

Hot Topic: Sales Tax

Written by Betsy Yagla

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What's happening with the state sales tax?



If Gov. Dannel Malloy has his way, next year's haircuts and yoga classes will cost you 6.35 percent more. That's because he's proposed adding these and other services to the list of items that Connecticut makes a profit from, via sales tax. Profits from an expanded sales tax are one way to plug a massive budget gap. A new Quinnipiac poll, released last week, shows 47 percent of voters approve of the sales tax hike, 52 don't like it. Two percent are undecided.

What's the proposal?

The state is staring down a \$3.5 billion budget deficit. In order to close that gap in the next two years, Malloy's budget proposes cost cutting, labor concessions and raising taxes. In addition to changes in the state's income tax, Malloy wants to raise the sales tax and broaden the number of things and services on which the sales tax is tagged.

That means doing away with some tax exemptions (for example, under current tax law valet parking is taxed but not valet parking at airports) and raising the sales tax rate from 6 percent to 6.35 percent. Municipalities will cash in on .10 percent of sales tax generated from local purchases.

The Connecticut Association of Nonprofits was one of the only groups to testify in favor of Malloy's tax increase proposal at a day-long hearing. The association's executive director called Malloy's proposal a "good start" but said it could go further by raising taxes on the rich and eliminating more sales tax exemptions.

What more will be taxed?

Currently there is a sales tax exemption on some goods and all services.

The governor is proposing tacking on sales tax to: airport valet parking, automotive storage, automobile road and towing services, boat services, car washes, clothing and footwear under \$50, cloth and fabric purchased for non-commercial sewing, cosmetic surgery, haircuts, hazardous waste removal, labor repair on small aircraft, limousine services, manicure and pedicure, non-prescription drugs, packing and crating, pet grooming services and yoga.

In addition, the sales tax exemption on trade-in vehicles will be removed, sales tax-free week will be eliminated and under the governor's proposal people who purchase things with coupons,

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discounts or trade-ins will pay sales tax on the full value of their purchase. And tobacco and alcohol taxes will go up.

Will this hurt the poor?

The sales tax is a “regressive” tax, meaning that the poor pay a larger portion of their income on sales tax than do the wealthy, because proportionately they spend more on things like food, clothing and gas.

The state’s poorest residents (earning less than \$26,000) spend 6.3 percent of their household income on sales tax, according to a 2009 study by the Institute on Taxation and Economic Policy, a tax research group. The second poorest group (\$26,000-\$44,000) spends about 4.5 percent. The state’s richest (\$1.3 million and up) spend less than 1 percent on sales tax.

So won’t raising sales tax hurt the poor? It could, but most of Malloy’s sales tax plan targets people spending on luxuries, like airport valet parking, boat services, cosmetic surgery and pet grooming. Still, there are some new sales tax services that would target everyone, including the poor, like haircuts and clothing under \$50.

Malloy’s budget proposed a state version of the federal Earned Income Tax Credit, which would help the state’s working poor. The EITC is a lump-sum payment triggered after taxes are filed by poor families. Malloy’s budget summary says the EITC would help to offset the increased burden imposed on the poor by the sales tax increase.

Will the rich pay more?

There are some taxes aimed at the middle- and upper-class, like a 3 percent “luxury” tax on clothing over \$1,000; jewelry over \$5,000; automobiles over \$50,000 and boats over \$100,000. On those items, the full sales tax would be 9.35 percent.

Jewelry, boat and car dealers are up in arms about the proposed changes, saying that customers will shop out of state, or companies will move out of state and that the added costs will kill the industries. The end result, they say, is that Connecticut will lose sales tax revenue because purchases on luxury goods will be made elsewhere.

Why make these changes?

“Long term it is a good idea to apply the sales tax to as large a base as possible,” says Joe Hero, a senior policy fellow at Connecticut Voices for Children, a New Haven nonprofit focused on tax reform. “The governor’s proposal is a start but it doesn’t go far enough. ... More broadly, if we want to make long-term reform to the sales tax, you would need to go further and apply it to all services. Then we could take a look at particular services where we feel sales tax shouldn’t apply and make an exemption. Which is different from the current framework where it applies to no services and add in some.”

Hero says there are three main arguments for broadening the sales tax.

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“First, there’s no strong economic argument to tax goods and not services. It violates tax neutrality principals and creates incentives to go into businesses that offer services and not goods. Second, the economy is shifting from goods-based to service-based, meaning that the sales tax, over time, collects less and less and makes that revenue less sustainable. Third, by not taxing services and having exemptions to the sales tax, we end up relying on rate increases to maintain revenue levels and the idea is that if we apply the sales tax broadly to services — to reflect today’s economy — we could lower the overall rate.”

But Gian-Carl Casa, undersecretary for the Office of Policy and Management (which drafts the budget), says the sales tax wasn’t expanded to other services because of “competitiveness and the cost of business.”

He says many businesses need to pay for services and tacking on a tax could hurt. “We’re trying to keep the cost of business down,” Casa says.

How will these changes help?

For one, an increase in the sales tax could help diversify the state’s tax base. Connecticut is overly reliant on property taxes, and the state’s municipalities can only raise funds through property taxes. Malloy’s budget estimates that adding the .10 percent sales tax would generate an additional \$24 million to be given to municipalities.

Casa says that the budget is designed “to get Connecticut back on solid fiscal footing” and doubts that more tax increases will be necessary in the near future.

How will these changes hurt?

Nearly everyone who testified at a nine-hour hearing last week about the proposal was opposed to them. Those opposed to the luxury tax — mostly jewelry store owners, car and boat dealers — say it will hurt business and lead to layoffs. Others from specific industries, like car wash owners and hairdressers, have similar concerns: Business is down due to the recession and taxing clients will only give them more reason to stay away. Hairdressers also worry that a tax would cut into their tips.