Testimony Supporting
H.B. No. 7415, An Act Concerning a Surcharge on Capital Gains

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Director of Fiscal Policy and Economic Inclusion
Finance, Revenue, and Bonding Committee
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Senator Fonfara, Representative Rojas, Senator Witkos, Representative Davis, and esteemed members of the Finance, Revenue, and Bonding Committee,

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

Thank you for this opportunity to support H.B. 7415, which would attach a two percent surcharge on capital gains income of tax filers in the top personal income tax bracket—those that report over $500,000 of income for single filers and $1,000,000 of income for joint filers. We strongly support this proposal and urge you to consider broadening it to other sources of unearned income and to the top two personal income tax brackets.

Everyone in America — regardless of where they were born, the state where they live, the color of their skin, or the size of their bank account — should have the opportunity to achieve their goals. Ensuring broad opportunity and prosperity yields gains for everyone, but it won’t happen unless we live our values in how we fund our priorities.

Smart state fiscal policies can play a critical role in building strong, equitable state economies. It is time we fix our tax laws to give working people and children a fair shot to get ahead by pursuing twin goals of assuring adequate revenues to support the programs and services vital to the well-being of our children and families and enhancing the fairness of our tax system.

**Ensuring adequate Revenue and Increasing Tax Fairness**

Increases on the relatively small group of taxpayers at the top of the income distribution—those who can most easily afford to pay more—can generate revenues that would allow lawmakers to minimize harmful cuts to essential services and programs when budgets are tight. Further, these revenues will enable the legislature to invest in initiatives such as expanding early childhood care and education, economic development, and strengthening the budget reserve fund in preparation for the next recession.

Our state tax system as a whole is upside down—it demands more from those at the bottom of the income ladder and less from those at the very top. The wealthy pay a smaller share of their income in state and local taxes than low- and middle-income people do, even though they are best able to pay more. An equitable tax system distributes taxes so that the lowest income taxpayers pay a smaller share of their income than the
highest income taxpayers. Importantly, wealthy households are disproportionately White: White families are three times more likely than families of color to be in the highest one percent of household incomes.

**Broaden the Base to Top Two Income Tax Brackets**

Connecticut Voices for Children has proposed to tax capital gains and qualified dividends on taxpayers in the top two personal income tax brackets. This proposal raises the tax on capital gains and qualified dividends from the current personal income tax rate of 6.9% and 6.99% to 8.5% and 10.75%. This proposal will raise an estimated $427 million annually from taxpayers at the very top of the income ladder.

**Expand Surcharge to Include Dividends and Taxable Interest**

Capital gains are profits from the sale of assets such as stocks, artwork, or real property. One way Connecticut can build a more broadly shared prosperity is by strengthening our taxes on unearned income. Unearned income—capital gains, qualified dividends, ordinary dividends, and interest—are generated by wealth and therefore go overwhelmingly to the wealthiest households in Connecticut.

Taxing capital gains, as well as dividends and interest, at a higher rate than other income would represent a return to the historical treatment of unearned income in Connecticut. When policymakers enacted Connecticut’s income tax in 1991, they also cut taxes for wealthier taxpayers by eliminating a seven percent tax on capital gains and a 14 percent tax on dividends and interest. Thereafter, investment incomes were subjected to the state income tax at a much lower rate of 4.5 percent. While the top income tax rate has increased to 6.99 percent, it is still below pre-1991 levels on unearned income.

Capital gains, dividends and interest are generated by wealth. Because wealth is highly concentrated, so is capital gains income. About 80 percent of capital gains income goes to the wealthiest five percent of taxpayers; 69 percent goes to the top one percent of taxpayers.

Adopting this modest increase to capital gains and qualified dividends could raise $427 million annually. Expanding this proposal to also cover ordinary dividends and interest would raise $550 million annually, with 98 percent of that revenue paid by the top one percent of Connecticut taxpayers. With this increase on unearned income, Connecticut would remain competitive with our neighboring states.

This surcharge would fall on those who can best afford it. As a fact sheet attached to my testimony describes, federal tax cuts proposed by the Trump administration and approved by Congress provided a windfall for the wealthiest five percent of Connecticut’s residents, who will pay $2 billion less in taxes in 2019. Even after the more modest capital gains proposal described above, which would raise $427 million, they would still enjoy a net tax cut of $1.6 billion. The top one percent of households would see an average net reduction of $36,000 in taxes.

Connecticut Voices for Children has proposed five specific revenue options that address both adequacy and equity in our tax system. We urge you to consider these proposals. The full brief can be found on our website at ctvoices.org.

**Preserve and Strengthen the Estate Tax**

Importantly, Connecticut Voices urges the legislature to preserve and strengthen the estate tax. Without an estate tax, a substantial portion of intergenerational transfers of wealth will become completely exempt from any state taxation, ever. That is because without an estate or inheritance tax, unrealized capital gains pass to an heir with a basis of the value as of the date of receipt. Unrealized capital gains account for a significant
proportion of the assets held by large estates, ranging from 25 to 32 percent of the value of estates worth between $3.5 and $10 million and as much as 55 percent of the value of estates worth more than $100 million.4

Inequality in Connecticut has reached record highs. Connecticut is the third most extreme state in terms of income inequality, with one percent of families taking home 27.3 percent of all income.5 Eliminating the estate tax and capping the estate tax at $15 million would perpetuate these disparities by allowing unlimited, untaxed, inter-generational transfers of wealth. The equalizing trends that followed progressive tax reform in the early 20th century have now been largely undone and “the wealthiest Americans now hold as large a wealth share as they did in the 1920s.”6 Almost every other state in the Northeast has an estate or inheritance tax. New York, New Jersey, Pennsylvania, Rhode Island, Massachusetts, Vermont, Maine, and the District of Columbia presently have an estate tax. By 2023, when Connecticut’s estate tax exemption is scheduled to match the federal exemption of $11.2 million, most of these states will have exemption levels that are significantly lower than the exemption level in Connecticut. These states also do not impose a cap on the amount of tax owed, as Connecticut does.

I thank you for this opportunity to testify in support of HB 7415 and I welcome any question you may have. I can be reached at jmills@ctvoices.org or 203-498-4240 (x 104).

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1 Institute for Taxation and Economic Policy, April 2019.
6 http://inequality.org/facts/wealth-inequality
Revenue Options to Support a Strong Foundation for Connecticut’s Future

April 2019

We can build a growing, inclusive economy that enables all families to thrive, provides quality education for all children from cradle to career, and offers the support services necessary so that all children have an equitable opportunity to reach their full potential.

To achieve this goal, Connecticut needs an adequate and equitable tax system.

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<th>Revenue Option</th>
<th>Annual Revenue</th>
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<tr>
<td>1</td>
<td><strong>Personal Income Tax</strong>&lt;br&gt; Increase top two brackets by 1 percentage point: 6.9% increased to 7.9% and 6.99% increased to 7.99%</td>
<td>$437 million annually</td>
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<td>2</td>
<td><strong>Capital Gains and Dividends</strong>&lt;br&gt; Apply a higher rate on capital gains on top two personal income tax brackets: 6.9% increased to 8.5% and 6.99% increased to 10.75%</td>
<td>$427 million annually</td>
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<td>3</td>
<td><strong>Sales Tax Base Broadening</strong>&lt;br&gt; Governor Lamont’s proposal to broaden the base of the sales tax. Must be paired with a progressive tax to prevent tax system from becoming more unfair.</td>
<td>$653 million annually</td>
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<td>4</td>
<td><strong>Estate and Gift Tax</strong>&lt;br&gt; - Do not repeal the Estate or Gift Tax&lt;br&gt; - Decouple Estate Tax from federal thresholds&lt;br&gt; - Lift $15 million cap</td>
<td>$200-400 million annually</td>
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<td>5</td>
<td><strong>Return spending and appropriations decisions to Legislature</strong>&lt;br&gt; Repeal the Bond Lock, address bond covenants, and adopt the prior Volatility Savings Policy.</td>
<td>Approximately $550-800 million in next biennial budget</td>
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Even with Modest Capital Gains Tax, Wealthiest Would Still Get Average of $36,000 from Trump Tax Cuts

State budget deficit brings threat of cuts

Connecticut faces a $4 billion deficit over the Fiscal Years 2020-21 biennial budget. Without adequate revenues, painful budget cuts that could fall heavily on children and families are inevitable.

State’s wealthiest get $2 billion federal tax cuts

Federal tax cuts proposed by the Trump Administration and approved by Congress in 2017 provided a windfall to Connecticut’s wealthiest residents. More than half (56 percent) of the Trump tax cuts will go to the wealthiest five percent of Connecticut taxpayers, who will pay $2 billion less in personal income, corporate, and estate taxes in 2019.

Capital gains tax would raise needed revenue

Adopting a state capital gains and qualified dividends tax of 8.5% and 10.75% on the top two income tax brackets would bring in $427 million in needed revenue. All of this increase would be paid by the richest five percent of state residents—those most able to afford the cost. Even after this modest increase, they would still enjoy a net tax cut of $1.6 billion because of the Trump tax cuts. The top one percent of Connecticut households would see an average net reduction of $36,000 in taxes.

$2 billion: Amount the wealthiest 5% of taxpayers will get from Trump tax cuts
$427 million: Increased amount they would pay in state taxes on capital gains and qualified dividends
$1.6 billion: Their net tax reduction after Trump tax cuts and capital gains and qualified dividends tax

Source: CT Voices for Children analysis of data from Institute on Taxation and Economic Policy, 2019.