

# Budget CONNECTION\$

A Connecticut Voices for Children  
Issue Brief

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## Revenue Changes in Governor Rowland's Proposed FY 03-05 Budget: Who Are the Tax "Winners" and "Losers"?

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According to the Governor's Biennial Budget Introduction Supplement (p. 34), the Governor has made permanent tax cuts that total \$2.064 *billion* over his tenure, pre-2002.<sup>1</sup> Since 2002, in the various deficit-reduction measures enacted to address the FY 02 and FY 03 deficits (including most recently PA 03-2 (HB 6495)), a total of \$888.5 million in tax increases have been enacted.<sup>2</sup> This restores about 46% of the more than \$2 billion in tax revenues that were cut in the prosperous late 1990s when the temporary surge in capital gains tax revenues generated budget surpluses. Although PA 03-2 helped to reduce some of the projected FY 04 and FY 05 deficits, significant deficits remain to be addressed. This short report summarizes how Governor Rowland proposes to address these deficits through changes on the *revenue* side of the budget. A subsequent analysis will look at proposed changes in spending.

**1. Proposed Revenue Changes, In Short.** The Governor's proposed FY 03-05 budget would increase *net* General Fund revenues in FY 03 by \$8.1 million, in FY 04 by \$199.1 million and in FY 05 by \$298.4 million. Once again, however, more than half of the proposed "new" revenues are one-time revenues from fund transfers; less than half of Governor Rowland's revenue solution *restores* funding on an on-going basis as is necessary to assure stability and adequacy in years ahead.

**a. FY 04.** The net new General Fund revenues of \$199.1 million come from the following sources:

### REVENUE GAINS:

- Taxes (net gain of \$52.9 million)
- Fee increases (\$4.7 million)
- Escheat unclaimed bottle deposits (\$18 million)
- Eliminate tobacco funds transfer to Tobacco and Health Trust Fund and Biomedical Trust Fund (\$16 million)
- Transfers of \$147 million in funds to the General Fund from five other fund accounts

<sup>1</sup> Note, however, that there were significant tax cuts in the 1990s *before* Governor Rowland was elected. These include the corporation business tax that was cut by \$1.3 *billion* beginning in 1991 – about \$500 million through corporate tax rate reductions and \$800 million through preferential tax breaks (credits, exemptions, exclusions and deductions).

<sup>2</sup> Note, however, that during this period of time there also have been additional tax reductions, notwithstanding the existence of a deficit. PA 02-1 (MSS), for example, exempted business analysis, management, consulting, and public relations services furnished "in connection with an aircraft" retroactive to 1/1/94 (\$0.8million revenue loss in FY 03 and \$0.2 million each year thereafter), while PA 02-4 (MSS) extended and expanded various tax breaks for clean fuels (revenue loss in FY 03 and FY 04, \$1.3 million). Data about changes in state taxes are drawn from the Governor's FY 03-05 Biennial Budget materials, the Connecticut State Budget 2001-03 Revisions, the Office of Fiscal Analysis' Fiscal Note on PA 03-2, and other OFA reports.

REVENUE LOSSES:

- Federal funds (*loss* of \$16 million due to state budget changes that reduce federal reimbursements). NOTE: This loss of federal funds *is in addition to* the projected \$43.7 million of federal funds that will be lost in FY 04 because of changes made in PA 03-2.
- Pequot grant (*net* loss of \$6.5 million)
- Postpone Generally Accepted Accounting Principles (GAAP) implementation (*loss* of \$17 million).

**b. FY 05.** The net new General Fund revenues of \$298.4 million come from similar sources, with a net \$126.6 million in increased tax revenues, \$6.7 million in increased fees, \$20 million from the escheat of unclaimed bottle deposits, \$147 million from the same fund transfers and \$16 million from tobacco settlement funds, as well as \$63.5 million from the Pequot Fund. These gains are offset by the postponed implementation of GAAP (\$17 million) and a very substantial *federal revenue loss* due to budget changes that *soars to \$62.4 million*. NOTE: This loss of federal funds *is in addition to* the projected \$43.7 million of federal funds that will be lost in FY 05 because of changes made in PA 03-2, bringing the *total loss* of federal funds to *more than \$100 million*.

**c. FY 04 and FY 05 in more detail.** The following table shows the proposed changes in revenues, by source.

<b>REVENUE CHANGES IN GOV. ROWLAND'S PROPOSED FY03-05 BUDGET</b>			
<b>(in millions)</b>			
	<b>FY 03</b>	<b>FY 04</b>	<b>FY 05</b>
<b>NET TOTAL TAXES</b>	<b>8.1</b>	<b>52.9</b>	<b>126.6</b>
Income Tax		80.0	118.6
Sales & Use Tax	0.1	(93.8)	(67.8)
Corporation Tax		27.8	21.3
Public Service Tax	1.5	6.3	6.7
Inheritance/Estate Tax		11.0	26.0
Insurance Co Tax	1.5	2.5	2.5
Real Estate Conveyance Tax	5.0	25.0	25.0
Oil Co Tax (transfer to emer. spill acc't)		(10.5)	(10.5)
Misc. Tax		4.6	4.8
<b>NET FEES</b>		<b>4.7</b>	<b>4.7</b>
<b>ESCHEATS</b> (unclaimed bottle deposits)		<b>18.0</b>	<b>20.0</b>
<b>FEDERAL FUNDS</b>		<b>(16.0)</b>	<b>(62.4)</b>
<b>TOTAL TRANSFERS TO GENERAL FUND</b>		<b>147.0</b>	<b>147.0</b>
From Energy Conservation & Load Mgmt Fund		72.0	72.0
From Clean Energy Fund		25.0	25.0
From CT Housing Finance Authority		40.0	40.0
From CT Innovations, Inc.		5.0	5.0
From CT Development Authority		5.0	5.0
<b>PEQUOT GRANT</b> (reduce grant by \$28.5M and pre-fund FY 05 grant by \$35M)		<b>(6.5)</b>	<b>63.5</b>
<b>GAAP IMPLEMENTATION</b> (postponed)		<b>(17.0)</b>	<b>(17.0)</b>

<b>TOBACCO SETTLEMENT</b> (eliminate transfers to Tobacco & Health Trust Fund & Biomedical Research Trust Fund)		<b>16.0</b>	<b>16.0</b>
<b>NET GENERAL FUND REVENUE CHANGES</b>	<b>\$8.1</b>	<b>\$199.1</b>	<b>\$298.4</b>

**2. A Closer Look at Governor Rowland’s Proposed Tax Changes.** The Governor’s FY 03-05 budget proposes to increase FY 04 tax revenues by a net \$52.9 million (\$179.1 million in tax increases offset by a \$115.7 million tax cut and a \$10.5 million transfer of tax revenues out of the General Fund to the emergency spill response account). The proposed changes would increase FY 05 tax revenues by a net \$126.6 million (\$253.5 million from tax increases offset by a \$116.4 million tax cut and a \$10.5 million transfer of tax revenues out of the General Fund to the emergency spill response account).

The proposed changes (and resulting changes in tax revenues) are as follows:

**Personal Income Tax. TOTAL GAIN: \$80.0M in FY 04; \$118.6M in FY05**

- Reduce maximum property tax credit from \$500 to \$400. GAIN: \$68M in FY 04; \$69.4M in FY 05
- Phase-out remaining \$100 property tax credit at higher income levels. GAIN: \$12M in FY 04; \$12.2 million in FY 05.
- Defer increase in singles exemption. GAIN: \$7.0M in FY 05
- Enhanced audit collections resulting from new computer system. GAIN: 30.0M in FY 05

**Sales & Use Tax. NET LOSS: -\$93.8M in FY 04, -\$67.8M in FY 05**

- Maintain tax on computer and data processing services at 1%. GAIN: \$10.8 million in FY 05.
- Eliminate sales tax free week. GAIN: \$3.1 million in FY 04; \$3.3 million in FY 05.
- Increase cable TV tax to 6% of gross receipts. GAIN: \$0.1M in FY 03, \$0.4M in FY 04, \$0.4M in FY 05
- Eliminate revenue intercept for tourism districts. GAIN: \$16.6M in FY 04, \$17.3M in FY 05.
- Eliminate transfers from hotel occupancy tax. GAIN: \$1.8M in FY 04; \$1.8M in FY 05.
- Enhanced audit collections resulting from new computer system. GAIN: \$15.0M in FY 05.
- Eliminate 5.75% tax on hospital patient care services. **LOSS: -\$115.7M in FY 04, -\$116.4M in FY 05.**

**Corporation Tax. TOTAL GAIN: \$27.8M in FY 04; \$21.3M in FY05**

- Eliminate Neighborhood Assistance Tax Credit. GAIN: \$2.0M in FY 04; \$2.0M in FY 05
- Eliminate Low and Moderate Income Housing Tax Credit. GAIN: \$2.0M in FY 04; \$2.0M in FY 05
- Eliminate Employer Assisted Housing Tax Credit. GAIN: \$0.5M in FY 04; \$0.5M in FY 05
- Eliminate Historic Housing Tax Credit. GAIN: \$0.5M in FY 04; \$0.5M in FY 05

- Impose 10% temporary surcharge in income year 2004 (NOTE: PA 03-2 (HB 6495) adopted a 20% temporary surcharge in FY 03). GAIN: \$22.8M in FY 04; \$12.3M in FY 05<sup>3</sup>

**Public Service Tax. GAIN: \$1.5M in FY 03; \$6.3M in FY 04; \$6.7M in FY 05**

- Increase Cable TV gross receipts tax from 5% to 6%.

**Inheritance & Estate Tax. GAIN: \$11.0M in FY 04; \$26.0M in FY 05**

- Continue to defer phase-out of inheritance tax (for another 2 years).

**Insurance Companies Tax. GAIN: \$1.5M in FY 03; \$2.5M in FY 04; \$2.5M in FY 05.**

- Extend to insurance companies the limit on use of tax credits to 70% of tax due

**Real Estate Conveyance Tax. GAIN: \$5.0M in FY 03; \$25M in FY 04; \$25M in FY 05**

- Increase temporarily state real estate conveyance tax rates. NOTE: The municipal tax was already increased temporarily in PA 03-2 (HB 6495).

**Oil Companies Tax. GENERAL FUND REVENUE LOSS: -\$10.5M in FY 04; -\$10.5M in FY 05**

- Transfer revenues to emergency spill response account.

**Miscellaneous Taxes. TOTAL GAIN: \$4.6M in FY 04, \$4.8M in FY 05**

- Defer gift tax phase-out for another year. GAIN: None in FY 04 or FY 05. Note: PA 02-1 (MSS), section 76, had deferred the phase-out the gift tax, allowing the phase-out to resume January 1, 2004. It is unclear why OFA reports no revenue gain.
- Retain Tourism account surcharge in General Fund. GAIN: \$4.6M in FY 04, \$4.8M in FY 05

Importantly, a number of these proposed tax changes do not *increase* existing taxes, but rather re-allocate where tax revenues go. For each dollar of tax revenue now kept in (or transferred to) the General Fund, there is a dollar *reduction* in the account or fund to which these revenues previously had been credited.

**3. The Governor's Proposed Tax Changes In Context.** *If these changes are adopted*, the total net new taxes enacted to address the General Fund deficits in FY 02-04 will total about \$948 million. That is, the *net* increase in state taxes in the last two years to address our budget deficits will still be *less than half* (46%) the tax cuts enacted since Governor Rowland came into office.

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<sup>3</sup> Revenues from the 10% surtax on *income year* 2004 (January 1-December 30, 2004) will be received by the state in both FY 04 (July 1, 2003 through June 30, 2004) and FY 05 (July 1, 2004 through June 30, 2005), hence the revenues in both FY 04 and FY 05.

Importantly, however, as the table and charts below illustrate, the *net tax savings* will not have been equitably distributed. While the personal income tax is still less than it was before Governor Rowland took office, 71% of the income tax cuts made in the late 1990s will have been erased if the Governor's proposal is adopted. By comparison, only 17% of the corporation tax cuts would be rolled-back in FY 04 if the Governor's plan is adopted,<sup>4</sup> and *none* of the tax cuts enacted to offset corporations' property taxes would be touched.

The following table compares the distribution of tax cuts during Governor Rowland's tenure, before 2002, to the on-going<sup>5</sup> tax increases enacted to date to address the FY 02-03 deficits. It also compares the Governor's proposed tax increases (and cuts) for FY 04 in his FY 03-05 budget plan. The column on the far right shows what the *net* tax change would be in FY 04 if Governor Rowland's budget plan were adopted (all numbers are in millions):

	Tax Cuts in Rowland Tenure, Pre-2002	Tax Increases: 2002-03 & PA 03-2	Governor's Proposed FY 04 Tax Increases	Total Tax Increases (2002-03 & Governor's Proposed 04)	Net Changes in Taxes in FY 04 If Governor Rowland's Proposal Is Adopted
Income Tax	-711.5	428.3	80.0	508.3	-203.2
Sales Tax	-193.3	143.6	-93.8	49.8	-143.5
Corporation Tax	-496.6	58.5	27.8	86.3	-410.3
Hospital Tax	-190.4	0	0	0	-190.4
Cigarette Tax	0	195.5	0	195.5	195.5
Inheritance Tax	-158.1	0	11	11	-147.1
Gasoline Tax	-190.2	25.7	0	25.7	-164.5
Local Business Property Tax	-66.1	0	0	0	-66.1
Other Taxes <sup>6</sup>	-57.8	36.9	27.9	64.8	7.0
<b>TOTAL</b>	<b>-2,064.0</b>	<b>888.5</b>	<b>52.9</b>	<b>941.4</b>	<b>-1,122.6</b>

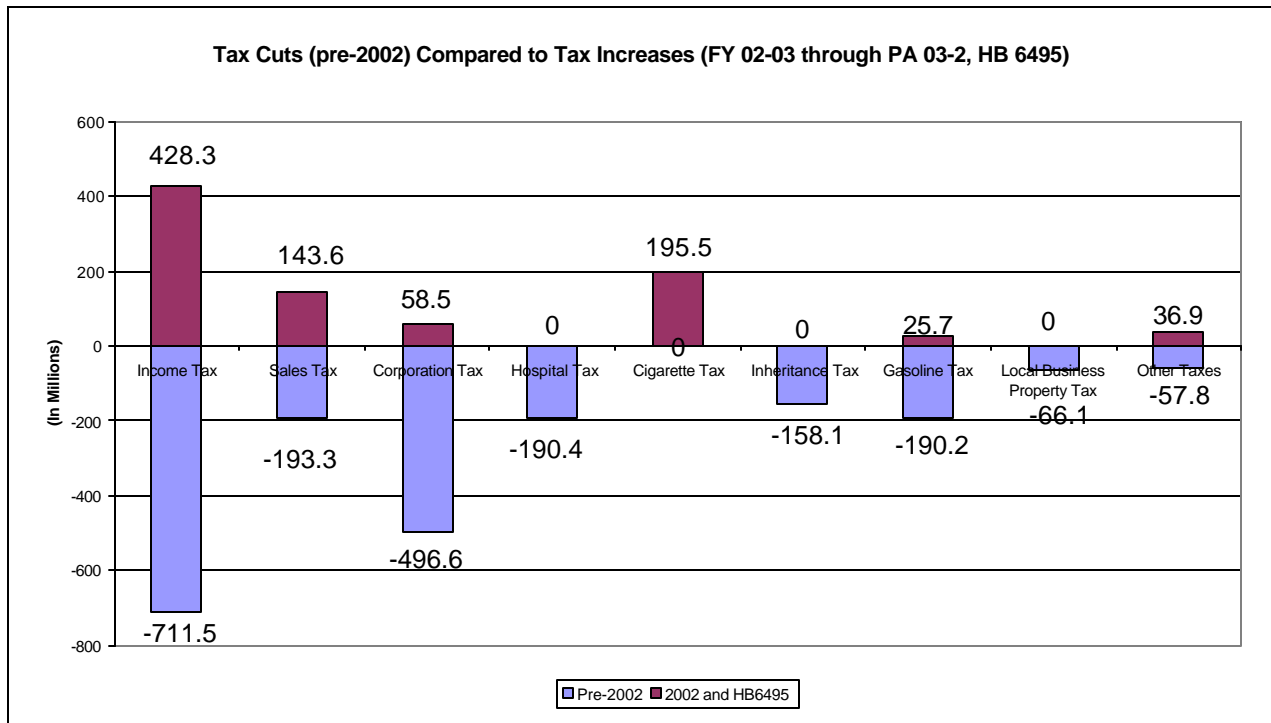
**4. A Look at the Tax “Winners” and “Losers” To Date.** As shown in the preceding table, Connecticut did not simply roll-back the various taxes that were cut under Governor Rowland before 2002. Rather, there is significant variation among the taxes that were *increased* since General Fund deficits have emerged and the taxes that were cut when there were General Fund surpluses.

<sup>4</sup> Importantly, \$22.8 million of the proposed corporation tax increase in FY04 is from a temporary surcharge. If one excludes this sum, since it does not represent a *permanent* increase in the corporation tax, then \$433.1 million of corporate tax savings of the \$496.6 enacted during Governor Rowland's tenure would continue – all but 13% of the tax cuts would remain.

<sup>5</sup> The table does not include temporary, one-time charges and surtaxes, but only structural changes to the state tax code that address the structural deficit.

<sup>6</sup> This includes the new \$250 fee on Limited Liability Partnerships (LLPs), Limited Liability Corporations (LLCs) and S Corporations. Since this is not a change to the corporation tax itself, it is listed under “other taxes.”

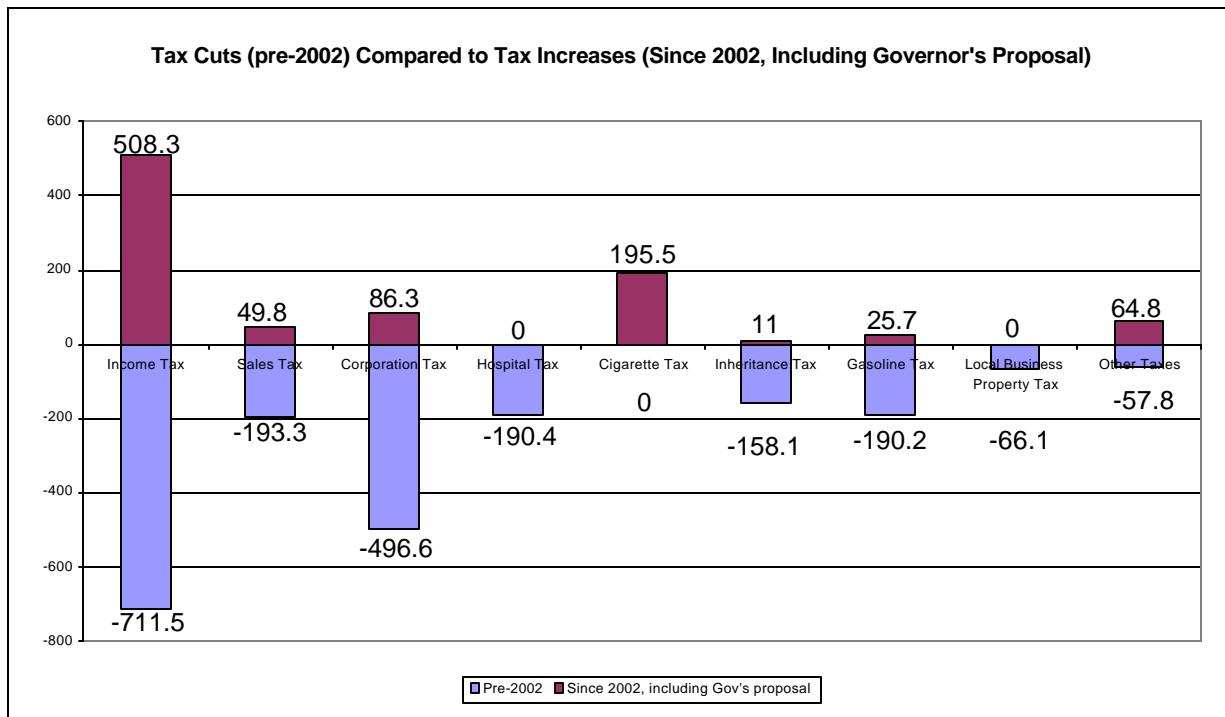
The following chart shows how the *on-going tax increases* enacted *so far* (including the changes made in PA 03-2, but *not* including the Governor’s proposed changes in his FY 03-05 Budget) compare to the tax *cuts* enacted since Governor Rowland took office, by type of tax. For example, the chart shows that in the late 1990s, the personal income tax was reduced by a total of \$711.5 million (largely because of the property tax credit). To date, deficit-mitigation efforts have *increased* the personal income tax by \$428.3 million.



The tax increases (and reductions) included on this chart are those that are *not temporary*. Excluded as a tax “cut,” for example, were the two tax rebates. Similarly excluded on the chart is the one-time 20% surcharge on the corporation tax included in PA 03-2. Since this is *not* a permanent increase in corporate tax revenues, but a temporary charge applicable to income year 2003 only, it does not address our state’s *structural* deficit so is not included. If it were, the corporate<sup>7</sup> tax increase shown on this chart would increase by \$27.8 million for a total of \$86.3 million (rather than the \$58.5 million shown).

The next chart *adds in* Governor Rowland’s proposed changes to the preceding chart, showing the *total* change in the various revenues if the Governor’s proposal is adopted without change.

<sup>7</sup> The \$250 annual tax on limited liability companies (LLCs), limited liability partnerships (LLPs) and Subchapter S corporations, applicable to income years on or after January 1, 2002 (enacted in PA 02-1 (MSS) and PA 02-4 (MSS)) is included under “other taxes” rather than “corporation tax” on this chart. This was estimated to generate \$28 million in revenue in FY 03. The 20% surcharge on this tax for income year 2003 (PA 03-2) is excluded from the chart, for reasons discussed in the text. If included, the additional revenues would be about \$4 million in FY 04.



**5. The Impact of Governor Rowland's Proposed Changes on Who Are the Tax "Winners" and "Losers."** The final charts illustrate who are the winners and losers of these revenue changes from the pre-2002 tax cuts *through* Governor's proposed tax increases, if adopted.

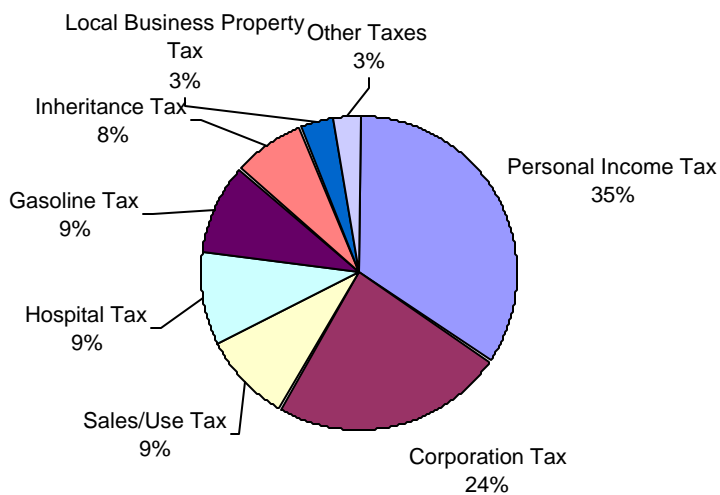
The first chart shows the distribution of \$2.064 billion in tax cuts enacted after Governor Rowland took office but before 2002, by type of tax.

The second chart shows the distribution of the \$1.176 billion in *net* tax cuts to date – the \$2.064 billion in tax cuts before 2002 and the *tax increases* since that time, by type of tax.

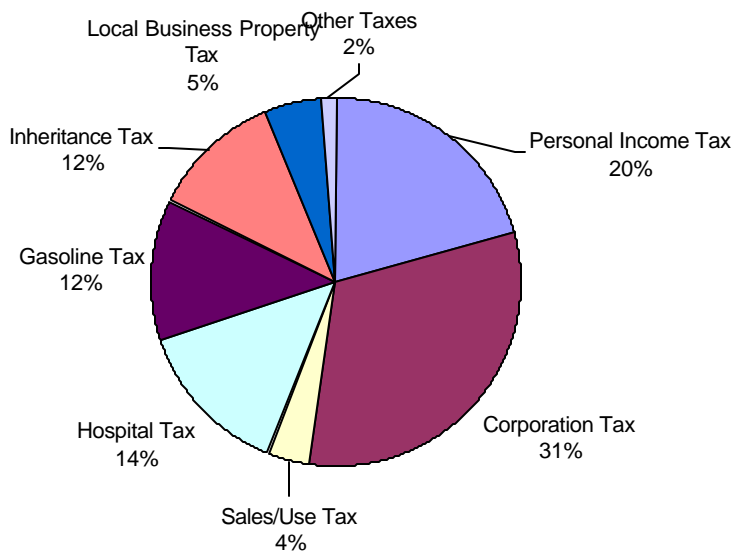
The final chart shows what the distribution of *net tax cuts* will be if Governor Rowland's budget plan for FY 04 is adopted. Note that the second and third charts do not include in the "pie" the various taxes that have had a *net increase* over this period, such as the cigarette tax (\$195.5 million in new taxes).

Comparing the three charts, it is evident that, corporations increasingly have emerged as "winners" in this time of changing tax revenues. While 27% of the tax cuts enacted after Governor Rowland took office but before 2002 directly benefited corporations (both through savings in the corporation tax and property tax reductions), 36% of the *net* tax cuts as of this date (i.e., the pre-2002 tax cuts offset by the tax increases since that time) benefit corporations. If Governor Rowland's proposal for FY 04 is enacted, 37% of the *net* tax cuts will benefit corporations. By comparison, 35% of the pre-2002 tax cuts were to the personal income tax. As of this date, 20% of the *net* tax cuts are to the personal income tax. If Governor Rowland's proposal for FY 04 is adopted, only 15% of the *net* tax cuts would be to the personal income tax.

**Tax Cuts (Rowland Administration, pre-2002): \$2.064 Billion**



**Net Tax Cuts To Date (Pre-2002 Tax Cuts Less Recent Tax Increases): \$1.176 Billion**



**Net Tax Cuts (Pre-2002 Tax Cuts Less Recent Tax Increases, Including Gov. Rowland's FY 04 Proposal):  
\$1.123 Billion**

