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TAX REPORT

Fiscal Woes Force Some States To Consider Increase in Taxes

By **TOM HERMAN** and **MICHELLE HIGGINS**
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Hang on to your wallets.

While tax-cut fever grips Washington, many states are expected to raise taxes this year. States now face their worst fiscal crisis since World War II, said Raymond C. Scheppach, executive director of the National Governors Association.

Confronted by strong voter resistance to higher taxes, governors, legislators and mayors are struggling to avoid even mentioning the dreaded "t" word. Even as evidence mounts of financial woes, the general response among state officials so far has been " 'A tax increase over my dead body,' " said Verenda Smith of the Federation of Tax Administrators in Washington.

"But we're starting to see cracks in the resolve as their budget pictures become more clear," Ms. Smith said.

In Connecticut, for example, Republican Gov. John Rowland is calling for about \$200 million in tax increases, along with spending cuts and union concessions. Those tax increases would include an increase in income taxes paid by those earning more than \$1 million a year. "We can delay the surgery, but we cannot avoid it. This budget bleeding will not go away," Gov. Rowland said.

In California, Gov. Gray Davis, a Democrat, is expected to call for higher taxes to help plug a huge projected budget deficit. But he hasn't given details.

In New York City, officials recently approved an 18.5% increase in property taxes. Mayor Michael Bloomberg called it "a difficult decision" but said the city had to take steps to close a huge budget deficit.

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That may not be enough. "The property-tax increase in the city really only goes part way" to closing the city's deficit, said Felix Rohatyn, the New York financier who was one of the major figures in rescuing the city from financial crisis in the mid-1970s. "So there certainly will be expenditure cuts, but there probably will also be additional tax increases, such as a reinstatement of the commuter tax."

Asked about New York State, Mr. Rohatyn replied: "It seems to me very unlikely that the state can close its budget deficit without some types of tax increases."

While many state leaders have opposed higher taxes, they appear to be running out of options. States already have taken the easy steps, such as draining rainy-day reserves and raising cigarette taxes. Officials also are cutting spending. "But even cutting spending deeply will not result in balanced budgets in many places," said Ms. Smith of the Federation of Tax Administrators (www.taxadmin.org¹).

The severity of the nationwide problem is underscored by a new survey showing that state-tax revenues remain in the doldrums.

State-tax collections rose 2.5% in the July-to-September quarter from the same year-earlier period, said Nicholas W. Jenny of the Nelson A. Rockefeller Institute of Government in Albany, N.Y. But that increase "is deceiving because many states delayed their tax collections following the events of September 11th" of 2001, said Mr. Jenny. After adjusting for tax-law changes, processing and inflation, the increase "actually becomes a decline" of 0.9%.

"This is the worst fiscal crisis for the states that I've ever seen, really, going back to the post World War II period," said Richard P. Nathan, director of the institute, the public policy research arm of the State University of New York. The [report](#)² is available on the institute's Web site (www.rockinst.org³).

Budget deficits looming over state governments will likely reach \$60 billion to \$85 billion in fiscal 2004, according to a separate report by the Center on Budget and Policy Priorities in Washington (www.cbpp.org⁴). The report is by Iris J. Lav, the center's deputy director, and Nicholas Johnson, director of the center's state fiscal project. "With the depths of these deficits, I think there will be little choice but to have substantial tax increases in many states," Ms. Lav said.

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PAUL VOLCKER BLASTS idea of permanently repealing the estate tax.

The former Federal Reserve Board chairman urges Washington to overhaul the tax, instead of eliminating it completely. Mr. Volcker makes his appeal in the foreword to a new book by William H. Gates Sr. (father of the Microsoft executive and co-head of the Bill & Melinda Gates Foundation) and Chuck Collins (co-founder of Responsible Wealth, a Boston-based group). Their book is called: "Wealth and Our Commonwealth." The subtitle: "Why America Should Tax Accumulated Fortunes."

"I didn't get it last year. I still don't get it," Mr. Volcker writes. "Why, right now, in the aftermath of the greatest burst of paper wealth creation in all of American history [in all of history for all I know], in the midst of growing concern [even alarm] about the growing disparity of wealth and income in the United States, right in the face of increasing pressures on the federal budget, has there been so much effort to abolish the estate tax?"

Mr. Volcker agrees with Messrs. Gates and Collins that the \$1 million basic exclusion from the tax is too low. "Similarly, the annual allowances for individual tax-free gifts, now \$11,000, could be raised significantly," he

writes.

"But by all means, let's keep the tax on truly huge fortunes," Mr. Volcker concludes.

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RHODE ISLAND URGES tax preparers to file electronically.

"Tight budgets may severely limit the amount of seasonal help we get for the upcoming 2003 tax season," Rhode Island's tax department says on its Web site. "This will mean slower processing of RI income tax refunds than in past years. If you want your clients to get timely income tax refunds, file their returns electronically."

For those professional preparers who can't file electronically, "make sure your preparation software puts a 2-D barcode on the paper returns that your firm is preparing," the department says. "E-Filing or 2-D filing are processed very fast with very little effort. These two methods of filing will insure that your clients get their refunds promptly."

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BRIEFS: At a recent holiday party in Washington, Bill Sweetnam, Treasury's benefits tax counsel, sang (and danced to) the following song, to the tune of "Satisfaction," by the Rolling Stones: "I can't get no explanation/ I must write my regulation/ 'Cause I write/ And I write/ And I write/ And I write/ Regulations/ Regulations." ... Another verse from the song, written by Mr. Sweetnam and a husband-and-wife team, Preston Rutledge and Julie Gackenbach: "When I'm writing up the regs/ And a man comes in to tell me/ How helpful my regs can be/ But they can't be too long/ Or complicated/ So says OMB/ I can't get no/ Oh, no, no/ Hey, hey, hey,/ It's the White House's way."

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