STATE OF CONNECTICUT
OFFICE OF POLICY AND MANAGEMENT

TESTIMONY PRESENTED TO THE FINANCE, REVENUE, AND BONDING COMMITTEE
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Testimony Supporting Senate Bill No. 981

AN ACT CONCERNING REVENUE ITEMS TO IMPLEMENT THE GOVERNOR'S BUDGET

Senator Fonfara, Representative Horn and distinguished members of the Finance, Revenue and Bonding Committee, thank you for the opportunity to offer testimony on Senate Bill No. 981, An Act Concerning Revenue Items to Implement the Governor's Budget.

This bill contains the major revenue elements of the Governor's plan to provide low- and middle-class income tax relief as well as balance the FY 2024-FY 2025 biennial budget.

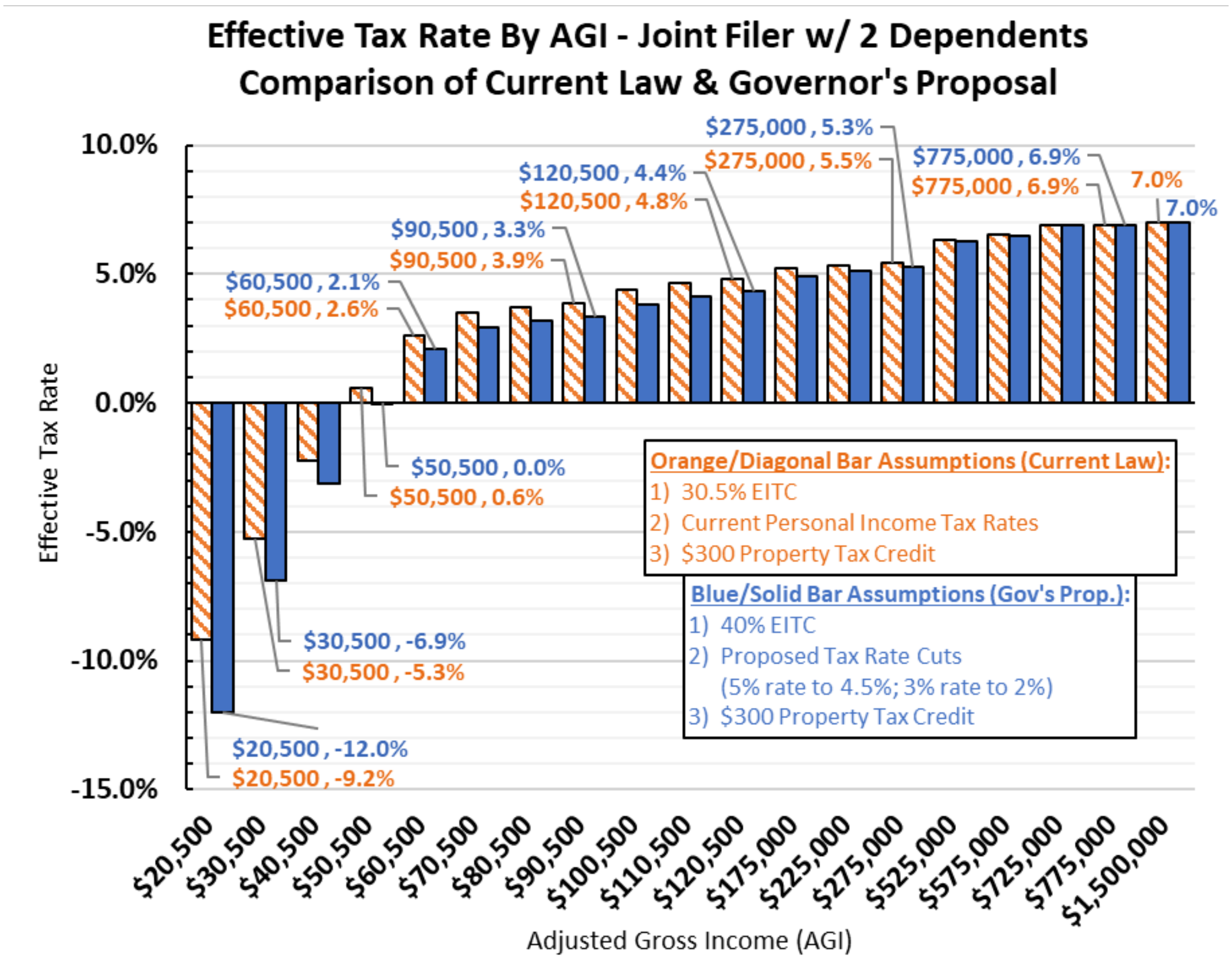
The state ended FY 2022 with a surplus of $1.3 billion, its fourth consecutive year-end surplus for a cumulative total of $2.1 billion over that four-year period. In addition to those surpluses, since FY 2018, the volatility cap provisions that were enacted in the 2017 bipartisan budget have directed $7.2 billion to the state's Budget Reserve Fund (BRF). The combination of these unprecedented levels of resources has allowed the state to fully recapitalize the BRF to the 15% level and, given the statutory provisions regarding the BRF, generated a "waterfall" enabling $5.8 billion to be directed toward the state's unfunded pension liabilities. This has led to a dramatic change in the state's financial trajectory from that experienced following the 2008 global financial crisis. This change has led to credit rating upgrades by all four of the agencies that rate the state's bonds.

Considering the state's strong financial position, the Governor believes it is time for broad-based tax relief for Connecticut's residents. The magnitude of the tax cuts reflects the Governor's desire to provide meaningful middle class tax relief while maintaining overall budgetary discipline and not jeopardizing the loss of federal stimulus funds. In addition, by targeting relief toward working families and the middle class, these tax cuts should enhance the equity already inherent in Connecticut's progressive tax code.

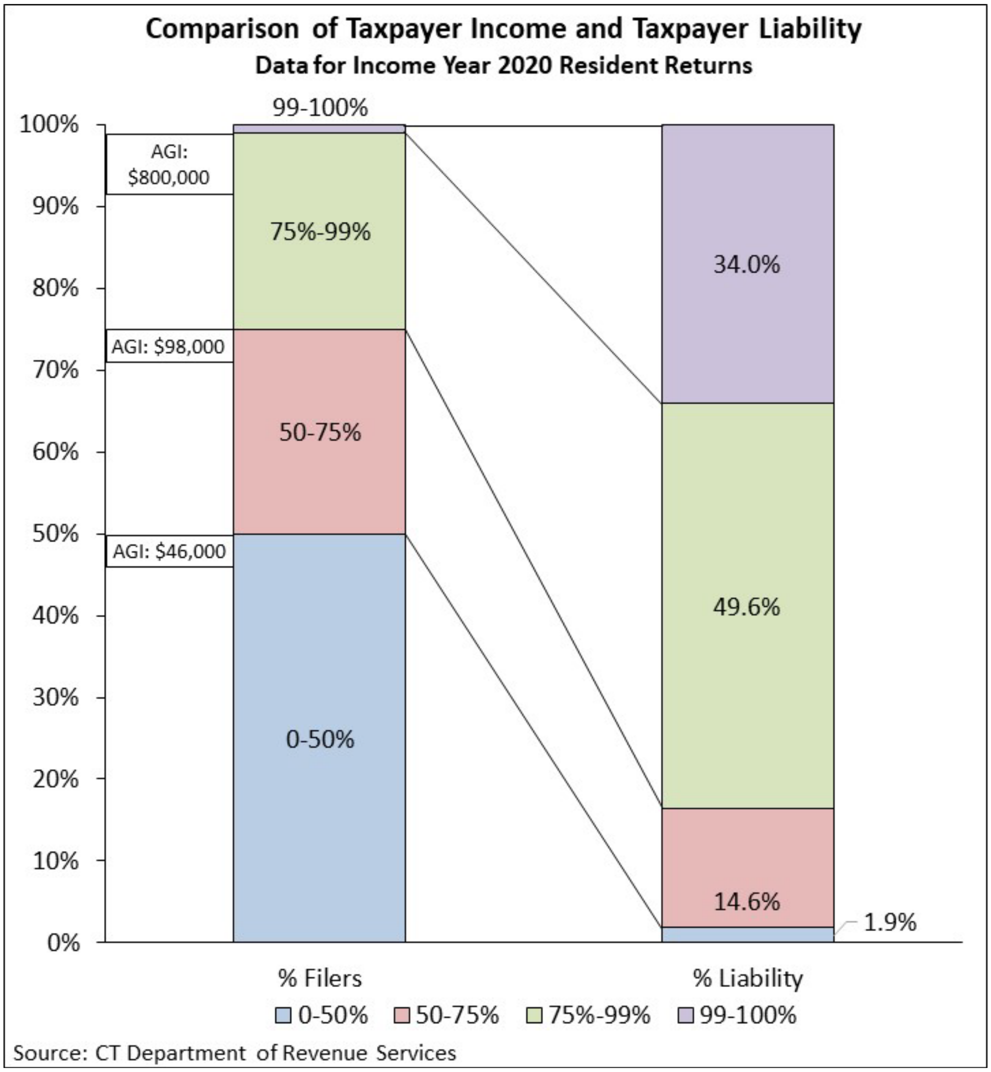
Connecticut's tax code is progressive on many fronts. For instance, our sales tax does not tax food or prescription and non-prescription drugs and has a separate luxury tax on the sale of certain high value goods. We are one of only 17 states to levy an Estate tax, the only state to impose a gift tax. Our real estate conveyance tax has graduated rates that includes a mansion tax rate. All those are significant, but they are magnified by the progressivity inherent in the state's revenue workhorse – our income tax. That tax has numerous measures to ensure equity that I think should be reiterated. This includes:

1. Seven graduated tax brackets
2. Recapture of the lower tax brackets at higher income levels
3. Exemptions of $15,000 for single filers and $24,000 for joint filers that phase-out at higher income levels
4. Personal tax credits that begin at 75% that phase-out at higher income levels
5. Social security and pensions & annuities exemptions that end at $75,000 for single filers and $100,000 for joint filers
6. Property tax credit that is phased out at higher income levels
7. Earned Income Tax Credit (EITC)

Many would say that our income tax begins with a 3.0% rate. Given the state's Earned Income Tax Credit, that would be inaccurate. Technically, our income tax begins with a negative rate as our EITC is refundable, and with the other progressive elements mentioned above, results is a steeply progressive state income tax. As indicated in the graphic below, the Governor's income tax proposal serves to enhance that progressivity.



In the end, the progressive elements inherent in our state's income tax code results in the top 1% of all filers paying 34% of the tax and the top 25% of all filers paying 83.6% of the tax.



As a state we also need to be extremely mindful of the competitive marketplace in which we operate. Nine states in our nation impose no broad-based income tax (Florida, Texas, Nevada, Tennessee, South Dakota, Wyoming, Washington, Alaska, and New Hampshire). Many of them are some of our country's fastest growing communities. In addition, the 2017 federal Tax Cuts and Jobs Act (TCJA) significantly impacted our state's competitive position vis a vis other states with the imposition of a $10,000 cap on state and local tax (SALT) deductions. As an example, for those state taxpayers in our highest 6.99% tax bracket, prior to the TCJA, those taxpayers were able to fully deduct their Connecticut income tax payments and if they were in the then highest 39% federal tax bracket, that effectively reduced our 6.99% rate to 4.26%. Overnight, passage of the TCJA meant such taxpayers faced the full 6.99% state rate, an increase of 64% in net state tax liability. Although such taxpayers may have benefitted from the reduction in the top federal tax rate to 37%, they would have benefitted from a tax perspective even more were they a resident of a state without an income tax. Mindful of the bar chart cited above over who pays our income tax, we need to retain such citizens in our state.

Against this backdrop the Governor is proposing to reduce the state's income tax by lowering the 5.0% rate to 4.5% and the 3.0% rate to 2.0%, the first income tax rate reductions in almost thirty years. In addition, the Governor is proposing to permanently increase the state's refundable EITC from 30.5% to 40%. At the national level, fully 96% of the dollars claimed under the EITC go to filers with at least one-child. Taken together the income tax relief proposed by the Governor would amount to $485 million annually with more than 75% of those dollars flowing to those filers earning less than $150,000. Some EITC filers could see an increase of up to $659 based on 2022 IRS EITC tables (will be higher in 2023) and filers outside the EITC eligibility ranges could see savings close to $300 for single filers and close to $600 for joint filers. Of the state's 1.7 million filers, 1.1 million could see some form of rate relief and over 200,000 EITC filers would see additional benefits.

To encourage businesses to expand and invest in the state, the Governor is proposing to restore to 93.01% the personal income tax credit for pass-through entity taxes (PET) paid to the state. The 2017 federal TCJA limited the amount of state and local taxes that could be deducted federally to $10,000 per filer. In 2018, Connecticut was the first state to enact a response to this federal change via a new revenue-neutral state PET tax. After its first year in operation, the tax credit was reduced to 87.5% to generate additional revenue for the state. Restoring the credit to its original amount is expected to impact approximately 125,000 business entities, saving owners $60.0 million annually. The Governor is also proposing to provide businesses with the option to either pay the PET or to pay tax on the pass-through entity's income at the personal income tax level, thereby allowing business owners to decide what is most advantageous for their specific circumstances. This option is available in every other state with a PET. Moreover, this would position the state favorably for when the SALT cap is scheduled to sunset on December 31, 2025.

To encourage firms to expand their childcare benefits for employees with children, the Governor is proposing to double the existing corporate human capital investment tax credit from 5% to 10%. This credit encourages firms to invest in work education programs, workforce training, and to make donations to higher education institutions for various improvements. As part of the adjustments to this credit, the Governor is also proposing that the existing 5% tax credit for childcare be increased to 25%. Childcare expenses or insufficient availability of childcare often act as impediments to parents returning to – or remaining in – the workforce. Various expenditures are eligible for this credit, including subsidies paid to employees for childcare expenses and the development of childcare centers. Smaller firms may also be able to avail themselves of a limited federal tax credit of 25% for employer-provided childcare expenses. For a modest annual cost of $3.5 million, both businesses and the state should benefit in reducing the obstacles toward greater workforce participation in the state's labor market.

My agency has provided a fact-sheet that accompanies my testimony here today that details the other important revenue initiatives contained in this bill. Although not singled out in my testimony here today I hope your committee gives serious consideration to these worthwhile measures.

On a final note, with the extension of the fiscal guardrails for up to ten years, that was passed on unanimous basis in PA 23-1, section 10 of the bill before you today is no longer required.

I respectfully request that the committee support this bill. I would like to again thank the committee for the opportunity to present this testimony, and I am happy to answer any questions you may have.

Governor Ned Lamont
State of Connecticut

FACT SHEET
2023 Legislative Session

SENATE BILL 981
AN ACT CONCERNING REVENUE ITEMS TO IMPLEMENT THE GOVERNOR'S BUDGET

Summary of Proposal:
This bill contains the major revenue elements of the Governor's plan to provide low- and middle-class income tax relief as well as balance the FY 2024 – FY 2025 biennial budget. The fiscal impact of the Governor's recommended proposals would decrease revenue by $314.9 million in FY 2023, decrease by $206.8 million in FY 2024, and decrease by $472.9 million in FY 2025. The reduction in marginal rates in the Personal Income Tax and the Pass-through Entity Tax proposals would reduce the volatility cap transfer amount by $41.0 million in FY 2024 and $91.6 million in FY 2025. The net General Fund revenue impact would decrease revenues by $165.8 million in FY 2024 and decrease by $381.3 million in FY 2025 prior to accounting for the state's revenue cap. The Governor is not recommending any policy changes that would impact revenue in the Special Transportation Fund.

Reason for Proposal:
To provide low- and middle-class tax relief and to support Governor Lamont's proposed biennial budget.

Significant Impacts:
The bill will have the following impact on the state's revenue in FY 2024 and FY 2025 (all dollar amounts in millions):

Sec.	Governor's Proposals - General Fund	FY 2024	FY 2025
1-3	Maintain 10% Corp. Tax Surcharge for IY 2023 through IY 2025	$ 80.0	$ 50.0
4-5	Increase Human Capital Credit from 5% to 10%; 25% for Childcare	(2.1)	(3.5)
6	Match Federal Estate Filing Timeline from 6 to 9 Months	(38.0)	-
7-8	Repeal Cannabis Expansion of Angel Investor Tax Credit	12.5	15.0
9	Increase EITC Rate from 30.5% to 40% for IY 2023	(44.6)	(44.6)
10	Bond Lock Extension – Not required due to passage of PA 23-1	-	-
11	Maintain Current Treatment of Bond Premium for Debt Service	Exp. Bdgt.	Exp. Bdgt.
12	Reduce Tobacco & Health Trust Fund Transfer from $12M to $6M	6.0	6.0
13	Reduce 5% Rate to 4.5% & 3% Rate to 2.0%	(193.6)	(435.8)
14-20	Restore PET Credit from 87.5% to 93.01%	(27.0)	(60.0)
21	Eliminate $314.9M of ARPA for FY 2023 Revenue Replacement	-	-
	Gross General Fund Impact	**$ (206.8)**	**$ (472.9)**
	Volatility Adjustment	41.0	91.6
	Net General Fund Impact	**$ (165.8)**	**$ (381.3)**

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Additional Information:

Sections 1-3: Maintain 10% Corporation Tax Surcharge for IY 2023 through IY 2025, Inclusive. This proposal extends the 10% corporation tax surcharge for 3 income years—income years 2023, 2024, & 2025. The 10% surcharge is on top of the existing 7.5% rate. The surcharge does not apply to companies (1) with less than $100 million in annual gross revenues or (2) whose tax liability does not exceed the $250 minimum tax. Effective 1/1/2023.

Sections 4-5: Increase Human Capital Tax Credit from 5% to 10% & to 25% for Childcare. This proposal would:

1. Increase the overall rate at which the tax credit is earned from 5% to 10% of qualifying expenses;
2. Increase the rate at which the tax credit is earned for expenses relating to childcare subsidies and the development of a childcare center from 5% to 25%; and
3. Increase the limitation at which the tax credit can be claimed against Corporation Tax liability from 50.01% to 70% of tax liability for tax credits earned for childcare subsidies and development of a childcare center only.

Aside from the expenses related to childcare as noted above, this tax credit can also be earned for expenses related to job training, work education and training programs, and donations of capital to higher education institutions. This expansion of the tax credit is estimated to cost the state $2.1 million in FY 2024 and $3.5 million annually beginning in FY 2025. Effective 1/1/2024.

Section 6: Match the Federal Estate Tax Filing Timeline from 6 to 9 Months. This proposal extends the timeline for when the Estate Tax must be filed by changing the filing deadline to match the federal timeline from 6 months to 9 months following the death of a person. The federal return is needed in order to file the CT return so this proposal would enhance compliance. Prior to 2009, the state conformed to the federal due date, but due to budget shortfalls, the state decoupled from the federal due date to create a one-time revenue acceleration. This is not a tax cut as it only results in a shift of revenue of approximately $38.0 million in FY 2024. The CT Estate Tax is 12% over the federal exemption amount, which is $12.92 million for 2023. Effective 7/1/2023.

Sections 7-8: Repeal Cannabis Expansion of the Angel Investor Tax Credit. This proposal would eliminate the expansion of the Angel Investor Tax Credit for investments made in cannabis-related businesses. The Angel Investor Tax Credit program provides a tax credit worth 25% of investments made in businesses related to bioscience, advanced materials, photonics, information technology, or emerging technology. Investments must be at least $25K and tax credits are capped at $500K per angel investor. No more than $5 million in tax credits can be issued per FY through FY 2028, inclusive. In the 2021 legislative session, the tax credit program was expanded to investments made in cannabis-related businesses. For investments in cannabis-related businesses only, the tax credit was worth 40% of the investment and was capped at $15 million per FY through FY 2028, inclusive. Due to the overwhelming interest in entities seeking to be part of the cannabis market, this proposal would scale the program back to its original parameters, excluding cannabis. This proposal would generate $12.5 million of General Fund revenue in FY 2024 and $15.0 million annually beginning in FY 2025. Effective 7/1/2023.

Section 9: Increase the EITC from 30.5% to 40% for IY 2023. This proposal would increase the Earned Income Tax Credit (EITC) from 30.5% to 40% of the federal tax credit permanently beginning in income year 2023 — a 31% increase. The maximum benefit of a filer with 3 children would increase from $2,115 to $2,774 – an increase of $659. In 2020, the EITC was at 23%. During the 2021 legislative session, the EITC was increased to 30.5% beginning in income year 2021. This tax credit is refundable and will benefit approximately 211,000 recipients. With this increase, Connecticut will have the 5th highest EITC in the nation and almost double the national average of a 22% EITC. Increasing the EITC to 40% is estimated to cost the state approximately $44.6 million beginning in FY 2024. Under this proposal and the Personal Income Tax cut proposal (section 13), a family of 4 with an AGI of $50,500 or less will pay no income tax to CT. Effective 1/1/2023.

Section 10: Bond Lock Extension. [Note: this section is no longer required due to passage of PA 23-1] This proposal would extend the Bond Lock by 10 years from FY 2024 through the end of FY 2033. The current Bond Lock is set to expire at the end of FY 2023 and has been a critical feature in ensuring the success of the fiscal guardrails by incorporating those guardrails into a bond covenant. The Bond Lock essentially states that the General Assembly cannot alter the State's spending cap, revenue cap, or volatility cap unless the Governor declares a state of emergency, or the General Assembly passes an alteration with at least a three-fifths vote in each chamber. Effective upon passage.

Section 11: Maintain Current Treatment of Bond Premium for Debt Service. This proposal would delay the change in how bond premium is treated until FY 2026. Under current law starting in FY 2024 all bond premium generated for the issuance of general obligation sales will be deposited into the state's bond funds to pay for projects and programs. This proposal would allow general obligation bond premium generated during the biennium to pay down debt service. This proposal is estimated to save the state $20 million in FY 2024 and $60 million in FY 2025. Effective 7/1/2023.

Section 12: Reduce the Tobacco & Health Trust Fund Transfer from $12 million to $6 million. This proposal would reduce the General Fund revenue intercept from $12.0 million to $6.0 million annually beginning in FY 2024. In 2022, the General Assembly reinstituted the transfer of $12.0 million from the General Fund to the Tobacco and Health Trust Fund in order to 1) support and encourage development of programs to reduce tobacco abuse through prevention, education and cessation programs, 2) support and encourage development of programs to reduce substance abuse, and 3) develop and implement programs to meet the unmet physical and mental health needs in the state. The transfer had been dormant since 2017. Effective 7/1/2023.

Section 13: Reduce the 5% PIT Rate to 4.5% and 3% PIT Rate to 2%. This proposal would lower the 2 lowest marginal rates in the Personal Income Tax. The 5% rate would be reduced to 4.5% and the 3% rate would be reduced to 2%. This would be the first income tax rate relief in almost 30 years. This would impact approximately 1.1 million (63.2%) of the 1.7 million Personal Income Tax filers. Depending on a filers adjusted gross income (AGI), some joint filers could receive almost $600 in tax relief and some single filers could receive almost $300 in tax relief. This proposal is expected to cost the state approximately $193.6 million in FY 2024 and $435.8 million in FY 2025, however, a portion of this will impact the volatility cap. General Fund budgetary balance is expected to be reduced by $174.2 million in FY 2024 and $392.2 million in FY 2025. Under this proposal and the EITC proposal (section 9), a family of 4 with an AGI of $50,500 or less will pay no income tax to CT. Effective 1/1/2024.

Sections 14-20: Restore the PET Credit from 87.5% to 93.01%. This proposal would make the Pass-through Entity Tax (PET) and tax credit revenue neutral again (as when the PE Tax was first enacted in 2018) by increasing the tax credit percentage against the Personal Income tax from 87.5% to 93.01%. In the 2019 legislative session, the PET credit was reduced from 93.01 to 87.5% to generate approximately $50 million of revenue to address budget shortfalls. Because the tax and credit will be revenue neutral, this proposal will provide businesses with the option to decide whether the federal tax savings are worth the administrative costs of paying the tax at the entity level rather than at the individual level. This proposal is estimated to cost the state $27.0 million in FY 2024 and $60.0 million annually beginning in FY 2025, however, a portion (approx. 80%) of this proposal would impact the volatility cap. General Fund budgetary balance is expected to be reduced by $5.4 million in FY 2024 and $12.0 million annually beginning in FY 2025. Effective 1/1/2024.

Section 21: Eliminate the Use of ARPA for FY 2023 Revenue Replacement. The FY 2023 General Fund budget anticipated utilizing $314.9 million of federal American Rescue Plan Act of 2021 (ARPA) dollars to help balance the FY 2023 budget. This proposal would eliminate the one-time $314.9 million of ARPA revenue replacement from the General Fund in FY 2023 as the current projected surplus is in excess of $1.3 billion as of 1/20/23. Removing this ARPA revenue replacement would reduce the projected FY 2023 surplus by $314.9 million and allow $314.9 million of ARPA funds to be used for other priorities. Effective upon passage.