Budget CONNECTion$

A Connecticut Voices for Children
Issue Brief
March 2003

Addressing the FY 03 Deficit: PA 03-2 & How It Compares to the Vetoed Bill

PA 03-2 (HB 6495), AAC Modifications to Current and Future State Expenditures and Revenues

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March 1, 2003

This report summarizes the bill approved February 26, 2003 by the House on a 79-68 vote,[1] by the Senate on a 18-15 vote[2] and signed by the Governor on February 28, 2003 to address the remaining SFY 03 deficit – PA 03-2 (HB 6495), An Act Concerning Modifications to Current and Future State Expenditures and Revenues. Our summary is based on the analysis by the non-partisan Office of Fiscal Analysis (OFA) of the bill as passed with three amendments,[3] as well as the bill's text as amended (LCO 3689,[4] LCO 3700,[5] LCO 3701[6]).[7] This report also compares this new bill to the earlier deficit-mitigation bill vetoed by Governor Rowland on February 19, 2003 -- PA 03-1 (HB 6397).[8]

Spending cuts. As amended, this bill reduces FY 03 General Fund allotments to various budget accounts by about $129 million, Transportation Fund allotments by $9.0 million, and allotments to the Pequot Fund by $21.5 million. *Total* spending reductions authorized by this bill, however, exceed this figure. As noted herein, a number of cuts result from changes in state-funded programs result in reduced spending not only in the current fiscal year, but years following. Spending reductions that continue on into FY 04 total nearly $99 million in that fiscal year.

NOTE: the spending reductions in this bill are *in addition to* the nearly $900 million of cuts that already have been made to mitigate the FY 02 and FY 03 deficits. For context, the revised FY 03 General Fund budget, when first adopted, was $12.1 billion.

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1 The House roll-call vote is at http://www.cga.state.ct.us/2003/vote/h/2003HV-00022-R00HB06495-HV.htm.
2 The Senate roll-call vote is at http://www.cga.state.ct.us/2003/vote/s/2003SV-00042-R00HB06495-SV.htm.
3 OFA's fiscal note on HB 6405 as amended by House A, B, and C is at http://www.cga.state.ct.us/2003/fn/2003HB-06495-R01-FN.htm. A correction to that fiscal note is at http://www.cga.state.ct.us/2003/sfn/2003HB-06495-R01-COR.htm.
4 The text of HB 6495 (LCO 3689), House Amendment A, approved on a 71-69 vote, is at http://www.cga.state.ct.us/2003/amd/h/2003HB-06495-R00HA-AMD.htm..
5 The text of House Amendment B, approved on a 111-30 vote, is at http://www.cga.state.ct.us/2003/amd/h/2003HB-06495-R00HB-AMD.htm.
6 The text of House Amendment C is at http://www.cga.state.ct.us/2003/amd/h/pdf/2003HB-06495-R00HC-AMD.pdf.
7 House Amendment D, which would have restored HUSKY coverage for parents and relative caregivers with incomes between 100% and 150% of the federal poverty level (i.e., between $15,020 and $22,530 for a family of 3), was defeated on a voice vote.
8 The text of this vetoed bill is at http://www.cga.state.ct.us/2003/act/Pa/2003PA-00001-R00HB-06397-PA.htm.

This report is produced with the support of the Stoneman Family Foundation, the Melville Charitable Trust, and the Center on Budget and Policy Priorities/Ford Foundations. The contents of this report are the responsibility of Connecticut Voices for Children.

Revenue increases. According to OFA, in FY 03 the bill would generate $439.8 million in *net* new revenues. This figure *excludes* about $5.65 million in annual revenues from increases in court fees and $6 million in revenues from a fund transfer (since these new revenues are dedicated to specific budgeted expenses and OFA does not count them as General Fund revenues). The $439.8 million in net new revenues *includes* a loss of $15.8 million in federal revenue resulting from changes in this bill to programs that receive federal funds. Importantly, about $140 million of the $439.8 million in "new" FY 03 revenues in this bill (nearly one-third) come from re-allocated funds, fund transfers, and other one-time sources, rather from increased taxes. *On-going revenues* generated from new taxes and fees are about $300 million of the total net new revenues in FY 03 (about 68%).

As illustrated in the following table, net new General Fund revenues in this bill are less than in the bill that was vetoed:

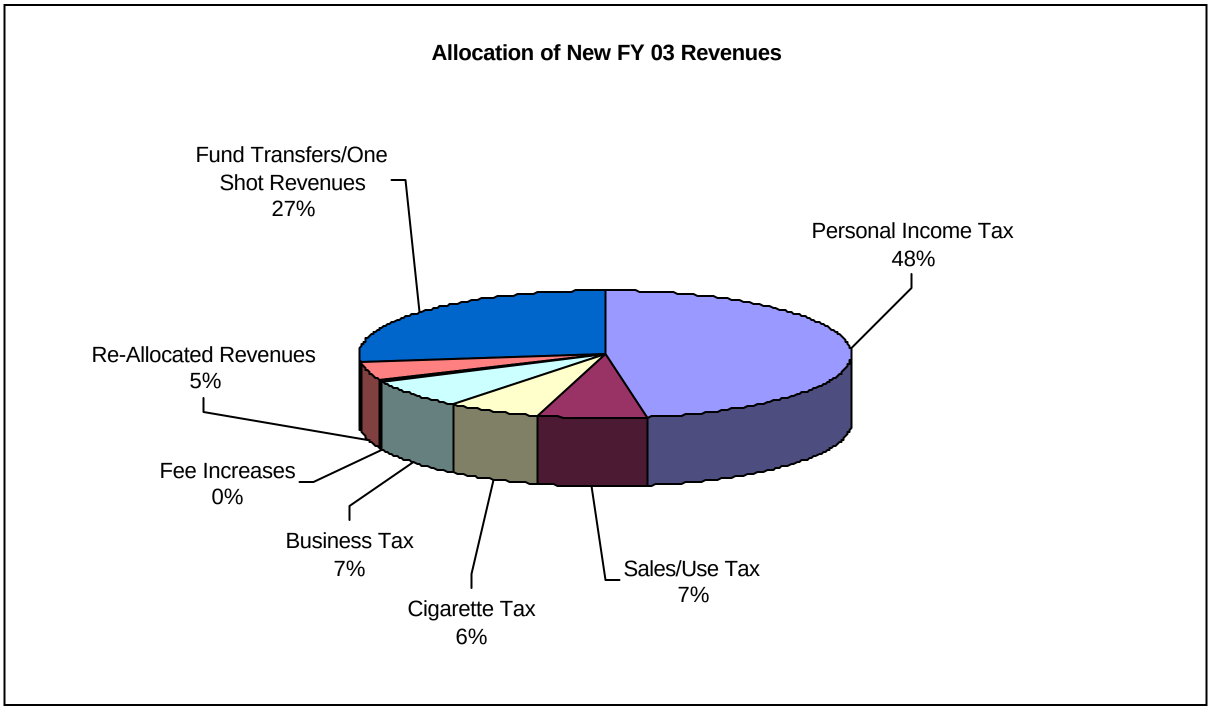
Comparison of Net New General Fund Revenues in HB 6495 and PA 03-1 (vetoed)		
	HB 6495	**PA 03-1 (vetoed)**
FY 03	$439.8M	$473.4M
FY 04	$634.3M	$832.3M
FY 05	$593.9M	$775.0M
TOTAL	**$1,668.0M**	**$2,080.7M**

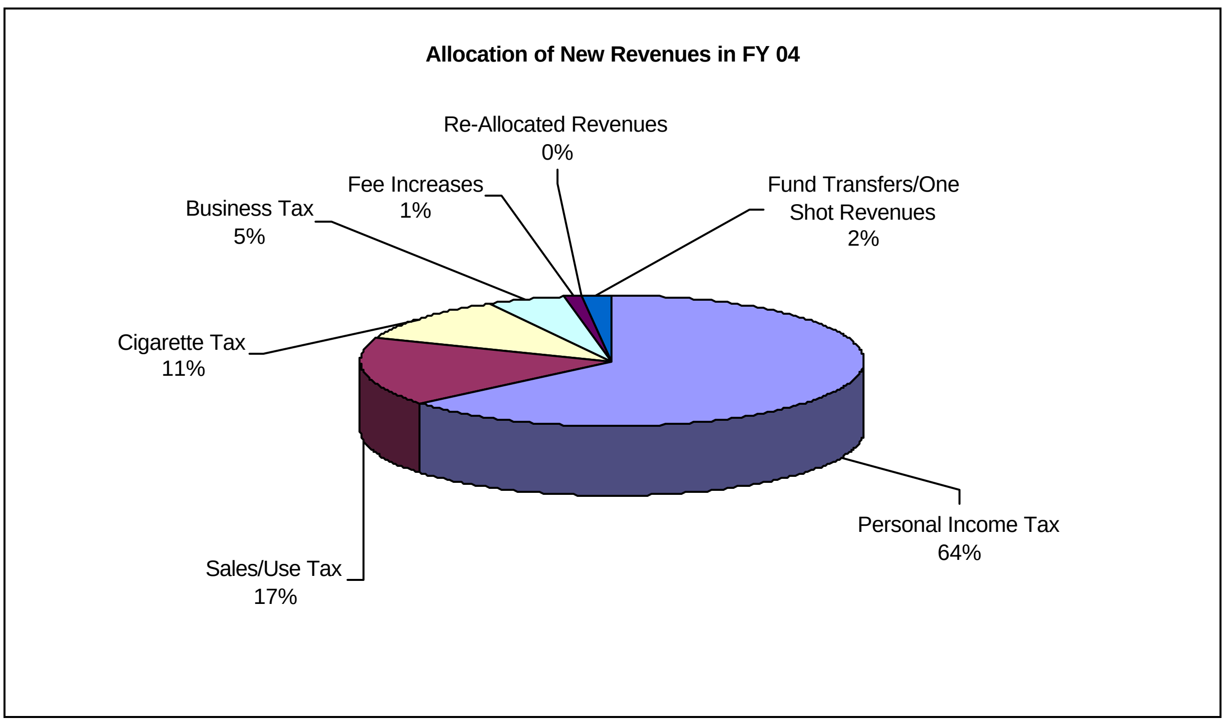
In addition, the bill would enhance municipal revenues by $7.4 million this year, $25 million in FY 04 and nothing in FY 05. The annual revenue gain for towns will be greater than this if any of the towns located in targeted investment communities elect to increase their real estate conveyance tax further, as this bill allows. By comparison, the increase in municipal revenues under the vetoed bill would have been $8.5 million in FY 03, $40-45 million in FY 04, and $15-20 million in FY 05.

It is significant that this bill will generate *new*, on-going revenues in this year and the years following (though it still relies in *this* fiscal year to a significant extent on one-time revenues). Restoring revenues to the General Fund revenue stream is *essential* to the long-term fiscal stability of the state.

More than $2 billion of taxes were cut in the late 1990s in reliance on large, but temporarily inflated, capital gains-related income tax revenues in a very strong economy. Yet, so far in the state's deficit-mitigating efforts, only 14% of the solution (to the cumulative $2.25 billion of FY 02 and FY 03 deficits thus far addressed) has come from new, on-going revenues. The balance has come from spending cuts, borrowing and the use of one-time revenues (e.g., the tax amnesty, fund transfers from quasi-public agencies, other budget funds, the tobacco settlement fund). HB 6495 begins to reverse this course, and set Connecticut on the track to more stable, predictable, and adequate state revenues.

The distribution of the tax and fee increases and other "new" revenues in HB 6495 is also important, as illustrate in the charts below:


Allocation of New FY 03 Revenues
Fund Transfers/One Shot Revenues 27%
Personal Income Tax 48%
Re-Allocated Revenues 5%
Fee Increases 0%
Business Tax 7%
Cigarette Tax 6%
Sales/Use Tax 7%


Allocation of New Revenues in FY 04
Re-Allocated Revenues 0%
Fee Increases 1%
Business Tax 5%
Fund Transfers/One Shot Revenues 2%
Cigarette Tax 11%
Personal Income Tax 64%
Sales/Use Tax 17%

Summary of Spending Cuts

Allotment reductions. Section 1 specifies that the "Governor shall modify allotment requisitions or allotments in force as follows, provided the amount of any allotment reduction resulting from the Governor's January 24, 2003 reductions or from this section shall not exceed the *larger* of the Governor's January 24, 2003, reduction or the reduction in this section." The total sum authorized by this section varies depending on whether the Governor's January 24, 2003 reductions are interpreted to include lapses as well as rescissions. If the lapses are included, there are many more accounts in which the total amount of the Governor's reductions exceed the reductions in section 1 than if the lapses are not included. OFA has interpreted this section to include only the Governor's rescissions. Table I at the end of this report provides detail on the specific allotment reductions, with those highlighted being the budget accounts in which the Governor's January reductions exceed the amounts shown in this section (and so are therefore authorized by this section).

Section 1 on its face shows a net reduction to the General Fund of $89.21 million. This represents $93.27 million of proposed spending reductions to various accounts, offset by a $4.053 million increase to the Priority School District account. However, the total of the spending cuts *actually* authorized by section 1 (using the Governor's January 24, 2003 rescission number when it is larger for any given account) is $97.08 million. If one *also* includes the lapses (so one compares the combined rescissions and lapses made by the Governor on January 24, 2003 to the amounts in this section and picks the larger) then the total of the spending cuts authorized by this section are more than $108 million. **CUTS: At least $97M in FY 03.** Note: **Section 6(a)** specifies that any allotment reduction to an appropriation must be applied proportionately to all grantees from that budget account line.

Importantly, OFA notes "the modifications made to allotments in this amendment do not change the FY 03 spending cap or budget growth rates, as FY 03 appropriations are not being reduced."

Grants to towns. The bill makes a ***net* reduction of $40.065 million** in FY 03 grants to municipalities. **Section 2** cuts Town Aid Road grants from the Special Transportation Fund by $9.0 million (up from $7.5 million in the vetoed bill) in FY 03. **Section 3** cuts grants to towns from the Mashantucket Pequot and Mohegan Fund by $21.5 million (up from $20.0 million in the vetoed bill) in FY 03. These reductions are in addition to the $10.775 million in *net* allotment reductions in Section 1 affecting town grants: a reductions of $2.7 million from the drug enforcement program (up from $1.5 million in the vetoed bill); $12 million cut from PILOT for new manufacturing machinery and equipment (up from $10 million in the vetoed bill); and $0.119 million cut from waste water treatment grants, offset by a $4.053 million *increase* in grants to priority school districts. **Section 6(a)** states that the modification to an allotment for a municipal grant account is to be applied on a *pro rata* basis, while **Section 6(j)** specifies that no additional allotment reductions may be made to the Priority School District grant.

Accounts funded with FY 01 "surplus" funds. Section 4 reduces by about **$4 million** in FY 03 various budget accounts funded in part with FY 01 "surplus" funds. This represents an increase from the $3.65 million that would have been cut from these accounts in the vetoed budget. Largest cuts are to DEP's recreational fishing program ($1M); DSS Nursing Home Staffing ($1M); DMHAS, CT Mental Health Center ($0.1M), Grants for Mental Health Services ($0.1M), and Regional Action

Councils ($0.2M); Stamford Hospital ($0.25M); Yale-New Haven Hospital ($0.33M); DPH, Biomedical Research ($0.2M); and Judicial Dept. Alternative Incarceration Program ($0.2M); Department of Veterans' Affairs, Transitional Living Services for Veterans ($0.4M). **CUTS: $4.0M in FY 03.**

Section 5 requires the Governor to effect a total of **$36.5 million** in other economies. This includes $4.5 million from an Early Retirement Incentive Program for managers (described below). These mandated "economies" are as follows:

- **Early Retirement Incentive Program**. **Section 6(b)** authorizes an early retirement incentive program for full- and part-time state employees who are part of the State Employee Retirement System, and defines eligibility for it. The specific incentive is that an individual eligible for the ERIP may add up to three years to age, to service, or to a combination of the two. It specifies that employees who were laid off or whose positions were abolished between 11/1/02 and 5/31/03 who would otherwise have been eligible for this program are eligible beginning 3/1/03 if the employee is at least 52 years old or becomes 52 by 5/31/03. It further specifies that "any such employee who retires shall not be rehired." **CUT:** The total savings from early retirement are expected to total **$44.0 million in FY 03:** a) $4.5 million in General Fund savings from the early retirement program for managers (included in the Governor's mandated "economies"), b) $36.9 million in General Fund savings from the ERIP program for state employees who are part of the State Employee Retirement System (which would be an "identifiable portion of the Governor's $93.1 million union concession proposal) and c) $2.6 million in Special Transportation Fund savings for persons employed through that Fund.

  In addition, **subsection F of section 6(b)** requires OPM to "ensure" that positions refilled pursuant to the early retirement program, or "filled for any other purpose," from March 1, 2003 to June 30, 2004 be "at least 2,000" in number and that they first be offered to laid off state employees. This section also authorizes, in FY 04 and FY 05, that up to 80% of positions vacated in any bargaining unit as a result of the early retirement plan can be refilled provided that at least 70% of these positions be classified as "essential" and not more than 30% as non-essential.

  NOTE: This "refill" section was not in the vetoed bill. Rather, it "replaced" the section in the vetoed bill [Section 6(l)] that had *required* the re-hiring of the thousands of state employees who had been laid off (with certain exceptions, such as persons laid off because of the termination of grant-funded or durational positions). **Section 6(i)** provides that any state employee rehired is to be considered "continuously" employed for purposes of the State Employee Retirement system.

  In addition, **section 6(h)** requires the Retirement Commission to request an actuarial interim valuation to take into account the impact of the Early Retirement Incentive Program. It is estimated that this will result in a certification of a **lower state contribution in FY 05 of about $20 million.**

- **Fleet reduction. CUT: $2.25M in FY 03.**

- **Additional allotment reductions** (in addition to the current statutory authority and the extraordinary authority given last session). **Section 6(c)** authorizes the Governor to make additional allotment reductions of $12.75 million so long as new allotment reductions do not exceed 1.75% of any appropriated account. Also, allotment reductions may *not* be made (pursuant to this authority) in grants to towns, personal services, higher education operating expenses, or entitlements. NOTE: This allotment reduction authority was increased by $0.5 million from previous versions of this bill. **CUT: $12.75M in FY 03.**

- **Corrections Initiative.** Section 6(d) directs how some of the mandated $10 million in savings are to be achieved, directing the delayed opening of the MacDougal Correctional Center in Suffield until July 1, 2003 (with projected savings of $3.5 million). **CUT: $10M in FY 03.**

- **Limit on Travel by Executive & Judicial Employees. CUT: $1M in FY 03.**

- **Energy Costs Reductions**. Sections 20-21 mandate the transfer to the General Fund of funds from the non-state Conservation and Load Management Fund beginning in February 2003 through July 2005 (see below). In the General Fund, these funds are to be used for state agency electrical costs (and the amended bill reduces agency allotments by $6 million for these energy costs). **CUT: $6M in FY 03; $12M in FY 04; and $12M in FY 05.**

Nursing Home Funding. Section 17 delays the 2% nursing home rate increase scheduled for January 1, 2003 until June 1, 2003, saving $10.5M. **CUT: $10.5M in FY 03**

Home Health Services. **Section 8** requires DSS to adjust its home health fee schedule to include a separate fee for a home visit that is solely for the purpose of "administering medications" (defined to include such things as blood pressure checks, glucometer readings, pulse rate checks as well as actual medication administration). DSS is not to pay for medication administration in addition to any other nursing service at the same visit. This is expected to result in savings. **CUT: $3M in FY 03; $9.5M in FY 04; $9.5M in FY 05 and thereafter.**

Other Changes in Health Services. Sections 7, 9-12, 14, 15, 18, and 52 mandate programmatic changes to various other health care services, cutting spending in this current year and years hereafter. **CUTS: $21.0M in FY 03, $83.8M in FY 04**

Change	FY 03 Cut	FY 04 Cut
Eliminate continuous eligibility for kids on HUSKY A (Medicaid) **(Sec. 7)**	**$0.8M**	**$3.5M**
Impose $1 copay for outpatient medical services (if not in MCO) and $1 co-pay per prescription for persons on Medicaid. DSS Comm'r is given discretion to modify co-pay requirements if patients' drugs are dispensed in less than a 30-day supply or patients are residents of institutional settings. **(Sec.**	**$1.65M** (out-patient) **$1.1M** (prescription)	**$6.6M** (out-patient) **$4.5M** (prescription)

9)		
Impose $1 co-pay for outpatient medical services and $1 co-pay per prescription for persons on state administered general assistance (SAGA). DSS Comm'r is given discretion to modify co-pay requirements if patients' drugs are dispensed in less than a 30-day supply or patients are residents of institutional settings. **(Sec. 18)**	**$1.1M** (combined)	**$2.75M** (combined)
Effective April 1, 2003, suspends (until July 1, 2005) Medicaid coverage for parents of children enrolled in HUSKY if parents' income is between 100% and 150% of the federal poverty level (i.e., family of 4 w/ income between $18,100 and $27,150 or family of 3 w/ income between $15,020 and $22,530). 23,000 low-income parents will lose coverage, although *state* savings are half the amount shown (since there is a 50% federal match). **(Sec. 10)**	**$12.0M**	**$54.0M**
Cut pharmacy dispensing fee from $3.85 to $3.60 for each prescription dispensed under Medicaid, SAGA, ConnPACE and AIDS-drug assistance programs eff. March 1, 2003 **(Sec. 11)**	**$0.9**	**$1.8M**
Eliminate guaranteed eligibility (had been guaranteed for up to 6 mo.) for persons on medical assistance **(Sec. 12)**	**$1.2M**	**$5.3M**
Increase co-payment requirement for ConnPACE from $12 to $16.25/prescription if single and income is under $20,300 (or married and combined income under $27,500) and $20/prescription if over these income levels **(Sec. 14)**	**$2.09M**	**$5.1M**
Increase annual ConnPACE registration fee from $25 to $30/year **(Sec. 15)**	**$0.13**	**$0.26**
Requires DSS Comm'r to use generic substitutes for prescription drugs at lower cost for Medicaid, General Assistance, and ConnPACE **(Sec. 52)**	**Unknown**	**Unknown**

Other reductions to programs supporting low-income families

- **TANF. Section 13** reduces from three to two the number of permitted 3-month extensions after the initial 21-month period of eligibility for cash assistance for children and parents, effective July 1, 2003. **CUT: $3.5M in FY 04 and each year thereafter.**

- **Transitional Child Care Subsidy Program. Section 16** reduces the income eligibility standards for those who quality for transitional child care (subsidies for child care provided to persons no longer eligible for temporary family assistance) from 75% of the state median income to 55% of the state median income eff. 3/1/03. **CUT: $0.5M in FY 03; $1.0M in FY 04 and thereafter.**

Other changes

- **Section 19** requires DSS to adopt a preferred drug list by July 1, 2003 and directs the Medicaid Pharmaceutical and Therapeutic Committee (previously established to provide guidance) to begin meeting by March 31, 2003. There is no direct fiscal impact from this section since the current services estimates for FY 04 already assume savings from the preferred drug list.

- **Section 56** eliminates the scheduled increase in the personal needs allowance for recipients of Supplemental Assistance. **CUT: $0.47M in FY 03; $0.946M in FY 04.**

Spending provisions not included in this bill that *were* in the vetoed bill

Nursing Home Funding. Section 6(i) and 6(j) of the vetoed bill would have transferred $2 million of funds appropriated for Nursing Home Staffing to a new "Non-profit Nursing Home Incentive Grant" account at DSS ($1 million) and to the DSS account for Disproportionate Share payments to Urban Hospitals ($1 million). These provisions were not included in HB 6495, as amended.

Revenue Summary

State Revenue Increases

I. **Personal income tax. TOTAL: $207.4M in FY 03; $403.9M in FY 04; $393.0M in FY 05**

A. Rate increases and additional tax brackets

Section 22 increases Connecticut's top bracket income tax rate from 4.5% to 5%, but leaves unchanged the personal exemptions and the lower 3% rate on the first dollars of taxable income. (Taxable income is equal to adjusted gross income less applicable personal exemptions). The result is that joint filers and surviving spouses will pay 3% on *taxable income* up to $20,000 and 5% on all taxable income over $20,000; heads of household will pay 3% on taxable income up to $16,000 and

5% on all income over this; and single filers will pay 3% on taxable income up to $10,000 and 5% on all income over this. The section also increases the income tax rate on trusts and estates from 4.5% to 5%. OFA states that the increase will affect CT taxpayers filing jointly if their adjusted gross income (AGI) is over $44,000, over $22,500 for single filers, over $22,000 for married people filing separately, and over $35,000 for heads of household. The following table shows how this bill changes the income tax due, using married couples filing jointly as an example:

Adjusted Gross Income	Income Tax Due Under Current Law	Income Tax Due Under HB 6495	*Additional* Income Tax Due Under HB 6495	*Additional* Income Tax Due if Taxpayer Takes Federal Deduction	% of Filers Who Itemize (Take Federal Deduction)
$22,700	$0	$0	$0	$0	15%
$37,800	$269	$269	$0	$0	32%
$61,800	$1,828	$1,971	$143	$104	63%
$106,400	$4,488	$4,920	$432	$315	90%
$225,000	$9,825	$10,850	$1,025	$666	93%
$1,124,000	$50,280	$55,800	$5,520	$3,389	90%

Importantly, because *federal* income taxes are being *cut*, Connecticut taxpayers will end up paying *less* in total federal and state income taxes, even with the increase in HB 6495, as the following table illustrates (for married couples, filing jointly).

Adjusted Gross Income	*Additional* CT Income Tax Due (HB 6495) if Filer Takes Federal Deduction	Average Federal Income Tax Cut, 2004 (from 2001 changes)	Net *Reduction* in Total Federal & CT Income Taxes
$22,700	$0	-$296	-$296
$37,800	$0	-$442	-$442
$61,800	$104	-$693	-$575
$106,400	$315	-$1,211	-$884
$225,000	$666	-$2,400	-$1,709
$1,124,000	$3,389	-$19,130	-$15,528

HB 6495's changes in the CT income tax compared to the changes in the vetoed bill. HB 6495's "flat-tax" approach to increasing state income tax revenues is a *very significant* change from the income tax provisions in the vetoed bill (section 22) in three basic ways:

- **HB 6495 increases the income tax due from more lower and middle-income families.** The vetoed bill increased the number of personal income tax brackets from two to five by adding three new brackets (5%, 5.5%, and 5.75%), but did not impose these higher rates on filers with the lowest incomes. Specifically, the vetoed bill increased the tax on *taxable* income over $100,000 for joint filers, $80,000 for head of household filers, $53,126 for single filers, and $50,000 for married couples filing separately. Under the vetoed bill, married couples filing jointly, for example, would have paid 5% on their taxable income from $100,001 to $200,000, 5.5% on any taxable income from $200,001 to $500,000, and 5.75%

on any taxable income over $500,000. By comparison, under HB 6495, the 5% rate will also apply to taxable income between $20,000 and $100,000 for married couples. HB 6495, therefore, results in a greater number of low and average-wage families being subject to the increase in the income tax.

- **HB 6495 is *more regressive* than the bill that was vetoed**. That is, under HB 6495 lower and middle-income families will pay *more* in state income tax than they would have paid under the vetoed bill, while higher income families will pay *less* than they would have paid under the vetoed bill. For example, married couples with an Adjusted Gross Income of $55,000 will pay $86 *more* in income tax under this bill than they would under the vetoed bill. Couples with AGI of $120,000 or $170,000 will pay $400 *more*. By comparison, a couple with an AGI of $680,000 will pay $2,471 *less* under HB 6495 than they would have under the vetoed bill, a couple with AGI of $1.37 million will pay $7,665 *less*, and a couple with AGI of $7 million will pay about $50,000 *less* under HB 6495l than they would have paid under the vetoed bill.

- **HB 6495 raises *less revenue* than the vetoed bill**, as shown the following table:

	HB 6495 New Revenues	**Vetoed Bill New Revenues**[9]	**Difference (HB 6495 – Vetoed Bill)**
FY 03	$207.4M	$245.0M	-$37.6M
FY 04	$403.9M	$478.0M	-$74.1M
FY 05	$393.0M	$465.4M	-$72.4M

Section 23 directs the DRS Commissioner to adjust withholding tables by March 1, 2003 to begin to collect the increased tax effective January 1, 2003 (and thereby seek to collect six months of withholding under the new rates by June 30, 2003). **Section 24** specifies that the additional tax is due in any June 2003 estimated payment by any taxpayer who is subject to the tax.

NOTE: In addition, HB 6495 does *not* include a phase-out of the property tax credit against the personal income tax. This provision in the vetoed bill (section 25) would have reduced the property tax credit available to people with Adjusted Gross Income over $100,500 for joint filers, $78,000 for heads of household, $54,500 for singles, and $50,250 for married separate filers by applying the phase-out of the credit to the full $500 credit (to eliminate the residual $100 credit for higher income taxpayers) and reducing the credit by $50 rather than $40 at each step of the phase-out. **LOST REVENUE BY NOT INCLUDING THIS PROVISION:** $12M in additional revenues in FY 04, and years thereafter.

II. Sales & Use Tax. TOTAL GAIN: $31.9M in FY 03; $105.5 in FY 04; $106.5 in FY 05

A. Repeal exemptions. Sections 27 and 57 repeal the exemption in the sales/use tax on health & athletic club services (except if provided by non-profit organizations or municipalities) ($1.9M FY 03; $7.5M FY 04; $8.5M FY 05) and on newspapers and magazines ($17.2M FY 03;

9 In addition, the vetoed bill included a phase-out of the property tax credit against the personal income tax for higher-income taxpayers. This would have resulted in an *additional* revenue gain of $12.0 million in FY 04 and all years thereafter.

$68M FY 04; $66M FY 05). **Sections 25-27** also repeal the exemption on advertising and public relations services related to the development of direct mail and media advertising, but impose a 3% tax rate on these services, rather than the regular 6% rate ($5.0M FY 03; $20.0M FY 04; $22.5M FY 05). **TOTAL GAIN: $24.1M in FY 03; $75.5M in FY 04; $74.5M in FY 05.**

B. Reduce exemption. Section 28 reduces the sales tax exemption for sales of individual items of clothing and footwear from $75/item to $50/item effective April 1, 2003. **GAIN: $7.8M in FY 03, $30.0M in FY 04, $32.0M in FY 05.**

NOTE: HB 6495 *did not include* the rate increase on computer & data processing services that had been included in the vetoed bill (sections 26-27). The vetoed bill would have increased the rate on these services from 1% to 3% starting January 1, 2003 and made 3% rate permanent**. LOST REVENUE BY NOT INCLUDING THIS PROVISION**: $6.4M in FY 03; $20.0M in FY 04; $30M in FY 05. HB 6495 also reduced the sales tax rate on advertising services to 3% while the vetoed bill would have imposed the full 6% sales tax rate. **LOST REVENUE FROM THE RATE REDUCTION:** $5.0M in FY 03; $20.0M in FY 04; $22.5M in FY 05.

III. Estate/Inheritance Taxes. TOTAL GAIN: NOTHING

Section 56 repeals current law (Conn. Gen. Stat. 12-399 and 17b-106a) that: a) voids the state estate tax if a person dies after the repeal of the federal estate tax or state estate tax credit against the federal tax or the federal tax or state tax credit found to be unconstitutional; and b) requires that if Congress changes the federal estate tax credit, the state tax automatically adjust to absorb the full federal credit.

NOTE: HB 6495 fails to decouple state generation-skipping transfer and estate taxes from federal tax changes by freezing taxes as they were on January 1, 2001. *Failure to decouple reduces FY 04 revenues by $56M and FY 05 revenues by $100M.* Also, the vetoed bill (section 43) would have delayed for another two years the remaining steps of the phase-out of the inheritance tax.[10] This provision is not included in HB 6495. **LOST REVENUE BY NOT INCLUDING THIS PROVISION: $6.5M in FY 04 and $23.5M in FY 05**

IV. Gift Tax. TOTAL GAIN: NOTHING

HB 6495 includes no provisions regarding the gift tax.

NOTE: The vetoed bill (section 30) would have delayed by one year the remaining steps of the phase-out of gift tax and maintain current rates until January 1, 2005 (i.e., no gift tax on gifts under $25,000/individual/year, $250 plus 2% of gift on gifts of $25,001 to $50,000/individual/year, and

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[10] This would have eliminated the tax for Class B heirs (e.g., brothers, sisters, nephew, nieces) on January 1, 2006 (instead of January 1, 2004) and eliminated the tax for Class C heirs (more remote relatives and unrelated persons) on January 1, 2008 (instead of January 1, 2006). Inheritances by spouses and direct descendants (children and grandchildren) would have remained exempt, as would have inheritances by Class B beneficiaries that are $600,000 or less, and by Class C beneficiaries that are $200,000 or less.

additional graduated rates as gifts increase in value). **LOST REVENUE BY NOT INCLUDING THIS PROVISION:** $1.0M in FY 05

V. Cigarette Tax. TOTAL GAIN: $27.5M in FY 03; $70.9 in FY 04; $70.9M in FY 05

Sections 29-31 increase cigarette tax by 40 cents per pack ($1.11 to $1.51/pack) effective March 15, 2003, and tax cigarettes that are in inventory just prior to this date.

VI. Business Tax. TOTAL GAIN: $32.4 in FY 03: $33.0 in FY 04: $0 in FY 05

Corporation tax surcharges. Sections 32-35 impose a surtax of 20% for the income year 1/1/03-1/1/04 on the corporation tax and on the annual $250 tax on Limited Liability Corporations (LLCs), Limited Liability Partnerships (LLPs), and S corporations. This increases the tax on LLCs, LLPs, and S corporations from $250 to $300/year in 2003. The additional tax due from other corporations varies by tax due. Companies subject to the tax are required to calculate their surcharges based on their tax liability *excluding credits*. **Section 35** requires taxpayers to make June 2003 estimated payments based on this increase, overriding the "safe-harbor" statute. The surcharge applies whether a corporation uses the net income or the alternative capital base method to calculate its tax.

NOTE: The vetoed budget (sections 34-37) imposed a surtax of 20% for the 2003 income year and 10% surtax for the 2004 income year. (Indeed, the earliest version of the vetoed bill that Voices reviewed would have imposed a 20% surcharge in income years 2003 and 2004 and a 15% surcharge in 2005, while a later amendment (LCO 3017) would have imposed a 20% surcharge in income year 2002, 15% in income year 2003, and 10% in income year 2004.) **LOST REVENUE BY ROLLING BACK SURTAX FROM WHAT WAS IN THE VETOED BILL**: $20.4M in FY 04 and $15.7M in FY 05.

VII. Real Estate Conveyance Tax. GAIN: NOTHING

HB 6495 includes no provision to increase the state portion of the real estate conveyance tax; House Amendment B deleted this provision.

NOTE: The vetoed bill (section 42) increased temporarily (from March 1, 2003 to June 30, 2004) both the *state* and the *municipal* portions of the real estate conveyance tax, which is paid by sellers. The *state* rate was increased from 1% to 1.25% on sales of commercial property and the part of the sale price of residential property over $800,000, and the rate was increased from 0.5% to 0.75% on residential property sold for $800,000 or less and on conveyances to financial institutions holding delinquent mortgages on the property. **LOST REVENUE BY NOT INCLUDING THIS PROVISION**: $10M in FY 03; $41M in FY 04.

VIII. Fee Increases. TOTAL GAIN: $1.7M in FY 03; $5.65M in FY 04; $5.65M in FY 05

A. **Attorneys' occupation tax. Section 42** extends the $450 annual tax to attorneys admitted *pro hac vice* (i.e., out-of-state attorneys admitted to appear in CT courts). **GAIN: ~$0.22M annually.**

B. Court fees. Sections 43-49 create three new court fees and increase seven existing court fees and extend the exemption from certain court fees already granted to various state officials and employees to attorneys who are employed by DSS and expands the fees from which officials are exempt (with "minimal fiscal impact"). **GAIN: At least $1.5M in FY 03; $4.9M in FY 04 and thereafter.**

NOTE: Section 51 specifies that these fees (and those from the occupation tax) are to be credited to the Judicial Department's Other Expenses account up to a maximum of $1.5 million in FY 03 and $4.9 million annually thereafter.

C. Program fees. Section 50 establishes s $205 program fee for the Community Service Labor Program within the Court Support Services Division. This program is available to persons charged with violating drug law laws and acts as a prison diversion program. In FY 02, 3,700 people participated. The fee is to be waived for indigents. **GAIN: $0.2M-$0.3M in FY 03 and thereafter** (to be deposited into the Alternative Incarceration Program Account of the General Fund).

IX. Re-Allocated Revenues. TOTAL GAIN: $21M in FY 03; $1M in FY 04; $1M in FY 05

A. Hotel tax allocation to tourism districts. Section 41 requires the DRS Commissioner to retain as General Fund revenues an extra $1 million from the state's 12% tax on hotel and lodging houses that would otherwise be distributed to the 11 tourism districts. Five of the tourism districts will have their statutorily-required allotments reduced proportionately, the other six are made exempt from any reduction (Capital City Economic Development Authority, Greater Hartford Arts Council, New Haven Coliseum Authority, Stamford Center for the Arts, Maritime Center Authority in Norwalk, and Greater Fairfield Tourism District to market Bridgeport attractions). **GAIN: $1M in FY 03; $1M in FY 0 4; $1M in FY 05.**

B. Petroleum Products Gross Earnings Tax revenue. Section 36 suspends for the fiscal year ending June 30, 2003 (FY 03) the transfer of revenues from this tax to the Special Transportation Fund, keeping these funds in the General Fund. Current law requires the DRS Commissioner to transfer $11.5 million of the petroleum products gross earnings tax revenues attributable to sales of motor vehicle fuels to the Transportation Fund each quarter. **GAIN: $20M in FY 03 to General Fund. LOSS: $20M in FY 03 to Transportation Fund.**

X. One-Time Revenues/Fund Transfers. TOTAL GAIN: $118.5M in FY 03; $12M in FY 04; $12M in FY 05

A. Accrual of tax payments. Sections 37-39 allow the Comptroller to count ("accrue) certain corporate, personal income, and real estate conveyance tax payments received in July as part of the revenues of the preceding fiscal year (which ends June 30). **GAIN: $34M in FY 03 only.**

In addition, **Sections 54-55** require cable TV companies to pay their 5% gross earnings tax on a quarterly rather than an annual basis and authorizes the comptroller to accrue to the preceding fiscal year all such taxes postmarked by July 31. **GAIN: $15M in FY 03 only.**

B. Energy Conservation and Load Management Fund. Sections 20-21 transfer $1 million per month ($12 million/year) beginning February 2003 through July 2005 from this Fund to a non-lapsing account within General Fund. Funds are to be used for state agencies' electrical costs. (Allotments for such costs in state agencies' budgets are reduced by same amount.) This Fund is *not* a state fund, but a fund electric distribution companies are required to maintain. These companies fund the fund through an assessment of 3 mills/kilowatt hour of electricity sold. Annual receipts to the fund are about $83-$88 million/year. **GAIN: $6.0M FY 03; $12M FY 04; $12M FY 05.**

C. Special Transportation Fund. Section 6(f) transfers $52.0 million to the General Fund from the Special Transportation Fund. **GAIN: $51.0M in FY 03.**

D. Probate Court Administration Fund. Section 6(g) transfers $10.0 million from this Fund to the General Fund. **GAIN: $10.0M in FY 03.**

E. Commercial Recording Account. Section 6(h) transfers $2.5 million from this account to the General Fund. **GAIN: $2.5M in FY 03.**

NOTE: The vetoed bill (section 6(e)) would have transferred $8.9 million in each of FY 03, FY 04, and FY 05 from the principal of the Soldiers, Sailors and Marine Fund to the General Fund to fund the Property Tax Relief for Veterans grant administered by OPM. The Fund currently has $56.4 million in reserves that earned $3.2M in interest in FY 02. This provision is not included in HB 6405. The "revenue gain" in the vetoed bill to the General Fund would have been the $8.9 million in each of the three fiscal years.

<u>Municipal Revenue Increases</u> TOTAL GAIN: $7.4M in FY 03; $25M in FY 04; $0M in FY 05

Real Estate Conveyance Tax. Section 40 increases temporarily (from March 15, 2003 to June 30, 2004) the *municipal* portions of the real estate conveyance tax from 0.11% to 0.25% of the total sale price (with the amount paid by the seller). This section also gives 17 "targeted investment communities" and any town that has a manufacturing plant that qualifies for enterprise zone benefits the option of increasing their conveyance tax by an additional quarter point, to 0.5%. Towns affected by this supplemental authority are: Bloomfield, Bridgeport, Bristol, East Hartford, Groton, Hamden, Hartford, Meriden, Middletown, New Britain, New Haven, New London, Norwalk, Norwich, Southington, Stamford, Waterbury, and Windham. (NOTE: The revenue gain noted below *will be greater* if any of the towns authorized to increase the conveyance tax an additional 0.25% do so, i.e., from 0.11% to 0.5%). If *all* of them so increase the tax, it is anticipated that an additional $1.7 million in revenues would be generated for the towns in FY 03, and $10 million more in FY 04.) Unimproved land or property sold for $2,000 or less is exempt.

Property Tax Exemption For New Manufacturing Machinery And Equipment And Trucks. Current law exempts these new purchases from property taxes for five years after being acquired. Under the Payment In Lieu of Taxes (PILOT) program, the state reimburses towns for 80% of the property taxes lost through such exemptions if they were approved on or after October 1, 2002, and 100% for exemptions approved before this date.

Section 53 of HB 6495 allows municipalities (in municipal FY 04) to tax the *difference* between: 1) the amount of the FY 03 state reimbursement (PILOT) for property reimbursed at 80% of the exemption (less the Governor's extraordinary rescissions) and 2) the reduced amount of the FY 03 PILOT specified in this bill. The revenue impact of this provision is unclear. As OFA comments in its fiscal note, "It is uncertain whether municipalities would opt to implement this tax and it is unknown what proportion of the FY 03 PILOT for Manufacturing Machinery and Equipment is reimbursed at the 80% exemption rate versus those properties reimbursed at the 100% rate.

The vetoed bill (section 56) would have allowed municipalities to tax 25% of the value of new manufacturing machinery, equipment, and large trucks appearing on the October 1, 2002 and 2003 grand lists and would have reduced the exemption for these assessment years to 75% of the assessed value of the property. **ANTICIPATED MUNICIPAL GAIN IN VETOED BILL:** $15-20M in FY 04 and $15m-20M in FY 05.

Change to Budget Reserve Fund

Section 501 of HB 6495 (added to the bill by House Amendment B) amends Conn. Gen. Stat. §4-30a to increase the size of the Budget Reserve Fund (the "Rainy Day" Fund) from 7.5% to 10% of net General Fund appropriations for the fiscal year in progress. This means that all unappropriated surplus (when Connecticut next enjoys budget surplus) must be transferred first to the Budget Reserve Fund until it reaches 10% of net General Fund appropriations for that year. After that, any unappropriated surplus remaining is to be used to reduce debt service and provide funds for the State Employees Retirement Fund.

Given Connecticut's increasing reliance on the personal income tax for state revenues, and the volatility of this revenue source (because of the high proportion of income taxes derived from capital gains and dividends), increasing the Budget Reserve Fund to buffer against sudden changes in revenues is a good idea. Indeed, the Center on Budget and Policy Priorities, in a March 1999 report, urged states to increase their Budget Reserve Funds to avert precisely the type of crisis Connecticut and other states are facing now. This report estimated that Connecticut's Rainy Day Fund needed to be 20%-25% of General Fund expenditures to weather the next rescission and predicted that Connecticut's shortfall in reserves would be between 15% and 20% of its General Fund expenditures. Sadly, this was an prescient, *but avoidable*, prediction. [11]

[11] I. Lav & A.Berube, *When It Rains, It Pours: A Look at the Adequacy of State Rainy Day Funds and Budget Reserves* (Center on Budget and Policy Priorities, March 1999), available at, http://www.cbpp.org/3-11-99sfp.pdf.

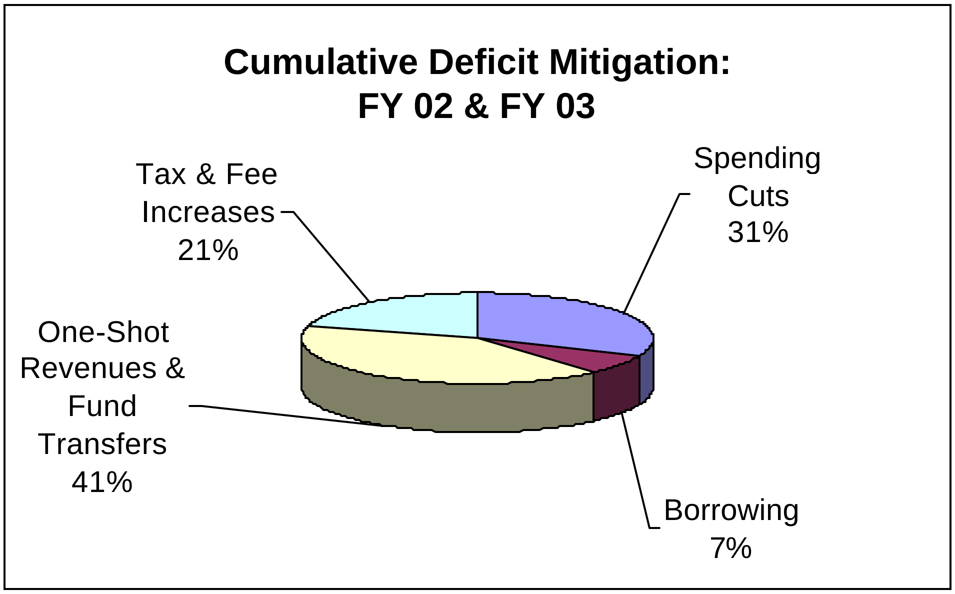
Conclusion: This Bill in Context

HB 6495 must be considered in context -- against the backdrop of the $2.29 *billion* of deficit-mitigation that had already has taken place before HB 6495 was adopted. To date, deficit-mitigation had relied far more on one-time revenues/fund transfers (46% of the solution), spending cuts (30%), and borrowing (10%), than on increasing fees and taxes (14%). The failure to *increase* Connecticut's on-going revenues was of particular concern since the primary reason the General Fund has a deficit now is excessive tax cutting in the late 1990s, rather than excessive state spending. Over the late 1990s, the General Assembly and Governor approved some $2 billion in permanent tax cuts when economic times were good and the state was awash in capital gains-related income tax revenues. Since our deficits result primarily from excessive revenue reductions, rather than excessive increases in state spending in the late 1990s, restoring state tax revenues *must be* an important element of *permanent* budget solution.

Importantly, HB 6495 restores some of the depleted General Fund revenue stream. However compared to the vetoed budget, HB 6495 generates *less* in new, on-going revenues, as the following table illustrates:

New State Revenues in HB 6495 & the Vetoed Budget Bill: A Comparison				
	HB 6495 (Approved Bill)		PA 03-1 (Vetoed Bill)	
TAX & FEE INCREASES	FY 03	FY 04	FY 03	FY 04
Personal Income Tax				
Rate change	$207.4	$403.9	$245.0	$478.0
Property tax credit phase-out	Not included	Not included	$0	$12
Sales/Use Tax				
Repeal exemptions	$24.1	$75.5	$40.1	$119.5
Reduce clothing exemption	$7.8	$30.0	$10.4	$30.0
3% tax on computer and data processing services	Not included	Not included	$6.4	$20.0
Cigarette Tax				
Increase tax by 40 cents/pack	$27.5	$70.9	$30.5	$70.9
Business Tax				
Temporary surtax	$32.4	$33.0	$32.4	$53.4
Fees				
Increase various fees	$1.7	$5.65	$1.7	$5.65
Estate/Inheritance Tax				
Postpone phase-out	Not included	Not included	$0	$6.5
Gift Tax				
Postpone phase-out	Not included	Not included	$0	$1.0
Real Estate Conveyance Tax				
Temporary rate increase	Not included	Not included	$10.0	$41.0
TOTAL NEW TAXES/FEES	$300	$619	$377	$838

Including HB 6495, Connecticut has addressed nearly *$3 billion* in General Fund deficits since the first rescissions in late 2002. The following table and chart shows the allocation of *all* deficit-mitigation to date for FY 02 and FY 03, through and including HB 6495. What is noteworthy is that for every $1 of tax and fee increases to date, there have been $1.54 of spending cuts.



Deficit Mitigation to Date: FY 02 and FY 03 (through HB 6495) (in millions)				
	FY 02	FY 03 prior to HB 6495	HB 6495	**TOTAL**
Spending Cuts[12]	$353	$340	$241	**$934**
Borrowing	$222	$0	$0	**$222**
One-Shot Revenues/Fund Transfers[13]	$595	$470	$120	**$1,185**
Tax & Fee Increases	$54	$263	$299	**$616**
TOTAL	$1,224	$1,073	$660	**$2,957**
Source: Office of Policy and Management: Secretary Ryan's September 2002 Presentation to Governor's Council on Economic Competitiveness & Technology; Hartford Courant, February 28, 2003, p. A12 (citing OPM data)[14]				

[12] "Spending cuts" include reductions in appropriated spending in a variety of budget accounts, reduction in debt service, under-funding teachers' retirement, reduction in town aid (for roads, education), reduction in budget accounts funded with FY 01 "surplus," cuts to carry-forward funds, ordinary and "extratordinary" allotment rescissions and "unallocated lapses."

[13] One-shot revenues/Fund transfers include draining of the Budget Reserve Fund, liquidation of the Anthem stock, revenues received from the tax amnesty program, a retroactive home care payment, transfers from the cash reserves of quasi-public agencies and various other Funds to the General Fund.

[14] This report's characterization of what are one-short revenues & fund transfers differs somewhat from what was reported in the Hartford Courant. This report concludes there are about $140 million in one-shot revenues and fund transfers in HB 6495, rather than the $120 million reported in the Courant.

TABLE I: AGENCY ACCOUNT	**Gov's 1/24 Rescissions (in millions)**	**HB 6495 (sec.1) (part-year cuts)** (in millions)	**Larger of 1/24 Rescissions & HB 6495 – i.e., What Section 1 Approves** (in millions)
Commission on Children			
Social Health Index		-0.03	-0.03
State Comptroller			
Personal Services		-0.25	-0.25
Other Expenses		-0.1	-0.1
OPM			
Drugs Don't Work		-0.085	-0.085
LEAP		-0.45	-0.45
Children and Youth Program Development		-0.217	-0.217
Justice Assistance Grants		-0.699	-0.699
Boys and Girls Club		-0.087	-0.087
Drug Enforcement Program *(other than payments to local towns)*		-0.692	-0.692
Drug Enforcement Program (grants to towns)		-2.7	-2.7
PILOT-New Manufacturing Machinery		-12.0	-12.0
Waste Water Treatment Host Grant		-0.1185	-0.1185
Office of Workforce Competitiveness			
Personal Services		-0.1	-0.1
CETC Workforce		-0.31	-0.31
Department of Administrative Services			
Personal Services		-0.3	-0.3
Department of Information Technology			
Personal Services		-0.3	-0.3
Automated Personnel System		-0.25	-0.25
Department of Public Works			
Other Expenses		-1.5	-1.5
Management Services		-0.75	-0.75
Facilities Design Expenses		-0.75	-0.75
Department of Public Safety			
Personal Services		-1.25	-1.25
Fleet Purchase		-1.6	-1.6

Labor Department			
Other Expenses		-0.1	-0.1
Vocational and Manpower Training	-0.079	-0.25	-0.25
DECD			
Other Expenses		-0.7	-0.7
Cluster Initiative		-0.25	-0.25
Department of Public Health			
Tobacco Education		-0.084	-0.084
Children's Health Initiatives		-0.22	-0.22
Department of Mental Retardation			
Personal Services	-2.0	-1.0	-2.0
Other Expenses		-0.5	-0.5
Early Intervention		-1.0	-1.0
Employment Opportunity & Day Services		-1.5	-1.5
Department of Mental Health and Addiction Services			
Regional Action Councils	-0.023	0	-0.023
General Assistance Managed Care	-3.38	-2.5	-3.38
Special populations		-2.6	-2.6
Gov's Partnership to Protect CT's Workforce	-0.02	-0.164	-0.164
Department of Social Services			
Other Expenses		-1.0	-1.0
Medicaid	-3.0	-32.45	-32.45
Old Age Assistance		-0.143	-0.143
Aid to the Blind		-0.004	-0.004
Aid to the Disabled		-0.325	-0.325
ConnPACE		-2.371	-2.371
Child Care Services/TANF/CCDBG		-0.5	-0.5
Human Resource Development (659)		-0.64	-0.64
Housing/Homeless Services	-0.12		-0.12
Disproportionate Share-Emergency Medical		-5.0	-5.0
State Administered General Assistance		-1.083	-1.083
Department of Education			
American School for the Deaf	-0.375		-0.375
State Library			
Basic Cultural Resources Grant		-0.626	-0.626
CT Educational Television		-0.217	-0.217
University of CT			
Operating Expenses		-1.141	-1.141
Tuition Freeze		-0.03	-0.03

Regional Campus Enhancement		-0.04	-0.04
University of CT Health Center			
Operating Expenses		-0.463	-0.463
AEHC for Bridgeport		-0.001	-0.001
Charter Oak State College			
Operating Expenses		-0.009	-0.009
Distance Learning Consortium		-0.006	-0.006
Regional-Technical Colleges			
Operating Expenses		-0.768	-0.768
Tuition Freeze		-0.014	-0.014
Woodland Street Operating Expenses		-0.003	-0.003
Connecticut State University			
Operating Expenses		-0.822	-0.822
Tuition Freeze		-0.041	-0.041
Waterbury-Based Degree Program		-0.005	-0.005
Department of Correction			
Personal Services		-2.443	-2.443
Other Expenses		-0.216	-0.216
Equipment		-0.121	-0.121
Workers' Comp Claims		-0.366	-0.366
Inmate Medical Services		-0.353	-0.353
Department of Children and Families			
Personal Services	-0.17	-0.17	-0.17
Other Expenses	-0.191	-0.191	-0.191
Short Term Residential Treatment	-0.0001	-0.0001	-0.0001
Substance Abuse Screening	-0.043	-0.043	-0.043
Local Systems of Care	-0.012		-0.012
Health Assessment & Consultation	-0.004	-0.004	-0.004
Grants for Psychiatric Clinics for Children	-0.662	-0.622	-0.622
Day Treatment Programs for Children	-0.287	-0.418	-0.418
Juvenile Justice Outreach Services	-0.029		-0.029
Child Abuse & Neglect Intervention	-0.067		-0.067
Community Emergency Services	-0.002		-0.002
Community Based Preventive Services	-0.031		-0.031
Family Violence Outreach & Counseling	-0.003		-0.003
Community Based Prevention Programs	-0.031	-0.031	-0.031
Support for Recovering Families	-0.001	-0.001	-0.001
Substance Abuse Treatment	-0.06		-0.06
Child Welfare Support Services	-0.004	-0.004	-0.004
Board & Care: Adoption	-0.605	-0.351	-0.605
Board & Care: Foster	-0.5		-0.5

Board & Care Residential	-3.67		-3.67
Individualized Family Supports	-0.095		-0.095
Community KidCare (628)	-0.715	-1	-1
Council to Administer the Children's Trust Fund			
Children's Trust Fund		-0.285	-0.285
Judicial Department			
Personal Services		-0.845	-0.845
Other Expenses		-1.655	-1.655
TOTAL GENERAL FUND	**-16.18**	**-93.27**	**-100.3**
SPECIAL TRANSPORTATION FUND			
Town Aid Road Grants		**-9.0**	**-9.0**
PEQUOT FUND			
Grants to Towns		**-21.5**	**-21.5**