CONNECTICUT VOICES FOR CHILDREN

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Testimony Concerning:
SB 592, An Act Establishing Tax Credits for Angel Investors
HB 5843, An Act Concerning Entertainment Industry Tax Credits
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Finance, Revenue and Bonding Committee
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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.

SB 592, An Act Establishing Tax Credits for Angel Investors

CT Voices opposes the enactment of <u>any</u> new business tax credits – including this proposed tax credits for angel investors" - until there is a *comprehensive* economic and fiscal assessment of *all* current business tax credits. This should include analysis not only of their individual return on investment but also their opportunity costs), repeal of those credits 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.[1] The goal of increasing entrepreneurial activity in the state is a worthy goal. However, CT Voices cannot support a new *transferable* credit against the *personal income tax* "equal to thirty percent of such investor's cash investment" up to $125,000 absent some independent economic analysis of the need for and merit of this particular tax credit and its opportunity cost. CT Voices also is concerned that this transferable credit would offset *personal income tax* liability for the first time for any Connecticut transferable business tax credit (which, to this point, has been limited to offsetting corporate business tax and insurance premiums tax liability). Of equal concern is that this bill sets *no* limit on the total revenue loss the state might experience in any given fiscal year from new transferable tax credit.

Further, we would *strongly* urge the Committee to *impose a moratorium* on the enactment of *any* new credit *or* the expansion of any existing tax credits until this comprehensive assessment has occurred and its recommended changes have been implemented. We urge this for several reasons:

- **There has been rapid growth in the state's business tax credits since the state spending cap was adopted (in number and amount of revenue loss)[2] without any recent, comprehensive**

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[1] 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.

[2] 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

assessment of their economic and fiscal value. The Legislative Program Review and Investigations Committee's 2006 study on *Connecticut's Tax System* Committee cited a study by the University of Connecticut's Center of Economic Analysis (CCEA) for the General Assembly's Finance, Revenue and Bonding Committee about the impact of Connecticut's corporate tax policy changes between 1995-2002 (re-released in 2005). The CCEA study concluded that the corporate rate reductions and tax credit and exemption programs enacted in the 1990s were a "mixed and small success for the Connecticut economy" and that the corporate tax rate reductions had had a greater positive impact than the new tax credits and exemptions.[3] Nothing more current or comprehensive has been done.

As the economy slows, it is particularly important that our economic development investments be extremely well-targeted. However, a common concern about tax credits, according to a 2006 report on "film tax" credits by the New England Policy Center of the Federal Reserve Bank of Boston, is that they "subsidize activity not originally targeted and…provide more incentive than needed to induce the desired response."[4]

- **The growth in uncapped transferable tax credits results in a *decline* in the General Assembly's control over state budgeting.** 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 fiscal year. As a result, the state's *total* revenue loss through tax credits is essentially open-ended. For credits that are *not* transferable, the total revenue loss is limited by the amount of tax liability that can be offset by the business claiming the credits. With *transferable* tax credits, however, even this is not a limit. For these credits, the outer limit is the state's *total* corporation business and insurance premiums tax liability. The angel investor tax credit would extend this potential for significant reduction in the state's tax revenues to the personal income tax.

With the state's annual revenue loss being open-ended, the General Assembly's capacity to correctly estimate in-coming revenues is deeply compromised and so also its control over the budget itself. Connecticut's recent experience with uncapped tax credits suggests that their revenue loss may far exceed original estimates. For example, 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 credit alone (i.e., 27% of the *total* in business tax credits in FY 09).

- **The General Assembly and DECD cede control over the allocation of Connecticut's economic development resources whenever transferable and uncapped tax credits are approved.** Everyone in Connecticut has a shared interest in keeping the state economically competitive – through investments in our schools and universities, training for our workforce, an ample supply of affordable housing, an infrastructure that supports economic growth, and well targeted economic incentives that help increase the number and quality of jobs. The CT Department of Economic and Community Development's new Economic Strategic Plan seeks to create a framework for thoughtful and strategic investment. This effort is undermined, however, by the adoption of transferable and uncapped tax credits. No longer do DECD and the General Assembly have control over the total incentive package provided to an industry, or an individual business. Uncapped and transferable tax credits undo the best-laid plans to balance investment across industries; as the revenue loss from an uncapped credit soars, it crowds out

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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).

[3] Legislative Program Review and Investigations Committee, *Connecticut's Tax System* (2006), pp. 202-3. The study cited was CCEA, *The Economic Impact of Connecticut's Corporate Tax Policy Changes: 1995-2002* (re-released December 2005), p. i. CCEA's report used the REMI econometric model.

[4] D. Saas, *Hollywood East? Film Tax Credits in New England* (New England Public Policy Center at the Federal Reserve Bank of Boston, October 2006), p. 4.

other economic investment possibilities *unless* the economic activity encouraged results in a net revenue gain to the state.

- **Transparency and accountability in the state's economic development efforts has declined as more and more business incentives are being provided through our tax code.** Economic development assistance awarded through the CT Department of Economic and Community Development (DECD) creates some 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 *all* tax credits. No comprehensive and strategic economic development plan has seemed to guide the adoption of new tax credits and 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. Critically, there is no *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?).

It is ironic that as Results-Based Accountability is being phased in to assess the performance of Connecticut's appropriated spending, accountability for its business "spending" through tax credits and other tax expenditures is diminishing. In an era of increasingly scarce resources, *both* should be scrutinized.

HB 5843, An Act Concerning Entertainment Industry Tax Credits

CT Voices urges the Committee to amend lines 12-21 of Section 1 to eliminate any possibility that production expenses or costs that are incurred *outside* Connecticut could become eligible for *any* tax credits. This language, added by a 2007 amendment to the "film production" tax credit,[5] appears to grant production companies a credit equal to 15% of production expenses or costs that are incurred outside Connecticut if "used" here (i.e., 50% of the 30% credit) between January 1, 2009 through December 31, 2011. As the Office of Legislative Research has reported, this provision seems to conflict with a subsequently-adopted amendment that requires that the 30% credit for qualifying production expenses apply *only* to expenses and costs incurred in Connecticut.[6]

CT Voices objects to the proposed increase in the annual cap on the digital animation production company tax credit from $15 million to $25 million, though we applaud the fact that *this* credit – unlike the other two "entertainment" tax credits -- *has* a cap, some standards that require an on-going Connecticut presence to be eligible for credits, and – with regard to the proposed expansion in this bill – some semblance of a requirement of an *on-going* state presence. As discussed in CT Voices' descriptive report on Connecticut's three "entertainment" tax credits,[7] OFA projects a $116 million FY 09 revenue loss from the "film production," "film infrastructure" and "digital animation" tax credits, or *more than one-third* of the total Connecticut business tax credits. Although the proposed increase in the digital animation credit cap is linked to the move of the Blue Sky Studios, Inc.

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[5] PA 07-236, §1.

[6] PA 07-4 (June Special Session), §69, amended the definition of "production expenses or costs" to clarify that they must be incurred "in the state" [Conn. Gen. Stat. §12-217jj(a)(5)] and also clarified that expenditures in the form of either compensation or purchases in connection with a qualified production must be incurred "in the state." Conn. Gen. Stat. §12-217jj(a)(5)(A). The OLR summary of PA 07-4 (JSS) noted that these provisions "appeared to conflict" with the earlier amendment that allowed some out-of-state expenses to be eligible for the credit.

[7] S. Geballe, *Starstruck? Connecticut's Block-Busting Spending on Entertainment Industry Tax Credits: Part 1: The Credits and Who is Claiming Them* (February 2006), available at: www.ctkidslink.org/publications/bud08enttaxcreditpart1.pdf.

across the border from New York, from press accounts this company already has committed to moving to Connecticut, is receiving other economic development assistance through DECD, and may be eligible for *other* tax credits if it creates *new* jobs in Connecticut. We applaud the effort, in lines 211-219, of the bill to attempt to tie the $10 million increase in tax credits to *some* standards: that the company execute a "binding" lease for at least 10 years; relocate "digital animation production activities conducted in another state to this state;" and "propose to undertake" an infrastructure project (that may also be eligible for tax credits). However, we are concerned that, absent an economic analysis that shows that the "digital animation" tax credits pay for themselves in increased tax revenues, this tax credit increase for a firm that already has committed to come to Connecticut will be at the expense of other essential public investment.

We also wonder at what point such specifically-targeted tax relief measures run afoul of the Connecticut Constitution's ban on "exclusive public emolument or privilege" (Article First, §1), as recently interpreted by the Connecticut Supreme Court in *Kinney v. State* (SC 18020, March 4, 2008).

CT Voices urges the Committee to *amend* this bill to target much more precisely the types of production activities that are eligible for the "film production" tax credit so that the net loss of revenue to the state from this credit is reduced. The CT Department of Economic and Community Development's recently-released report, *The Economic and Fiscal Impacts of Connecticut's Film Tax Credit,* found a "small and positive" impact on the Connecticut economy, but a *negative* fiscal impact on the state, with the $16.5 million in tax credits resulting in economic activity that returned just $1.25 million in state tax revenues (over a five-year horizon). This results in a net revenue loss of $15.25 million for the 13 productions studied (5 feature films, 3 television productions and 3 commercials or infomercials).

The study notes in its conclusion, "For every dollar spent on the tax credit, the state receives $0.08 back in additional revenue. This will have a small favorable fiscal impact *only if the state government pays for the film tax credit by reducing spending*." (p. 39, emphasis added). That is, there is a $1.25 million "gain" in film-related tax revenues *only after* Connecticut cuts its state spending by the amount of the tax credits; the tax credits do *not* pay for themselves. This finding – that Connecticut's film production credit is not paying for itself – is consistent with other studies of such credits, as discussed in the 2006 Policy Brief by the New England Public Policy Center of the Federal Reserve Bank of Boston, *Hollywood East? Film Tax Credits in New England*.[8] This report states:

> The evidence available suggests that film tax credits do attract film production and create jobs in states that have little or no film industry. However, they also cost states considerable foregone tax revenue. The film production stimulates little additional economic activity in other industries. Consequently, the film tax credits do not "pay for themselves" by indirectly generating additional corporate income, sales, and property tax revenues.

The report continues, "As more evidence becomes available, policy analysts and policymakers should evaluate the cost-effectiveness of film tax credits *relative to alternative policies designed to promote job creation and economic growth*. They should also take into account the economic effects of measures needed to offset the revenue losses incurred by film tax credits in order to maintain balanced budgets." (p. 1, emphasis added).

Notably, this Policy Report noted that Louisiana's fiscal analysis of its film tax credit found that for every dollar of revenue lost through the credit, it recovered 15 to 20 cents of revenue from tax receipts generated by stimulated economy activity – or about *twice* what DECD's report found was Connecticut's

[8] D. Saas, *Hollywood East? Film Tax Credits in New England* (New England Public Policy Center at the Federal Reserve Bank of Boston, October 2006).

revenue return. A clue to why Connecticut's revenue return is just *half* Louisiana's is found on p. 26 of DECD's report: "These findings suggest that the tax credit has attracted the more 'footloose" filming activities rather than the industry's underlying or fundamental activities" and on p. 39 where the report notes, "Connecticut experiences the tax credit impact during the year for which productions shot in the state (sic). The effects quickly dissipate after the productions complete their work and *leave the state.*" (emphasis added).

To reduce Connecticut's net revenue loss from this tax credit and more precisely and strategically target its incentives, some changes should be made to the statue authorizing the "film production" tax credit. Some possible changes are as follows:

- **Restrict tax credits to *new* production activity; eliminate eligibility for production work that already was being done by a Connecticut production company.** For example, some of the credits being claimed are for the World Wrestling Federation's TV shows Smackdown and RAW which have been airing since 2005. The production tax credits should target *new* production activity, not subsidize pre-existing activity.
- **Eliminate credits for the production of commercials, infomercials and other productions created for advertising purposes.** Tax credits intended to encourage new "film" production should not subsidize ordinary business expenses, such as producing commercials and infomercials.
- **Place a $1 million/person ceiling on payments to actors, producers, writers and other "above the line" personnel.** The DECD study characterized our $15 million/person cap as "extreme."
- **Clarify that the credit is limited to expenses that are *incurred* in Connecticut, not expenses incurred *outside* Connecticut that are *used* in Connecticut.**
- **Limit the credit to Connecticut-incurred expenditures that result in direct benefit to Connecticut businesses and residents or -- alternatively – create a smaller credit for Connecticut-incurred expenses for services and goods that are provided by non-resident companies and individuals.** This would reduce the extent to which Connecticut underwrites, for example, 30% of the costs of New York film crews that travel to the state and then return to New York with the money earned here.
- **Reduce the credit to something smaller than 30% of Connecticut production costs.** This would reduce the state's net revenue loss but keep Connecticut "competitive" with other states.
- **Bar the production company's sale of the credits, so the credits can only be taken against the production company's own tax liability.** This would better tie the revenue loss to actual state revenue gain. Credits have been sold to a bank, a department store, and a manufacturer.
- **Set a cap on the total amount of tax credits that can be awarded to any one production or any one company.** This would better distribute the incentive across multiple companies, expanding the base of state investment.
- **Set a cap on the total amount in credits that can be awarded each year.** This would limit the state's potential net revenue loss and assure better balance in the state's economic development portfolio. New York, for example, has an annual cap. If a company qualifies for credits in a year the cap has been reached, it can claim the credits in a subsequent year.
- **Switch the agency authorizing the credits from the Commission on Culture and Tourism to the Department of Economic and Community Development so improve oversight and integration with other state economic development initiatives.**
- **Sunset the tax credit after three years and require *independent* evaluation of the credit against some predetermined metrics** (e.g., number and quality of jobs created, net fiscal impact on state, opportunity cost of the credit).

Thank you for consideration of this testimony.