CONNECTICUT VOICES FOR CHILDREN
20 YEARS OF ADVANCING OPPORTUNITIES FOR CHILDREN AND FAMILIES

Testimony Regarding Revenue Options in Connecticut

Opposing S.B. 10: An Act Concerning Revenue Items to Implement the Governor's Budget

Regarding S.B. 11: An Act Concerning Connecticut's Response to Federal Tax Reform

Opposing H.B. 5009: An Act Exempting Car Wash Services from the Sales Tax

Opposing H.B. 5134: An Act Concerning a Tax Credit for Businesses that Provide Paid Family and Medical Leave

Ray Noonan
Associate Fiscal Policy Fellow, Connecticut Voices for Children
Finance, Revenue and Bonding Committee
March 2nd, 2018

Good afternoon Senator Fonfara, Senator Frantz, Representative Rojas, Representative Davis, and distinguished members of the Committee:

My name is Ray Noonan, and I am testifying today on behalf of Connecticut Voices for Children, a research-based child advocacy organization working to ensure that all Connecticut children have an equitable opportunity to achieve their full potential.

An effective revenue system should advance equitable opportunity, inclusive economic prosperity, and support for our most vulnerable residents. Doing so requires adhering to core taxation principles of equity, adequacy, and transparency. Amidst the background of a looming fiscal crisis, over the last few years, we have seen state policy stray from these principles. Reductions to the Earned Income Tax Credit and Property Tax Credit, critical supports for working families, have made our tax system less equitable. A revenue system that has not kept pace with our changing economy has made our tax system less adequate. The elimination of current services budgeting, which allowed citizens to understand just how much money is necessary to support the services they receive, has made our fiscal system less transparent.

This year is an opportunity to better align the state budget with best-practice principles by adopting equitable, adequate, and transparent tax practices. Through this lens, we see opportunities to improve the legislation discussed today, ultimately promoting equitable opportunity and inclusive economic growth for Connecticut's children and families.

S.B. 10: An Act Concerning Revenue Items to Implement the Governor's Budget

Although the Governor's budget reflects an effort to provide adequate revenue for state government, it includes changes that make the system less equitable. Furthermore, it fails to correct existing structural flaws that over time will limit revenue growth and forestall our state's ability to fund key priorities such as early childhood, transportation, and workforce development.

We **oppose** eliminating the $200 property tax credit for the elderly and households with dependents. This would raise taxes for middle-income families and build upon prior reductions. It would also exacerbate the flaws of Connecticut's property tax system, which makes life harder for working families—the very families harmed by years of austerity. In 2014, the median Connecticut household paid 8.45 percent of its Adjusted Gross Income (AGI) in property taxes, while the top tenth paid 2.29 percent of their AGI to the same.[1]

We urge the legislature to consider revenue options that do not ask more from low-income families. For example, while we appreciate the Governor's proposal to extend implementation of last fall's estate tax changes, we hope that the legislature will consider fully decoupling Connecticut's estate tax from the federal threshold. The federal tax bill doubled the estate tax exemption to $11 million for individuals.[2] As a result, because last fall's budget coupled Connecticut's estate tax exemption to the federal level, federal changes to the estate tax will cost Connecticut $62.3 million annually once fully implemented, money much needed to promote equitable opportunity for all children in the state.[3]

<u>S.B. 11: An Act Concerning Connecticut's Response to Federal Tax Reform</u>

The federal tax changes have pressured Connecticut to adjust its policies to remain competitive even though these changes mostly benefit the wealthy.

The Governor's first proposal, allowing municipalities to set up local charitable funds, benefits only those who itemize to deduct state and local taxes (SALT) from their federal tax liability. Research shows that the wealthiest are much more likely to itemize than the middle class. For Tax Year 2015, the latest year for which data is available, 92 percent of filers with Adjusted Gross Income above $500,000 itemized, as opposed to 7 percent of those making less than $30,000 per year.[4]

The Governor's second proposal, shifting taxes for owners of passthrough businesses, only benefits those who receive income from a passthrough business. This income disproportionately goes to the wealthy. The Brookings Institution notes that "about 70 percent of partnership income accrues to the top 1 percent" and "individuals in the bottom 80 percent earn virtually no pass-through income."[5]

These changes would accrue to the very population that already disproportionately benefitted from the federal tax bill.[6] The wealthiest 1 percent of Connecticut will receive 28 percent of the tax cuts in this bill, more than the share for the bottom 80 percent combined.[7] As a result, the Governor's changes will widen inequalities in effective tax rates between the wealthiest and everyone else.[8] To narrow these inequalities, **we urge the legislature to consider pairing the Governor's changes with others that will ease burdens for low-income families, such as restoring the state Earned Income Tax Credit to 30 percent of the federal credit.**

<u>H.B. 5009: An Act Exempting Car Wash Services from the Sales Tax</u>

We **oppose** this legislation, which would exempt another service from our outdated sales tax. The share of household spending on services has increased, while the share of household spending on goods has decreased.[9] Yet services continue to remain largely untaxed. **We should modernize our tax system, broadening the base of the sales tax while lowering the rate**. A recent analysis estimates that Connecticut could broaden its sales to include services (excluding business-to-business, health, shelter, and education), lower the rate from 6.35 percent to 5.5 percent, and still raise $730 million annually.[10]

These changes are especially important in the context of Connecticut's overall spending for tax expenditures. The Office of Fiscal Analysis's recent Tax Expenditure Report identifies 131 explicit sales tax exemptions, worth more than $4 billion in FY 2019.[11] These figures do not account for services that the state does not presume to be taxable, such as tennis lessons, limousine rides, and interior design, and thus underestimate Connecticut's spending to subsidize various industries. We have attached an appendix listing revenue estimates for applying the sales tax to various services. We hope that this list can help you think about how Connecticut's tax system might begin to align with a modern economy.

<u>H.B. 5134: An Act Concerning a Tax Credit for Businesses that Provide Paid Family and Medical Leave</u>

We **oppose** this legislation. Although we appreciate the bill's intent to incentivize businesses to offer paid family and medical leave, we are concerned that this approach would incentivize this benefit only for full-time employees who receive benefits, not for hourly workers or those who work multiple part-time jobs.

Thank you for this opportunity to testify. Please feel free to contact us if you have questions or need additional information. You can reach me at rnoonan@ctvoices.org or (203) 498-4240 x113.

Appendix: Estimated Revenue Raised by Applying Sales Tax to Services

The table below includes the estimated revenue that could be generated by expanding the sales tax to different services in Connecticut. It does not represent a comprehensive list of all services. The revenue estimates below are approximations. These estimates include business-to-business purchases.

Total	**$1,248.0 million**
Estimates from 2018 Tax Expenditure Report	FY 2019 Revenue Gain if Repealed ($ millions)
Computer and data processing services	218.5
Utilities for agricultural production or manufacturing	44.7
Renovation and Repair for Residential Real Property	30.7
Advertising agencies, advertising time/space, and direct mail	24.2
Calibration Services and ISO Services	15.3
Amusement and recreation services/Carnival rides	13.2
Environmental consulting services	7.2
Health club dues and athletic instruction	3.9
Motion picture leasing or rental	4.1
Tax preparation services	4.1
Sale of repair or maintenance on vessels	3.6
Winter boat storage	1.1
Massage therapist and electrologist services	0.9
Campground rentals	0.8
Media Payroll Services	0.4
Shoe repair services	0.2
Estimates from Institute on Taxation and Economic Policy	**FY 2017 Revenue ($ millions)**
Total	**875.1**
Attorneys / Legal Services	192.3
Architectural and Engineering Services	176.1
Investment counseling and portfolio management	119.8
Accounting and bookkeeping	101.7
Intrastate courier service	80.8
Website creation, hosting, and maintenance	57.8
Barber shops and beauty parlors	32.1
Veterinary services (doctors and hospitals)	29.7
Travel agent services	18.1
Funeral services	14.3
Check and debt collection	13.7
Laundry and dry cleaning services	12.8
Taxi fares	8.1
Interior design and decorating	6.5
Land surveying	2.8
Diaper service	2.5
Fur and clothing storage	2.2
Bowling alleys	2.0
Coin operated video games and pinball machines	1.1
Gift and package wrapping services	0.7

[1] Department of Revenue Services. (December 2014). *Connecticut Tax Incidence.* Retrieved from http://www.ct.gov/drs/lib/drs/research/drstaxincidencereport2014.pdf.
[2] Institute on Taxation and Economic Policy. (January 2018.) *What the Tax Cuts and Jobs Act Means for States- A Guide to Impacts and Options*. Retrieved from https://itep.org/what-the-tax-cuts-and-jobs-act-means-for-states-a-guide-to-impacts-and-options/.
[3] Office of Policy and Management. (February 2018.) *FY 2019 Budget Adjustments: Introduction.* Retrieved from http://www.ct.gov/opm/lib/opm/budget/2019midterm/21_introduction.pdf.
[4] Internal Revenue Service. *SOI Tax Stats – Individual Income Tax Returns Publication 1304 (Complete Report). Table 1.2: All Returns: Adjusted Gross Income, Exemptions, Deductions, and Tax Items.* Retrieved from https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report.
[5] Krupkin, A. & Looney, A. (May 2017). *9 Facts About Pass-Through Businesses.* Retrieved from https://www.brookings.edu/research/9-facts-about-pass-through-businesses/#fact8.
[6] Institute on Taxation and Economic Policy. (December 2017). *How the Final GOP-Trump Tax Bill Would Affect Connecticut Residents' Federal Taxes.* Retrieved from https://itep.org/finalgop-trumpbill-ct/.
[7] *Ibid.*
[8] Institute on Taxation and Economic Policy. (January 2015). *State & Local Taxes in 2015*. Retrieved from https://itep.org/whopays/connecticut/.
[9] Mazerov, M. (November 2016). *Missouri Nixes Sales Tax Base Expansion.* Retrieved from https://www.cbpp.org/blog/missouri-nixes-sales-tax-base-expansion
[10] Institute on Taxation and Economic Policy analysis. See Thomas, D. (January 2017). *Revenue Options are Key to Addressing Budget Shortfalls and Supporting Thriving Communities.* Retrieved from http://www.ctvoices.org/sites/default/files/Revenue%20Options%202017%20FINAL%20updated.pdf.
[11] Office of Fiscal Analysis. (February 2018). *Connecticut Tax Expenditure Report.* Retrieved from https://www.cga.ct.gov/ofa/Documents/year/TER/2018TER-20180201_Tax%20Expenditure%20Report%20FY%2018.pdf.