NEW HAVEN LEGAL ASSISTANCE ASSOCIATION, INC.
426 STATE STREET
NEW HAVEN, CONNECTICUT 06510-2018
TELEPHONE (203) 946-4811
FAX (203) 498-9271

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TESTIMONY BEFORE THE FINANCE, REVENUE AND BONDING COMMITTEE WITH RESPECT TO SB 446

Senator Fonfara, Representative Berger and members of the Finance Committee:

My name is Sheldon Toubman and I am an attorney with New Haven Legal Assistance Association. I am here to testify in support of a proposed amendment to SB 446 which would address a severe inequity among Connecticut's high income taxpayers and, in the process, go a long way toward addressing the large deficit facing our state next year.

First, I should explain my interest in this issue. I represent low income individuals, mostly vulnerable individuals on Medicaid and individuals with severe disabilities. They are critically reliant on our state's social services safety net, including the provision of services by state-funded non-profits. The safety net is being threatened with decimation because of the huge budget deficit. If that should happen, my clients would go without critical services, imperiling their health and, in some cases, even their lives. In addition, the budget deficit is threatening massive layoffs of state employees, many of whom are involved in direct service to our low income clients. Elimination of those positions means greater difficulty accessing essential services. Indeed, the Department of Social Services is already severely understaffed, such that individuals who remain fully eligible for benefits are nevertheless routinely cut off of those benefits because DSS simply does not have enough workers to process timely-submitted redetermination paperwork in time.

To avoid these and other drastic cuts, there really is no other choice but to include revenue enhancements in this year's budget. I urge you to adopt all of the recommendations of the Better Choices Coalition, which contains several thoughtful solutions. Their proposals include bringing our marginal tax rates for high income individuals and couples in line with those of our neighboring states, applying a fee to employers who do not pay their workers a living wage, and addressing tax cheating. But I particularly want to talk with you today about one new proposal, and that is to address the fact that some very highly compensated individuals in CT are, on the federal level, not being taxed at the same rate as other individuals at the same level of income. This concerns what is euphemistically called "carried interest" paid to extremely highly compensated hedge fund managers and private equity managers.

On the federal level, rather than being taxed at the marginal tax rate of 39.6% for ordinary income, these individuals, applying the fiction of "carried interest," have their incomes taxed at the much lower capital gains rate applicable to capital investments, or

20% -- even though their compensation is not based on any kind of investment at all, but merely on the individual's own labor. These highly compensated individuals have argued for the lower federal capital tax rate applicable to investments on the basis that most of their compensation is tied to how well the assets they manage perform. But the basis for that lower capital gains rate is that individuals are taking a **risk** by investing their own capital, which they could lose, and a lower tax rate might encourage them to take on socially-desirable investments. The rationale applied here, however, is completely hollow, because these individuals are **not putting anything at all of their own at risk**; rather, they are simply taking chances with **other** people's money. The only reason that the federal tax loophole has not been fixed at the federal law is that wealthy individuals have lobbied extensively to maintain this special tax break relative to other individuals at the same high income level.

It does not look like this inequity is going to be addressed on the federal level any time soon. But **we** can address it here in CT by applying a state tax just to those individuals so that the net tax rate they pay is the same as that of their wealthy neighbors who are earning the same amount but in another industry or line of work, such as corporate executives. There is no reason that they should not be taxed the full 39.6% which those other individuals are being taxed, just because of the baseless fiction that carried interest is somehow return on investment.

So the Better Choices Coalition recommendations include a proposal is to impose a state tax on hedge fund and private equity managers who are being paid under this carried interest fiction at the lower 20% federal tax rate, equal to the amount they **would** have paid to the federal government if they did not have this bogus loophole available to them. A recent projection is that taxing these individuals in CT an amount to make up for the 19.6% loophole they get on their federal taxes, relative to their neighbors, will raise about **$535 million per year**. *See* http://hedgeclippers.org/hedgepapers-no-26-wall-streets-lucrative-loophole/. While this does involve raising taxes on a few highly compensated individuals, it does so **only** to put them on par with their neighbors who are already being taxed 39.6% on their ordinary income.

We understand that some have expressed concern that any significant tax increase applied to wealthy residents could induce some of them to move to another state that does not have the tax. While this is difficult to confirm, to the extent that this is a concern, I note that this new initiative is being joined by advocates and legislators in both of our neighboring states in the Greater New York area, where, as a practical matter, hedge fund managers have to be based. In New York, there is pending before the state legislature a bill which would tax the full 19.6% difference that these individuals are evading in federal taxes. *See* "New York Legislators Plan to Introduce Measure on Carried Interest Tax," *New York Times* (March 6, 2016)(available at www.nytimes.com/2016/03/07/business/new-york-legislators-plan-to-introduce-measure-on-carried-interest-tax.html?_r=0) Here is a link to that bill: http://open.nysenate.gov/legislation/bills/2015/a9459 Advocates in New Jersey also are pursuing this.

Accordingly, rather than looking for ways to cut revenue that comes from wealthy taxpayers, such as the proposal to repeal the estate tax as currently contained in SB 446, we should instead be looking for ways to make our tax system fairer. I urge you to JF a substantially amended version of that bill which does not cut taxes and instead includes all of the elements of the Better Choices agenda, including the carried interest tax proposal. That way, if New York and New Jersey do in fact adopt state taxes by the end of the session which have the effect of making their very high income hedge fund managers and private equity managers subject to taxes equal to that of their same-income-level neighbors, CT will be poised to do the same. This, in conjunction with the other Better Choices proposals, would bring in substantial revenue to address our current budget deficit and avoid the shredding of our social safety net, while addressing a long-standing unfairness among high earners, in a way which avoids any potential of individuals who must be based in the greater New York area being incentivized to move out of state.

Thank you for the opportunity to speak with you today. I would be happy to answer any questions.