

THE WALL STREET JOURNAL.

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <http://www.djreprints.com>.

<https://www.wsj.com/articles/connecticut-nations-wealthiest-state-may-be-tapped-out-on-taxing-the-rich-1495186203>

U.S.

Connecticut, Nation's Wealthiest State, May be Tapped Out on Taxing the Rich

Connecticut's budget office expects 2017 income-tax collections to fall for the first time since the recession



Connecticut, which has the highest per capita income of any state, is forecasting a \$400 million shortfall in state income-tax collections this year, reviving a debate over tax increases for the state's wealthiest earners. Shown, downtown Stamford in 2015. PHOTO: SPENCER PLATT/GETTY IMAGES

By Joseph De Avila

May 19, 2017 5:30 a.m. ET

The wealthiest state in the U.S. is having trouble collecting enough money to pay its bills, and the Democratic governor doesn't think taxing the rich is the answer anymore.

After two decades of robust growth, Connecticut forecasts it will come in \$400 million short in income-tax collections this fiscal year, worsening a budget crisis that has prompted all three major ratings firms recently to downgrade the state's credit rating.

Connecticut's budget office estimates that income-tax collections will fall in fiscal 2017 for the first time since the recession.

About \$200 million of the drop in receipts came from the state's closely watched top 100 earners, who are the source of an outsize proportion of the state's revenue. Many of the state's richest residents work for hedge funds, which have been hurt by a downturn in the industry.

Gov. Dannel Malloy has twice before bet that taxing the wealthy would help solve the state's fiscal problems. But neither increase resulted in sustained revenue growth, according to his administration, which says it would be a mistake to do it a third time.

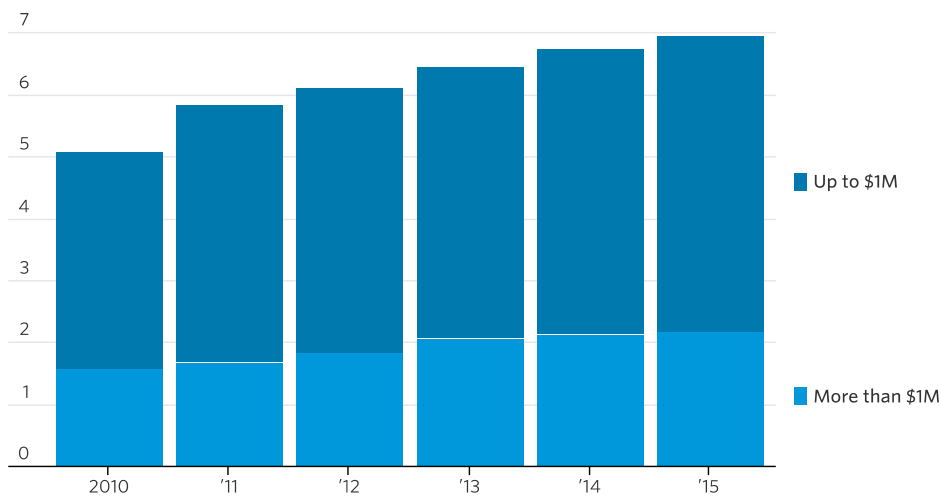
"You can't go back to that well again," said Kevin Sullivan, commissioner of Connecticut's Department of Revenue Services. "The idea that there is yet another significant amount, in terms of long-term stability, to get out of that portion of the population is just not true."

The tax question in Connecticut, where several thousand tax filers with adjusted gross

Tax Gap

Connecticut annual tax liability, by income

\$8 billion



Source: Connecticut Department of Revenue Services

THE WALL STREET JOURNAL

incomes of more than \$1 million a year account for about a third of all income tax receipts, comes amid a shift in tax policy nationally. President Donald Trump, who campaigned on promises to lower taxes, has proposed lowering business and individual rates. But he is also seeking to repeal a deduction on state taxes that will especially hit high-income earners, making it tougher for states to raise taxes among the richest.

Connecticut's fiscal troubles come as a majority of states face budget holes this cycle, according to a recent report issued by Standard & Poor's. At least nine states are considering some form of tax increase, such as raising corporation taxes and sales taxes, according to the report.

Connecticut is one of seven states, including Pennsylvania, New Jersey and Illinois, that is vulnerable to fiscal stress "even as the broader economy shows signs of gathering momentum," the report concluded.

It's a strange turn for Connecticut, which has the highest per capita income in the country, according to the Bureau of Economic Analysis, and is home to hundreds of hedge funds, Yale University, and businesses like insurer Aetna Inc. and industrial giant United Technologies Inc.



Connecticut Governor Dannel P. Malloy delivered his 2017 State of the State Address at the State Capital in Hartford on Jan. 4. He helped put through tax income increases in 2011 and 2015, raising the top rate to 6.99%. PHOTO: MICHELLE MCLOUGHLIN FOR THE WALL STREET JOURNAL

The state projects a \$5.1 billion budget deficit over the next two fiscal years, fueled by increases in fixed costs over that period including pension obligations, health-care expenses and debt servicing.

In its recent downgrade, which landed Connecticut with the third-lowest rating for a state, Moody's Investors Service flagged the state's shrinking population since 2013—the current population is 3.58 million—as contributing to an underperforming housing market and weak labor-force growth.

Some states that rely heavily on the wealthy for income taxes, such as New York, also have growing populations, which may better prepare them to weather bad times, said Mark Robbins, professor of public policy at the University of Connecticut.

“If you can count on a steady influx of new residents, you can count on some additional revenue for them,” Mr. Robbins said. But in Connecticut “where the population is flat, that is one thing you don't have to look to.”

Connecticut pitched leafy suburban neighborhoods and good schools for decades as a way to lure residents away from New York. But urban revival has gained steam, drawing away recent college graduates who aren't interested in such bedroom communities. The shift motivated General Electric Co. last year to move its top executives from Fairfield, Conn., to a new base in Boston.

Now state lawmakers are looking at options to address fiscal problems and reviving the debate on whether to increase taxes at the top.

Connecticut introduced its income tax in the early 1990s, and income-tax growth averaged 9% a year from 1993 through 2008. Since then, the average has been 2% a year. Gov. Malloy put through two tax income increases, in 2011 and 2015, raising the top rate to 6.99%.

Opponents of the past tax hikes have said yet another one would scare away the very people the state relies on. The number of tax filers leaving Connecticut have exceeded the number of filers moving into the Nutmeg state since at least 2010, according to the Internal Revenue Service.

Yet data from the state revenue department shows the number of full-time Connecticut tax filers with income of \$1 million or more grew to 11,223 in 2015, a 21% increase over 2011. The state says fewer than five of its top 100 taxpayers have fallen out of the ranking since 2014.

Mr. Sullivan of the state's revenue department said after each of the past two income-tax increases, the average tax liability for the state's 100 wealthiest residents would increase in one year and then fall. He said that suggests those wealthy residents either adjusted their tax strategies or earned less money in the down years.

The current decline in income taxes also could be the result of wealthy people deferring 2016 income in anticipation of national tax reform, he said.

Patrick Hayes, a Darien, Conn., resident who works in architectural interiors, says the state's fiscal mess proves that raising taxes on the wealthy can't solve Connecticut's problems.

“We need a better plan,” said Mr. Hayes, 49, who noted he is among the group of top earners in the state. “Has this strategy failed previously? Then why we do we keep pursuing it?”

To address the revenue shortfall, Gov. Malloy is seeking \$700 million in concessions from public-sector unions and has threatened pink slips if unions won't come to the table. He also wants to cut \$700 million in state funds to cities and towns.

Public-sector unions, however, maintain that the state's wealthy should help solve the state's fiscal problems.

State lawmakers should consider “asking Connecticut's wealthiest taxpayers and largest corporations to sacrifice and pay a little more to protect the services that people rely on,” said Larry Dorman, a spokesman for Council 4, the state's largest public-sector union.

Copyright ©2017 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <http://www.djreprints.com>.