

BUDGET CONNECTIONS

A Connecticut Voices for Children
Research Brief

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SFY 03 BUDGET REVISED: Part 1¹ **Addressing the SFY 02 Deficit & Adjusting SFY 03 Revenues**

Shelley Geballe, JD, MPH
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I. Overview

On June 30, 2002, the last day of the state fiscal year, the General Assembly approved HB 6002 – An Act Concerning Adjustments to the State Budget for the Biennium Ending June 30, 2003, State Revenues, and Operating a Motor Vehicle While Under the Influence of Intoxicating Liquor. <http://www.cga.state.ct.us/2002/tob/h/2002HB-06002-R00-HB.htm>.² The Governor signed the bill on July 1, 2002.

This bill, codified as PA 02-1 of the May 9 Special Session (MSS), made substantial changes to the SFY 03 budget that had been adopted in the 2001 General Assembly Session. These changes, together with earlier deficit reduction measures and the revenue generated by the increase in the tax on cigarettes (adopted during the 2002 regular session), sought to close a projected \$1.1 billion deficit in the SFY 03 budget, as originally adopted. On August 12, 2002 the General Assembly passed legislation to implement the revised SFY 03 budget (HB 6004, AAC State Expenditures), revise some of PA 02-1's (MSS) revenue sections (SB 700, AAC State Revenues), and add and revise bond projects (HB 6001, HB 6003, SB 701, SB 703, and SB 704). The Governor signed these bills August 15, 2002.

CT Voices' summary of the revised SFY 03 budget has three parts.³ This first part summarizes changes made to address the SFY 02 deficit and to increase revenues in SFY 03. The second part of the summary will focus on changes made in appropriations for SFY 03, and the third on changes in bonding. The report as a whole summarizes key elements of the budget bill (PA 02-1, MSS) and its implementing legislation (HB 6004), SB 700 (further revising revenues), and the bond bills. The report also compares PA 02-1 (MSS), the Governor's proposed revisions to the SFY 03 budget (*FY 2002-2003 Governor's Midterm Budget Adjustments*, February 6, 2002), and PA 02-38 (SB 660), which was adopted by the General Assembly in the regular session to revise the SFY03 budget, but was vetoed by the Governor.

¹ Part 2 of this analysis will focus on spending changes, and Part 3 on changes in bonding, in the revised SFY 03 budget.

² The House of Representatives passed the revised budget by an 84-54 vote and the Senate by a 20-11 vote.

³ The Office of Legislative Research includes summaries of each of the tax and spending bills, as well as the bond bills, on its website, www.cga.state.ct.us/olr. CT Voices' summary integrates these various analyses, and seeks to place the state's budget crisis, and what was done to attempt to address it, in some context.

The bottom line. The net General Fund deficit for SFY 02 (which ended June 30, 2002) is about \$812 million – a \$1.1 billion total deficit for SFY 02, less nearly \$300 million in deficit reduction measures enacted prior to the close of the fiscal year (outlined below).

The newly revised net SFY 03 budget is \$13.218 billion (compared to a \$13.518 billion budget originally adopted for SFY 03). Of this, \$12.092 billion is the revised net General Fund budget (compared to the \$12.431 billion net General Fund budget originally adopted for SFY 03). Thus, while the total revised SFY 03 budget is about \$300 million *less than* the original SFY 03 budget, the revised SFY 03 General Fund budget is \$339 million *less than* originally budgeted. By comparison, the revised Transportation Fund budget *exceeds* the original SFY 03 budget by \$26 million (\$903 million compared to \$877 million), and the Pequot and Mohegan Fund revised budget is \$14.22 million more than originally budgeted for SFY 03.

OFA calculates that the revised SFY 03 budget is 3.4% more than SFY 02 expenditures. The “real” (inflation-adjusted) growth, however, is less than this. The proposed budget is under the statutory spending cap for SFY 03 by \$376.3 million.

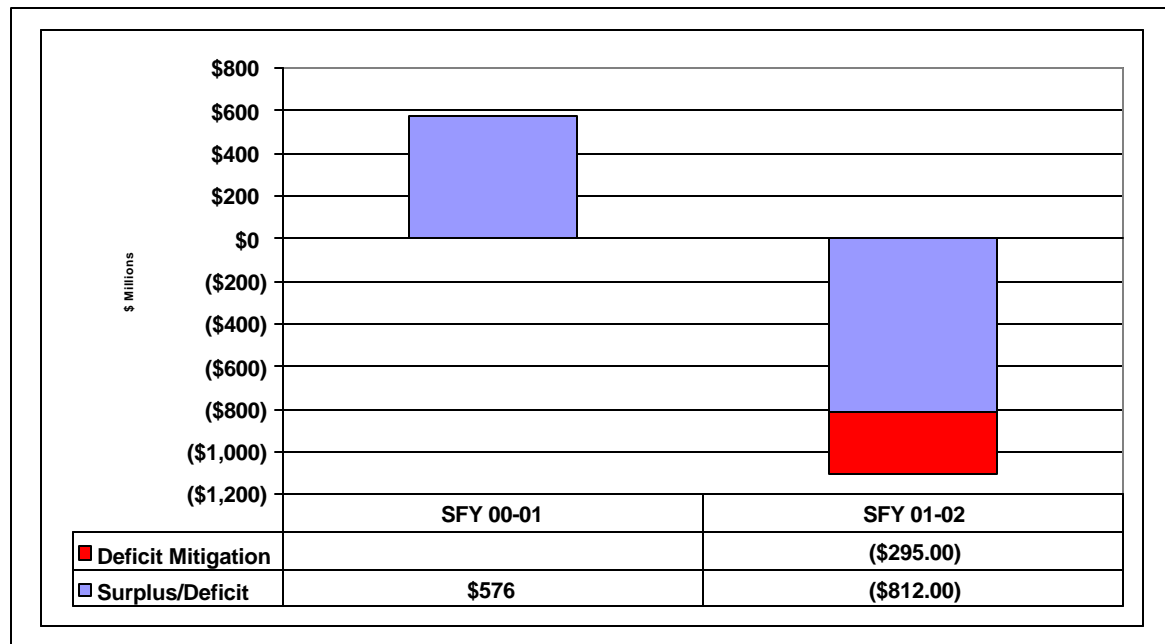
Revenues are increased, but with many one-time fixes. The “deficit” in the SFY 03 budget as adopted in 2001 is addressed through a combination of spending cuts, tax increases, transfers from various funds to the General Fund, carry-forwards, and the partial funding of pension fund obligations. Importantly, many of this revised budget’s “revenue” generating options are one-time in nature. For example, although PA 02-1 (MSS) has a “net” General Fund revenue gain of \$453 million, all but \$104 million of this “gain” is from transfers from other Funds to the General Fund and other “one-time” enhancements. That is, **more than three-quarters** of its “new” SFY 03 revenues are short-term fixes.⁴ Also, some of the SFY 03 budget-balancing measures shift funding responsibilities to future generations. For example, the revised SFY 03 budget funds the Teachers’ Retirement Fund at an 85%, rather than 100%, contribution level for a “savings” of \$32.2 million in the SFY 03 budget.

A boomerang budget. Use of one-time revenue sources and other budget gimmicks to “balance” the SFY 03 budget in this election year will only boomerang. Without a very significant improvement in state revenues, and some very fundamental structural changes to Connecticut’s tax code, the budget challenges in SFY 04 will far exceed those of SFY 03. Indeed, Moody’s Investors Service recently put a “negative” credit outlook on Connecticut based on this SFY 03 budget revision. Factors cited include: a) the revised SFY 03 budget relies on a total of about \$600 million in one-shot revenue sources that will leave the state with an increasing structural budget gap even with a natural economic recovery; b) the total depletion of the Rainy Day Fund to cover the SFY 02 deficit; c) Connecticut’s ranking as the most indebted state per capita; and d) Connecticut’s large unfunded pension liabilities.

⁴ By comparison, SB 660 (the Democratic budget vetoed by the Governor) included net new General Fund revenues that were \$144 million *greater* than those in the revised SFY 03 budget. Included in the Democratic budget, but not included in the final budget, was a 1% personal income surtax on adjusted gross income over \$1 million that would have generated \$219 million in new revenues.

II. SFY 02 Deficit Reduction, In More Detail⁵

A. The challenge. Over the past year, the General Fund’s “bottom line” shifted *by about \$1.7 billion* – from a SFY 01 *surplus* of nearly \$600 million to a total *deficit* in SFY 02 of \$1.11 billion (as of August 1, 2002), as illustrated in the chart below. While some of the SFY 02 deficit was addressed earlier in that fiscal year through spending cuts and an increased tax on cigarettes (as described below), a significant, and growing, deficit remained to be addressed in the May 9 Special Session.



The bottom line. As of August 1, 2002, the State Comptroller projected an \$812 million General Fund deficit in SFY 02 (the state fiscal year that ended June 30, 2002). This is more than the \$754 million deficit projected on June 1, 2002, but less than the \$828 million projected on July 1, 2002.⁶ This deficit projection takes into account about \$295 million in deficit-mitigation efforts made over SFY 02, including in the May Special session. They include: a) \$171 million in appropriation reductions in SA 02-1 (HB 7603) of the November, 2001 Special Session; b) \$40.5 million in additional revenues resulting from the April 3, 2001 \$0.61 increase in the cigarette tax (PA 02-1); c) \$56.28 million in forced savings (lapses) in agency appropriations (in addition to \$103.85 million of originally budgeted lapses); and d) \$26.68 million in re-allocated “SFY 01 surplus” funds credited as “new” SFY 02 General Fund revenues by PA 02-1 of the May Special Session (HB 6002, discussed in detail later). Despite these deficit reduction measures, and the total depletion of Connecticut’s \$594.7 million Budget Reserve (“Rainy Day”) Fund⁷ to help cover the remaining \$812 million

⁵ PA 02-1 (MSS), §§1-12, 16-17 address the SFY 02 deficit.

⁶ By comparison, the Transportation Fund is projected to end SFY 02 with a \$189.6 million *surplus* (up from \$172.5 million on July 1, 2002, and nearly \$52 million *more than* the \$138 million surplus projected for the Transportation Fund in the SFY 02 budget).

⁷ PA 02-118, An Increase to the Amount of the Budget Reserve (Rainy Day) Fund increases the amount of unappropriated budget surplus that must be transferred to the Rainy Day Fund. Currently, the Fund may have a balance of up to 5% of net General Fund Appropriations. PA 02-118 increases this to 7.5%. Since any unappropriated surplus beyond the current 5% level is used to reduce debt service and provide funding for the State Employees Retirement Fund, this change could potentially reduce funds used for these purposes. See I. Lav and A. Berube, *When It Rains It*

deficit, a net deficit balance estimated at \$218 million still exists, which the state now will *borrow* funds to cover.

The explanation. How can it be that Connecticut has moved from surpluses to deficits so quickly? Not surprisingly, the SFY 02 deficit resulted in part from spending that exceeded projections, but primarily from revenues that fell well below projections. The State Comptroller explains:

General Fund expenditures for Fiscal Year 2002 were \$309,019,000 higher than the previous fiscal year representing an increase of 2.6 percent. General Fund revenues for Fiscal Year 2002 were \$1,133,570,000 below the level attained in Fiscal Year 2001, a decline of 9.5 percent. The abrupt decline in revenues is the primary reason for the General Fund deficit.⁸

1. *Spending over budget.* A number of state agencies spent more than the funds appropriated to them for SFY02. Such deficiencies have become routine, though the amount of the total deficiency varies from year-to-year. At the time PA 02-1 (MSS) was adopted, total agency “deficiencies” contributed about \$109.5 million to the SFY 02 deficit, as follows:

Agency Deficiencies in SFY 02: \$109.5M	
Agency	Deficiency (in millions)
Department of Social Services	\$69.9
State Employees Health Services	\$10.0
State Department of Education	\$6.5
Department of Correction	\$5.5
Department of Mental Health & Addiction Services	\$4.1
Reserve for Salary Adjustments	\$4.0
DAS- Workers' Compensation	\$3.0
Department of Information & Technology	\$2.6
Department of Mental Retardation	\$1.6
Department of Environmental Protection	\$0.8
Department of Public Safety	\$0.7
Department of Public Health	\$0.5
Military Department	\$0.4
Source: Office of the State Comptroller, Monthly Letter to the Governor (July 3, 2002)	

Some of these deficiencies can be attributed to new state needs after the September 11 attacks. For example, the Military Department, DEP, and DPH all have had new costs associated with “homeland security.” Other deficiencies reflect continued acceleration of health care costs.

2. *Revenues below budget.* The more significant cause for the SFY 02 deficit, as noted above, was General Fund revenues that fell far short of the budget plan. As of June 3, 2002, revenues were short by \$962.8 million (up from the \$511.7 million revenue shortfall projected two months earlier).

Pours: A Look at the Adequacy of State Rainy Day Funds and Budget Reserves (Center on Budget and Policy Priorities, March 1999)(critiquing a 5% Budget Reserve Fund as inadequate to get states through a recession)(www.cbpp.org)

⁸ Office of the State Comptroller, *Monthly Letter to the Governor*, August 1, 2002.

The personal income tax was projected to be \$510 million under the SFY 02 budget plan (an 8.7% decline in income tax revenues from the last fiscal year, rather than the 2% increase projected). The sales tax was \$169 million below the budget plan (a 3.2% decline from last year, rather than the 2.2% growth anticipated). The corporation tax was \$121 million below what had been anticipated, while the estate and inheritance taxes were \$55 million less (due to declining estate values).

B. Addressing the SFY 02 deficit. To continue the efforts begun earlier in SFY 02 to address the deficit (through SA 02-1 (November Spec. Sess.), PA 02-1, and the forced lapses), PA 02-1 (MSS) cut a total of \$151.6 million of appropriations that had been made using, originally, SFY 01 surplus funds and re-directed these funds to other purposes. Specifically, it redirected \$96 million to cover state agency deficiencies, transferred \$29.1 million as credits to certain specific budget accounts (and allowed these funds to be carried forward into SFY 03), and then credited the balance of \$26.6 million to the General Fund as “revenues” for SFY 02. These transfers meant some budget accounts lost substantial funding (the “losers”), while other budget accounts gained (the “winners”).

1. *The “losers.”* Certain of the agency budget accounts that had been funded with some “SFY 01 surplus” funds were particularly hard hit in this re-allocation of funds to help address the SFY 02 deficit. Accounts that **lost a total of \$400,000 or more** in funding as a result of these deficit-addressing transfers are highlighted in the table below. Further detail on how these funds were re-allocated is provided in the following two sections:

Cuts in Accounts Funded with SFY 01 Surplus Funds (= or >\$400,000)	
Initiative/Account	Funds Cut by PA 02-1 (MSS)
OPM Private Provider Infrastructure Fund	\$4.5M
OPM Energy Contingency	\$11.8M
OPM Miscellaneous Grants	\$1.0M
OWC Jobs Funnel Projects	\$0.7M
OWC Workforce Development Boards	\$1.9M
Dep’t of Pubic Safety	\$1.9M
DOL CEIP Phase-out	\$1.4M
DOL Individual Development Accounts	\$0.4M
DEP Residential Underground Storage Tank Cleanup	\$5.0M
DMHAS Supportive Housing	\$5.1M
DMHAS Community Mental Health Strategic Investment Fund ⁹	\$6.0M
DOT Transportation Strategy Board	\$14.2M
DOT Dial-A-Ride Jobs Transportation	\$1.7M
DSS Temporary Family Assistance Supportive Employment	\$0.9M
DSS Hospital Restructuring Funding	\$10.6M
SDE Reading Institutes	\$0.9M
SDE Teacher Training	\$0.6M

⁹ Note: PA 02-1 (MSS) *doubled* the funds taken from DMHAS’ Community Mental Health Strategic Investment Fund to cover the deficit, as compared to PA 02-38 (SB 660, the budget vetoed by the Governor). PA 02-38 would have used \$3 million from this crucial fund to cover SFY 02 deficiencies.

SDE School Construction Grants	\$50.0M
SDE School Wiring	\$1.9M
SDE School Accountability	\$0.9M
SDE Poor Performing Schools	\$1.3M
Higher Education State Matching Grant Program	\$10.0M
DCF Transition Costs for CT Juvenile Training School	\$0.5M
DAS Workers' Compensation Claims	\$1.1M
Pequot Fund Grants to Towns	\$15M

2. The “winners” --“SFY 01 surplus” funds re-directed to cover state agency deficiencies. PA 02-1 re-directed a total of \$96 million of the “SFY 01 surplus” funds that had been appropriated to certain accounts to other accounts that have deficiencies, as follows:

SFY 01 Surplus Funds Transferred to Address SFY 02 Agency Deficiencies			
Sec. of PA 02-1	Account Funds Are Taken From	Budget Deficiency Addressed	Amount Re-Directed
8(a)	SDE School Construction	DSS, Medicaid	\$48.3M
8(b)	OPM Energy Contingency	DSS, Medicaid	\$10.0M
8(c)	DOT, Transportation Strategy Board	DSS, Medicaid	\$11.6M
2	OPM Private Provider Infrastructure Fund	DOIT, OE account	\$0.65M
3	OPM Private Provider Infrastructure Fund	DOIT, for Health Insurance Portability	\$1.9M
10	DEP, Residential Underground Storage Tank Clean-up	Reserve for Salary Adjustments	\$4.0M
12	DSS, Hospital Finance Restructuring Funding	State Employees' Health Insurance Cost-OE ¹⁰	\$10.0M
4,5	SDE School Construction	Military Dept, Personal Services, OE	\$0.2M
6	SDE School Construction	DEP, Personal Services	\$0.5M
7	SDE School Construction	DEP, OE	\$0.3M
9	DHE, Higher Ed State Matching Grant Fund	SDE, Excess Cost-Student Based	\$6.5M
11	DHE, Higher Ed State Matching Grant Fund	DAS, Workers' Comp	\$2.0M
	TOTAL		\$95.98M

3. The “winners” – “SFY 01 surplus” funds credited to other budget accounts. In addition to transferring these \$95.98 million to cover certain agencies' deficiencies, \$55.7 million of additional “SFY 01 surplus” funds were re-directed from the uses for which they had been appropriated in the 2001 Session. \$29.1 million of this was credited to specific *other* budget accounts and could be carried forward into SFY 03. The balance of \$26.6 million was credited to SFY 02 General Fund “resources” to help reduce the SFY 02 deficit.

¹⁰ Section 98 of HB 6004, the budget implementer, provides that these funds are not to lapse, but are to be carried forward for expenditure in SFY 03.

The first of the next two tables shows which budget accounts funded (in whole or part) with SFY 01 surplus funds were cut so that funds could be credited as SFY 02 General Fund resources. The second table shows the accounts *into* which some of these surplus funds were specifically transferred for SFY 02 and then allowed to be carried-forward into SFY 03 if unexpended on June 30,2002. Importantly, the “SFY 01 surplus” funds so re-allocated for use in SFY 03 provide only one-time funding for these accounts. Like the transfer of funds from quasi-public agencies, sale of Anthem stock and use of tobacco settlement funds, this re-allocation contributes to a significant budget hole in the SFY 04 budget. If programs funded in this manner are *not* to be cut in SFY 04 and years thereafter, significant new revenues will be needed.

“SFY 01 Surplus” Funds Cut From Accounts & Credited As SFY 02 General Fund Resources (PA 02-1, MSS, section 16)		
Agency	Account Cut	Amount Cut
General Fund		
Legislative Mgmt	CTN	\$0.1M
OPM	Energy Contingency	\$1.9M
	Private Provider Infrastructure	\$2.0M
	Misc. Grants	\$1.0M
OWC	Jobs Funnel	\$0.7M
	Workforce Development Boards	\$1.9M
	School-to-Work	\$0.1M
DAS	Disabilities Outreach Program	\$0.1M
	Hospital Billing Program	\$0.1M
DPS	Personal Services	\$1.9M
	Operating Expenses	\$0.2M
DOL	CEIP Phase-Out	\$1.4M
	Individual Development Accounts (IDAs)	\$0.4M
DEP	Residential Storage Tank Cleanup	\$1.0M
DMHAS	Medicaid Rehab Option	\$0.2M
	Supportive Housing	\$5.1M
	Comm. MH Strategic Investment Fund	\$6.0M
	APT Relocation	\$0.9M
DOT	Transportation Strategy Board	\$2.6M
	Dial-A-Ride/Jobs Transportation	\$1.7M
DSS	TFA Supportive Employment	\$0.9M
	Christian Community Action	\$0.2M
	Hospital Finance Restructuring Funding	\$0.6M
SDE	Reading Institutes	\$0.9M
	Teacher Training	\$0.6M
	School Wiring	\$1.9M
	School Construction	\$0.7M
	School Accountability	\$0.9M
	Poor Performing Schools	\$1.3M
DHE	Higher Ed State Matching Grant Program	\$1.5M
	Ed and Health Initiatives	\$0.1M

DCF	Transition costs for Juvenile Training School	\$0.5M
	Computerized Case Management	\$0.3M
DAS	Workers' Comp Claims Liabilities Transfer	\$1.1M
Pequot Fund	Grants to Towns	\$15.0M

In addition to these sums, \$1.4 million of DMHAS funds for Traumatic Brain Injury (TBI) Community Services were cut and the funds credited to SFY 02 General Fund resources (section 15), as were \$0.4 million of funds originally transferred to OPM from the Tobacco Settlement Fund to be used for grants to reduce tobacco abuse (section 14).

The following table provides detail on the amounts PA 02-1 (MSS) credited to specific *other* General Fund accounts using these newly-"created" SFY 02 General Fund resources. Items in italics were amended by HB 6004 (AAC State Expenditures) adopted on August 12, 2002 to implement the revised SFY 03 budget¹¹:

"SFY 01 Surplus Funds" Credited by PA 02-1 To Different Accounts, With Unexpended Funds in These Accounts Carried-Forward into SFY 03 (PA 02-1, MSS, section 17, as amended by HB 6004, section 114)		
Agency	Account Credited	Amount Credited
Legislative Mgmt	CTN	\$1.5M
OPM	Amistad	\$0.1M
	Adopt-A-House in Stamford	\$0.01M
	<i>Waterbury Youth Net</i>	<i>\$0.2</i>
	<i>Library Improvements</i>	<i>\$0.04</i>
	Arts Grants	<i>\$1.1M</i> ²
	Local Aid Adjustment	\$3.0M
Dept of Veteran Affairs	Transitional Living Services for Veterans	\$0.4M
OWC	Workforce Development Boards	\$0.4M
DOL	Opportunity Industrial Centers-Bridgeport	\$0.1M
	Individual Development Accounts (IDAs)	\$0.3M
Dept of Agriculture	CT Seafood Advisory Council	\$0.05M
	Food Council	\$0.03M
	Wine Council	\$0.03M
DEP	Recreational Fishing Programs	\$1.0M
	Grants for Water programs	\$0.08M
DECD	Women's Business Development Center	\$0.01M
	Entrepreneurial Centers	\$0.2M
	Payments to Local Gov't -Tax Abatement	\$2.2M

¹¹ Note, section 114 of HB 6004 transfers the same total amount of "SFY 01 surplus" funding but re-allocates it somewhat. Its \$1.34 million in additions (for Waterbury Youth Net, library improvements, arts grants, CT Mental Health Center, DMHAS' Regional Action Councils, DHE, and the CT Commission on the Arts, as noted in the table) are funded by an \$886,000 cut to tobacco education funding and a \$450,000 cut to DHE's Minority Advancement Program

¹² This is an increase of \$200,000 above what had been provided in PA 02-1 (MSS).

	Payments to Local Gov't – PILOT	\$2.9M
DPH	Tobacco Education	\$0.36 ¹³
	Biomedical Research	\$0.5M
	School-based Health Centers	\$0.15M
DMR	New Family Center	\$0.01M
DMHAS	Institute for Municipal & Regional Policy ¹⁴	\$0.1M
	<i>Connecticut Mental Health Center</i>	\$0.45M
	<i>Regional Action Councils</i>	\$0.2M
DSS	School Readiness	\$0.2M
	Community Services	\$0.2M
	Enhanced Funding for Griffin Hospital	\$0.2M
	Hartford Hospital	\$2.5M
	Yale-New Haven Hospital	\$3.3M
	Legal Immigrants	\$1.2M
	Nursing Home Staffing	\$2M
	Epilepsy Project	\$0.05M
	Elderly Health Screening	\$0.1M
	Elderly Express	\$0.08M
	Geriatric Assessment	\$0.03M
	Human Resource Development	\$0.4M
	Teen Pregnancy Prevention	\$0.03M
SDE	Jason Project	\$0.15M
	CT Writing Project	\$0.08M
	Youth Service Bureau	\$0.02M
	Magnet School	\$0.9M
	Young Parents Program- The Bridge	\$0.03M
State Library	Basic Cultural Resources Grant	\$0.13M
	Grants – Local Institutions in Humanities	\$0.21M
	<i>Connecticut Commission on the Arts</i>	\$0.2
DHE	Minority Advancement Program	\$0.021 ¹⁵
	Saturday Academy	\$0.1M
	<i>New England Board of Higher Education</i>	\$0.25
U Conn	Veterinary Diagnostic Laboratory	\$0.05M
DOC	Community Residential Services	\$0.24M
Parole Board	Community Residential Services	\$0.04M
DCF	Stamford Child Guidance Clinic	\$0.01M
	Covenant to Care	\$0.15M
	Neighborhood Center	\$0.09M
Judicial Dept	Alternative Incarceration Program	\$0.4M
TOTAL		\$29,051,513

¹³ This is a \$886,000 reduction from the \$1,247,208 included in PA 02-1 (MSS).

¹⁴ PA 02-1 (MMS) section 45 transfers these funds for the Institute to the Central Connecticut State University.

¹⁵ This is a reduction of \$450,000 from the \$657,109 included in PA 02-1 (MSS) for the Minority Advancement Program.

4. *Bonding to close the remaining SFY 02 deficit.* As explained above, \$151.6 million of funds from the SFY 01 surplus that had been appropriated to a variety of agency accounts are re-allocated by PA 02-1 (MSS), either to cover agency deficiencies, to be credited to other accounts, or simply to be credited as General Fund “resources” for SFY 02.¹⁶ In addition, the entire \$594.7 million Rainy Day Fund is drained to help close the SFY 02 deficit. Despite these measures, and those taken earlier in SFY 02, a net deficit balance in SFY 02 of about \$217 million remains. To address this, and close SFY 02 with a balanced bottom line, section 111 of SB 702 (AAC the Authorization of Bonds of the State for Capital Improvements and Other Purposes) authorizes the Treasurer to issue economic recovery notes (i.e. borrow funds through bonding). The State Comptroller is directed to certify the amount of the deficit to the Treasurer. The notes are to mature no later than five years after the date of issuance. Interest on the notes is exempt from state and federal income taxes. About \$218 million will need to be borrowed. The interest cost to the General Fund to borrow this sum, assuming a 3.5% rate over the 5-year period is \$22.9 million. As noted earlier, Connecticut has the highest debt per capita of any state in the nation.¹⁷ Borrowing funds to close the remaining SFY 02 deficit adds to our debt burden and jeopardizes the state’s credit rating.

III. SFY 03 Revenue Enhancement, In More Detail

A. Why more revenue is needed. Significant revenue shortfalls not only created the SFY 02 deficit, they also created a projected deficit in the SFY 03 budget as it originally had been adopted in the 2001 legislative session.

Some actions taken earlier in SFY 02 to address that year’s deficit also acted to help shore up SFY 03 revenues. For example, in the November 15, 2001 Special Session, the General Assembly voted to delay the scheduled phase-out of the inheritance tax. [PA 01-1 (Nov. 15 Spec. Sess.)] This is projected to save \$11 million in SFY 03 revenues. Similarly, in the regular 2002 Session, the General Assembly increased the cigarette tax. [PA 02-1].¹⁸ This was projected to generate \$122 million in additional SFY 03 revenues. Despite these revenue increases, and the spending cuts outlined below, the SFY 03 budget, as originally adopted, was doomed to be in deficit the moment this fiscal year began on July 1, 2002 unless adjustments were made in the 2002 legislative session.

¹⁶ Interestingly, section 19 of PA 02-1 (MSS) also specified that the Comptroller is “authorized to record as expenditures” in SFY 02 any expenditures made in the first month of SFY 03 (“from July 1, 2002 to July 31, 2002) if pursuant to the appropriations or transfer provisions of the first eighteen sections of the act.

¹⁷ As of February 28, 2002, Connecticut’s bond debt was more than \$11.8 billion; interest on the debt in SFY 01 was more than \$615 million. Connecticut is highest in the nation in tax-supported debt per capita and third highest in tax-supported debt as a percentage of personal income, according to Moody’s Investor’s Service. *Congressional Quarterly* ranks Connecticut fourth highest in state and local debt per capita, and 17th highest in state and local debt per capita as a percentage of personal income. See OFA, *State Bond Debt* (2002-R-0429, April 12, 2002). See also, S. Geballe, *Connecticut’s Credit Care: State Bonding for SFY 01* (CT Voices for Children, May 2000), available on www.ctkidslink.org.

¹⁸ A July, 2002 OLR Report, *Cigarette Tax Increase* (2002-R-0539) reports that Connecticut took in nearly \$26 million in cigarette tax revenue in April 2002, as compared to about \$8.7 million in April 2001. May 2002 figures show about \$21 million in tax revenue, more than twice the amount collected in May 2001. The report cautions that it is “probably too early to make any meaningful conclusions about the effect of the increase on consumption.” OLR cites a California study showing little decline in cigarettes purchased from non or lower-taxed sources after a 50 cent increase in tax. By comparison, New York City’s imposition of a \$1.50/pack tax (up from \$0.08/pack) on top of the state’s \$1.50/pack tax appears to have resulted in a 47% drop in packs sold in the city, although total revenues have still increased. M. Cooper, “Cigarette Tax, Highest in the Nation, Cuts Sales in City, *New York Times* (August 6, 2002).

Like a family facing tough budget times, the General Assembly sought to balance spending cuts with some revenue increases. For many in the General Assembly, who have served only when Connecticut's economy was strong, the choice to raise taxes – particularly in an election year – was a difficult one. As noted earlier, this revised SFY 03 budget chooses many one-time quick fixes, deferring to another year the necessary structural reforms to Connecticut state and local tax system that are essential to maintain the long-term fiscal stability of the state. Curiously, PA 02-1 (MSS) does not include a “statement of estimated revenues, itemized by major source, for each appropriated fund,” as explicitly required by Conn. Gen. Stat. §2-35.

B. PA 02-1's revenue increases. PA 02-1 (MSS) generates \$453 million in net new General Fund revenues in SFY 03 -- \$468.4 million in “new” revenues offset by about \$15 million in revenue reductions. Importantly, *more than three-quarters of these “new” revenues for SFY 03 are one-time fixes.* That is, they are not revenues that continue into SFY 04. By “balancing” the SFY 03 budget using largely one-time revenue sources, PA 02-1 creates a very significant budget hole in the SFY 04 budget. This is truly a “boomerang” budget, as it will come around in SFY 04 and smack the state with great force. PA 02-1 (MSS) generates additional revenues as follows:

- **New taxes.** \$103.6 million in new taxes (\$102.8 in *net* new taxes, as described below);
- **New fees.** \$1.3 million in new fees;
- **Tax amnesty program.** \$22 million from a one-time tax amnesty program (personal income tax, sales tax, corporation tax);
- **Fund transfers.** A total of \$341.3 million in various one-time transfers to the General Fund: a) \$114.1 million transferred from various budget Funds to the General Fund; b) \$100 million transferred from the budget reserves of three quasi-public agencies; and c) \$127.2 million credited from the Anthem demutualization.

These revenue gains are offset in two ways:

- **New sales and use tax exemption.** A new exemption from the sales and use tax, effective *retroactively to January 1, 1994*, for business analysis, management, consulting, and public relations services “furnished in connection with” aircraft owned or leased by a commercial air carrier and with a maximum certificated take-off weight of at least 6,000 pounds. This results in \$800,000 in lost revenues, reducing PA 02-1's (MSS) new tax revenues to a net of \$102.8 million.
- **Transfer to Pequot Fund.** A \$14.22 million *reduction* in General Fund revenues by increasing the transfer to the Mashantucket Pequot/Mohegan Fund by this amount.

The table that follows presents the specific revenue changes adopted in PA 02-1 (MSS):¹⁹

¹⁹ Importantly, as discussed more fully later, some of the revenue enhancements in PA 02-1 (MSS) were rescinded, or modified, by SB 700 (AAC State Revenues), passed by the General Assembly on August 12, 2002.

Revenue Source	Amount of New SFY 03 Revenue	PA 02-1 (MSS) sections
TOTAL CHANGES –GENERAL FUND	\$453.18M	
Personal income tax	\$28.0M	
- Defer increase in singles exemption/credits for 1 yr. ²⁰	\$12.0M	78-80
- Impose tax on non-resident casino gambling winnings, and on CT Lottery winnings under \$5,000, eff. 1/1/02 ²¹	\$6.0M	81
-Tax amnesty (one-time only) ²²	\$10.0M	82
Gift tax	\$2.6M	
-Defer partial phase-down of gift tax. Maintains tax exemption for gifts of \$25,000 or less and freezes tax at 2001 rates for gifts between \$25,000 and \$1 million, until 1/1/04 when phase-out is to resume. ²³		76
Sales/use tax	\$16.7M	
-Tax amnesty (one-time only)	\$6.0M	82
-Tax self-storage units, eff. 7/1/02 ²⁴	\$1.5M	66,68
-Defer by two years phase-out of sales/use tax on computer/data processing services (until 7/1/04) ²⁵	\$10.0M	69,70
-New sales tax exemption for various business analysis, management, management consulting and public relations services when rendered in connection with certain leased/owned aircraft, retroactively eff. to 1/1/94	(\$0.8)	65,67
Corporation tax	\$77.5M	

²⁰ The annual increase to the single filer exemption, the single filer credit, and to the single filer Connecticut adjusted gross income thresholds used to calculate the reduction in the property tax credit is delayed for two years. A single filer is an unmarried person (other than a qualifying widow or widower) who files his/her federal and state income tax returns as an unmarried person, and not as a head of household. PA 02-1 keeps the credit, exemption and threshold that are in effect in 2001 in effect for the 2002 and 2003 tax years. The scheduled increases are to resume in the 2004 tax year.

²¹ PA 02-1 (MSS) imposes the state income tax on non-residents' winnings from any wager, wagering transaction, or gambling activity in the state, if the proceeds must be reported to the Internal Revenue Service. NOTE: SB 700, section 17, subsequently eliminates this new tax on the gambling winnings of non-residents.

²² Between September 1, 2002 and November 30, 2002, delinquent taxpayers can pay their outstanding tax bills without penalty. The tax amnesty program applies to both business and non-business taxpayers and to all unreported or underreported tax liabilities (either returns not filed, or returns filed with underreported tax liabilities) as well as all unpaid tax liabilities (returns filed but taxes unpaid). The amnesty applies to any taxable periods ending on or before March 31, 2002. The amnesty applies to the sales tax, the personal income tax, and the corporate business tax. Interest is imposed on past due taxes. Amnesty is barred for taxpayers who have received notice that they are being audited for the period of time for which they are seeking amnesty or who are parties to any criminal or civil proceedings pending on June 1, 2002 for failure to file or for state tax fraud. In addition, section 5 of SB 700 also excludes persons who are parties to a closing agreement with DRS, who have made an offer of compromise that the DRS Commissioner has accepted, or who are parties to a managed audit agreement. DRS is authorized to use up to \$2 million of the revenues received through the tax amnesty program to administer it. NOTE: The Democratic budget vetoed by the Governor (PA 02-38) would have imposed an additional penalty of 5% of the taxes owed for any tax liability that could have been, but was not, satisfied during the amnesty period. This appears *not* to have been included in PA 02-1.

²³ The gift tax on gifts of \$25,000 or less was eliminated as of January 1, 2001.

²⁴ Sections 13-15 of SB 700 amend PA 02-1 (sections 66, 68) to limit this tax to U-Store-It types of storage.

²⁵ The 6% sales tax that had been imposed on these services has been reduced by 1%/year since 1997. The tax currently is 1%. This 1% tax was to have been eliminated this year; PA 02-1 delays the phase-out until 2004.

-Tax amnesty (one-time only)	\$6.0M	82
- <i>R & D tax credit limit</i> . Places limit on current R&D tax credit “refunds” – specifically, a maximum of \$1 million per filer for income years 2000 and 2001 if refund has not been paid as of 7/1/02, and \$1.5 million for income years 2002 and thereafter ²⁶	\$13.0M	60
- <i>Business entity tax</i> . Imposes \$250 annual state tax on LLCs, LLPs, and S-corporations, eff. 1/1/02 (NOTE: Though these entities once paid the corporate business tax on their income, they currently are subject to the lower-rate personal income tax. This is a new tax.) ²⁷	\$28.0M	55
- <i>Minimum tax</i> . Requires each corporation included in a combined return to pay the minimum tax, repeals the exemption from the corporate minimum tax for financial services companies, and bars companies from using tax credits to reduce their minimum corporate tax to less than \$250, applicable to income years on/after 1/1/02. ²⁸	\$0.5M	57,58
- <i>Tax credit cap</i> . Caps the use of tax credits in any income year to no more than 70% of company’s tax liability for the year (i.e. liability without the credits), applicable to income years on/after 1/1/02. ²⁹	\$30.0M	59

²⁶ The original law, passed in 1999, allows businesses with less than \$70 million in revenues to “sell” back to the state at 65% of their value any research and development tax credits the company qualified for but could not use because it did not have sufficient tax liability (income). CBIA explains that “this law aims to help young technology-based companies that have a lot of up-front” R&D costs before they start seeing income from product sales. CBIA, *Capitol Reporter*, July/August 2002. Note that this “sell-back” credit acts as a direct cash grant, but is not subject to any of the review that is supposed to be accorded such a grant if made through DECD.

²⁷ Section 1 of SB 700 amends PA 02-1 (MSS) to clarify the types of LLCs to which this new business entity minimum tax applies.

²⁸ About two-thirds of Connecticut corporations (33,000) paid only the corporate minimum tax of \$250/year in the last several years and many paid no corporate tax at all.

²⁹ For example, if a company has a \$1 million tax liability and \$900,000 in tax credits, under prior law the company would owe \$100,000 in tax. PA 02-1 (MSS) caps the credits available to reduce tax liability to \$700,000; the company would owe \$300,000 in tax. Note, however, that Connecticut has quite generous laws regarding the carry-forward of tax credits; these “unused” credits could be carried forward to reduce tax liability in future years and therefore state revenues in future years, as well.

Fees³⁰		
-Increase certain court-filing fees	\$1.3M	103-107
Transfers to General Fund from Other Funds & One-Time Enhancements	\$341.3M	
-Transfer funds from quasi-public agencies (\$85M CHFA, \$7.5M from each of CDA and CT Innovations)	\$100.0M	41
-Transfer from Tobacco Health Trust Fund	\$46.9M	37
-Transfer from Biomedical Research Trust Fund	\$4.0M	37
-Redirect SFY 03 transfer from Tobacco Settlement Fund to the Tobacco Health Trust Fund instead to the General Fund	\$12.0M	36
-Redirect SFY 03 transfer from Tobacco Settlement Fund to the Biomedical Research Trust Fund instead to the General Fund	\$4.0M	36
-Place proceeds from Anthem demutualization in General Fund	\$127.2M	39
-Transfer funds from Private Occupational Student Protection Fund	\$1.0M	40, 127-129
-Eliminate one-time transfer of petroleum tax to Conservation Fund (keep in General Fund)	\$1.0M	130
-Suspend transfers of petroleum tax payments to Underground Storage Fund for SFY 03 ³¹	\$12.0M	75
- Transfer funds from Home Construction Guarantee Fund ³²	\$1.2M	48,126
- Transfer funds from Probate Administration Fund	\$5.0M	42
- Transfer funds from Commercial Recording Account	\$1.0M	48
-Reduce petroleum tax transfer to the Transportation Fund ³³	\$26.0M	73
Increase transfer to Mashantucket Pequot/Mohegan Fund³⁴	(\$14.22M)	124

³⁰ NOTE: An additional \$750,000/year in new fees related to various Department of Environmental Protection licenses and permits also are imposed by PA 02-1 (MSS), sections 84-101. These funds are placed in the Conservation Fund, to help offset \$2 million in reduced revenues to that Fund required by PA 02-1 (MSS) (sections 72, 130). PA 02-1 (MSS) also eliminates an \$850,000 fisheries account allocation to DEP to enhance recreational fishing and a \$75,000 allocation to DEP to study the lobster industry in Long Island Sound. (section 72)

³¹ This fund reimburses responsible parties for expenses greater than \$10,000 but less than \$1 million related to cleaning up leaking nonresidential underground storage tanks, and pays administrative costs for the program.

³² The New Home Construction Guaranty Fund is funded through a \$480 fee paid every two years by state-registered new home and home improvement contractors. It reimburses consumers for losses and damages sustained when a contractor violates the registration laws and helps fund the Consumer Protection Enforcement account which the Department of Consumer Protection uses for expenses related to enforcing state occupational and business licensing and registration laws.

³³ PA 02-1 (MSS), section 73 cuts the amount of petroleum products gross earnings tax revenues (from motor vehicle fuel sales) that must be transferred to the Transportation Fund from the General Fund, boosting General Fund revenues by \$26 million. Specifically, \$5 million (rather than \$11.5 million) is to be transferred to the Transportation Fund for each quarter between the one ending September 30, 2002 and the one ending September 30, 2003 (a \$6.5 million reduction/quarter), and \$5.25 million transferred for each quarter thereafter. At the same time, PA 02-1 (MSS) adds \$26.0 million in revenues to the Transportation Fund by increasing the tax on diesel, propane and natural gas fuel sold in the state from 18 to 26 cents/gallon as August 1, 2002 (section 71), imposing a floor tax of 8 cents per gallon on diesel fuel inventory at the close of business on July 31, 2002 (section 74) and reducing the transfer from the Transportation Fund to the Conservation Fund by \$1 million. PA 02-1 (MSS) also increases various DEP license and permit fees, increasing revenues in the Conservation Fund by \$750,000.

Importantly, PA 02-1 (MSS) also *avoids a SFY 03 revenue loss* of \$50-\$70 million by making some changes in the corporation tax code to respond to changes in federal law and court decisions that would otherwise reduce SFY 03 corporate tax revenues. Specifically, the bill precludes the following revenue losses:

- **Federal bonus depreciation.** \$20 million is saved by de-coupling state law from the bonus federal depreciation changes recently enacted by Congress.³⁵ Specifically, PA 02-1 (MSS) bars the deduction on the state corporate tax of the bonus depreciation allowed under new federal law for certain assets placed into service after September 10, 2001 and before September 11, 2004. This provision may require corporations that have filed tax returns for the 2000 or 2001 income years deducting the bonus depreciation to amend their returns. (section 56). In addition, PA 02-1 (MSS) (section 77) modifies the definition of “Connecticut adjusted gross income” in the state’s personal income tax to require that bonus depreciation allowed as a deduction under federal law be added back in calculating CT AGI (section 77). This will apply to individuals who receive income from businesses that are not required to pay the state corporate tax (such as limited liability partnerships, limited liability companies, and S corporations). This change to the personal income tax is applicable for tax years commencing on or after January 1, 2002; individual taxpayers will not have to file amended returns for property placed in service during the retroactive period, September 10, 2001 - December 31, 2001.
- **Accurate reporting of business income.** \$10-\$25 million is saved by disallowing certain deductions from a corporation’s net income that are used to inaccurately or improperly reduce its net income (and therefore its taxes). This will protect corporate tax revenues after the Connecticut Supreme Court’s decision in Carpenter Technology Corp. v. Commissioner, 256 Conn. 455 (2001). PA 02-1 (MSS) expressly overruled that decision and grants the Commissioner of Revenue Services discretion to make adjustments to a business’ reported income where, as the result of the business’ transaction with a “related” entity, the business’ net income is not accurately reflected. (sections 61-62).³⁶
- **Interest payments.** \$20-25 million is saved by clarifying when the Department of Revenue Services must pay interest on tax refunds on late-filed and amended corporate and air carrier tax returns (sections 63-64).

³⁴ PA 02-1 (MSS) section 124 requires a total of \$121.11 million to be transferred from the General Fund to the Mashantucket Pequot and Mohegan Fund for SFY 03. This is \$14.22 million *more* than was to be transferred in the original budget for SFY 03.

³⁵ These bonus depreciation changes were a part of the federal Job Creation and Worker Assistance Act of 2002.

³⁶ Carpenter Technology set up a Delaware subsidiary, capitalized it with more than \$300 million, and then borrowed all but \$5,000 back a few days later. Carpenter paid interest on the loan to the subsidiary, and deducted this interest on its Connecticut corporate tax return, saving it \$196,102 in corporate taxes in 1990 and 1991. The DRS commissioner disallowed the deduction, saying the loan had no valid business purpose but the Connecticut Supreme Court overruled this determination, saying that the disallowance was unreasonable as the company’s arrangement did not result in an “improper or inaccurate” reflection of income. This section of PA 02-1 (MSS) affirms the DRS Commissioner’s position on this tax avoidance scheme and essentially overrules the Connecticut Supreme Court.

C. A bit more detail on several of PA 02-1's (MSS) revenue enhancements. The following provides some detail on various of these revenue enhancements:

Tobacco Settlement Fund transfers. Sections 36-37 of PA 02-1 (MSS) re-direct \$66.9 million of funds derived from Connecticut's successful litigation against tobacco companies to the General Fund. This is *\$8.4 million more* than SB 660 (the vetoed budget) would have transferred. Specifically, PA 02-1 (MSS): a) *intercepts* (and puts in the General Fund) funds that are otherwise mandated to be transferred directly from the Tobacco Settlement Fund into the Tobacco and Health Trust Fund (\$12 million) and the Biomedical Research Trust Fund (\$4 million); and b) transfers fund principal from the Tobacco and Health Trust Fund (\$46.9 million) and the Biomedical Research Trust fund (\$4 million) to the General Fund. The *net* result is a \$58.9 million loss to the Tobacco and Health Trust Fund and an \$8 million loss to the Biomedical Research Trust Fund.³⁷ This transfer leaves only \$3.757 million in the Tobacco and Health Trust Fund and *nothing* in the Biomedical Research Trust Fund.³⁸

Anthem Stock Sale. Section 39 of PA 02-1 (MSS) directs the State Treasurer to liquidate stock held in trust in the Anthem Demutualization Fund by 6/30/03, and directs that \$127.2 million from this liquidation be credited to the General Fund. NOTE: The Governor proposed using \$98 million of Anthem stock sale proceeds for General Fund revenues. Ownership of some of the stock is being contested

Transfers from quasi-public agencies. Section 41 of PA 02-1 (MSS) transfers \$100 million from the capital reserves of three quasi-public agencies and places the funds in the General Fund as SFY 03 "revenues." Specifically, it transfers to the General Fund as SFY 03 "revenues" \$85 million from Connecticut Housing Finance Authority, \$15 million from Connecticut Innovations, Inc. and \$15 million from the Connecticut Development Authority.

Importantly, cutting funds from CHFA can exacerbate Connecticut's affordable housing crisis. CHFA homebuyer mortgages are available to first-time homebuyers with low or moderate incomes who are buying moderately-priced homes within CHFA sale price limits. (Prior homeowners also may qualify if the home is within a targeted area and they have not owned a home in the past three years.) Of the 4,174 single family homebuyer mortgages granted by CHFA in 2001, all but one went to first-time buyers. 43% went to low-income earners (less than 80% of the area median income) while 49% when to moderate-income earners (between 80 and 120% of AMI).³⁹

³⁷ By comparison, SB 660 increased SFY 03 General Fund revenues a total of \$58.5 million-- intercepting the same \$16 million of funds and transferring \$39.5 million from the Tobacco and Health Trust Fund and \$3 million from the Biomedical Research Fund to the General Fund. The *net* result was a \$51.1 million loss to the Tobacco and Health Trust Fund and a \$7 million loss to the Biomedical Research Trust Fund.

³⁸ The Tobacco and Health Trust Fund was created by PA 99-2 (June Spec. Sess) as a separate non-lapsing fund to accept transfers from the Tobacco Settlement Fund. PA 00-216 specified that the Fund's purpose was to create a significant source of revenue for programs to decrease tobacco abuse, substance abuse, and to meet the state's unmet physical and mental health needs.

³⁹ CHFA also administers the federal Low-Income Housing Tax Credit program. Developers who receive LIHTCs typically sell them to private investors who benefit from a reduction in tax liability while the proceeds from the sale generate equity for the development. This reduces the need for debt financing and thereby enables the owner to charge affordable rents. These credits are often used to finance multi-family proposals. To be eligible for the credits, a project developer must set aside a minimum percentage of units for low-income residents for a certain period of time (usually at least 30 years). According to a report by the Office of Legislative Research, *CHFA Programs and Services* (2002-R-0602),

Increased court fees. The following court fees are increased to enhance SFY 03 revenues: a) jury fee in civil cases (\$300 to \$350); b) small claims filing fee (\$30 to \$35); c) motion to open, set aside, modify or extend Superior Court civil judgment (\$60 to \$70); d) motion to open or re-argue civil appeal (\$60 to \$70); e) application for personal property execution (\$10 to \$20); and f) application for wage execution (\$10 to \$20) (sections 103-107). These increases were also a part of SB 660.

Drunk driving provisions. Sections 108-117 of PA 02-1 (MSS) are adopted to avoid federal sanctions (specifically, a potential loss of 2% of federal highway construction funds in FFY 02, or about \$3.7 million, increasing to 8% in FFY 07) and also to make Connecticut eligible for a total of about \$2.8 million in federal incentive grants in FFY 02 and O3. PA 02-1 (MSS) lowers the current 0.10% blood-alcohol content (BAC) standard for defining drunk driving to 0.08%, eliminates the 0.07% standard for someone with a prior drunk driving conviction, and makes other changes regarding participation in and increased fees for alcohol education programs and evaluations.⁴⁰

Teachers' Retirement Fund. While not a revenue "enhancement," section 38(a) of PA 02-1 (MSS) allows the state's SFY 03 contribution to the teachers' retirement fund to be cut by \$32.175 million. This means that rather than making a 100% contribution to the fund this year, the contribution will be only 85%. The contribution is set at the same level as in SA 01-1 (section 11), rather than the \$214.7 million originally budgeted for SFY 03. This "saves" \$32.2 million in General Fund revenues for other purposes, but transfers a burden onto future generations.

D. SB 700's revenue reductions. Despite reports of a growing deficit in the SFY 03 budget, and despite the revenue increases and spending reductions included in PA 02-1 (MSS), SB 700 (AAC State Revenues) was enacted by the General Assembly on August 12, 2002.⁴¹ SB 700 does not *increase* SFY 03 revenues, but rather *reduces* SFY 03 revenues and also *precludes* some SFY 03 revenue gains. SB 700's total potential General Fund revenue "loss" in SFY 03 is between \$8 and \$20 million; the Transportation Fund loses \$0.5 million. Changes that result in revenue losses, or precluded revenue gains, are:⁴²

the demand for these credits to develop affordable housing generally exceeds the credits that are available by a two or three to one margin.

⁴⁰ This is one of several changes made to state law in an effort to preserve federal funding in SFY 03. Others include a) changing DCF's voluntary services program to require a permanency plan for children in voluntary services that is periodically reviewed and approved by a court so that DCF can maintain eligibility for federal reimbursement under Title IV-E (sections 29-35 & 37 of HB 6004); and b) requiring the Judicial Department of pay the cost for service of civil restraining orders involving domestic violence, stalking, or sexual assault to comply with a recent change in the federal funding requirements of the Violence Against Women Act (section 83 of HB 6004). The change in the voluntary services program is a setback to parents of children with severe mental health needs, who have turned to DCF's voluntary services program to gain access to children's mental health services. Because of this change, these parents again will be treated like parents who have abused their children; all will need a permanency plan for their children.

⁴¹ SB 700 was approved by the House on a 93-43 vote (with 15 absent and not voting) and by the Senate on a 28 to 5 vote (with 3 absent and not voting).

⁴² SB 700's other sections do not impact SFY 03 revenues so dramatically. Section 1 clarifies the definition of a Limited Liability Company (LLC) for purposes of imposing the new \$250/year tax pursuant to PA 02-1 (MSS). There is expected to be no fiscal impact from this clarification. Sections 5-6 expand the categories of taxpayers who are ineligible to participate in the tax amnesty program created by PA 02-1, with no fiscal impact expected. (Taxpayers who are parties to closing agreements with the DRS Commissioner, who have made an offer of compromise that has been accepted by the DRS Commissioner, or who are parties to a managed audit agreement may not seek tax amnesty.) Section 7 concerns municipal taxation of a power plant's real and personal property during and after the construction period, limiting any change to those facilities that have provided an application for a permanent electric generating facility to the Connecticut Siting Council between January 1, 2002 and April 1, 2002, inclusive.

- **Exempting taxpayers from interest and penalty assessments.** Sections 2-4 of SB 700 exempt taxpayers from interest and penalty charges if the changes made in PA 02-1 (MSS) trigger an underpayment of estimated taxes due on or before July 15, 2002. (Note: A number of the revenue changes in PA 02-1 (MSS) are effective for the 2002 tax year.)
- **Expanding and extending various tax exemptions and credits for “clean” fuels.** Sections 8-12 exempt from tax various sales of “clean” fuels and related products. A number of these exemptions had been adopted previously, but had sunsetted on July 1, 2002.⁴³ SB 700 extends the exemptions for an additional two years, thereby precluding the revenue gain that would have occurred if the exemptions had been allowed to sunset. In some other cases, SB 700 extends exemptions. More than \$1.5 million in SFY 03 revenues is to be lost.⁴⁴
- **Clarifying the definition of self-storage units.** Sections 13-15 “clarify” the new sales tax imposed by PA 02-1 (MSS) on “self-storage units” to exclude certain types of storage. This new tax, included in PA 02-1 (MSS), was to have generated \$1.5 million in new SFY 03 revenues. The “clarification” reduces projected new revenues by \$375,000, leaving \$1.125 million in new SFY 03 revenues.
- **Exempting non-cable communications services bought by a cable network.** Section 16 creates a new exemption to the sales and use tax on community antenna television services. Non-cable communications services are exempt if bought by a cable network. This results in a revenue loss of “less than \$100,000” per year.
- **Exempting non-residents’ non-lottery gambling winnings.** PA 02-1 (MSS) amended the personal income tax to tax non-residents’ non-lottery Connecticut gambling winnings. (Connecticut’s income tax already taxes non-residents’ Connecticut Lottery winnings.) This

⁴³ Exemptions that were to sunset on July 1, 2002 include: a) petroleum gross earnings tax exemption for propane gas used as a fuel in a motor vehicle [PA 01-6, sec. 20, June Spec. Sess.]; b) sales/use tax exemption for new motor vehicles powered by alternative fuel, conversion equipment for converting vehicles to clean alternative fuel, and equipment used in compressed natural gas or electric recharging stations for vehicles powered by clean alternative fuel [PA 01-6, sec. 22]; and c) an exemption from the sales/use tax for sales of passenger cars with an EPA estimated highway mileage rating of at least 50 miles/gallon [PA 00-170, sec. 6].

⁴⁴ SB 700’s specific SFY 03 revenue losses and precluded SFY 03 revenue gains are: a) a \$225,000 one-time loss from exempting from the petroleum gross earnings tax sales between January 1, 2000 and July 1, 2001 of propane fuel for motor vehicles (section 8); b) a \$125,000/year precluded revenue gain by extending from July 1, 2002 to July 1, 2004 the exemptions from the petroleum fuels tax for sales of propane when used as fuel in motor vehicles and fuel cell fuel (section 8), c) a \$75,000/year precluded revenue gain by extending from July 1, 2002 to July 1, 2004 the exemption from the public service company’s tax the sale of natural gas and propane when used as a motor vehicle fuel (section 9); d) a \$50,000/year precluded revenue gain by extending from July 1, 2002 to July 1, 2004 the exemption from the sales and use tax for sales of motor vehicles that exclusively use alternative fuels and equipment used in alternative fuel or recharging stations (section 10); e) a \$50,000/year revenue loss by extending from July 1, 2002 to July 1, 2004 the sales tax exemption for sales of vehicles and related equipment exclusively powered by hydrogen (section 10); f) a \$500,000/year precluded revenue gain by extending from July 1, 2002 to July 1, 2004 the clean alternative fuels business tax credit (section 11); and g) a \$500,000/year precluded revenue gain to the Transportation Fund by extending from July 1, 2002 to July 1, 2004 the exemptions of compressed gas, liquefied natural gas, and liquid petroleum gas from the motor fuels tax (section 12)

expansion of the personal income tax was to have generated \$6 million of new revenues in SFY 03. Section 17 wholly repeals this change, precluding this revenue gain of \$6 million.⁴⁵

- **Assuring the continued “refund” of “unused” R & D credits.** Section 19 states that companies that are required by PA 02-1 (MSS) to pay Connecticut’s alternative minimum tax of \$250/year still can “sell-back” to the state their “unused” research and development credits at 65% of their value.⁴⁶ This clarification precludes a revenue gain of about \$13 million (from foregone credit refunds). OFA states, however, “the exchange of unused R & D credits were always anticipated to be refunded by the state.”

In addition, section 18 of SB 700 allows the Commissioner of the Department of Economic and Community Development to renew a defense plant zone designation for two additional two-year periods. If the DECD Commissioner so acts, the extension would result in both a cost and revenue loss to the state and a revenue loss to eligible municipalities (currently Stratford) to the extent that the extension provides various financial incentives for business activity. Financial incentives available to businesses in a defense plant zone include a loan program, a corporation business tax credit, a job incentive program, an 80% property tax abatement program (with 50% state reimbursement of the lost property taxes to the town), a sales tax exemption for repair and replacement parts, and an exemption from the Real Estate Conveyance tax.⁴⁷

E. Other SFY 03 revenue changes. PA 02-1 (MSS) and SB 700 were not the only legislation that had an impact on SFY 03 revenues.⁴⁸ Other changes, enacted in the 2002 regular session and in earlier years, impact on SFY 03 revenues. A review of a number of these follows:

⁴⁵ The casinos urged repeal, claiming that taxing the gross winnings of non-residents would make Connecticut’s gambling industry non-competitive with other states and that, as a result, fewer non-residents would come to Connecticut to gamble and total gambling revenues would fall, rather than increase. It appears, however, that other states tax the “net” winnings of non-residents (i.e., gambling winnings less gambling losses). Assuming there were no constitutional barriers to imposing this tax, the General Assembly could have imposed the personal income tax on the net winnings of non-residents (rather than simply repealing the tax totally), generating new revenues for SFY 03 while keeping Connecticut “competitive” in casino gambling.

⁴⁶ As noted earlier, PA 99-173 permits companies with less than \$70 million in gross sales to sell unused Research and Development credits and Research and Experimentation credits back to the state at 65% of their value. These credits are “unused” because the company has insufficient tax liability to offset. This credit “sell-back” is like a cash grant program to smaller businesses, but without any of the oversight that economic development grants are expected to receive if made through DECD. In 2002, this credit sell-back provision cost Connecticut \$30 million and benefited about 450 companies.

⁴⁷ A municipality is found to be “severely impacted by a prime defense contract cutback” if the DECD Commissioner finds that one or more businesses in the town have lost one or more prime defense contracts or subcontracts or there has been a significant reduction in such contracts and that the contract cutback has caused (or will cause) a loss of jobs in the town and a severe adverse impact in the town. Conn. Gen. Stat. 32-56 outlines factors the Commissioner is to consider in making this determination. The designation is effective for two years. Section 18 of SB 700 allows the DECD Commissioner to extend the designation for two additional two-year periods, after a public hearing and making the findings required by this state law.

⁴⁸ In addition, to these bills enacted in the May 9 Special Session, section 79 of HB 6004 (the budget implementer bill) allows professionals who have missed their normally scheduled renewal date for a Department of Public Health-issued license, certificate, permit, or registration because they were on active duty in the armed forces additional time (up to six months after discharge) to pay any required fee and complete any required continuing education or refresher training requirements without having their license, certificate, permit or registration lapse. DPH may have some modest revenue gain from this change.

1. *November 2001 special session and 2002 regular session.* Changes made in the regular 2002 Session, and the November 2001 special session that preceded it include:

- **Succession tax.** PA 01-1 (Nov. 15 Spec. Sess.) delayed the scheduled phase-out of the succession (inheritance) tax by postponing *by one year* the increase in the exemption amounts for transfers to Class B and Class C beneficiaries. Currently, estates can transfer assets, free of any succession tax, to surviving spouses (class AA inheritors) and immediate family, such as parents and children (class A inheritors). For persons dying in 2002, there is no succession tax on the net taxable estate transferred to Class B beneficiaries (e.g., other relatives, primarily brothers, sisters, nieces, nephews, and sons/daughters-in-law) if the estate transferred is less than \$600,000 in value. There is no succession tax if assets valued at less than \$200,000 pass to Class C beneficiaries (e.g., individuals not closely related by blood, non-relatives, and organizations). These exemption amounts were to have increased in 2002. Now they will not increase until 1/1/03. *This phase-out delay is projected to increase revenues by \$11.0 million in SFY 03, and \$28.1 million in SFY 04.*⁴⁹
- **Increase in cigarette tax.** PA 02-1 (SB 37) increased the cigarette excise tax by 61 cents per pack effective April 3, 2002. OFA estimated that this would increase SFY 03 revenues by \$122.3 million (and increase SFY 02 revenues by \$39.7 million).
- **Changes in health care-related taxes.** PA 02-3 (SB 33) restructured some elements of health care financing. Sections 1-3 pertain to taxes on patient care services, and specify that taxes (and exemptions from tax) are to be based on when the hospital receives payment for the service, not when the services are rendered. The change means that hospitals do not have to remit taxes for services rendered in May and June 2001, resulting in an \$18 million revenue loss in SFY 02. (A 2001 law totally exempted these services from the 5.75% sales tax for the period July 1, 2001 through June 30, 2002)

Section 4 repealed the tax credit against the insurance premiums tax that was granted to commercial managed care organizations (MCOs) providing HUSKY A and B coverage, retroactive to January 1, 2001.⁵⁰ This repeal results in additional General Fund revenues of \$14 million in SFY 02 and \$15.6 million in SFY 03. To offset this lost benefit to the MCOs, however, Section 5 provides a supplemental cash payment in SFY 02 equal to the amount of the credit the company would have received (provided the company pays the full amount of tax due). Section 5 also provides an *additional* supplemental payment for SFY 03 equal to \$36.75 times the average number of persons the plan covers through HUSKY over the period January-June, 2002 inclusive. These supplemental payments, when the Governor proposed them, were projected to cost \$14 million in SFY 02 and \$18.3 million in SFY 03.

⁴⁹ Connecticut's estate and succession taxes are among its most progressive taxes, as they most commonly impact only on transfers of wealth from Connecticut's most wealthy residents. Total repeal or a rolling back of the phase-out should be considered. See S. Geballe, E. Scalettar, & D. Hall, *Enhancing State Investments Through Smart Budget Choices* (CT Voices for Children, February 4, 2002) Wealth now is more inequitably distributed than income in the United States, and the levels of inequality in wealth are comparable to those in the United States in the so-called Gilded Age of the late 1890s. Indeed, estate, succession and inheritance taxes were first enacted in the early 1900s to help reduce the great wealth inequalities of this so-called Gilded Age. See K. Phillips, *Wealth and Democracy* (Broadway Books, New York, 2002).

⁵⁰ This tax credit, set at \$73.50 per covered life (generally), could be taken against the MCOs' tax liability on its *commercial* policies (there was already no tax imposed on the HUSKY A and B policies themselves). In SFY 02, this credit was to have resulted in a revenue loss of \$14.5 million.

Viewed together, these changes in funding the MCOs could result in a net *loss* to the General Fund of \$3 million in SFY 03.⁵¹

- **Surcharge on rental trucks.** Section 85 of PA 02-70 (SB 20) extends the 3% motor vehicle rental surcharge currently applied to rental cars to the rental of any “rental truck” rented within Connecticut for a period of less than 31 days. The tax is added to any other sales/use taxes imposed. “Rental truck” is defined to be a vehicle rented without a driver with a weight of not more than 26,000 pounds and used in the transportation of personal property (but not for business purposes) or a trailer with a weight of not more than 6,000 pounds. The provision requires the rental truck company to pay the Department of Revenue Services any money from the surcharge that exceeds the amount paid by the company in personal property tax, and title and registration fees. Because of the timing of the effective date of this change, there is no revenue gain anticipated in SFY 03, and \$50,000-\$100,000 of additional revenue in SFY 04 and each year thereafter.
- **Terrorist victim relief.** Section 7 of PA 02-126 (SB 102) exempts from Connecticut income tax for one year the tax that would otherwise have been paid by a “specified terrorist victim,” i.e., any individual who died as a result of wounds or injury incurred as a result of the terrorist attacks against the United States on September 11, 2001, or who died as a result of an attack involving anthrax occurring on or after September 11, 2001 and before January 1, 2002. Such individuals (and their estates) do not need to file a Connecticut income tax return for 2001. Any Connecticut income tax that is unpaid at the time of death (including interest, additions to tax and penalties) will not be assessed and, if assessed, will be abated, and if collected, will be refunded to the legal representative of the estate. This exemption from the income tax is expected to reduce SFY 03 revenues by about \$500,000 and affect fewer than 100 taxpayers.⁵²

⁵¹ This credit for managed care organizations providing HUSKY coverage was adopted in large part to provide greater compensation to the MCOs without exceeding through direct payments what would have been paid under fee for service (a requirement of federal law) and to avoid an additional appropriation that would be counted against the state spending cap. The credit benefited only the for-profit MCOs providing HUSKY coverage; there was no financial benefit to any non-profit MCO (since the credit was against the insurance premiums tax paid on *other* commercial policies). Though the repeal of this credit results in a revenue gain to the state in SFY 02 and 03, this is more than offset by increased expenditures through these supplemental payments. Importantly, however, PA 02-3 also increased transparency in the use of HUSKY funds by requiring (in section 6) that each managed care subcontractor paying claims for mental health and dental care through a Medicaid managed care plan submit quarterly reports to DSS on the proportion and amount of its monthly payment from the MCO that has been paid *directly to health care providers* and the proportion used by the subcontractor for its own administrative costs and profit.

⁵² The Connecticut Constitution (Art. 1, sec. 1) states that “no man or set of men are entitled to exclusive public emoluments or privileges from the community.” This has been interpreted by the Connecticut Supreme Court to mean that public funds may not be granted to any individual or individuals were they would clearly serve only private gain or advantage, and have no public purpose. While this change in the state income tax lessens the financial impact of the events of September 11 and Connecticut’s anthrax death on the families of the specific individuals identified here, if its *public* purpose is to assist those harmed by the terrorist attacks the provision is too limited. For example, many of the families of Connecticut National Guard members who have been activated for the last year in response to the attacks have suffered reduced income (employers are not required to make up the difference between the National Guard salary and the salary the Guardsman was being paid) as well as increased expenses maintaining contact with the now-distant Guardsmen. Other families have had a loss of income because a family member was laid off after the terrorist attacks. Yet none of these individuals will enjoy any reduction in *their* state income tax under this section.

The following table shows the net impact of various bills' SFY 03 revenue changes:

SFY 03 Enhanced Revenues	01-1 (NSS)	02-1	02-126	02-1 (MSS)	SB 700	TOTAL
Taxes	\$11M	\$122.3M	(\$0.5M)	\$102.8M	(\$8.0M)	\$227.6M
Fees				\$1.3M		\$1.3M
Tax amnesty				\$22M		\$22M
Fund Transfers				\$341.3M		\$341.3M
Precluded losses				\$50-70M		\$50-70M
Increased transfer to Pequot Fund				(\$14.22)		(\$14.22)

2. *Earlier changes.* Certain changes in taxation adopted *prior to* the November 2001 Special Session and the 2002 General Assembly session were to be phased in during SFY 03. These also erode SFY 03 state revenues. These changes include (but are not necessarily limited to):

- **Fuel oil exemption.** Section 1 of PA 97-281 phases out from the petroleum gross earnings tax grade number 6 fuel oil if used by certain types of manufacturers and grade number 2 fuel oil if used exclusively in certain vessels primarily engaged in interstate commerce. Revenues lost through this phase-out were about \$900,000 in 2000. PA 97-281 phased out this tax altogether on July 1, 2002.
- **Extension of single factor apportionment to income from all credit card activities.** Section 18 of PA 96-175 extended single factor apportionment⁵³ to companies with income from credit card activities, conforming their treatment to the favorable single-factor treatment already given to financial services under Conn. Gen. Stat. 12-218(b). Previously, companies with income from credit card activities could elect single factor apportionment only if they were operating in a distressed municipality in Connecticut. [Conn. Gen. Stat. 12-218(j), as amended by PA 96-175, sec. 18, effective income years on or after January 1, 2002].

In addition, there are multiple tax exemptions, deductions, exclusions, credits and rate changes that were enacted over the 1990s that continue to erode revenues from our income tax, sales/use tax, corporate tax, and all other taxes.⁵⁴ According to the Office of Fiscal Analysis' 2002 *Connecticut Tax Expenditure Report* (<http://www.cga.state.ct.us/ofa/documents/taxexp1-2002.pdf>) if all of these preferential benefits were repealed, Connecticut could collect nearly \$4 billion in additional tax revenues. That is, the revenues Connecticut *loses* through tax expenditures are *more than one-third* of the total revenues Connecticut now collects through taxes. These revenue losses are *not* reviewed on an annual, or even periodic, basis (as appropriations are), although state priorities change and the rationales for the tax preferences may longer exist, or be as compelling.

⁵³ Single factor apportionment allows the taxation of a multi-state corporation to be based on the proportion of its sales within Connecticut, without regard to the proportion of its employees or property within Connecticut.

⁵⁴ For example, Connecticut exempts from sales tax all sales of clothing and footwear costing less than \$300 *per item* for the week beginning August 18, 2002 and ending August 24, 2002, inclusive. This "sales tax" holiday was first adopted in 2000. [Conn. Gen. Stat. 12-407d]. The sales tax holiday reduced SFY 02 revenues by about \$3 million.

F. A bit of comparison. As outlined above, PA 02-1 (MSS) increased General Fund revenues by a net \$453 million, and SB 700 thereafter *reduced* revenues (by cutting revenues or precluding revenue increases) by nearly \$8 million.⁵⁵

By comparison, the revised SFY 03 budget adopted by the General Assembly but vetoed by the Governor (PA 02-38, SB 660) increased SFY 03 revenues by a *net* \$597 million. Not only did SB 660 generate \$150 million *more* in revenues, it also generated these revenues somewhat differently. Specifically, PA 02-38 (SB 660) generated its nearly \$600 million in net new SFY 03 revenues as follows:

- **New taxes.** \$281.4 million in net new tax revenue (\$284.6 million in new tax revenue reduced by \$3.2 million in new tax exemptions). Of this, \$219 million was from the 1% surtax on personal income over \$1 million;
- **New fees.** \$2.5 million in new fees;
- **New federal funds.** \$29.7 million in new federal funds;
- **Fund transfers.** \$300 million in transfers from various funds to the General Fund (\$16 million re-directed from the Tobacco Settlement Fund to the General Fund and \$284 million transferred to the General Fund from various other Funds, e.g., Tobacco Health Trust Fund, Biomedical Research Trust Fund, Anthem Demutualization Fund, cash reserves of quasi-public agencies).⁵⁶

SB 660 did not include a new sales tax exemption for aircraft-related business services (as did PA 02-1, MSS), but *did* include a \$17.5 million *reduction* in General Fund revenues by increasing the funds transferred to Pequot/Mohegan Fund (compared to the \$14.22 million transfer in PA 02-1, MSS).

The following table compares the revenue-generating provisions of PA 02-1 (MSS), as amended by SB 700, and SB 660:

Comparison of Net New Revenues for SFY 03 Final Budget Bills v. Vetoed Democratic Budget		
	PA 02-1, MSS (as amended by SB 700)	PA 02-38 (SB 660) (vetoed budget)
Personal Income Tax	\$12.0M	\$230.5M
Gift Tax	\$2.6M	\$2.6M
Sales Tax	\$10.1M	(\$0.1M)
Corporation Tax	\$71.0M	\$25.0M
Public Service Companies Tax	(\$0.1)	(\$2.5M)
Oil Companies/Petroleum Tax	(\$0.1)	\$3.9M
Tax Amnesty (one time, personal income tax, sales tax, corporation tax)	\$22.0M	\$22.0M

⁵⁵ This assumes that OFA is correct that there was no legislative intent to prevent the sell-back of R&D credits in imposing the corporate minimum tax of \$250/year on *all* corporations. If OFA is incorrect, SB 700 results in an additional \$13 million revenue loss.

⁵⁶ For a complete listing of the fund transfers authorized by SB 660, see S. Geballe & D. Hall, *SB 660: The Democratic Response to Governor Rowland's Proposed Revisions to the SFY 03 Budget* (CT Voices for Children, May 1, 2002), on www.ctkidslink.org.

Fees	\$1.3M	\$2.5M
Federal grants	0	\$29.7
Fund Transfers & Use of Anthem Demutualization Funds	\$341.3M	\$300.4M
Transfer to Pequot/Mohegan Fund	(\$14.22M)	(\$17.5M)
TOTAL	\$446M	\$597M

Notably, PA 02-1 (MSS) does *not* include a key component of SB 660, the 1% surtax on personal income over \$1 million/year that would have generated about \$219 million of the \$230.5 million increase in personal income tax revenues (95%). Indeed, SB 660’s inclusion of this provision was one of the reasons that Governor Rowland vetoed the bill. He stated in his veto message, “[T]his budget includes an income tax increase on a relatively small segment of the population that is fundamentally unfair and was not given a public hearing... This tax increase may provide the impetus for some of our state’s largest taxpayers and wealthiest residents to take up residence in some other state.”

Governor Rowland also objected to SB 660’s suspension of the research and development credit sell-back program for two years (that would have saved the General Fund \$25 million in tax refunds). He said in his veto message that this “unfairly penalizes businesses that have *already earned* the research and development credit by suspending it for one year. Essentially, this budget reaches back in time to take away a tax credit that certain corporations have already lawfully earned.” (emphasis added) PA 02-1 (MSS), as noted above, now sets a cap on how much credit each eligible company may “sell back” to the state each year.

G. What PA 02-1 *did not* include as new revenues.

In addition to the revenue options not included from SB 660 (as discussed above), PA 02-1 (MSS) did *not include* certain revenue measures that either had been proposed by the Governor or were reported out favorably by the Finance Committee. They include:

Governor and Finance Committee Revenue Options Not Included in PA 02-1		
Proposal	Who Proposed	Add'l SFY 03 Revenue
Return (escheat) unclaimed bottle deposits to state	Governor	\$15.0M
Increase corporate Alternative Minimum Tax from \$250/year to \$450/year. NOTE: Revenue gain of \$6.2 million on original bill included revenue from prohibiting tax credits from being used to avoid paying the minimum tax. This was included in PA 02-1, and is expected to generate \$0.5 million. The revenue estimate of \$5.7 million shown here does not include this sum)	Finance Committee	~\$5.7M
Freeze state estate and generation-skipping tax at the amount of the federal credit allowed on 1/1/01 by de-coupling state estate tax from recent federal changes	Finance Committee	\$8M

PA 02-1 (MSS) also failed to adopt other revenue-generating proposals that had been included in Finance Committee bill SB 611, such as:

- Increasing the alcohol beverage tax on distilled spirits (\$6.5M of additional revenue)
- Repealing the sales tax exemption on vending machine sales of food and of items costing less than 50 cents (\$1.2M)
- Reducing by half the credit against the corporation and other business taxes for personal property taxes paid on computer and data processing services (\$10-20M)
- Reducing from 5% to 3% the corporate tax credit for amounts spent on fixed capital investments (\$8-\$16M)
- Imposing the sales tax on health and athletic club services (\$10M)
- Imposing the sales tax on amusement parks and arcades (\$1M); and
- Imposing the sales tax on golf courses and country clubs (\$4M).

Also not included in PA 02-1 (MSS) are other proposals made by the One CT Campaign (a coalition of more than 80 social service, human service, religious, education, and labor organizations) to help ensure that the corporate community pays its “fair share” of state taxes, and that tax expenditures are used only to serve essential public purposes in these difficult fiscal times. Over the 1990s, the share of state revenues borne by corporations has markedly declined. In 1991, business taxes contributed 19% of all state revenues, in 2002 only 7%.⁵⁷ Now, about two-thirds of Connecticut’s corporations (33,000) pay the minimum corporate tax of only \$250/year. Revenue enhancements from the corporate community proposed by the One CT Campaign include:

- Sun-setting tax expenditures characterized by OFA in its *Connecticut Tax Expenditure Report* as “expedient” and others that serve a less important purpose than the programs and services that could continue to be funded if the exemption, deduction, or credit were repealed (e.g. the sales tax exemption for direct mail advertising services, winter storage of pleasure boats)
- A temporary 20% rollback of certain preferential corporate tax benefits.

IV. Carry-forwards

PA 02-1 (MSS) authorizes the carry-forward of certain funds unexpended on June 30, 2002 (the end of SFY 02) for use in SFY 03. HB 6004, *AAC State Expenditures* (adopted August 12, 2002 to implement PA 02-1, MSS), modifies some of these carry forwards.

In reviewing Part 2 of this budget summary, which highlights the appropriations made in the final revised SFY 03 budget, it is important to keep these carry-forward funds in mind as they will provide some funding in SFY 03 to help “cover” cuts. They will *not*, however, provide continued funding in years after SFY 03 for the specific accounts that are “cut.” Note also that some of the SFY 01 “surplus” funds that were re-allocated to certain accounts (described earlier) also were authorized to be carried forward, but provide no on-going funding stream for these accounts in SFY 04 and years beyond. This creates a structural deficit in the SFY 04 budget.

⁵⁷ See D. Hall, E. Scalettar, D. Hall & S. Geballe, *An Overlooked Form of Spending: Tax Expenditures and the Need for Review* (CT Voices for Children, January 2002)

The carry-forwards authorized by PA 02-1 (MSS), as modified by HB 6004, include (but are not necessarily limited to):

- State Employees Health Service Cost account, for Other Expenses, \$10 million (transferred from DSS Hospital Finance Restructuring SFY 01 surplus by section 12 of PA 02-1, MSS) and the unexpended balance of funds for this account appropriated by section 1 of SA 01-1 of June Special Session (section 98 of HB 6004).
- OPM –Interlocal Agreements, \$0.03 million; Drug Enforcement, \$2.04 million; PILOT for new manufacturing and equipment, \$1 million (section 29, PA 02-1 MSS).
- OWC – CETC Workforce, \$0.776 million; Jobs Funnel, all unexpended funds (section 30, PA 02-1, MSS; section 72, HB 6004⁵⁸).
- DOL – Workforce Investment Act, \$7.8 million; Welfare to Work Grant program, \$0.8 million (section 31, PA 02-1, MSS).
- DOC (Department of Correction) – Inmate medical services, \$0.3 million (section 34, PA 02-1, MSS); unexpended funds for Workers Compensation Claims (section 53, PA 02-1, MSS).
- DMV – Reflectorized license plates and upgrading of data processing system, \$3.0 million (section 35, PA 02-1, MSS).
- DOT – \$1.2 million of funds appropriated for Transportation Strategy Board to be used for Jobs Access programs to SE Connecticut and Dial-A-Ride, \$1 million; urban downtown plan, \$0.1 million; and study of an L Bus Route, \$0.1 million (section 44, PA 02-1, MSS, as amended by section 113 of HB 6004).⁵⁹ Also, unexpended funds for Bus Operation and Rail Operations are carried forward (section 54 (a) and (b), PA 02-1, MSS).
- DMHAS - \$0.1 million of funds for Community Mental Health Strategy Fund are carried forward, but are transferred to the Central CT State University for the Institute for Municipal and Regional Policy at the Center for Public Policy and Practical Politics (section 45, PA 02-1, MSS).
- Legislative Management. – Unexpended funds appropriated for Capitol Security Improvement projects, Flag Restoration, Other Expenses, Minor Capital Improvements, and the CCDC Playground Improvements (section 49 of PA 02-1, MSS)

V. Summary

Like other states, Connecticut’s budget is facing significant challenge. With revenues far below those projected, and expenditures higher than expected in some accounts, the state’s budget “bottom line” has shifted dramatically in the past year, from bountiful surplus to expanding deficit.

Importantly, even if the economy had not slowed, Connecticut would have faced significant budget challenges over the next several years, resulting from very large revenue reductions (particularly in corporate taxes) enacted over the 1990s. These “tax expenditures” (exemptions, exclusions, credits,

⁵⁸ PA 02-1 had capped the carry-forward for OWC’s Jobs Funnel program at \$700,000. Section 72 of HB 6004 allows the full unexpended balance of this account to be carried forward for expenditure in SFY 03.

⁵⁹ Section 113 of HB 6004 cut by \$364,000 the funds allocated by section 44 of PA 02-1 (MSS) for the Transportation Strategy Board. Section 44 had provided for \$1,564,264 to be expended as follows: \$1 million for jobs access programs in southeast Connecticut and Dial-A-Ride; \$464,264 for consultant services for the Board; and \$100,000 for an urban downtown traffic plan.

deductions, and rate reductions) are *not* periodically reviewed to assess if they still have merit, particularly in these tough budget times. Now, by using hundreds of millions of dollars of one-shot “revenues” to close the SFY 03 deficit rather than addressing the structural revenue shortfall, the budget crisis is merely delayed, not solved. This is truly a *boomerang* budget, both in how it generated its “new” revenues, and in the programs and services in which it made its cuts. (See Part 2 of this Budget Summary)

The next legislative session will require strong political leadership. Connecticut will need to make significant structural changes to its state and local taxes to ensure not only adequate and stable revenues, but also that our revenues are generated in an equitable manner. Without question, a part of the solution to this budget crisis will require that some of the tax breaks enacted in the boom years of the late 1990s be rolled back. What remains to be seen is whether additional revenues will come from those who benefited most in the prosperous 1990s and so have the greatest capacity to take on additional fiscal responsibility, or whether the budget will be balanced on the backs of those who have far less.