



How Well Do the Governor's and Finance Committee's Tax Proposals Ensure an Adequate and More Equitable Revenue System?

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The 2007 General Assembly Session has featured bold ideas that seek to address universally-identified challenges that face our state – in education, health care, affordable housing, transportation, and energy. Both the Governor's budget and the budget approved by the Appropriations and Finance, Revenue and Bonding Committees *increase* state revenues. To maintain our current level of state services, while also increasing state investments, requires this. So the fundamental questions are *how* much to increase state revenues, and *on whose shoulders* these additional taxes should be placed?

Notwithstanding the current temporary budget surplus, increases in state revenues are needed. Although an operating surplus is projected for FY 07 (the fourth year in a row), the FY 08 budget faces significant challenges. Without change, the FY 08 General Fund budget would be in the hole nearly \$500 million. This results from the use of one-time revenues to balance the FY 07 budget, last year's state tax cuts and changes in federal reimbursement programs that cut General Fund revenue growth to 2% (rather than 3.8% growth without the changes), and rapid growth in health care expenses, debt service and other budget areas. Some agency budgets remain below *actual* FY 02 spending; funding cut in the last recession still has not been fully restored. State and local spending is 8.75% of state gross domestic product, 4th lowest among all states (in 2003).

Connecticut's current state and local tax system places an unfair burden on its lower and middle-income families. Connecticut's current tax structure unfairly requires our poorer and middle-income residents to pay a greater share of their income in state and local taxes than our wealthiest residents. As the following chart illustrates, our relatively "flat" personal income tax does not offset the overall regressivity of our sales/excise and property taxes. As a result, the share of income residents paid in state and local taxes *decreases* as income *increases*.

Connecticut State and Local Taxes as a Share of Income ¹							
	Poorest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Sales/Excise tax	6.3%	4.7%	3.7%	3.1%	2.2%	1.5%	0.8%
Property tax	3.8%	4.4%	4.1%	4.3%	3.7%	2.9%	1.0%
Income tax	0.3%	1.2%	2.5%	3.3%	3.9%	4.2%	4.7%
Total taxes	10.3%	10.3%	10.4%	10.7%	9.8%	8.6%	6.4%
Federal deduction offset	-0.1%	-0.3%	-0.8%	-1.5%	-2.0%	-2.1%	-2.0%
Total taxes as share of income after federal deduction	10.2%	10.1%	9.5%	9.2%	7.8%	6.5%	4.4%
The Institute on Taxation and Economic Policy, <i>Who Pays? A Distributional Analysis of the Tax Systems in All 50 States</i> (2 nd edition)(2003), p. 28.							

Robert McIntyre from the Institute of Taxation and Economic Policy (ITEP) notes that "Connecticut's income tax fails to offset the regressivity of its sales and excise taxes, giving the state an unfair, regressive system. Taxes ought

¹ These data are for non-elderly taxpayers, as of 2002. This analysis has not been updated since that time to reflect changes in state and local tax law.

to be based on people’s ability to pay them, which means that the share of income taxes should rise as income grows, not fall as is the case in Connecticut.” In Connecticut, those with the lowest incomes face the highest tax burden relative to their incomes, hindering their ability to invest in themselves and increasing the likelihood that they will need state services.

Although the Governor and the Finance Committee both propose to increase state revenues, they differ in how they approach the task, particularly with regard to the personal income tax. The Governor proposes to increase the 5% rate of the personal income tax to 5.5% and to eliminate the property tax credit against the state income tax. These proposals would increase General Fund FY 08 revenues by \$617.5 million for the income tax rate increase and \$100 million for the property tax credit repeal. It is important to note, however, that under the Governor’s proposal, the revenue raised by the property tax credit repeal is intended to cover revenue losses from the elimination of the property tax on cars and other motor vehicles.

By comparison, the Finance Committee proposes to reduce the personal income tax’s 5% rate to 4.5% for certain middle income taxpayers and enact more steeply graduated rates for higher income taxpayers. It also proposes to increase the property tax credit from a maximum of \$500 to \$1,000 and to create a 20% state earned income tax credit. These proposals would increase General Fund revenues by a net \$655.8 million in FY 08 (a \$991.1 million net increase from the rate changes, offset by a \$280.0 million reduction from the increase in the property tax credit and a \$55.3 million reduction from the state EITC).

Who would pay the increased tax under the Governor’s and Finance Committee’s personal income tax proposals differs substantially. As illustrated in the chart below, the Finance Committee’s proposal would *reduce* income taxes for joint filers reporting a Connecticut Adjusted Gross Income of about \$190,000 or less, and impose less income tax than the Governor’s proposal for those with CT AGI of \$200,000. By comparison, for those joint filers reporting CT AGI of \$300,000 or more, the Finance Committee proposal would impose *more* tax than the Governor’s proposal. That is, the Finance Committee’s proposal is more *progressive* than the Governor’s proposal (in reducing income taxes on those with less income and more sharply increasing income taxes on those with more incomes) and so would *do more* to make Connecticut’s overall state and local tax system more equitable.

Changes in State Personal Income Tax Due Under Governor’s Proposal and the Finance, Revenue and Bonding Committee’s Proposal						
JT Filers	Current Law	Gov's Proposal	Finance Com. Proposal	(Gov-Current)	(Finance-Current)	(Gov-Finance)
25,000	0	0	0	0	0	0
40,000	0	87	0	87	0	87
50,000	350	659	0	309	-350	659
60,000	1,300	1,701	737	401	-563	964
75,000	2,515	3,038	1,891	523	-624	1,147
100,000	4,008	4,675	3,268	667	-740	1,407
120,000	5,200	5,920	4,600	720	-600	1,320
150,000	6,850	7,637	6,460	787	-390	1,177
200,000	9,600	10,500	9,665	900	65	835
300,000	14,600	16,000	16,250	1,400	1,650	-250
600,000	29,600	32,500	37,000	2,900	7,400	-4,500
900,000	44,600	49,000	57,950	4,400	13,350	-8,950
1,500,000	74,600	82,000	99,650	7,400	25,050	-17,650
2,500,000	124,600	137,000	169,150	12,400	44,550	-32,150

The proposed Budget and Revenue Package helps reduce the regressivity of Connecticut’s overall tax structure by enacting a state Earned Income Tax Credit (EITC), a refundable tax credit for families that are working hard but earning low incomes. In 2004, 165,000 families (including families in every Connecticut town) benefited from the federal EITC. The EITC rewards work and helps address the ‘benefit cliff’ that occurs when families lose eligibility for child care assistance, energy assistance, and housing assistance as their income rises, though their full time work does not provide enough income to meet essential needs. An EITC will further aid Connecticut by stimulating the local economy, as families use the EITC to pay off overdue bills and other needed expenses so funds are quickly and directly returned to the local economy.

The state EITC also helps reduce income tax burdens among our lowest income families. The enactment of a state EITC and a more progressive income tax rate structure will greatly aid in reducing the overall regressivity of Connecticut’s tax system, as will a shift from reliance on property tax revenues to a greater reliance on the income tax.

Although the Finance Committee proposal imposes higher taxes on our wealthiest taxpayers, it also is those taxpayers who have benefited most from recent federal tax cuts. The Finance Committee bill includes tax cuts for the “bottom” 88% of Connecticut’s taxpayers while the wealthiest 12% (those with CT AGI over \$190,000 for joint filers) are asked to pay more in personal income tax. These wealthier taxpayers have received significant reductions in their federal income taxes since 2001, and are expected to continue to benefit from federal tax cuts in years to come. On average, taxpayers in the nation’s top income quintile – including the top 12% of Connecticut taxpayers – received, on average, a cumulative total between \$12,000 and \$250,000 in federal tax cuts over the last six years (2001-2006). In contrast, over the same six-year period, the bottom 80% of income earners nationally – including the majority of Connecticut residents – received on average \$450 to \$6,000 in federal tax cuts.

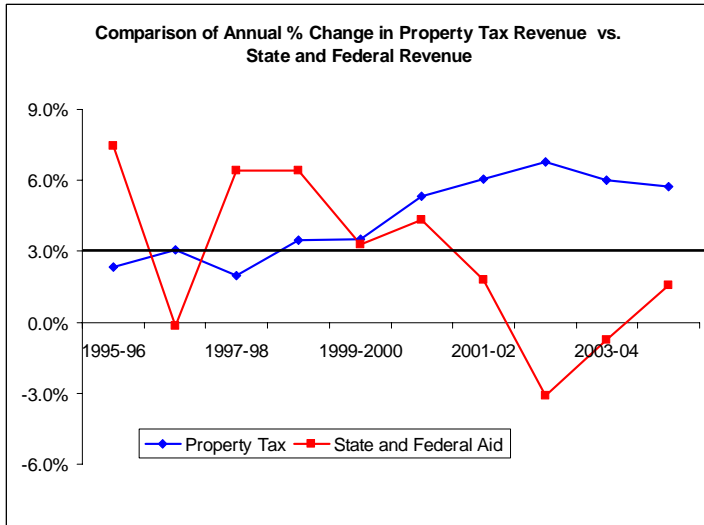
All US Taxpayers				
US Income Quintiles		Average 2006 Income	Average Cumulative Tax Cut (2001-2006)	Average Cumulative Tax Cut (2007-2010)
Lowest 20 %		\$11,300	\$453	\$345
Second 20 %		\$23,200	\$2,213	\$1,784
Middle 20 %		\$37,900	\$3,698	\$2,881
Fourth 20 %		\$62,700	\$6,185	\$4,341
Top 20%	Next 15%	\$110,000	\$12,783	\$6,019
	Next 4%	\$242,000	\$28,087	\$9,586
	Top 1%	\$1,458,000	\$251,468	\$267,166
Institute on Taxation and Economic Policy Tax Model, March 2007				

The top 12% of Connecticut taxpayers (with incomes above \$190,000) received significant federal tax cuts between 2001 and 2006 – on average, a cumulative total of \$12,783 to \$251,468 over the last six years.

Under the Finance Committee’s proposal, a couple filing jointly with \$2,500,000 in income would pay an additional \$44,550 in state income taxes for the 2008 tax year. This amount is less than the benefit this couple would receive that year from federal tax cuts. Since the federal government, through recent spending cuts, is shifting increasing responsibility to state budgets to fund essential services (including in education), increasing state taxes on those who have benefited most from federal tax cuts is an important and equitable way to increase state revenues to meet these new needs.

A progressive income tax can help lessen our reliance on the property tax. Connecticut is one of just twelve states that do not allow towns to impose a sales and/or income tax. Connecticut towns, as a result, rely to a far larger extent on the local property tax to fund town services, including public education, than do towns in other

states. In FY 04, for example, 98.2% of Connecticut towns' taxes were from the property tax (compared to 73.2% across all 50 states). Property taxes were 84% of town's "own source" revenues (a term that includes taxes, fees, and charges), compared to 46.3% across all 50 states. When the state provides adequate funding for K-12 education, this reduces the pressure on towns to raise property taxes. Conversely, cuts in federal and state support of local programs can result in property tax increases. These increases can pose challenges to families and individuals with low and fixed incomes. Further, the towns with the lowest family incomes tend also to be the towns with the highest equalized mill rates; the towns with the highest equalized mill rates in FY 05 were Waterbury, New Britain, Bridgeport and Hartford (30.66, 26.77, 26.55, and 25.89, respectively) and those with the lowest were in Greenwich, Salisbury, Washington, and Darien (5.26, 7.62, 7.69 and 8.36, respectively).



Connecticut towns have increased property taxes most during periods of declining state and federal aid. When state and federal aid is more adequate, the growth in property taxes is fairly steady. As illustrated in the chart to the left (embedded in the Governor's PowerPoint presentation on her property tax cap proposal), property taxes increased by 3% per year or less between FY 96 and FY 99. The rate of increase in the property tax began to climb beginning in FY 2000, just as state aid as a share of K-12 education funding began to slide. In FY 00, state aid as a share of K-12 education was 42.3% (shy of the high point in the last 20 years of 45.5% in FY 90) then fell to 41% in FY 01, 40.7% in

FY 02, 39.5% in FY 03, and 38% in FY 04 – years when property taxes increased at more than 3%.

The Governor's and the Finance Committee's proposals to increase the personal income tax to support increased state aid to elementary and secondary education can help relieve pressure on towns to fund schools through the property tax. Specifically, the Governor proposes to increase the ECS grant from \$1.627 billion in the current fiscal year to \$1.848 billion in FY 08 (which is \$16.1 million more than the Appropriations Committee proposes for FY 08, although neither proposal requires the full funding increases to be spent on education).

The Appropriations Committee would increase the amount of money the state pays towns for untaxed property in their towns through the PILOT program – by \$10 million for PILOT for state-owned property and \$10 million for colleges and hospital property (the Governor's plan, by comparison, reduces both grants below the level needed to maintain current services). Increasing PILOT payments raises local revenue by more fairly reimbursing towns for the revenue they cannot collect under state laws that define certain property to be exempt from property tax.

When *all* statutory grants to towns are counted (including ECS and PILOT, but excluding the Governor's proposed CAR grant that would merely replace the revenues towns would lose from the Governor's proposal to repeal the property tax on cars), both budgets increase town aid over FY 07. However, the budget approved by the Appropriations Committee would increase town aid under the statutory grants by \$235 million over FY 07, or \$39 million more than the Governor proposes.

The Finance Committee's proposal includes one additional feature to help reduce the property tax burden on families. It would double the maximum property tax credit against the personal income tax – from \$500 to \$1000. By comparison, the Governor would eliminate this credit (as part of her larger proposal to eliminate totally the property tax on cars and other motor vehicles). The property tax credit provides targeted support to families and seniors with property tax liabilities who are on a fixed budget, as well as to residents who own property in towns that have been forced to significantly raise property taxes.

These measures, if adopted, would help towns slow the growth in property taxes to pre-2000 levels.