

A Temporary Surcharge on CT's Highest-Income Taxpayers

Background: CT has the nation's highest per capita income. However, among all states with an income tax, CT has the *lowest* top-bracket state income tax rate, at 4.5%. CT's top rate is *lower* than the top bracket rate in New York (6.85%), New Jersey (6.37%), and Massachusetts (5.3%, with a 12% rate on certain capital gains income). Moreover, when CT's income tax was adopted in 1991 it replaced a 7% tax on capital gains income and a 1%-14% tax on dividends and interest income. Therefore, CT taxpayers with significant amounts of dividends, interest and capital gains income (as compared to wage income) enjoyed an income tax *cut* when the state income tax passed.

Proposal: **SB 611** proposes to increase the state income tax on taxable income *over \$1 million* from 4.5% to 5.5% for the 2002 tax year (January 1, 2002 to December 31, 2002). Based on data from 1999 CT income tax returns, this change could generate more than \$170 million in additional state income tax revenues to help balance the SFY 03 budget.

Why this is a good idea:

- **It is a best choice among difficult budget-balancing choices.** 2001 Nobel Laureate Joseph Stiglitz writes that in times of recession and state budget deficits, a state's decision to balance its budget by increasing taxes on its highest income taxpayers is a *smarter choice* than a decision to reduce government spending on goods and services or cut transfer payments.¹ Cuts in government spending can exacerbate the recession and send consumers the wrong message about confidence in the economy. By comparison, a modest rate increase on the state's highest income taxpayers, particularly one like this for a single year, will have little harmful effect on the economy.
- **Few taxpayers will bear the additional tax burden.** Based on 1999 CT income tax data, a 5.5% rate on income over \$1 million would impact fewer than 6,400 out of 1,354,000 CT resident tax filers – less than *half of 1%* (about 3,700 tax filers with an average adjusted gross income (AGI) of \$1.36 million *each*, and 2,600 tax filers with an AGI of \$7.03 million *each*).
- **The federal government will help subsidize the tax increase.** CT taxpayers subject to this higher tax rate can deduct the additional state income tax they pay on their federal tax return, thereby reducing their federal income taxes. Therefore, the *net cost* to a wealthy CT taxpayer of each additional dollar of state income tax is *less than a dollar*. Rather, each dollar increase in state income tax actually costs these taxpayers about sixty cents. Thus, a state income tax rate increase on CT's wealthiest taxpayers triggers a significant *federal subsidy* to CT – a kind of “revenue sharing” to CT's advantage.
- **This increase enhances the stability of CT's revenues and can improve the state's credit rating.** The CT income tax is a more stable tax than its sales/use and corporate taxes – that is, it is less impacted by changes in the economy. Increasing reliance on the income tax can enhance the state's bond rating, resulting in a decline in debt service payments.

¹ Orszag, P. & J. Stiglitz, *Spending Cuts Vs. Tax Increases at the State Level: Is One More Counter-Productive Than the Other During a Recession?* Center on Budget & Policy Priorities, 2001.

Connecticut Resident Tax Filers (1999)

Adjusted Gross Income (AGI) Range	Number of Tax Filers	Average AGI/ Filer	Average Income Tax Liability/Filer	% of CT Tax Returns	% of Total CT AGI	% of CT Income Tax Liability
\$200,001 - \$500,000	41,405	\$294,476	\$10,721	3.06%	11.7%	14.6%
\$500,001 - \$1,000,000	9,189	\$679,846	\$23,186	0.68%	6.0%	7.0%
\$1000,001 - \$\$2,000,000	3,721	\$1,364,275	\$44,894	0.27%	4.9%	5.5%
Over \$2,000,000	2,634	\$7,031,213	\$227,260	0.19%	17.8%	19.7%

Source: *1999 Personal Income Tax Statistics*, Department of Revenue Services, 2001 (Total CT Resident Returns Filed = 1,354,154)

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