



**MASSACHUSETTS
HIGH TECHNOLOGY
COUNCIL**

HIGH TECH NEWS

VOLUME 25

Number 7

July 2002

In this issue:

Council Pushes for Budget Growth Limit Works to Stave Off Capital Gains Tax Hike

**Glimmer of Hope
in State Budget...**

As we enter the state's new fiscal year, there is hope that Beacon Hill is prepared to finally adopt protections that will help prevent a repeat of the fiscal uncertainty of the past 12 months. And while the headlines have focused on "slashing programs" and new taxes, this budget could also provide some hope for taxpayers who have grown weary of a roller coaster budget process that ultimately results in a less competitive business climate once the economy slows. Taxpayer hopes lie in the form of a budget growth limit, similar to the one first recommended by the Council earlier this winter, that may be included as part of the final fiscal year '03 budget.

**Council Growth
Limit Still Alive...**

The budget growth limit, originally proposed by Governor Jane Swift and Speaker Thomas Finneran after lengthy consultation with the Council, allows state spending to grow annually at two percent plus inflation. Any revenue over the limit would be used to replenish the rainy day account, fund capital projects and, most important, return money to the taxpayers. This limit is crucial to maintaining a sustainable budget by requiring state government to spend responsibly through the boom years. While the House overwhelmingly supported the limit by a vote of 133 to 14 in its budget plan, the Senate rejected the measure on a voice vote. The Council would like to thank Senator Steve Baddour (D-Haverhill) for filing the budget growth amendment against the wishes of many in his own party.

**Budget Conferees
Meeting...**

The joint budget conference committee is now working to hammer out differences between the two branches' fiscal plans. The conference committee has only met a few times so far, a sign the compromise plan will not be released until near the close of the legislative session July 31. The FY 03 budget is already late, with the state operating on one-month interim budgets originated by Swift. Council staff has already had discussions with the offices of Swift and Finneran, and have been assured of their active support for the limit throughout the budget process.

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| <p>Cap Gains Tax Hike Hurts Competitiveness...</p> | <p>In addition to pushing for passage of the growth limit, the Council is also advocating for the Legislature to undo some of the damage from the proposed increases to the capital gains tax. Both the House and the Senate flattened the capital gains tax rate at 5.3% on the sale of all long-term assets, eliminating the positive competitive benefits of the 1994 capital gains tax phaseout law. This 1994 law, which was strongly supported by the Council, eliminated the capital gains tax on all assets held more than six years, thus encouraging patient capital investment. And while the House also brought the short-term capital gains rate (assets held less than one year) to 5.3 percent, the Senate kept the short-term rate at a highest-in-the-nation 12 percent.</p> |
| <p>Double-cross to Investors...</p> | <p>It could be argued that increasing the capital gains tax is a double-cross to investors who made financial decisions years ago based on the state tax code. That would be bad enough. But what is worse – and almost unfathomable – is that the tax hike would be retroactive for any capital gains realizations taken so far in 2002. Someone who sold stock or their home earlier this year would be hit with an unexpected 5.3 percent tax bill. This is a difficult pill for investors to swallow in a recession, especially for retirees who sold long-treasured assets in order to pay for life's expenses.</p> |
| <p>Not a Reliable Revenue Source...</p> | <p>The Council has argued from the beginning of the budget debate that capital gains revenue is a poor revenue source to base budget decisions on, especially to close a gaping budget hole. In fact, since the Legislature approved the capital gains tax hike the Department of Revenue has again lowered its estimate for calendar year 2003 capital gains revenue. This reduction means that revenues have dropped from more than \$1 billion in 2001, to an expected \$310 million for 2003 under the new House rate schedule. Included in that figure are significant revenues from the retroactivity provision that may yet be eliminated by the Legislature. Hiking the capital gains tax may not even be <i>penny-wise</i> because plummeting revenues from this source have reduced its already negligible affect on addressing the current fiscal challenges. But there is no question that it is <i>pound-foolish</i> because it will harm the Massachusetts economy for years to come.</p> |
| <p>Chance for Change in Conference...</p> | <p>Still, because a reversal is still possible in the conference committee, the Council has been pressing for changes that will help Massachusetts retain its competitive edge. The Council is continuing to make progress in convincing lawmakers to remove the retroactive provisions in this bill, and is pushing to preserve a structure that encourages long-term asset retention.</p> |
| <p>New Logan Runway One Step Closer...</p> | <p>While the news on the state budget is mixed but still hopeful, the same can be said for the new runway at Logan Airport. On June 21, FAA Administrator Jane Garvey released the Final Environmental Impact Statement for Runway 14/32. This required filing is the final step to closing the FAA approval process for getting the long awaited new runway built. The report lauded the efficiency and environmental benefits of the new runway, supporting the findings in the volumes of other studies and blue-ribbon commissions.</p> |

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| Wind Restriction Unfounded... | However, Garvey also included a restriction that only allows runway use when northwest winds measure 10 knots or more. In fact, the Boston Herald reported that Garvey had concocted this wind restriction under the consultation of two Boston political fixers – both with no or extremely limited aviation experience. This provision is a dramatic departure from normal FAA policy and would make Logan the only major airport in the nation with a wind restriction in place. In addition, this restriction would diminish the effectiveness of the new delay-reduction runway - eliminating nearly 20,000 hours of delay benefits a year. |
| Help Support Runway Efforts... | Just as it has been at every step of the runway-approval process, Council members' ongoing participation during this process will be crucial to pushing the project forward for the final few yards. Council staff will communicate with members in the near future to enlist their support of the new runway during the 30-day public comment period. With the FAA process all but final, the only remaining step is to modify the 26-year-old injunction on new Logan airside improvement in state court. The court date is tentatively set for early 2003. |
| Mitt Romney Meets with Directors... | On June 26, Republican Gubernatorial candidate Mitt Romney was the special guest of the Council's Board of Directors. Romney, the former Chairman of Bain Capital and the man credited with rescuing the 2002 Winter Olympics in Salt Lake, interacted with the Directors on issues ranging from the fiscal/tax policy, education, transportation infrastructure and overall management of state resources. Chairman George Chamillard and President Christopher Anderson provided Romney an overview of the Council agenda. |
| Paul Tsongas-like Philosophy... | Romney, who has an extensive business and management background, told the Directors that providing a strong economy will help all of the residents of the Commonwealth. Romney's message was similar to that of the late, great US Senator Paul Tsongas, a good friend of the Council who constantly preached the importance of protecting the "goose that lays the golden eggs" of the state's economy. Romney currently holds a significant lead over all his potential Democratic rivals for the November election. |



Guest Commentary: State budget matters to Mass. technology community

07/01/2002 07:44 AM

By Christopher R. Anderson

Massachusetts has a long tradition of technological innovation and entrepreneurial leadership. But it also has a long tradition of government and business not always seeing eye to eye. This disconnection goes largely unnoticed during periods of economic growth. But during an economic funk, tech companies and their employees can suffer.

One competitive tax policy we acquired in 1994 is a creative capital gains structure that rewards patient investment. While short-term gains (on assets held less than a year) are taxed at a highest-in-the-nation 12 percent, long-term gains begin at 5 percent and are phased down to zero after six years.

As part of a \$1.2 billion new tax package, both houses of the legislature dissolved the incentive for patient capital investment by flattening the long-term rate at 5.3 percent. This is shortsighted fiscal policy that will weaken the state's competitiveness for the following reasons:

- It hurts all types of investors. A 2002 Beacon Hill Institute study revealed that increasing the tax on long-term capital gains will harm those who can least afford it: those earning \$20,000 or less, including the elderly and the unemployed. Of the nearly 800,000 residents who filed for capital gains in 1999, 42 percent had incomes of \$50,000 or less, and 71 percent had incomes of \$100,000 or less.
- It imperils economic recovery. In the past 20 years, four of five increases in federal or state capital gains tax rates have resulted in decreased tax collections, and all five decreases in rates have resulted in increased tax collections. Investors base investment decisions at least in part on the tax rate, and those decisions have an impact on general economic conditions.
- It is penny-wise and pound-foolish. When there are very few capital gains being realized, there are lower capital gains tax revenues, regardless of the rate. The Legislature hopes to generate more than \$500 million in the upcoming fiscal year from the new rate, but that is optimistic given Wall Street woes and that the retroactive nature of the bill is being re-examined by the Legislature. A capital gains tax increase does little to close the multibillion-dollar spending hole. But when the boom years return and stock option values move into the black, this "hidden tax" hike could mean more than \$800 million in new costs for employees, investors and small business owners.

The enormous growth in capital gains revenue in the 1990s paced a doubling of the state budget. When capital gains and other state tax revenues dropped, the rapid budget growth proved unsustainable and led to the current fiscal instability.

To reign in spending during future boom periods, House Speaker Thomas Finneran, D-Boston, and acting Gov. Jane Swift joined in support of a budget growth limit to cap annual spending increases of 2 percent plus inflation. Their plan, adopted by the House last month, would prohibit the state's relying on an artificial bubble from capital gains tax receipts or any other revenues and

mandate responsible investment of taxpayer money.

If implemented in 1991, the limit would have allowed the state budget to grow from \$13 billion to \$20 billion in 2001 — \$3 billion less than was actually approved for that year. Since spending levels would have increased at a sustainable rate, there would have been no “budget crisis” during the current downturn and taxpayers would experience stability in state fiscal administration. Furthermore, the limit directs excess revenues to fund capital projects, replenish the state rainy-day fund and reimburse taxpayers.

Only in a budget growth limit does a framework exist for temporary tax increases. But the Legislature must also atone for its error in judgment by restoring a capital gains tax structure that rewards patient investment and ensures future economic competitiveness. By implementing a budget growth limit, eliminating the punitive retroactivity component of the tax package and maintaining a preferential tax rate on the sale of long-held capital assets, Beacon Hill will show it understands the concerns of high tech workers and entrepreneurs.

Christopher R. Anderson is president of the Massachusetts High Technology Council.