CONNECTICUT VOICES FOR CHILDREN

Testimony Regarding

S.B. #933: An Act Concerning the Governor's Recommendations on Revenue

Testimony of Dr. Douglas Hall[1]

To the Committee on Finance, Revenue and Bonding

February 23, 2009

Senator Daily, Representative Staples, and distinguished Members of the Finance, Revenue, and Bonding Committee,

I am testifying on behalf of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to promote the well-being of Connecticut's children, youth, and families. I submit this testimony because the manner in which Connecticut raises and spends its revenues is of great importance to the state's children and families.[2]

Connecticut Voices for Children does not support S.B. #933, the Governor's recommendations on revenue, though we do support the provision to cap the film production tax credit at $30 million/year.

The Governor's recommendations on revenue fall short of at least two major tenets of state taxation, ***adequacy*** and ***fairness.***

An **adequate** revenue system is one that "provides sufficient revenues to fund essential public services, which include not only current services but also presently unmet essential needs."[3] The Governor's budget proposal contained in this bill falls demonstrably short of this measure. On February 4, 2009, at the time the Governor's budget proposal was released, her recommendations fell short of meeting even current service levels of funding by $1.1 billion for FY10, and by $1.3B for FY11, *before* accounting for $2.7 billion in additional projected deficit that the non-partisan Office of Fiscal Analysis (OFA) included in its February 2 estimate. Between the unmet current services needs in her budget, and the portion of the projected deficit unaddressed in her budget, the two-year budget falls short of even a conservative definition of adequacy by $5.1 billion. Moreover, her budget does virtually nothing to put Connecticut on more sound fiscal ground for the future. Based on OFA's projections, the anticipated deficit for FY12 is almost $5 billion (see Figure 1, below).

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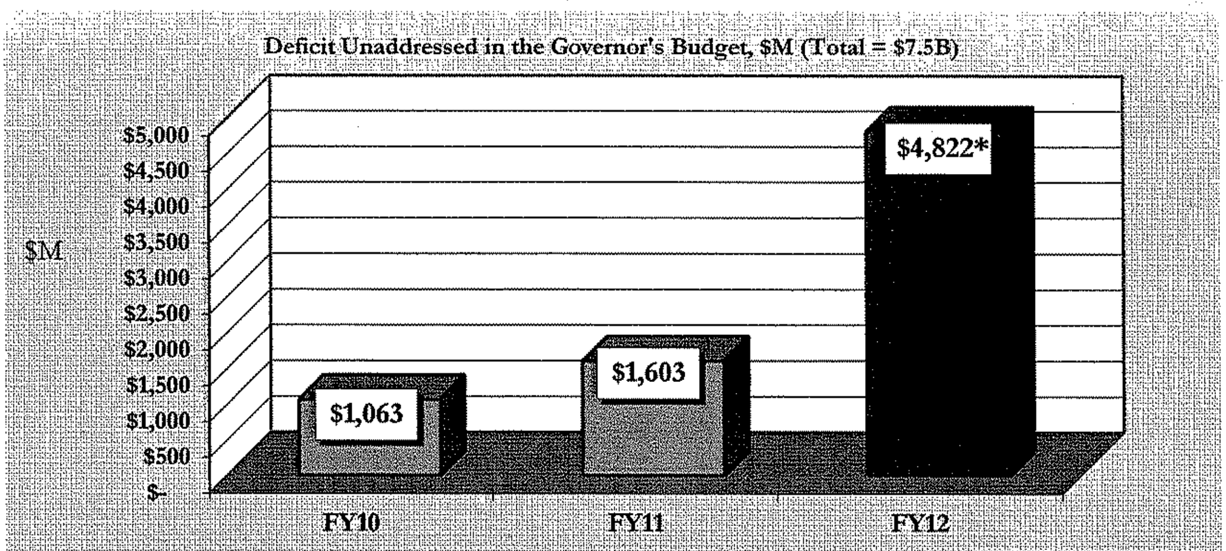
1 Douglas Hall is Acting Managing Director of Connecticut Voices for Children. He has a PhD in political studies, and has extensively studied state level economic development policies.

2 This testimony draws heavily on two documents; Better Choices for Connecticut, *Better Choices for Connecticut: State Budget Proposal*, (Better Choices for Connecticut, February 2009), and Connecticut Voices for Children, *Connecticut Revenues In Context: The Governor's Proposed FY 10 Budget*, (Connecticut Voices for Children, February 2009).

3 Better Choices for Connecticut, 6.

33 Whitney Avenue • New Haven, CT 06510 • Phone 203-498-4240 • Fax 203-498-4242 | Web Site: www.ctkidslink.org
53 Oak Street, Suite 15 • Hartford, CT 06106 • Phone 860-548-1661 • Fax 860-548-1783 | E-mail: voices@ctkidslink.org



* While there is no expectation that a biennial budget would address budget deficits projected beyond the biennium, the important point to note is that the Governor's budget proposes virtually no revenues beyond the biennium. Of her new revenue sources, the most significant that is scheduled to extend beyond the biennium is the proposal to increase licenses, permits and fees by approximately $100 million/year. While this IS a sigificant amount of money, it clearly falls FAR short of addressing a FY12 projected deficit of almost $5B. These figures are based on OFA's February 2 projections.

Figure 1

Connecticut's overall tax structure is demonstrably unfair, a situation that the Governor's revenue proposal does nothing to rectify. Connecticut's overall tax structure (state and local taxes) is notably regressive, with those at the top end of the income scale contributing less than half the share of their income in combined state and local taxes than do families in the bottom four quintiles (see Figure 2 below).

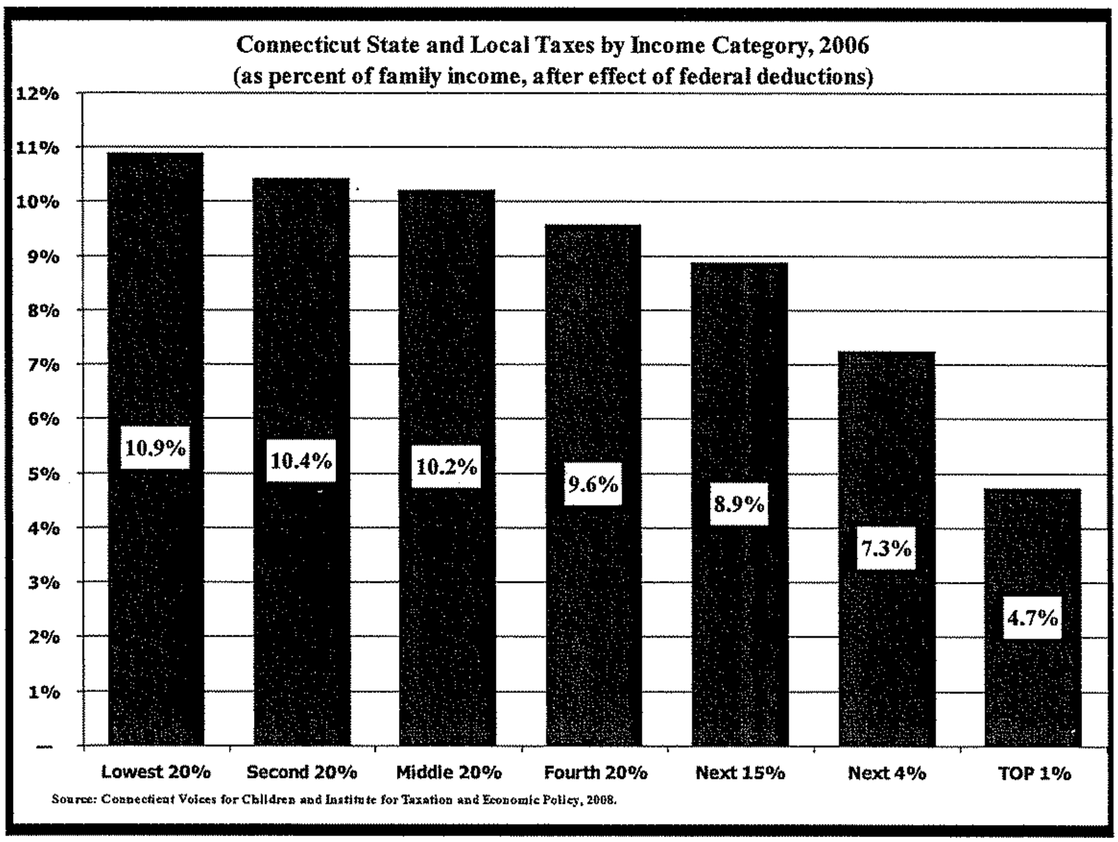


Figure 2

Two components of the Governor's revenue recommendation further exacerbate the existing unfairness of Connecticut's tax structure:

1. **Suspension of the sales tax-free week for two years.** This move is estimated to save the state over $4 million in revenues that would otherwise be lost through this sales tax exemption. Because the sales tax is the most regressive tax levied by the state, any move to increase sales tax revenues should consider the question "Who Pays?"[4]. As seen in Figure 2 above, Connecticut's highest income families – particularly those in the top 5% of income earners[5] – pay a much smaller proportion of their incomes in combined state and local taxes. Any increase in the sales tax – the most regressive tax levied at the state or local level – makes Connecticut's overall tax structure *even less fair.*

2. **Increase cost of Licenses, Permits and Fees (LPFs).** This revenue enhancement is the most significant source of new state level revenues identified in the Governor's budget. The Governor proposes that no license or permit should be less than $15, and that all LPFs less than $150 be doubled, LPFs between $150 and $1000 be increased by 25%, and LPFs greater than $1000 be increased by $250. Research on the tax incidence of licenses, permits and fees shows that such sources of revenue are similar to sales and use taxes in their tax incidence, with middle and lower income families paying a significantly higher share of their household income than do higher-income families.[6] Moreover, from a family's perspective, the distinction between licenses, permits and fees on the one hand, and tax increases on the other hand, may not be meaningful. In both cases, they have less disposable income.

A step in the right direction

Capping the Film Industry Tax Credit at $30 million per year represents an important step in the right direction. Because OFA's tax expenditure analysis shows the film and digital media tax credit costing the state $90 million in 2009, the savings from capping the credit at $30 million may be as high as $60 million. Capping the credit is particularly important given that the credit has been open-ended and growing considerably each year.[7]

Although Connecticut Voices for Children supports a cap on the film industry tax credit, this legislation needs to be modified to better protect Connecticut's corporate tax revenues. As currently written, credits issued under the film production tax credit "may be sold, assigned, or otherwise transferred in whole or in part, to one or more taxpayers…". Through this

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[4] The Institute for Tax and Economic Policy (ITEP), *Who Pays? 3rd Edition*, forthcoming, 2009.

[5] The income of families in the top 5% of families in Connecticut start at $287,000. The range for the top 1% of family incomes begins at just over $1 million, with an average income of $3.3 million.

[6] For example, a 1999 study by researchers at UC Berkeley showed that although higher income families paid higher total dollar amounts in vehicle license fees (VLFs), that amount accounted for a significantly lower proportion of total household income. Jennifer Dill, et al, *The Incidence of the California Vehicle License Fee*, (UC Berkeley, Institute of Urban and Regional Development, 1999). Tax experts from the Institute of Taxation and Economic Policy (ITEP) have modeled the disparity in use that would be required in order for a CT license, permit or fee to not be regressive. Their findings show that individuals in the top 1% of incomes would have to license (or otherwise make use of) more than 67 times as many units as individuals in the bottom 20% of incomes in order for the incidence to be anything other than regressive.

[7] A more complete analysis of the film tax credit and related incentives for the film and entertainment industry can be found in S. Geballe, *Starstruck? Connecticut's Block-Busting Spending on Entertainment Industry Tax Credits, Part 1: The Credits and Who is Claiming Them* http://www.ctkidslink.org/publications/bud08enttaxcreditpart1.pdf

mechanism, firms such as Kohl's department stores have ended up claiming the credit against taxes owed to Connecticut.

Better Choices for Connecticut

Connecticut Voices for Children is a member of a newly formed coalition, the Better Choices for Connecticut coalition. This coalition was created to reform the state tax system and raise the revenues needed to protect crucial public structures – like schools, health care programs, roads, environmental protection agencies, and public safety organizations – from severe cuts that would undermine the state's economic recovery and quality of life.

The Coalition's revenue proposals would raise an estimated $1.7 billion in new revenues, avoiding commensurate spending cuts that would not only decimate critical state services, but would also further exacerbate the state's current economic woes, leading to employment loss of approximately 23,000 jobs in FY10.[8]

The components of the Better Choices for Connecticut Budget Proposal include the following:

1. **Raising income taxes on the state's wealthiest residents**
   This proposal, which would generate approximately $1.0 billion in new revenue, would require the creation of three new income tax brackets:
   - Marginal rate of 6.0 percent on taxable income between $200,000 and $500,000;
   - Marginal rate of 7.0 percent on taxable income between $500,000 and $1 million; and
   - Marginal rate of 8.0 percent on taxable income greater than $1 million.

A more progressive income tax will protect Connecticut's economy better than the alternatives. According to Nobel Prize winning economist Joseph Stiglitz and Peter Orszag, the incoming Director of the Office of Management and Budget, "tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy in the short run than tax increases focused on higher-income families."[9]

Under this progressive income tax proposal, Connecticut's marginal rates for high income families would remain significantly lower than those of most neighboring states. Of the 41 states with income taxes, only seven have a lower top marginal rate than Connecticut.

2. Reform corporate business tax rules so that corporations pay their fair share of taxes. This committee recently heard public testimony from Connecticut Voices for Children in support of **SB 807, *An Act Concerning Combined Reporting for the Purposes of the Corporation Business Tax.*** In the absence of such legislation, current corporate tax rules enable many large and profitable corporations to avoid paying their fair share and shift the responsibility for taxes onto in-

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[8] Based on research from the Center for Economic and Policy Research (CEPR), *Will Workers Survive State Budget Belt-Tightening?*, (CEPR, December 2008).

[9] Peter Orszag And Joseph Stiglitz, Center on Budget and Policy Priorities, *Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive Than the Other During a Recession?* (2001), http://www.cbpp.org/10-30-01sfp.pdf.

state businesses and individuals. Connecticut should reform these policy flaws and broaden the base of the corporation business tax to raise revenue and promote fairness. We have estimated that adoption of legislation requiring mandatory combined reporting would result in approximately $110 million in additional revenue.

3. Adoption of a one percentage point increase in the sales tax, combined with both a state level earned income tax credit, and a new small business property tax credit. We estimate that increasing Connecticut's sales tax rate by 1 percentage point would generate additional revenues of approximately $450 million when paired with a state EITC and a small business property tax credit. **The adoption of a state EITC** is critical to ensuring that this step doesn't contribute to Connecticut's already very unfair tax structure, which requires lower income families to pay a much larger share of their household income in taxes than do higher income families.

4. Scale back public subsidies to the entertainment industry. The Better Choices for Connecticut coalition shares with the Governor a belief that scaling back the so-called "film tax credits" is appropriate given the state's current fiscal situation. By ensuring that each of the film tax credits is capped and that none of them can be transferred, the Better Choices budget proposal anticipates savings of approximately $95 million.

5. Increase Cigarette Taxes and Alcohol Excise Taxes. We estimate an additional $79 million in revenue, through the imposition of a $2.50 per carton tax on cigarettes, applied to 80% of current projected sales, paired with a modest increase in the alcohol excise tax. Increasing cigarette taxes will not only raise revenue, it will discourage smoking, particularly among Connecticut's children and youth, thereby reducing long-term health costs.

Concluding Thoughts

The current budget crisis presents Connecticut with important challenges, but it also presents unprecedented opportunities. As the Better Choices for Connecticut budget proposal notes, state revenues – taxes, fees, and other income – are the collective investments that support our communities and maintain the high standards we all expect and enjoy. Our public structures – good schools, safe roads, quality health care programs, and strong public safety agencies are vital to preserving this quality of life and to ensuring Connecticut's economic vitality.

Connecticut is at an important crossroads. We can choose together to proceed down a path of shared prosperity, where we collectively invest in, and benefit from, a world class education system, high quality systems of public health and transportation, and strategic support for areas with proven return on investment, such as early care and education. That is not the path articulated in the Governor's budget, and presented in SB #933. It's time for a Better Choice for Connecticut.

Thank you for your time and for consideration of our testimony.