CONNECTICUT VOICES FOR CHILDREN

Connecticut's Personal Income Tax: How It Works and How Connecticut Compares to Neighboring States

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How does the tax work?

Connecticut's personal income tax applies to the earned and investment income of Connecticut residents, trusts, and estates, and to Connecticut source income of part-year residents and non-residents. In 2005, 1.4 million personal income tax returns were filed in Connecticut.[1]

The tax is based on Connecticut Adjusted Gross Income (AGI) – federal AGI adjusted by a number of state additions and exclusions.

A *personal exemption* excludes from the tax the first $24,000 in AGI for joint filers ($12,625 for single filers, $19,000 for heads of household). There are no additional exemptions for children and other dependents (unlike in other states). The personal exemption phases out at higher incomes, disappearing at AGI of $71,000 for joint filers ($36,250 for single filers, $56,000 for heads of household).[2]

Also, a new law allows a deduction for contributions of up to $10,000/year for joint filers and $5,000/year for single filers to the CT Higher Education Trust (CHET), a state-sponsored college savings program administered by the State Treasurer designed to help Connecticut families save for future college expenses.[3]

For individual taxpayers (as opposed to trusts and estates), the tax has *two brackets*—a 3% bracket on the first $20,000 of taxable income for joint filers ($10,000 for single filers, $16,000 for heads of household), and a 5% bracket on additional income.[4]

Are there credits available to offset income tax liability?

A few credits can offset Connecticut's personal income tax. A *property tax credit* of up to $500 (depending on filer type and level of income) is allowed for property taxes paid on a primary residence and/or motor vehicle (if the taxpayer owns the home or car). A *low-income credit* reduces the tax burden on less affluent taxpayers and phases out as income grows, disappearing at $100,500 for joint filers ($58,500 for single filers, $78,500 for heads of household).[5]

Taxpayers also may take a credit for taxes paid to other jurisdictions (generally states and localities). Thus, for example, Connecticut residents who work in New York deduct the income tax paid to New York for the income that is earned there in calculating their Connecticut tax liability.

Where does the burden of Connecticut's personal income tax fall?

Connecticut's income tax threshold (the income level at which taxpayers are liable for tax) has not been adjusted upward since first adopted in 1991.[6] Adjusting for inflation, the threshold has fallen significantly in recent years as compared to other states and relative to the poverty threshold. This means that each year, an increasing number of lower-wage families are becoming subject to the state's income tax. Connecticut is now *the only* state with an income tax that has not adjusted its tax threshold upward since 1991.

Further, Connecticut's overall tax system is regressive – those with the least income pay more of their income in state and local taxes than those with the most income. Specifically, the poorest 20% of Connecticut families pay about 10.2% of their income in state and local taxes, the middle 20% pay 9.5% while the wealthiest 1% pay just 4.4% of their income in state and local taxes (after federal deductions taken

New Haven Office: 33 Whitney Ave. • New Haven CT 06510 • Phone: 203.498.4240 • Fax: 203.498.4242
Hartford Office: 60 Gillett St. Suite 204 • Hartford CT 06105 • Phone: 860.548.1661 • Fax: 860.548.1783
Web Site: www.ctkidslink.org
E-mail: voices@ctkidslink.org

for state property and income taxes paid). For this reason, imposing a higher income tax on our wealthiest residents is necessary to make our overall tax system more equitable.[7] As it stands, however, the income tax is not progressive enough to provide this balance. While Connecticut's income tax is progressive at the low end, at higher income levels it is quite flat. The 3% rate applies to relatively little income, while the 5% rate applies to all income above this – i.e., everyone from the middle class to the very wealthiest.

It is sometimes said that Connecticut should not increase the income tax on our most wealthy residents as they already pay more in state income tax than those who are not as wealthy. This is true. But this reflects the fact that our wealthiest residents have a disproportionate share of the income, not that our income tax requires them to pay a much higher tax rate on that income.

In 2004, the wealthiest 1% of taxpayers (those reporting more than $500,000 in income) reported a total of 30.5% of all Connecticut personal income, and paid 33.0% of the total Connecticut personal income tax. By comparison, taxpayers reporting adjusted gross income from $50,001 to $200,000 (39.0% of all taxpayers) reported a total of 41.1% of all income, and paid 45.7% of the total Connecticut personal income tax.[8] Thus, taxpayers with more moderate incomes actually pay a higher percentage of total taxes relative to their total income than do those in the top 1%.

Connecticut's current personal income tax is– in some ways– less progressive than the tax that it replaced in 1991 – a 7% tax on capital gains and a tax as high as 14% on dividends and interest.[9]

"Uncle Sam" subsidizes Connecticut's personal income tax.

Connecticut income tax payments are deductible in calculating taxable income for purposes of the federal income tax. This means that Connecticut taxpayers who itemize deductions on their federal returns receive, in effect, a federal subsidy for income tax paid to Connecticut.[10] The subsidy varies based on the taxpayers' federal marginal tax rate, with the biggest subsidies—up to 35%—for taxpayers who report the most income. *Thus, for a couple earning $2,000,000 a year, a 3% rate increase on their income over $1 million would raise $30,000 in new state revenues but "cost" the couple only an additional $19,500. While the couple would pay the full $30,000 to Connecticut, that sum would be deducted on their federal income tax, reducing their federal tax liability -- this savings to the couple represents the "subsidy" from Uncle Sam.*[11]

How does our income tax compare to our neighbor states?

Among states in the region with income taxes, Connecticut has the lowest top-bracket rate. Among states with a broad-based personal income tax, Connecticut's top bracket rate is sixth lowest (tied with Alabama and Mississippi).[12] Also, with only two brackets, Connecticut's rate schedule is closer to a "flat tax" than that of all but six states—the six states that actually have a flat (one-bracket) tax. Most states have more brackets; the median is five brackets.

State and Local Personal Income Tax Rates, 2005[13]

State/City	# of Brackets	Top Marginal Rate
New York City/State Combined	7	12.15%
Rhode Island	5	9.9%
Vermont	5	9.5%
New Jersey	6	8.97%
Maine	4	8.5%
New York State	7	7.7*
Massachusetts	1	5.3% (12% cap. gain)[14]
Connecticut	**2**	**5%**

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[1] Connecticut Department of Revenue Services, 2005 Personal Income Tax Statistics, available at http://www.ct.gov/drs/lib/drs/research/05inctax/2005incometaxbytown.pdf#46168.

[2] Connecticut Department of Revenue Services, Annual Report Fiscal Year 2005-06, p. 39, available at: http://www.ct.gov/drs/lib/drs/research/annualreport/drs_annual_report_fy06.pdf.

[3] For more information about the CHET program, see www.aboutchet.com/ourplan/index.htmlhttp://www.aboutchet.com/ourplan/index.html.

[4] Connecticut Department of Revenue Services, Annual Report Fiscal Year 2005-06, p. 38, available at: http://www.ct.gov/drs/lib/drs/research/annualreport/drs_annual_report_fy06.pdf.

[5] Because the property tax credit and low-income credit phase out as income increases, they enhance the progressivity of Connecticut's income tax.

[6] The "tax threshold" is defined as the income level at which a taxpayer first owes income tax, taking into account exemptions,

credits and deductions that are ***universally*** available. Taxpayers with incomes higher than the threshold amounts may still pay no income tax if eligible for the property tax credit against the state income tax. Families who neither own their own homes, nor own a car, are ineligible for this credit.

[7] *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 2nd Edition* (Institute on Taxation on Economic Policy, 2003), available at www.ctj.org/itep/whopays.htm.

[8] Connecticut Department of Revenue Services, 2004 Personal Income Tax Statistics, available at http://www.ct.gov/drs/lib/drs/research/04inctax/2004taxtables.pdf#44736

[9] Connecticut Office of Fiscal Analysis, *CT Revenue and Budget Data,* (2006), p. 79-89.

[10] Each year Connecticut gets back in federal funding only sixty-six cents of each dollar sent to the federal government in taxes—the second worst balance of payments in the nation but one that reflects a more progressive federal income tax, the state's great wealth, and the need-based formulas used in many federal grant programs. See *Federal Tax Burdens and Expenditures by State: Which States Gain Most from Federal Fiscal Operations?* (Tax Foundation, 2006), available at www.taxfoundation.org/sr139.pdf.

[11] That same couple would also enjoy a federal tax reduction in 2004 of more than $100,000 as a result of federal tax cuts passed in 2001-03. Note that this calculation assumes that taxpayers face standard federal rates rather than the Alternative Minimum Tax (AMT). If a taxpayer has sufficient deductions to be subject to the AMT, then Uncle Sam will no longer subsidize that taxpayer's Connecticut tax burden.

[12] See State Individual Income Taxes, available at www.taxadmin.org/fta/rate/ind_inc.html.

[13] Sources of this data: Id.; For New York City and State Combined rates, see New York State Dept. of Taxation, Instructions for Resident Income Tax Form, available at ww.tax.state.ny.us/pdf/2005/inc/it150_201i_36_64.pdf. For updated New Jersey rates see New Jersey Division of Taxation, 2004 NJ-1040 Tax Rates Schedule available at www.tax.state.ri.us/form/2005/per/05sched.pdf.

[14] Massachusetts has a higher, 12% rate for certain capital gains income—primarily short term capital gains. For details and 2004 changes, see Massachusetts Department of Revenue, Personal Income Tax – Tax Rates and Payments, available at www.massdor.com/help/guids/abate_amend/Personal/issues/RatesTax.htm.