ACCY Advocates for Connecticut's Children and Youth

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Testimony Concerning

Senate Bill 1118, An Act Concerning Economic Development

Testimony of Shelley Geballe, JD, MPH, Douglas Hall, PhD, & Mary Glassman, JD
Finance, Revenue and Bonding Committee
March 13, 2007

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

Shelley Geballe is President, Douglas Hall is Associate Research Director, and Mary Glassman is Director of Legislative Affairs of Connecticut Voices for Children, a research and policy organization that works statewide to promote the well being of Connecticut's children, youth and families. We submit this written testimony on behalf of Voices' sister lobbying organization – Advocates for Connecticut's Children and Youth (ACCY).

We support the Governor's efforts to "clarify" the recently-enacted "movie tax" credit to reduce the state's potential revenue losses, and urge that a cap be placed on the total amount that can be claimed in any year by all claimants.

We oppose the Governor's proposals to expand the job creation tax credit and create a new biofuels tax credit without an objective cost-effectiveness analysis that also considers the opportunity costs associated with the projected revenue losses.

We urge the Co-Chairs of this Committee, acting as Chairpersons of the Business Tax Credits and Tax Policy Review Committee, to convene the Tax Credit and Tax Policy Review Committee, and to study and evaluate all existing credits against the corporation business tax and report annually their findings to this full Committee, as required by Conn. Gen. Stat. §12-217z.

1. There is a great need to clarify the "movie tax" credit, cap the total amount that can be claimed in a single year by all claimants, and sunset the credit unless a neutral assessment of its cost-effectiveness shows it to be equal to or greater than other public investments in promoting the state's economic well-being. Last Session, a new tax credit was created for "qualified" film and digital media production, preproduction and post-production expenses incurred in Connecticut.[1] Credits were available to companies that produced films and other types of television, video, and digital programming content in Connecticut. The *transferable* credit is equal to 30% of the production costs incurred here and is administered by the Connecticut Commission on Culture and Tourism. The estimated revenue loss from the new credit, when the credit was enacted, was $10 million in FY 08 and $20 million in FY 09. However the manner in which the credit was drafted apparently afforded many more opportunities to claim the credit than had been anticipated. The Governor proposes "clarifying" the Film Industry Tax Credit and "focusing its application" and "thus limiting the state's potential exposure by $21.0 million in each year of

[1] PA 06-83 and PA 06-186, effective July 1, 2006 and applicable to income years beginning on or after January 1, 2006.

the biennium"[2] - **an amount far greater than the estimated *total* cost of the credit when it was adopted.** Among the changes the Governor proposes are a $5 million limit on the salaries that are eligible for the credit and an increase in the threshold eligibility of the project from $50,000 to $250,000. To prevent an unlimited raid on the state treasury, this credit should be capped pending a neutral assessment of its cost effectiveness and whether the revenues forgone should be better used for other public investment.

> **For example, the projected FY 09 revenue loss from the "movie tax" credit when it was adopted last year ($20 million) is roughly equal to the funding now being sought by the University of Connecticut to hire sufficient professors to address the surge in the number of enrolled students ($22.2 million). Query which investment would provide a greater long-term return on the state's investment?**

2. **The job creation tax credit should not be so generously expanded.** In the 2006 Session, a new tax credit was enacted (PA 06-186) that can be taken against various business taxes. It is available to firms that: a) relocate to Connecticut; b) create at least fifty new, full-time jobs in Connecticut; and c) hire new employees for these jobs and keep them employed in Connecticut for at least twelve months. A qualifying firm can claim a credit equal to 25% of the income tax withheld from the wages of each new employee for five successive years. Unused credits expire each year and cannot be carried forward to future years. The total amount of credits granted to all firms is not to exceed $10 million in any one fiscal year. Firms planning to re-locate to Connecticut and claim the credit are required to apply to the Commissioner of Economic and Community Development for the credits. The Commissioner is authorized to approve full or partial credits only if the proposed company relocation: a) is economically viable only with the credits; and b) provides a net benefit to economic development and employment in the state. Projected General Fund revenues losses from this new credit are $2 million in FY 07, and $4.0 million in FY 08.

The Governor proposes to eliminate the requirement that firms "relocate" to Connecticut, would grant the credit if only 25 new jobs are created (rather than 50) and would increase the value of the credit to 50% of the income tax withheld from the wages of the new employees and paid to the state. That is, under the Governor's proposal, the current credit would be changed such that if *any* firm creates *half* the number of new Connecticut jobs, it would get *double* the tax credit for up to five years!

Given businesses' concern that Connecticut's lack of qualified workers is a cause of slow job growth, eliminating this credit (and others) and using the revenues saved to enhance education and job training could have a more direct and more long-lasting benefit to the state.

3. **Tax credits are a questionable way to promote economic development.** The recent study on Connecticut's tax system by the Program Review and Investigations Committee of the General Assembly noted that Connecticut's business taxes have been "reduced substantially" and now are not "more burdensome than other states." Further, *The Connecticut Economy,* after review of Connecticut's various business taxes concluded, "There's no disputing that job growth has been sluggish in the Nutmeg State. But the data just reviewed make it hard to argue that the main source of this ooze is an undue burden of business taxation." Indeed, the author suggests that Connecticut should "trumpet to the world that Connecticut is a *low*-tax state to do business."[3]

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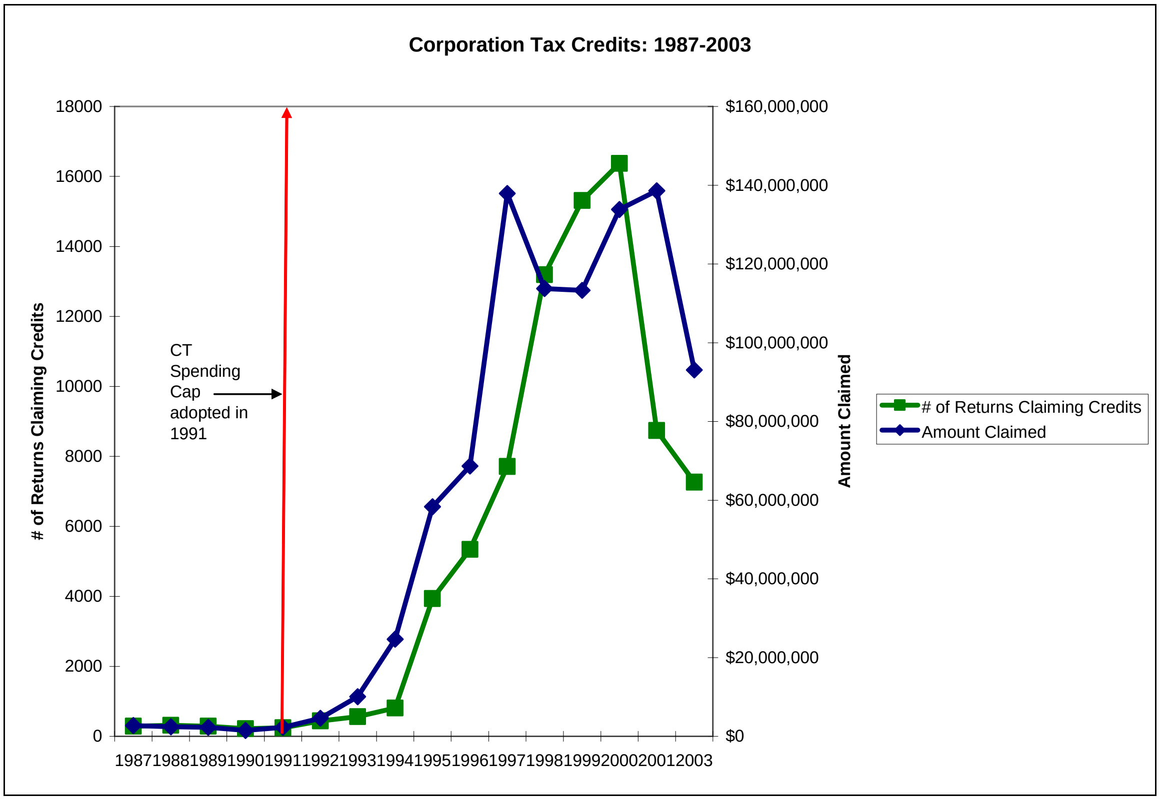
[3] A. Wright, "Connecticut Business Taxes in Perspective," *The Connecticut Economy* (Spring, 2006), pp. 4-7 (relying in large part on a comprehensive study of state business tax burden across all states commissioned by the Council on State Taxation, a trade

The Committee's study also questioned the propriety of "using the tax system to influence economic decisions on spending or investments." The study, in particular, cast doubt on the effectiveness of tax credits, stating "While corporations may be able to superficially demonstrate the use of a particular feature or credit (e.g., number and value of research and development credits taken) it is difficult to assess whether these policies are achieving the desired outcome."[4] **It concluded, "[L]egislative efforts at spurring economic development through tax credits and incentives appear to have little positive effect on job growth or in enhancing the state's competitive position."[5]**

Despite the questionable merits of credits as an economic development tool, there has been an explosion in the number of tax credits created and claimed in Connecticut, since the state spending cap was adopted, as the following chart illustrates:



Using tax credits (as well as other tax expenditures like exemptions and deductions) to promote economic development avoids spending cap constraints; credits are not considered appropriated spending. However, the consequence of using tax expenditures to promote economic development (rather than direct grants and loans through, for example, the Department of Economic and Community Development) is that there is less transparency and accountability. There is no public report that shows which companies claimed tax benefits, and in what amounts, much less the economic benefits that resulted for the state. It can be hard to predict revenue loss, as the recent film tax credit clearly reveals. Credits that are refundable, or transferable, are comparable to outright cash grants, yet fail to have comparable

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association of nearly 600 corporations doing business in multiple states and nations, and completed by tax researchers affiliated with Ernst & Young.

4 Legislative Program Review and Investigations Committee, *Connecticut's Tax System:: Findings and Recommendations* (January 19, 2006), p. 49.

5 Legislative Program Review & Investigations Committee, *Connecticut's Tax System, Findings and Recommendations*, Adopted 1/19/06 pp.1-2.

oversight to DECD grants. Not only are state revenues permanently eroded (except, in the unlikely case, that the tax break is repealed) but policy makers and the public have little idea what the state has gained. This is directly contrary to the goals of Results-Based Accountability in state budgeting.

4. We urge the Co-Chairs of this Committee, acting as Chairpersons of the Business Tax Credits and Tax Policy Review Committee, to convene this Committee, study and evaluate all existing credits against the corporation business tax as required by state law, and report annually to this full Committee as required by Conn. Gen. Stat. §12-217z.

Conn. Gen. Stat. Sec. 12-217z establishes a Business Tax Credit and Tax Policy Review Committee, directs that all appointments to the Committee be made no later than August 15, 2005, directs that the co-chairs of the Finance, Revenue and Bonding Committee be the chairpersons of this Committee, and that the Committee meet "not less than twice a year, and at such other times as the chairpersons deem necessary." The statute further directs that the Committee shall:

> Study and evaluate all the existing credits against the corporation business tax, evaluate changes or modifications made to such tax, and consider further changes in policy regarding the taxation of businesses. The study shall include, but is not limited to, consideration of the following with respect to each credit or policy: (1) Has the credit or policy provided a benefit to the state in terms of (A) measurable economic development, (B) new investments in the state, (C) new jobs or retention of existing jobs, or measurable benefits for the workforce in the state; (2) is there sufficient justification to continue the credit or policy as it currently exists or is it obsolete; (3) could the credit or policy be more efficiently administered as part of a broad-based credit or policy; and (4) does the credit or policy add unnecessary complexity in the application, administration and approval process for the corporation business tax. The committee shall also engage in an analysis of the history, rationale and estimated revenue loss as a result of each tax credit or policy change, and shall recommend revisions necessary to change the tax by eliminating or changing any redundant, obsolete or unnecessary tax credit or any credit or tax policy that is not providing a measurable benefit sufficient to justify any revenue loss to the state.

The Committee is further directed to "report its findings and recommendations to the joint standing committee of the General Assembly having cognizance of matters relating to finance, revenue and bonding no later than January 1, 2006, and annually thereafter, in accordance with section 11-4a."

To our knowledge, this Committee has met just once, to receive a presentation by the Department of Revenue Services. No study and evaluation of existing credits has been conducted, and no report to the Finance, Revenue and Bonding Committee made by either January 1, 2006 or January 1, 2007.

The General Assembly has embarked on a process of Results-Based Accountability in state budgeting. To date, the focus has been only on appropriated spending. It is essential that there be a comparable periodic review of tax credits, just as there is an annual review of appropriations, to assess the cost-effectiveness of this form of public investment in our businesses and economic development.