



Written Testimony of State Treasurer Denise L. Nappier  
SUBMITTED TO THE FINANCE, REVENUE AND BONDING COMMITTEE  
APRIL 11, 2017

Senator Fonfara, Senator Frantz, Representative Rojas, Representative Davis and members of the Finance, Revenue and Bonding Committee, thank you for the opportunity to submit testimony concerning **Raised Bill 7313**, *An Act Imposing a Surcharge on Income Derived from Investment Management Services*.

HB 7313, if enacted: (i) could have a materially adverse effect upon my Office, other governmental entities, or significant sectors of the Connecticut's economy and (ii) is unlikely to accomplish what we believe to be the impetus behind this legislation; taxation of certain hedge fund principals' performance fees known as "carried interest" at a higher rate than the 15% capital gains rate. Here are some of the unintended consequences that I have identified as may arise from HB 7313:

1. The bill appears to affect a broader population than intended. It is difficult to determine with any degree of certainty exactly what investment professionals are targeted by HB 7313 without greater clarity. Indeed, many, if not most, of those who provide investment management services, as defined, do not receive carried interest as a performance fee or bonus. As written, HB 7313 would impose a 19% income tax surcharge on "investment management services," which is broadly defined by the proposed legislation to include the following services (i) the provision of advice regarding the advisability of investing in, purchasing or selling "specified assets," (ii) the management, acquisition or disposal of "specified assets," (iii) the arrangement of financing with respect to the acquisition of a "specified asset" or (iv) any activity in support of the foregoing services. In short, HB 7313 is broadly written and therefore could apply to all income earned by individuals working in the financial services industry (including in banking, securities, investment advisory services, insurance, among others), as well as professionals, such as attorneys, accountants, actuaries and others who advise clients regarding investments, acquisitions or other transactions involving "specified assets." Indeed, Bond Counsel has advised that, based upon the existing language of the bill, the only professionals associated with debt issuances that are, perhaps, not subject to HB 7313 are the underwriters. The proposed legislation also could be read to include employees of the Office of the Treasurer who are paid to provide investment management services for the benefit of the State of Connecticut and its residents.
2. It is likely that the procurers of financial services would ultimately pay the additional costs arising from the proposed surcharge. Even if Raised Bill No. 7313 were to be more narrowly drawn so as to limit the scope of the financial service professionals subject to the 19% income tax surcharge, we are concerned that those professionals, upon whom the Office of the State Treasurer relies for investment

advice in the issuance of debt and the investment of pension and trust funds, will increase the fees charged to the State in an effort to “pass through” the cost of the tax surcharge liability. Such increased fees necessarily would adversely impact the cost of the issuance of debt by the State and the net investment return on funds held for the benefit of the State, State employees and other citizens.

3. HB 7313 could limit the pool of available top tier financial service providers doing business in Connecticut. Rather than passing through the increased cost of doing business to the end user, some investment management service providers may elect to avoid doing business with the Office of the Treasurer altogether. This action could close off access to top tier or most lucrative investment opportunities, including with existing relationships.
4. The proposed legislation could fuel an exodus of financial service firms from Connecticut and the region. HB 7313 also represents a state tax policy that is not without risk. The financial services sector is a crucially important driver of the Connecticut economy. Although the proposed legislation would not go into effect until similar legislation were enacted in New York, New Jersey and Massachusetts, we remain concerned that similar tax laws in neighboring or nearby states would not prevent the potential costly loss of financial service jobs in Connecticut. The provision of investment management services generally does not require the location of the service provider, including hedge fund managers, to be close to the location of a customer. For example, the Office of the Treasurer retains investment advisors located in many jurisdictions outside of the four states seeking to enact this legislation. Investment management service providers are highly mobile, and there is no shortage of states seeking to lure these high-paying and, therefore, high tax-revenue-generating jobs. Thus, in an effort to raise revenue, this legislation actually could result in a negative outcome. Given the current economic challenges faced by our State, we would urge the legislature to judiciously consider anything that might adversely affect our tax revenues and, as a result, the State’s credit rating.

While I am proud to be among those in state government to provide leadership where the federal government has remained silent, I urge caution and question whether this important tax matter could be more effectively resolved at the state level. If, as we suspect, this bill intends to provide leadership to address the federal income taxation of “carried interest,” it is our view that any such attempt is best made at the federal level, where a more narrowly-drawn solution can be adopted which would be the law in all states. Such an approach would maintain a level playing field for all investors.

I urge the General Assembly to carefully consider the potential negative challenges arising from HB 7313.

Thank you for the opportunity to comment on this proposed legislation.