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The Government Affairs Group at Murtha Cullina LLP is pleased to provide information about current topics of interest.

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BUDGET WARS - CONNECTICUT ARMISTICE

*“What a long strange trip it’s been.”
lyrics from “Truckin” by the Grateful Dead*

Setting a record for the longest budget battle in the state’s history, Connecticut legislators finally approved a \$37.5 billion biennial budget shortly after 2:00 AM on September 1. A breakthrough on the stalemated budget negotiations came when Governor M. Jodi Rell announced on August 26th that she would support an increase in the state income tax for high income individuals. Rell’s announcement brought a swift conclusion to a seven-month battle over the major aspects of the state budget.

What should have turned out to be a victory lap for all parties was undone, however, by a fiscal pea under the Governor’s mattress. At the last minute, Democrats inserted \$8.3 million for various local programs that had not been agreed to by budget negotiators. Rell reacted by scolding the legislature’s Democrat leadership, line-item vetoing the \$8.3 million budget additions and letting the budget document become law without her signature. The howls of contempt that came from the Democrat majority would have silenced the hound of the Baskervilles. State Attorney General Richard Blumenthal stepped in and rescued the distraught Democrats when he advised the Governor that by not signing the budget document, she legally gave up her right to line-item veto specific appropriation measures in the bill. This latest dust-up between Rell and the Democrats does not bode well for future budget negotiations. What follows is a review of the budget approved for FYs 10 and 11.

Appropriations

	FY10	FY11
General Fund	\$17.3 billion	\$17.5 billion
Growth Rate (from prior year)	-0.8%	1.8%
Transportation Fund	\$1.1 billion	\$1.17 billion
Growth Rate (from prior year)	-1.9%	3.4%

Funding Allocations (FY10)

Function of Government	\$ Amount	Percent of Total
Human Services	5,069,937,117	26.49%
Education / Museums / Libraries	4,023,400,580	21.03%
Non-Functional	2,409,774,766	12.59%
Debt Service	2,106,338,133	11.01%
Health and Hospitals	1,705,540,463	8.91%
Corrections	1,565,848,719	8.18%
Judicial	565,560,537	2.96%
General Government	547,921,610	2.86%
Transportation	484,438,647	2.53%
Regulation and Protection	420,985,540	2.20%
Conservation & Development	156,416,870	0.82%
Legislative	79,319,948	0.41%

Major Funding Adjustments

Department of Social Services	
Restructure Medicaid fee-for-service	-\$207 million (over 2 years)
Department of Children & Families	
Reduce managerial positions by 25%	-\$6.8 million
Department of Developmental Services	
Reduce Funding for Birth-to-Three	-\$11.4 million (over 2 years)
Department of Mental Health and Addiction	
Services - Add funding to support 370 new young adult referrals	+23.6 million (over 2 years)
Department of Education	
Flat funding of Education Cost Sharing Grant to municipalities	+\$3.77 billion (over 2 years)
Teachers' Retirement Board	
Eliminate state contribution to retired teacher health insurance account	-\$61million (over 2 years)
Judges' Retirement Fund	
Eliminate state contribution to pension fund	-\$31.5 million (over 2 years)
State Agency Rescissions	
Generic rescissions	-\$53 million (over 2 years)

Major Revenue Changes

To meet the revenue requirements of the state, adjustments were made in a wide range of Connecticut state taxes, the largest of which was the adoption of a new tax table for high in-

come individuals and households in the state. The following is a summary of the tax changes and anticipated revenues:

Revenues (FY10)

Revenue Source	\$ Amount	Percent of Total
Personal Income	6,630,700,000	33.59%
Sales & Use	3,221,500,000	16.32%
Federal Funds	4,051,800,000	20.53%
Business	1,437,400,000	7.28%
Other Revenue	2,194,800,000	11.12%
Other Taxes	532,000,000	2.69%
Gambling	677,500,000	3.43%
Motor Fuels	494,700,000	2.51%
Tobacco	499,900,000	2.53%

Income Tax Changes

The budget bill increases income taxes for incomes over \$1 million for joint filers, \$800,000 for heads of households and \$500,000 for single filers and married people filing separately. Below are the current and new income tax rates and brackets. These new rates and brackets are applicable to tax years starting on and after January 1, 2009.

Tax Rates		Connecticut Taxable Income			
		Married Filing Jointly		Single	
<i>Current</i>	<i>Bill</i>	<i>Over</i>	<i>But Not Over</i>	<i>Over</i>	<i>But Not Over</i>
3.0%	3.0%	\$0	\$20,000	\$0	\$10,000
5.0%	5.0%	20,000	1,000,000	10,000	500,000
	6.5%	Over \$1,000,000		Over \$500,000	

Tax Rates		Head of Household		Married Filing Separately	
		<i>Over</i>	<i>But Not Over</i>	<i>Over</i>	<i>But Not Over</i>
<i>Current</i>	<i>Bill</i>	<i>Over</i>	<i>But Not Over</i>	<i>Over</i>	<i>But Not Over</i>
3.0%	3.0%	\$0	\$16,000	\$0	\$10,000
5.0%	5.0%	16,000	800,000	10,000	500,000
	6.5%	Over \$800,000		Over \$500,000	

Anticipated Revenues - \$594 million (FY10) and \$400 million (FY11)

Corporate Tax Surcharge

The new budget imposes a 10% corporate tax surcharge for income years 2009, 2010 and 2011 applicable to corporations with gross revenues of \$100 million or more for these years.

Anticipated Revenues - \$74.1 million (FY10), \$41.1 million (FY11) and \$22.1 million (FY12).

Sales Tax

The budget reduces the state sales tax, starting January 1, 2010, from 6% to 5.5%. If, however, prior to January 1, 2010 (or later in the year prior to July 1) the revenues for the fiscal year decline by 1% or more, the sales tax will be restored to the 6% level.

Potential Revenue Loss - \$129.5 million (FY10) and \$268 million (FY11).

Estate and Gift Tax

Starting with deaths occurring and gifts made on or after January 1, 2010, the budget reduces the estate and gift tax by exempting estates and gifts under \$3.5 million, up from the current \$2 million threshold. The budget also reduces the marginal tax rates on estates and gifts valued at \$3.5 million to \$10.1 million by 25% and eliminates the tax “cliff” on estates and gifts that previously were taxed on the first dollar of the estate or gift once the \$2 million threshold had been reached.

Anticipated Revenue Loss - \$5.9 million (FY10) and \$70.3 million (FY11).

Cigarette and Tobacco Taxes

The new budget increases the tax on a pack of cigarettes by \$1, from \$2 to \$3. In addition, the tax on tobacco products for cigars, cheroots, pipe tobacco and similar products is increased from 20% to 27.5% of the wholesale price and the tax on snuff tobacco is raised from 40 cents to 55 cents. These new tax rates are effective on and after October 1, 2009.

Anticipated revenues- \$100.9 million (FY10) and \$119.6 million (FY11).

Securitization

The budget requires the State Treasurer and the Secretary of the Office of Policy and Management to develop a financing plan to raise up to \$1.3 billion in FY11 by securitizing future state revenue streams in order to fund state debt instruments.

State Fee Increases

The budget increases the fee schedules for over 750 state licenses, permits and charges, primarily effective October 1, 2009.

Anticipated Revenues - \$52.1 million (FY10) and \$45.1 million (FY11).

The State's Economic Future and the State Budget

While a majority of economists agree that the recessionary period, which began in December 2007, is giving way to a recovery, most businesses are taking a “wait and see” approach before making new investments or adding additional workers. While Connecticut's unemployment rate is 7.8%, significantly below the 9.7% national rate, the impact of the global reces-

sion, the tight credit market and a devalued real estate market suggest Connecticut is a long way from full economic recovery. The legislature's Office of Fiscal Analysis predicts revenue gaps of \$2.9 billion in FY12, \$3 billion in FY13 and \$3.1 billion in FY14. Economists expect it will take until late 2013 before the traditional full employment rate (5.5%) is achieved. Since the income tax is the major source of state revenues that is largely tied to employment, the next few years will be extremely difficult for political leaders and constituents alike.

If you have any questions about the issues addressed here, please feel free to contact David McQuade, Senior Government Affairs Consultant, at 860-240-6141 / dmcquade@murthalaw.com, or your attorney.



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