same commitment.

These rates may seem high, but at the time, the federal corporate income tax rate was 46 percent. Since state tax payments are deductible from federal corporate income tax bills, it meant the federal government was indirectly picking up almost half of state tax bills.

Connecticut's reliance on the CBT peaked at the end of the 1980s, as the economy slowed and the state grappled with deficits after a years-long spending binge. In fiscal 1990, the CBT made up just over 14 percent of receipts after O'Neill and the General Assembly added surcharges that brought the effective rate to 13.8 percent.

Figure 5

CBT as Percent of General Fund Tax Revenues



CT Office of the State Comptroller

"The Limitless Well"

Connecticut in many ways is already on the path to repealing the CBT. The rates have been lowered; credits have further reduced liabilities. And for some businesses, they've been exempted entirely.

Policymakers in Hartford have long recognized the CBT's deleterious effects on growth.

Governor Lowell Weicker in 1991 pointed to the CBT, then the country's highest effective rate at almost 14 percent, as part of the justification for imposing a personal income tax.

"I want business to get a very clear signal from Connecticut's tax policies: We want you here," Weicker told the General Assembly. "We need you here. And you are no longer the limitless well to which everybody turned when new revenue was needed."[36]

The surtax was removed for tax year 1993, bringing the tax back to a permanent-law rate of 11.5 percent.

The General Assembly trimmed it again in 1993, setting it to 11.25 percent for tax year 1995 and scaling down to 10 percent by 1998.[37]

In 1995, Governor John Rowland proposed further cutting the tax, to 8 percent.

The *Hartford Courant* editorial page described the rate cuts as "the most effective way to encourage job-producing companies to expand in or to move to Connecticut."[38]

Later that year, the governor and the General Assembly agreed to cuts that incrementally trimmed the CBT's income tax rate further, to 7.5 percent, in 2000.[39]

It's worth noting that the CBT rate cuts in the late 1990s helped wean the state from a highly volatile revenue source. When the economy fell into recession a few years later, CBT revenues fell by more than half from fiscal 2000 to fiscal 2002, and Hartford would have faced far larger budget gaps had it remained as dependent on CBT revenues.

Of course the state has gone back to the well in tough times.

In 2003, a surtax was added that hiked tax bills by 20 percent in 2003, 25 percent in 2004, and 20 percent in 2006. The surtax was again applied in 2009, this time for 10 percent on businesses with gross incomes of at least $100 million.[40] The surtax rose to 20 percent in 2011 and it remained until 2018, when it fell to 10 percent, where it remains today in tax year 2021.

Connecticut also took steps in 2015 to change how certain businesses calculated their corporation business tax bills, or as Governor Dannel Malloy put it, to "close a loophole in the corporation tax which has allowed some of Connecticut's largest businesses to pay little or no taxes while benefiting from the services and infrastructure provided by Connecticut taxpayers."

Beginning in tax year 2016, the state required businesses with common ownership and engaged in a "unitary business" to file a single tax return that considered, among other things, the income of businesses that otherwise weren't subject to the corporation business tax. In many cases, the change increased the group's total tax liability, so much so that the General Assembly later capped at $2.5 million how much a group's tax bills could rise under the new formula.

In 2015, fewer than 400 unitary returns were filed. That number jumped to more than 4,600 unitary returns the next year.

But Connecticut has made several especially noteworthy reductions or exemptions.

First, Connecticut in tax year 1997 began phasing out the CBT for S corporations, so-called "passthrough entities," and by tax year 2001 eliminated their liability entirely.[41] (A separate $250 "business entity tax" was eliminated later.)[42] Profits are instead treated as ordinary income.

In 2000, the General Assembly changed the way broadcasters were taxed specifically to encourage sports network ESPN to make a planned $500 million investment in its Bristol facility. The move saved ESPN an estimated $15 million annually.[43]

The state is currently phasing out the "capital base" calculation under provisions adopted in 2019 at the insistence of General Assembly.[44] The CBT's capital base formula means businesses that aren't operating profitably, such as startups, get taxed on their cash holdings and other property, reducing their ability to become profitable in the future. This calculation was due to end after tax year 2023, but was postponed until 2024 in the state budget adopted this spring. Some businesses, such as real estate investment trusts and regulated investment companies, were already exempted from the capital base formula.

But perhaps most notably, the state has exempted entire subsectors of the economy from the CBT, including:[45]

- domestic insurance companies, since their products are separately taxed;
- foreign insurance companies, to avoid retaliation;
- certain turbine manufacturers;
- certain alternate energy systems companies; and
- non-US corporations "whose sole activity in state is the trading of stocks, commodities and securities."[46]

For these last three categories, this reflects an explicit acknowledgment that it is better to forgo taxing profits entirely if it means having more people living and working in Connecticut—paying income taxes and sales taxes.

This tradeoff should be applied across the entire state economy.

Why CT's CBT Should Be Repealed

David Brunori, professor at The George Washington University Law School, recently summarized the political inertia which lets state corporate income taxes persist:

> ***That corporate income taxes have long been among the most complicated and controversial levies it is surprising how little policy debate occurs. Few political leaders can, or are willing to, discuss fundamental questions such as whether the state corporate tax is effective, who ultimately pays the tax, and whether the tax advances any economic or tax policy goals. Policy leaders can articulate the reasons—and in particular the benefits—of taxing personal income, sales, and property. They can discuss the reasons for imposing excise and severance taxes. Yet, identifying the benefits of taxing corporate income is difficult to discern in public policy discussions.***[47]

The strongest argument for preserving the CBT is likely that out-of-staters may invest in Connecticut, hire people, and realize profits here without themselves paying personal income taxes on earnings taken as dividends. In such a worst-case scenario, Connecticut would "only" realize tax revenues from the workers paying personal income tax on their earnings, and the corporation itself would pay property taxes and sales taxes. But the opportunity to tax the resultant profits would be lost.

A Corporate Income Tax Is A Destructive Tax

Groundbreaking research by the Organisation for Economic Co-operation and Development (OECD) in 2008 examined decades of economic and tax data across developed nations, finding corporate income taxes "appear to have a particularly negative impact on GDP per capita" when compared to property, consumption, and even personal income taxes.[48]

The same paper showed that reducing the proportion of government that came from taxing corporate income had a greater positive effect on economic growth than making the same reduction to the personal income tax.

Among the 36 OECD nations, the unweighted average of members' combined statutory corporate income tax rates slid from 32.2 percent to 23.3 percent between 2000 and 2020.[49] A similar drop was observed among G-20 members, going from 34.7 percent to 26.9 percent during the period.

The United States during this period dropped its federal rate from 35 percent to 21 percent with the 2017 Tax Cuts and Jobs Act. And the average statutory tax rate on $100,000 in corporate income levied by US states slid from an unweighted average of 7.37 percent in 2004 to 6.80 percent in 2018.[50]

North Carolina has undertaken a particularly bold approach among the states, bringing its corporate income tax rate down from 6.9 percent in 2013 to 2.5 percent since 2019.[51] Lawmakers have since introduced a plan to phase the tax out entirely by 2028.[52] A 2019 study estimated the state was on pace to add 82,000 jobs over a decade as a result of the initial rate cut, and that eliminating the tax would lead to another 43,000.[53]

The benefit of a lower corporate income tax rate has been on display in Ireland. *The Economist* in 1988 described Ireland as "poorest of the rich" as it discussed how the island nation lagged its continental peers on everything from per-capita GDP to its public debt burden.[54] "Radical tax reform," the magazine's editors wrote, "is essential for Ireland's future growth."[55] What followed was nothing short of radical: in the mid-1990s Dublin slashed its corporate income tax rate from 36 percent to just 12.5 percent, below most other Western economies.[56] While the nation benefited from a number of other outside factors, the corporate rate cuts played a key role in the country's explosive growth over the following decade. Most notably, total employment exploded, rising 21 percent from 1997 to 2000 as foreign corporations and capital flooded in.[57]

For Connecticut, a comprehensive rethinking of state tax policy and its effect on the economy is long overdue. A 2015 legislative task force reviewed the CBT and suggested technical changes but did not question the underlying premise behind taxing corporate income.[58]

Yankee Institute in 2020 identified 200 taxes and fees that together brought in about $50 million or 0.22 percent of state revenue. State tax commissioner Mark Boughton recently acknowledged "we have taxes that actually cost us more to collect than we get in return so we want to eliminate those."[59]

Eliminating those smaller taxes would not be transformative. But their continued existence are a testament to the haphazard nature of Connecticut's tax policies and the lack of scrutiny that's allowed the CBT to endure.

Repeal Is A Less Expensive Way To Create Jobs

Connecticut missed out on much of a decade-long national economic expansion but it wasn't for want of trying.

The state heaped loans, grants, tax credits, and other incentives on preferred businesses in hopes of dislodging Connecticut from its economic doldrums—while squeezing profitable businesses harder with additional corporate income taxes.

Connecticut state government has, for more than a generation, tried to counter the poor business climate with targeted incentives. As the state's lack of job creation during 2017, 2018, and 2019 showed, the current approach has failed to kickstart the state economy. And it wasn't for want of spending.

A complete accounting does not exist of the taxpayer dollars that have been dolloped on businesses over the past decade. One state data exhibit shows that, on top of tax credits and other abatements, the state dispensed almost $584 million in grants and forgiven loans alone for economic development purposes between 2010 and 2019.[60] The state Department of Economic and Community Development, on the other hand, reports more than $1.4 billion in "investments" under management.[61] Neither figure captures the full range of targeted tax breaks, abatements, and other costs, or the costs borne by taxpayers to borrow funds and to administer these programs.

The link between reductions in employer taxes and job creation, on the other hand, has been well established.

The Congressional Budget Office in 2010 estimated that each $1 million in employer-side payroll tax cuts would translate into 4 to 11 additional jobs between then and 2015.[62] From fiscal 2010 to 2015, Connecticut CBT receipts averaged $611 million. Using the CBO model as a first-order approximation, eliminating the CBT would have resulted in the creation of between 2,400 and 6,700 jobs by the end of the fifth year.

A 2005 study by UConn's Connecticut Center for Economic Analysis that looked specifically at Connecticut's CBT rate reductions between 1996 and 2000 found an even larger benefit. The cuts had led to an additional 5,956 private-sector jobs by 2002 (along with a smaller amount of foregone public employment).[63] The net reduction in tax revenue for that year was estimated at $21,407 per job (about $29,100 in 2021 dollars), declining in later years as more jobs were created.

The UConn study also noted that rate cuts had a greater impact on private-sector employment than the state's tax credits and exemptions designed for the same purpose. The 13 deals executed between 2011 and 2016 for Governor Malloy's "First Five Plus" job-creation program, by 2019 had created just 3,842 net new jobs at a total cost of $255 million in grants, loan forgiveness, and tax credits, or a one-time cost of $66,451 per job.[64] (Malloy meanwhile increased the CBT burden for the state's largest businesses, both by increasing the surtax on their liability and changing how it was calculated.)

A 2021 state-commissioned report highlighted the state's money-losing practice of subsidizing film and television producers, showing the program had a net loss of $680 million since 2010 to support about 3,500 jobs—a recurring cost of about $45,000 per job per year.[65]

It's worth noting that the state's economic development reporting has been repeatedly cited for its inaccurate or incomplete accounting of state subsidies.[66] This is a separate challenge for policymakers and another reason for the state to reevaluate its direct support for individual businesses.

CBT Costs Businesses More Than It Makes For CT

Eliminating the CBT would amount to an instant infusion of cash into the state economy—and more than it would cost state coffers.

That's because businesses must make quarterly payments which amount to zero-interest loans to the state. CBT refunds averaged $130 million between 2016 and 2020.

Businesses must meanwhile spend time and resources complying with the CBT.

Even after they've fulfilled federal tax requirements, businesses face additional work to meet Connecticut's different rules on matters ranging from geographic allocation of income to depreciation.

State corporate income tax compliance costs are poorly understood, and the CBT is no exception. But research in the 1990s found state taxes put a considerably larger compliance burden, as a function of how much they generate, on businesses compared to federal taxes.[67]

CBT Is Less Practical Than Ever

Long before technology weaved together global collaborators and COVID scattered workplaces, Connecticut has struggled with questions related to what exactly the CBT was taxing.

In 1937, New Britain-based Stanley Works sued over the state's efforts to tax dividends from its Canadian subsidiaries. The U.S. Supreme Court ruled for the company.

Spector Motor Service, a Missouri trucking company, fought Connecticut officials for a decade over the way its business income was linked to the state. The case by 1951 had worked its way to the U.S. Supreme Court, which sided with Spector.

A 2001 study by the Multistate Tax Commission estimated that 29 percent of would-be CBT revenue was being sheltered, either in other states or overseas.[68]

The explosion of remote work, independent contractors, and novel business models is poised to intensify the challenge facing businesses, which must make complicated apportionments, and state officials, who must verify them.

These calculations inevitably become political value judgements as one-size-fits-all formulae are developed by the General Assembly. But there will never be a "correct" approach—only the approach preferred by Hartford.

CBT Hits Smaller Businesses Harder

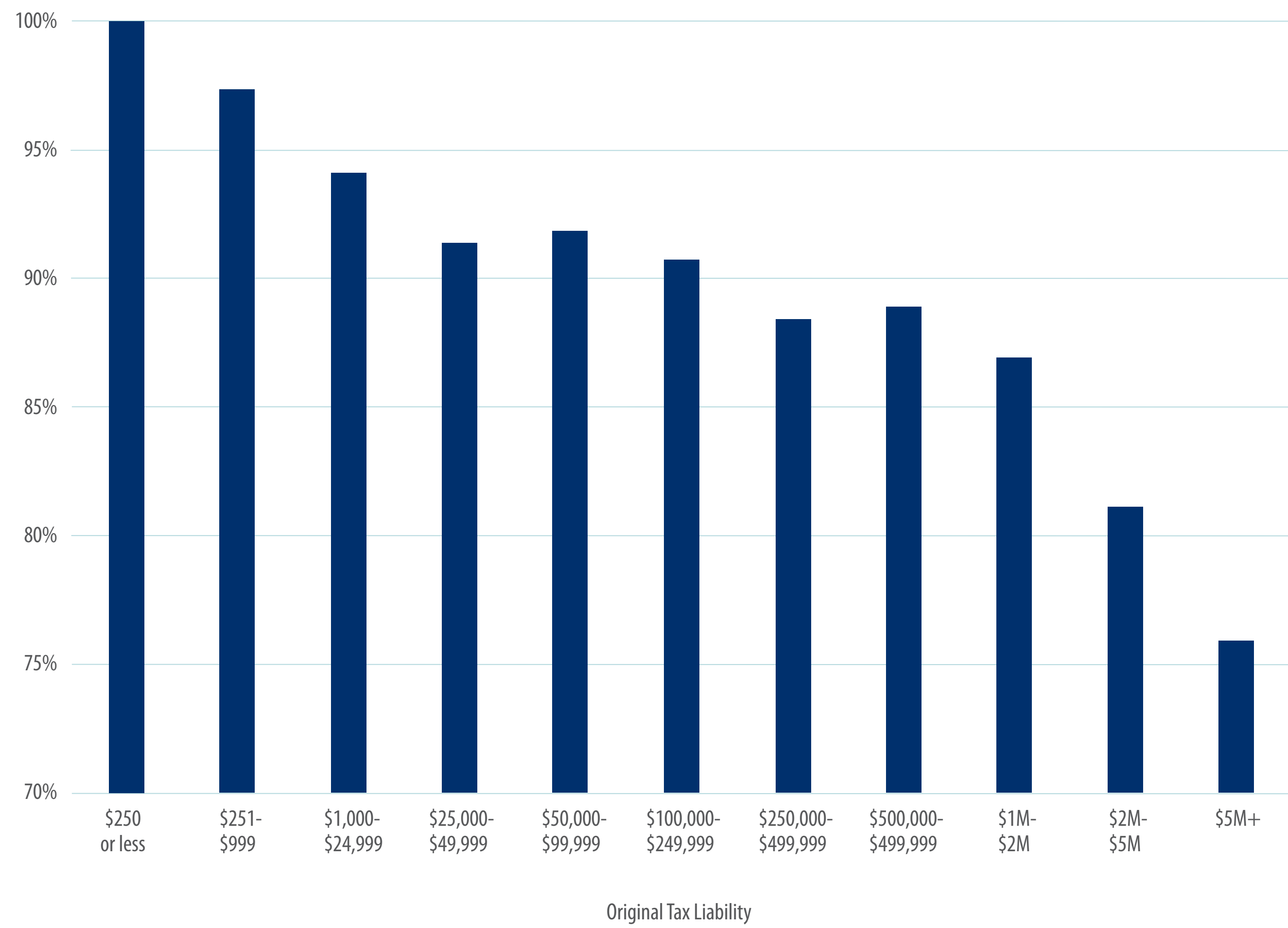
The CBT is a bigger problem for Connecticut's smaller businesses.

The larger the business, the more likely it is to benefit from the state's tax credit system. (figure 6)

Connecticut's largest CBT payers shaved off the largest portion of their liability in 2018 thanks to credits.

Figure 6

Percentage of Original Tax Liability (2018) Due After Credits



Source: CT Dept. of Revenue Services

Smaller firms are also less well-positioned to use accounting maneuvers to reduce their liability by, for instance, reporting a net operating loss.

General Electric, on the other hand, summarized the avenues available to large firms in its annual report:

> *Our global and diversified business portfolio gives us the opportunity to employ various prudent and feasible tax planning strategies to facilitate the recoverability of future deductions.*[69]

In 2018, a dozen businesses had their total CBT liability capped under rules that limited the extent to which the state's 2015 changes could hike their tax bills, meaning they together owed $56 million instead of approximately $96 million.[70] Among these unidentified 12, they shaved an average of 30 percent more off bills thanks to tax credits and ultimately paid $37 million.

Had it not been for these limits and credits, one or more companies likely would have left the state. But the extent to which their liabilities were slashed is an indictment of the CBT itself and the natural inequities that come about when trying to tax corporate income as opposed to consumption or personal income.

Besides paying a higher effective rate, smaller businesses face a greater compliance burden as a function of their size. A 2002 University of Michigan study that examined large and mid-size businesses found corporate income tax compliance costs were "clearly regressive in terms of company size."[71]

Repealing CBT Would Lower CT Energy Costs

Repealing the CBT would translate into lower energy costs because both electricity generators and state utilities pay the tax.

The savings could be recouped from utilities through regulatory proceedings such as those initiated after the 2017 federal corporate income tax rate cuts. Prices would be expected to drop slightly on the competitive wholesale electricity market, where plants are in competition to generate electricity at a cost low enough to win the ongoing auctions overseen by ISO New England.

It would also open the door for reducing the state's support for Millstone Nuclear Power Plant. The state's two main electric utilities, Eversource and United Illuminating, are required to purchase half or more of the plant's output at an above-market price.[72]

A 2003 study put Millstone's state tax bill—almost entirely CBT—at $4.7 million, meaning the mandatory power purchase agreements could be amended for a comparable amount, and the electric rates could be further reduced.[73]

Neighbors Are Making CBT Repeal Mean More

Much of Connecticut's success as a corporate destination in the late 20th century resulted as much from New York's policy choices as it did Connecticut's. And if the CBT is repealed, it can happen again.

The 2017 cuts to the federal corporate income tax rate, from 35 percent to 21 percent, instantly increased the potential savings from moving to lower-tax states, since businesses are now essentially paying 79 percent of their state tax bills instead of 65 percent.

The Empire State in March amended its similar corporate franchise tax (CFT), aiming a surcharge at businesses with incomes over $5 million that edged their rates up from 6.5 percent to 7.25 percent. New York also reversed the phaseout of its capital base tax, hiking the rate from 0.025 percent to 0.1875 percent—a 650 percent increase. This was a remarkable turn after Cuomo in 2014 said the base formula "discourages corporations from placing capital in the state" and called it a "disincentive for corporations to grow their businesses here."[74]

Many New York businesses were paying more to begin with. Businesses in the Hudson Valley, on Long Island, and in New York City pay a CFT surcharge (which increased to 30 percent in 2021) to fund the Metropolitan Transportation Authority (MTA). And businesses in New York City pay a separate local 8.85 percent tax on corporate income.

All told, businesses in New York City were already paying the country's highest marginal corporate income tax rate even before Albany's 2021 hikes.[75]

New Jersey has meanwhile boosted its top corporate income tax rate to 11.5 percent.[76]

Life After CBT

Failing to attract jobs and residents has come at a high cost. Connecticut over the past five years has averaged per-capita personal income and sales tax receipts of $3,702. If Connecticut had kept pace with the entire Northeast since 1990 and added an additional 121,100 residents, and had those people and their economic activity generated taxes at the same level, Connecticut would last year have collected about $448 million in additional sales and personal income tax revenues.

CBT repeal has a strong prospect of paying for itself and more in the long term as it helps reverse demographic and corporate migration trends.

In the interim, the immediate need for private-sector job growth would justify tighter controls on state spending to help finance it.

Mindful of what became known as "the Kansas experiment," where officials in 2012 bet on never-realized growth to offset reduced revenues, can Connecticut afford to eliminate the CBT without banking on substantial and immediate economic growth? The short answer is "yes."

The CBT makes up only about 5 percent of Connecticut's general fund tax receipts, averaging $834 Million over the past five years.

The biennial budget adopted in June 2021 puts $969 million in the state's budget reserve fund (BRF) in fiscal 2022 and almost $800 million in fiscal 2023, putting the fund well beyond its statutory target of 15 percent of general fund expenses.[77] A portion of state surpluses are pledged to the state's two primary public pension systems under a policy of reducing unfunded liabilities without enacting structural reforms.

A comprehensive turnaround of Connecticut's business climate would reduce the perceived need to spend generally on "economic development."

At the agency level, the Lamont administration expects to spend about $16 million annually on the state's Department of Economic Community Development each year of the next fiscal biennium.

But the bulk of Connecticut's efforts to boost the economy have come in the form of grants, loans, and other direct assistance to preferred businesses. State lawmakers can and should finance CBT repeal by eliminating not only these but also the categorical sales tax breaks, personal income tax credits, and other provisions in the tax code designed to benefit specific industries.

The state's record in mitigating rather than addressing its decaying business climate has been underwhelming:

- State data show Connecticut has inked 42 deals since 2010 in which the combined cost of grants and forgiven loans has been $100,000 or more per job created.[78]
- Connecticut subsidizes film and television producers by picking up as much as 30 percent of production costs. Other states have abandoned the practice in recent years, and Connecticut officials have acknowledged the subsidy is a net loser for taxpayers.
- The state's economic development agency has repeatedly violated state law, improperly forgiving loans and issuing excessive amounts of tax credits.[79]

The single-year savings from eliminating these incentives is not clear, and some costs will persist because they were financed through bonding.

Between 2009 and 2018, the state averaged $200 million per year in grants, loans, and other large incentive programs. But the state spent still more on other tax incentives, such as the film and television production credits and myriad sales tax breaks.

Abolishing these incentives, and repurposing expected surpluses, would offset a significant part of the revenue loss from eliminating the CBT, putting minimal pressure on existing state programs.

Under legislation sponsored by Rep. Joshua Elliot (D-Hamden), Connecticut could partner with other states to simultaneously eliminate tax breaks and other benefits granted seemingly out of necessity.[80] This approach, which addresses concerns about "unilateral disarmament," can be used to end not only direct aid to businesses, such as the film and television production credit, but also special tax breaks. This includes Connecticut's sales tax exemption on aviation fuel ($15 million per year) and the special lower sales tax rate applied to boat purchases in response to special treatment offered by New York and Rhode Island.[81]

The first-year cost of CBT repeal would be slightly reduced because CBT payments lag. CBT receivables totaled almost $60 Million at the end of fiscal 2019.[82] After that, CBT enforcement costs would be eliminated in the outyears. The total Department of Revenue Services (DRS) budget is expected to be almost $68 Million in FY22 and more than $69 Million in FY23.[83] CBT enforcement is a complex operation and while CBT is just one-twentieth of state revenues, CBT collection is likely responsible for an outsized share of DRS costs.

Conclusion

Policymakers for the past century have insisted on taking a bite of corporate activity separately from any rational approach to taxing consumption, land and buildings, or personal income. But Hartford has a once-in-a-generation opportunity to attract capital to the state and revive the stalled economy by breaking with other states and eliminating its corporate income tax, the CBT.

Connecticut should act quickly to capitalize on the present circumstances as companies prepare to make one-time moves.

If lawmakers are instead interested in developing a longer roadmap to CBT repeal, they should:

- repeal any economic development programs which result in a net reduction in tax revenue, such as the film and television production credit, and instead reduce the CBT tax rate;
- estimate the cost of CBT compliance, with an eye to the impact on smaller businesses, and the cost of collecting it; and
- enact the Elliot bill to develop agreements with other states to eliminate targeted tax breaks and other corporate benefits.

But as the process of taxing corporate income becomes increasingly complex, and as place plays a decreasing role in the economy, Connecticut stands to gain the most by acting quickly to make itself stand apart again.

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