CONNECTICUT VOICES FOR CHILDREN

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Testimony Concerning:
SB 28, An Act Implementing the Governor's Budget Recommendations Concerning Certain Taxes and Revenues &
HB 5028, An Act Concerning Property Tax Limits, Relief from Unfunded Mandates, Regional Performance Incentives, Municipal Operational Efficiencies and Property Tax Credits for Certain Volunteers

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Finance, Revenue and Bonding Committee
March 11, 2008

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

I am President 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. We 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, just as it is to Connecticut's businesses.

CT Voices has concerns about a number of the Governor's proposed revenue changes that would reduce General Fund revenues in FY 09 by $78.6 million and (together with the impact of a slowing economy and some increasing state costs) result – according to a recent projection by OFA -- in a FY 09 deficit of $93.4 million.

SB 28, An Act Implementing the Governor's Budget Recommendations Concerning Certain Taxes and Revenues.

1. CT Voices opposes the elimination of the Business Entity Tax.[1] The basis for our opposition includes: a) if the goal is to help small business, elimination is overbroad since not all business entities paying Connecticut's Business entity tax are small businesses;[2] b) Connecticut's Business Entity Tax is less burdensome than our neighboring states;[3] c) to reduce the significant loss of revenues in FY 09 and FY 10 and truly target relief to small business, it would be fairer to create a graduated Business Entity Tax, not a total exemption.[4]

[1] For more complete critique, see S. Geballe, *The Case for Reforming, Not Eliminating, Connecticut's Business Entity Tax* (February 2008), available at: www.ctkidslink.org/publications/bud08businessentitytax.pdf..
[2] In 2003, 18 of Connecticut's 100 largest companies (based on sales) paid this $250/year tax (not the corporation business tax) and close to three-quarters of the production companies claiming a combined total of $51 million in saleable "film production" tax credits (36 of the 49 companies) are LLCs so also pay the $250/year tax for the privilege of doing business in Connecticut.
[3] Some states impose a tax on each *member* or *partner* in the business entity (e.g., New York). Others impose an additional tax based on the *net income* of the entity (e.g., New Jersey, New Hampshire) or charge a higher annual entity tax (Rhode Island at $500/year/entity). At $20.83/month, this tax hardly burdensome; it's less than many professional license fees.
[4] For example, small companies (e.g., with gross receipts below $50,000/year or total assets under $50,000) could pay a smaller tax (or no tax), while large, very profitable companies or LLCs that are holding real estate or other assets to insulate their

2. CT Voices opposes the enactment of <u>any</u> new business tax credits – including the Governor's proposed "green building corporation tax credit" - until there is a comprehensive assessment of all business tax credits, repeal of those providing insufficient return on investment, adoption of clear standards for transparency and accountability, and a plan for periodic and independent review of tax credits against pre-defined and clear performance benchmarks.[5] Although the goal of reducing greenhouse gas emissions is an essential one, CT Voices cannot support a new corporate tax credit "in the amount of 25% of the cost of the investment, up to $50,000 per business per year" absent some independent economic analysis of the need for and merit of this particular tax credit and its opportunity cost.

Further, given the rapid growth in the state's business tax credits since the state spending cap was adopted (in number and amount of revenue loss),[6] the loss of control over state budgeting that results from the enactment of tax credits that are uncapped in terms of their total revenue loss/year,[7] and the lack of transparency and accountability that now exists when economic development is done through our tax code,[8] we would *strongly* urge the Committee to *impose a moratorium* on the enactment of *any* new tax credits until this comprehensive assessment has occurred and its recommended changes have been implemented.

3. The Governor's proposed exemption of "working farms" from the estate tax is overbroad. CT Voices concurs that the preservation of farmland is an important state priority, but believes that the Governor's proposal is not as well targeted as it should be for the following reasons. First, there is little evidence that the estate tax has posed a significant problem for farmers (according to the Congressional Budget Office,[9] only 1,659 farmers *nationwide* owed any federal estate tax in 2000 when the federal estate tax exemption was $1.35 million/couple; 92% of these estates had liquid assets sufficient to pay the tax). Second, an **unlimited** estate tax exemption for farmland could be abused by wealthy individuals whose primary occupation is not farming.[10] Third, taxes on the transfers of accumulated wealth have been a part

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wealthy owners from personal liability would pay more than $250/year, as *their* share of public investment in the services and labor force they need to succeed.

5 For a more thorough examination of Connecticut's business tax credits, see S. Geballe, *Business Tax Credits: The Blank Check in Connecticut's Economic Development Portfolio?* (February 2008), available at:: www.ctkidslink.org/publications/bud08taxcredits.pdf.

6 In FY 09, Connecticut projects a $305.6 million revenue loss from corporate business tax credits (and a $338.3 million revenue loss from *all* business tax credits combined). This is 113 times greater than the revenue loss from corporate tax credits twenty years ago, and six times greater than the FY 08 operating budget of the Department of Economic and Community Development (including bond and carry-forward funds).

7 Just a third of Connecticut's business tax credits put a ceiling on the total amount of credits that can be claimed in a given year. As a result, the state's total revenue loss through tax credits is open-ended. So, for example, although the revenue loss from the "green building" tax credit is estimated to be $2.0 million annually beginning in FY 10, experience with other tax credits that are uncapped suggests that the revenue loss may far exceed this. The "film production" tax credit originally was projected to result in a $28.9 million revenue loss in FY 09. The Office of Fiscal Analysis now projects a $90.5 million revenue loss from this one alone (i.e., 27% of the *total* in business tax credits in FY 09).

8 Economic development assistance awarded through the CT Department of Economic and Community Development (DECD) creates a paper trail regarding the economic benefits awarded to a corporation, the corporation benefiting, and the expected benefits to the state from the award (including new jobs). There is *no* comparable oversight for tax credits. Further, no comprehensive and strategic economic development plan seems to guide the adoption of new tax credits. There is no process for the on-going periodic review of existing tax credits and repeal of those with inadequate return on the state's investment, and no required independent inquiry into the opportunity costs of our current tax credits (i.e., if the current $338.3 million in FY 09 business tax credits were invested into *different* industries or projects, could Connecticut get even greater economic return?).

9 Congressional Budget Office, *Effects of the Federal Estate Tax on Farms and Small Businesses* (July 2005), available at http://cbo.gov/ftpdocs/65xx/doc6512/07-06-EstateTax.pdf.

10 Although the Governor's proposed exemption would apply only to "working" farms, it does not seem also to require that the property owner of that "working farm" be the farmer and it sets no ceiling on the amount of the exemption. The land could be leased, for example, to someone "working" the farm. Further, although the proposal appears to condition the exemption on continuing to farm the land, the requirement is just for ten years after the decedent's death. A sale to developers could

of Connecticut's tax code since at least the early 1900s, and make our state and local tax system more equitable. Finally, with farmland preservation as a goal, the reform could be more precisely targeted by amending Connecticut law to provide some special protection for Connecticut farmers, as federal law does, such as through: a) special use valuations if the property continues as a family-owned farm; b) allowing the tax to be paid over multiple years; and c) reductions in estate valuation for qualified conservation easements. Alternatively, Connecticut also could *increase* its estate tax exemption by some fixed amount if "working farmland" is a significant part of the estate and the farm passes to family members who continue to farm it. Washington State, for example, provides a separate $2 million exemption, in addition to its standard $2 million exemption, if 50% of the estate was in property used for farming at the time of the decedent's death, the family materially participated in the farm's operations, and the property has passed to a family member.

4. CT Voices questions the value of the proposed sales tax exemption for Energy Star Appliances. The Governor's proposed 12-month sales tax exemption for Energy Star appliances (effective July 1, 2008 through June 30, 2009) is "expected to save consumers $23 million." CT Voices questions the value of this new exemption, particularly given the projected revenue loss. With energy prices in Connecticut increasing, there is every reason to believe that consumers will increase their conservation behaviors simply to reduce their energy costs. Further, this tax credit is likely to disproportionately benefit Connecticut's wealthier families, since they are the families who most easily can afford to conserve energy by replacing appliances *before* they are broken -- and would do so even without a sales tax exemption.

We also are concerned with the continued erosion of Connecticut's sales tax base, to which this currently-"temporary" exemption would contribute. There now are 121 exemptions to Connecticut's sales tax, two-thirds of which have been enacted since 1980 (and most since 1990). OFA estimates a $2.57 *billion* revenue loss in sales and use taxes in FY 09 due to exemptions, compared to the $3.68 billion in sales tax that the Governor estimates *will be* collected. That is, in FY 09, *for every dollar of sales tax collected, Connecticut will not collect close to seventy cents due to exemptions from this tax.* Were some or all of the exemptions repealed, it would be possible to substantially *reduce* Connecticut's sales tax rate. This would make *many* products and services more affordable, not just those that happen to benefit from a preferential sales tax exemption.

HB 5028, An Act Concerning Property Tax Limits, Relief from Unfunded Mandates, Regional Performance Incentives, Municipal Operational Efficiencies & Property Tax Credits for Certain Volunteers

CT Voices opposes the Governor's proposal for a cap on the growth of local property taxes, but supports some of her proposals to assist cities and towns in containing health and energy costs and to encourage towns to join together to provide services on a regional basis.[11] As part of a more comprehensive property tax reform package, the Governor again has proposed a cap on the growth of local property taxes. The cap would be phased in, starting at 4% in FY 09, declining to 3.5% in FY 10, and reaching 3% in FY 11 and the years thereafter. The proposal contained some exemptions to the cap including: a) for regional school district increases above the cap limit; b) for certain types of major cost increases; and c) "general" overrides that would require a two-thirds approval of the local legislative body, with voters able to *reverse* any legislative action to override that limit. Municipalities also would be allowed

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thereafter occur without penalty. See SB 28, An Act Implementing the Governor's Budget Recommendations Concerning Certain Taxes and Revenues, §§5-7.

[11] For more complete critique of the 2008 property tax cap proposal, see S. Geballe, *The Governor's Proposed Property Tax Cap: The Wrong "Cure" for Connecticut's Relatively High Property Taxes* (February 2008). Available at: www.ctkidslink.org/publications/bud08propertytaxcap.pdf.

to opt out of the cap for two-year periods, but only with a two-thirds vote of the municipality's legislative body and with approval by town voters.

There are significant problems with the property tax cap as the Governor has proposed. They include:

- **The proposal fails to address the single biggest factor contributing to high property taxes – insufficient state aid to cities and towns.** Recent history in Connecticut shows, in fact, that when the state is a good partner in helping its towns, property tax growth remains below 3% each year, *without a cap.* The Governor noted last year, "During the five year period from FY 1994-95 to FY 1999-00, state aid increased by an average of 4.65% per year, while property taxes increased by an average of 2.87% per year. Conversely, during the five year period ending FY 2004-05, state aid increased by an average of less than 1% per year, while property taxes increased by almost 6% per year…Additional state aid is a critical first step in providing property tax relief."[12] Yet, the Governor's proposed FY 09 budget revisions would actually reduce funding to towns by $26.2 million from the original FY 09 appropriated level.

- **The cap is not conditional on state exemptions of local property taxes remaining constant.** The proposed cap would allow spending over the cap "in the amount of any decrease in state grants-in-aid for any fiscal year over the amount of such state grants-in-aid for the preceding fiscal year." However, there is no escape valve for towns if the state exempts more of its property from tax, or level-funds the state grants (resulting in a reduction in state resources, adjusting for inflation).

- **The cap's exemptions (by vote of the local legislative body), general overrides, and opt-out provisions, while creating a more flexible cap than the cap the Governor proposed in 2007, will likely result in growing inequities across our cities and towns.** Connecticut's 169 cities and towns vary greatly, including in the composition and value of their grand lists (and the proportion of property exempt from tax), in factors known to contribute to the need and demand for town services (e.g., age composition of the population, number of miles of roads, population density, age of infrastructure, rate of population growth), and in the extent of the towns' unfunded liabilities (health, pension). Given these differences, the impacts of a 3% cap on property tax growth will be experienced in 169 different ways that cannot be easily predicted.

However, research done on the impact of spending caps in other states shows that override votes are more common in wealthy communities. Further, when override votes occur, they also are more likely to be successful in wealthy communities. If Connecticut's wealthier towns vote to over-ride, or opt-out, of the cap, current disparities in educational and other pubic resources will further expand. Wealthier communities will see a further increase in their property values as their town services and schools excel relative to other towns, while Connecticut's poorer towns and cities will continue to lose ground in education, services and property values.

Although CT Voices opposes the proposed cap on property taxes, **it supports** the proposals in this bill to help cities and towns control their health care and energy costs (§§ 5-6), as well as proposals that would encourage, and provide financial support for, efforts by towns to work together to achieve economies of scale through regional partnerships (§§ 10-11).

Thank you for your consideration of this testimony.

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[12] Governor Rell, *Investing in Our Future: Targeting Educational Excellence and Property Tax Relief in Connecticut* (PowerPoint Presentation, March 27, 2007), p.17.