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“Who Pays?” How Our State and Local Tax System Burdens Connecticut’s Poor and Middle Class

**Douglas Hall, Ph.D.
Shelley Geballe, J.D., M.P.H.**

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New Haven Office
33 Whitney Ave.
New Haven CT 06510
Phone: 203.498.4240
Fax: 203.498.4242

Hartford Office
53 Oak St. Suite 15
Hartford CT 06106
Phone: 860.548.1661
Fax: 860.548.1783

Web Site: www.ctkidslink.org
E-mail: voices@ctkidslink.org

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A common measure of tax equity is the share of one’s income paid in tax as compared to other taxpayers. Measured by this metric, Connecticut’s state and local tax system is regressive.¹ That is, our wealthiest families pay a much *smaller* share of their income in state and local taxes than do more than four in five other Connecticut families.

Indeed, the Institute on Taxation and Economic Policy’s forthcoming *Who Pays* report² finds that Connecticut’s wealthiest 1% of families³ pay *less than half* the share of their income in state and local taxes than do the poorer four fifths (80%) of Connecticut families, after federal income tax deductions for state income and property taxes are factored in.⁴

As shown in Figure 1, below, the inequity between our wealthiest and other Connecticut families extends even to families with incomes between the 95th and 99th percentiles; Connecticut’s “near wealthiest” families pay about one and a half times the share of their incomes in state and local tax as do the wealthiest 1%.

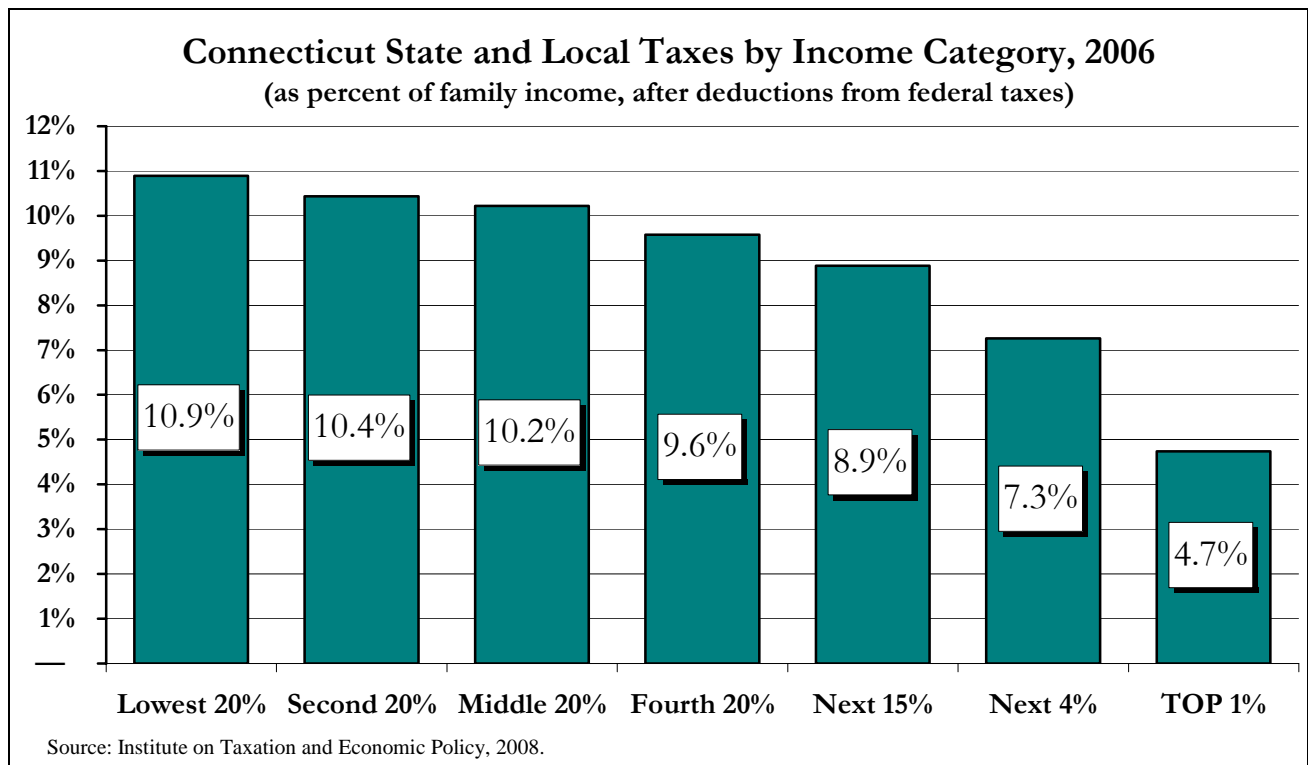


Figure 1

This report examines how state and local tax burden as a share of income varies by family income, and the differential incidence of income, sales and property taxes. It also suggests a more progressive personal income tax rate structure and a refundable state earned income tax credit as two ways to amend our state tax system so that Connecticut's combined state and local tax burden is more equitably shared by its families.

Where Connecticut Stands: An Uneven Tax Burden

The differential manner in which income, property and sales taxes fall on Connecticut families of varying incomes is shown in Figure 2, below. It shows the share of personal income paid in each of the three taxes – sales/excise, property, and income tax -- *prior* to the impact of federal income tax deductions.

As is evident from Figure 2, lower and middle income families pay a larger share of their incomes in sales and property taxes than do higher income families. By comparison, higher income families pay a larger share of *their* incomes in income tax than do lower and middle income families.

In total, however, the state's wealthiest families pay a much smaller share of their income in state and local taxes than do its middle and lower income families. Why? Connecticut's personal income tax does not have a sufficiently progressive rate structure to offset the regressivity of the other two taxes.

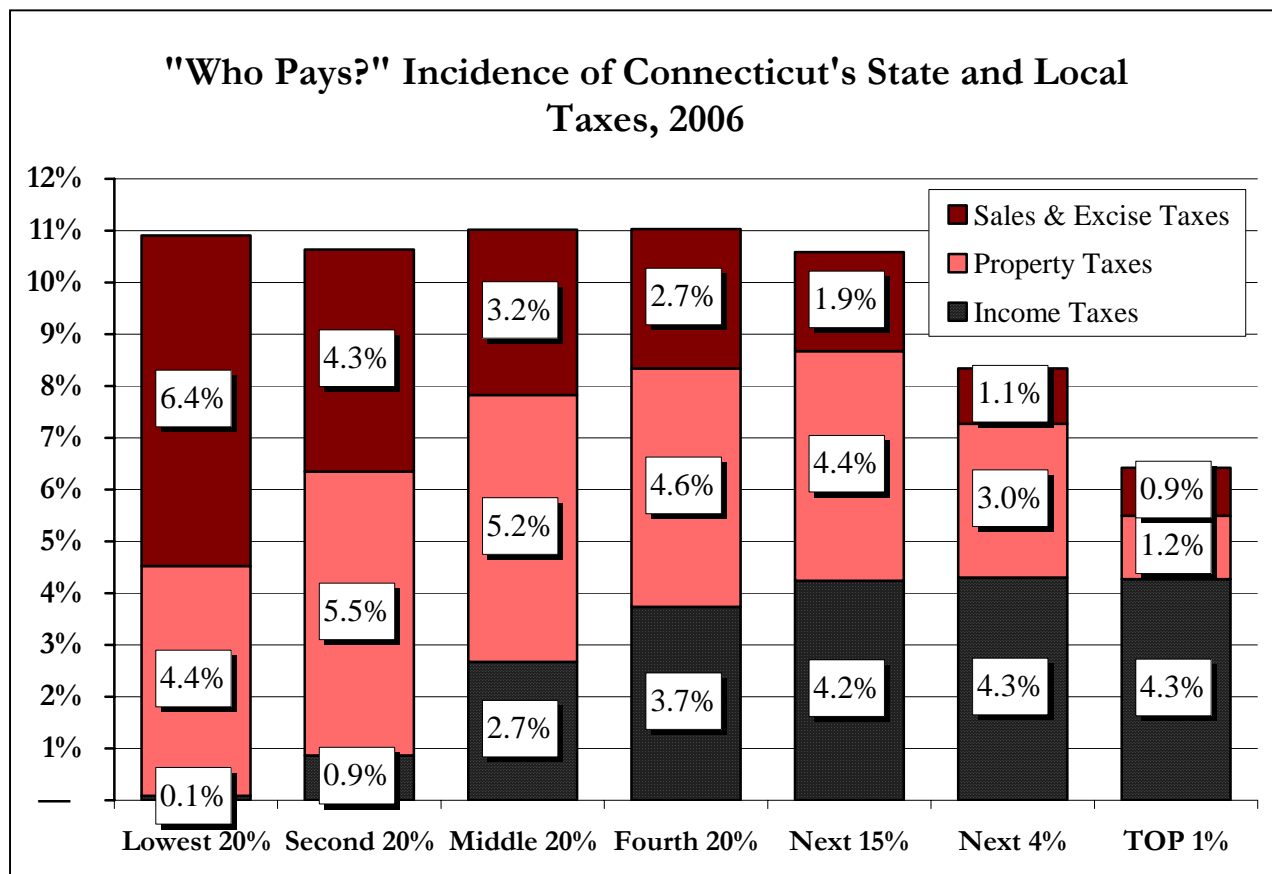


Figure 2

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Income Range	Less than \$25,000	\$25,000 – \$42,000	\$42,000 – \$69,000	\$69,000 – \$111,000	\$111,000 – \$287,000	\$287,000 – \$1,013,000	\$1,013,000 or more
Average Income in Group	\$15,100	\$33,400	\$55,100	\$87,800	\$155,200	\$411,600	\$3,251,500
% of Income Paid in:							
Sales & Excise Taxes	6.4%	4.3%	3.2%	2.7%	1.9%	1.1%	0.9%
General Sales—Individuals	2.5%	1.9%	1.5%	1.3%	1.0%	0.6%	0.5%
Other Sales & Excise—Ind.	1.6%	0.9%	0.6%	0.5%	0.3%	0.1%	0.1%
Sales & Excise on Business	2.2%	1.5%	1.1%	0.9%	0.6%	0.4%	0.3%
Property Taxes	4.4%	5.5%	5.2%	4.6%	4.4%	3.0%	1.2%
Property Taxes on Families	4.4%	5.4%	5.1%	4.5%	4.3%	2.8%	0.8%
Other Property Taxes	0.0%	0.0%	0.0%	0.1%	0.1%	0.2%	0.4%
Income Taxes	0.1%	0.9%	2.7%	3.7%	4.2%	4.3%	4.3%
Personal Income Tax	0.1%	0.8%	2.7%	3.7%	4.2%	4.2%	4.1%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%
TOTAL TAXES	10.9%	10.6%	11.0%	11.0%	10.6%	8.3%	6.4%
Federal Deduction Offset	-0.0%	-0.2%	-0.8%	-1.5%	-1.7%	-1.1%	-1.7%
TOTAL AFTER OFFSET	10.9%	10.4%	10.2%	9.6%	8.9%	7.3%	4.7%

Table 1

The following is evident from the data in Figure 2 and Table 1 above:

- The wealthiest 1% of Connecticut’s families, with an average income in 2006 of \$3,251,500, paid 6.4% of their income in state and local taxes (and 4.7% taking into account the federal deduction offset). By comparison, the poorest 20% of Connecticut’s families, with an average income in 2006 of \$15,100, paid 10.9% of their income in state and local taxes (and the same share after the federal offset), or *more than twice* the share paid by the wealthiest 1%.⁵
- Prior to the federal offset, Connecticut’s state and local tax burden as a share of personal income is essentially “flat” for its middle and lower income families. All but the wealthiest 5% of Connecticut’s families paid between 10.6% and 11% of their income in state and local taxes. By comparison, the wealthiest 1% of Connecticut families paid 6.4% of their income in state and local taxes, and the next wealthiest 4% paid 8.3%. That is, those families most financially able pay state and local taxes actually bear *less* of a burden than their less wealthy peers.
- Taking into account the federal offset, Connecticut’s state and local tax system becomes regressive even among the lowest 80% of income earners. The share of income paid in state and local taxes *declines* as total income *increases*. In fact, this pattern fits the classic model for a regressive tax structure.

Some assert that Connecticut’s wealthiest families pay *more* than their fair share of tax, citing in particular the income tax they paid as a share of total state income tax revenues. While it is accurate that Connecticut’s wealthiest residents pay a large share of Connecticut’s total income taxes, it is also true that they report a large share of the total income in the state. As shown in Table 2 below, in

2006, the top 1% of taxpayers in Connecticut (those reporting Connecticut Adjusted Gross Income of \$750,000 or more) paid 33% of the state's total income taxes, but also reported 31% of the state's total income. The top 6% of taxpayers (those with Connecticut AGI of \$200,000 and up) paid 53% of state income taxes, and reported 48% of the state income. That is, the fact that our wealthiest residents pay a larger share of Connecticut's personal income tax than other residents reflects the fact that they have a larger share of Connecticut's income than do other residents, *not* that they are taxed far more heavily. In fact, the share of income tax the top 1% paid in 2006 is roughly comparable to the share of income the top 1% reported in 2006.

	Top 1% of Taxpayers (CT AGI of \$750,000 and up)	Top 6% of Taxpayers (CT AGI of \$200,000 and up)	Bottom 90% of Taxpayers (CT AGI of less than \$150,000)
Share of total Connecticut Adjusted Gross Income reported	31%	48%	45%
Share of total personal income tax paid	33%	53%	38%
Source: Connecticut Department of Revenue Services, 2006 Personal Income Tax data, analyzed by Connecticut Voices for Children.			

Table 2

Connecticut Compared to Other States

Figure 3, below, shows that Connecticut's highest income families -- those in the top 1% -- pay a substantially smaller share of their income in combined state and local taxes than do their counterparts in Connecticut's neighboring states: 6.4% in Connecticut, compared to 6.7% in Massachusetts, 7.0% in Rhode Island, 7.9% in New Jersey, and 10.6% in New York.

Because the average income of Connecticut's wealthiest 1% of families tends to be significantly higher than the average incomes of the wealthiest 1% in most other states, this chart actually may understate where Connecticut ranks compared to other states after the federal offset is considered since the value of the federal deduction for income and property taxes increases as the taxpayer's federal income tax rate increases.

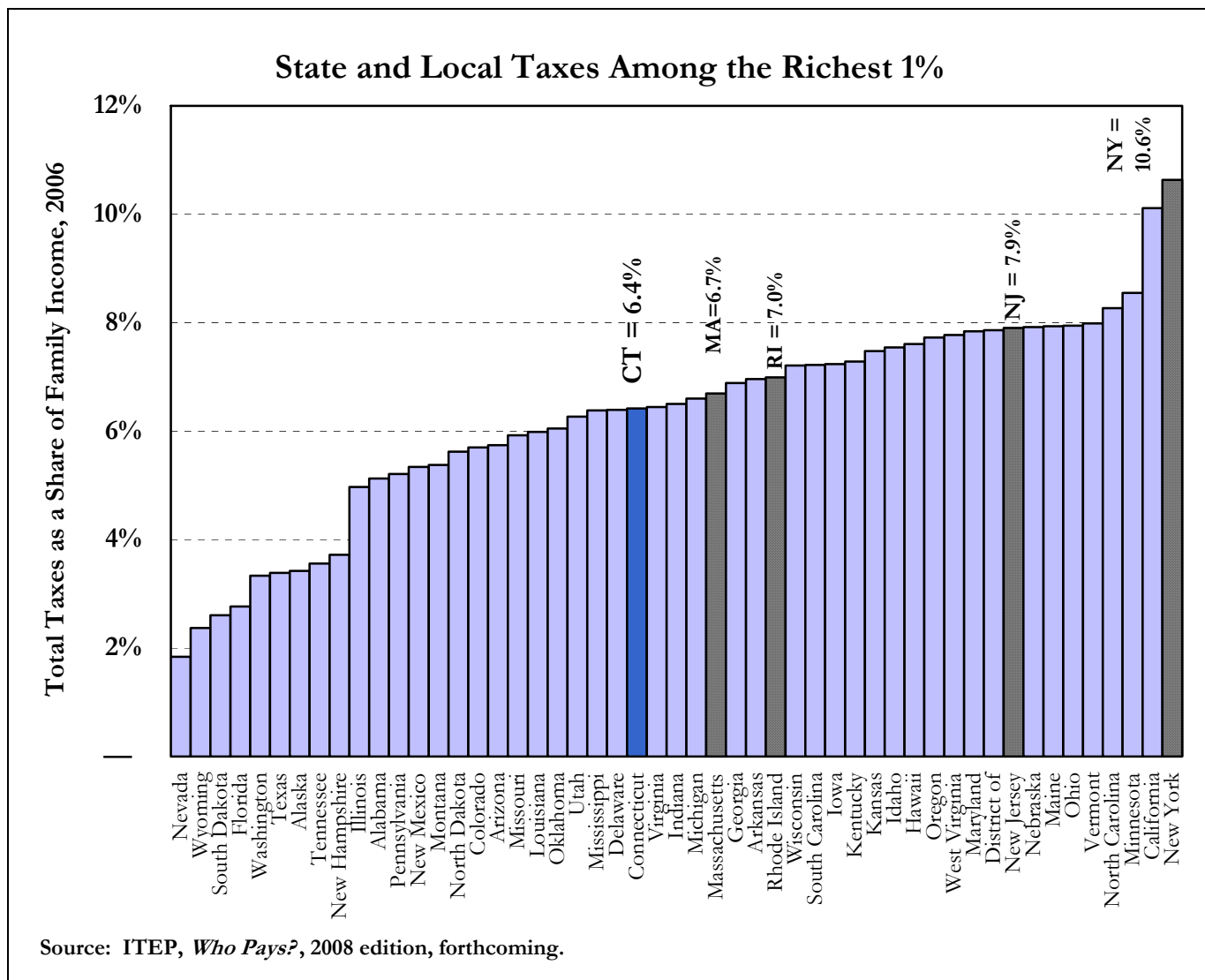


Figure 3

Toward a More Fair Tax Structure

At a recent public hearing of the Human Services Committee,⁶ Robert Genuario, Secretary of the Office of Policy and Management, cited “the progressivity of the Connecticut state income tax as it exists” as a rationale for opposing the creation of a state Earned Income Tax Credit.

As this report has illustrated, however, determining whether the overall impact of Connecticut’s tax system is progressive, flat, or regressive, requires an examination of both state and local taxes, including not only the state income tax, but also sales and property taxes. *This* examination clearly shows that our state and local tax system requires families with the least to pay proportionately more in tax than those with the most.

To make Connecticut’s state and local tax structure fairer, the state should provide additional state aid to Connecticut’s cities and towns to reduce the state’s relatively high property taxes, increase the state income tax on those most able to pay it, and adopt a refundable state earned income tax credit.

Providing additional state aid to Connecticut’s cities and towns to reduce Connecticut’s relatively high property taxes. Providing full funding for the Payment in Lieu of Taxes program

and increasing the state's share of K-12 education funding to close to 50% would reduce the pressure on our local property tax; reductions in local property tax would provide particular benefit to our middle-income families and to small, start-up businesses.

Increasing the share of income paid in tax by our wealthiest families. The Institute on Taxation and Economic Policy (ITEP) has modeled the impact on Connecticut's tax structure of adopting a top income tax bracket of 6% applied to income of married couple families over \$200,000 and to the income of single filers over \$100,000.

The impact of this change can be seen in Figure 4 below. It shows that this new tax rate would result in the wealthiest 1% of Connecticut families paying an additional 0.64% of their income in state personal income tax, bringing the total share of their income paid in state and local tax to 7.0% before the federal offset. The next wealthiest 4% of families would pay an additional 0.06% of their income in tax, increasing the total share of their income paid in state and local taxes to 8.4% before the federal offset.

ITEP estimates that adding this 6% top bracket to Connecticut's income tax would generate approximately **\$470 million** in additional revenue, while **affecting only 7%** of Connecticut taxpayers.

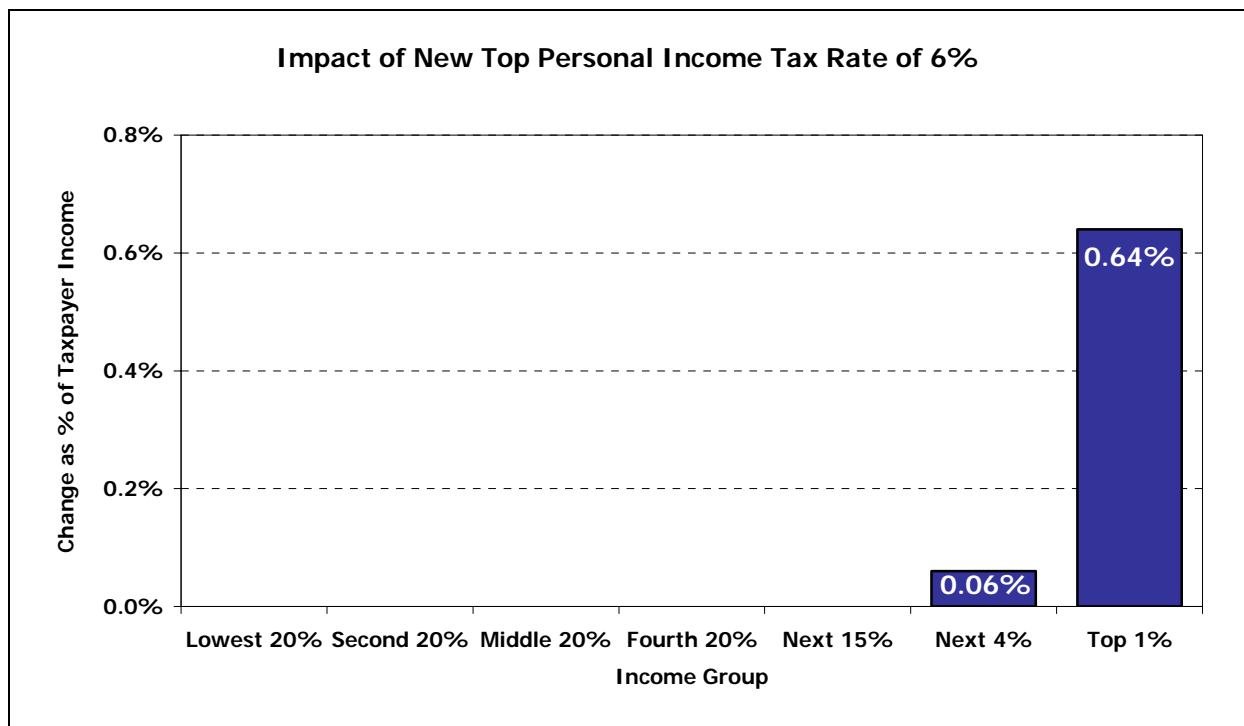


Figure 4

Notably, *even with* this rate increase, the share of income paid in state and local taxes by Connecticut's wealthiest 5% would *remain smaller* than what is paid by the "bottom" 95% of Connecticut families. That is, this change would only begin to close the gap in relative tax burden between Connecticut's low- and middle-income families and its wealthiest families.

Adopting a state earned income tax credit and increasing Connecticut's personal exemptions can make Connecticut's tax code fairer. Another way to make Connecticut's tax structure fairer is to adjust the tax burden at the other end of the income distribution by adopting a

refundable state earned income tax credit. (EITC)⁷ and increasing Connecticut's personal exemptions to account for inflation.⁸

Both measures would help compensate for the fact that Connecticut's tax threshold – the income level at which families begin to pay the state personal income tax – has not changed since the tax was adopted in 1991. As a result, more low-income families are becoming subject to the tax.

Connecticut's tax threshold as a share of the federal poverty level, for example, has steadily declined. In 1991, low-income Connecticut families began paying the state income tax when their incomes were 73 percent above the federal poverty level. By 2007, by comparison, families became liable for the state income tax when their incomes were just 14 percent above the poverty level, as illustrated in Figure 5 below.

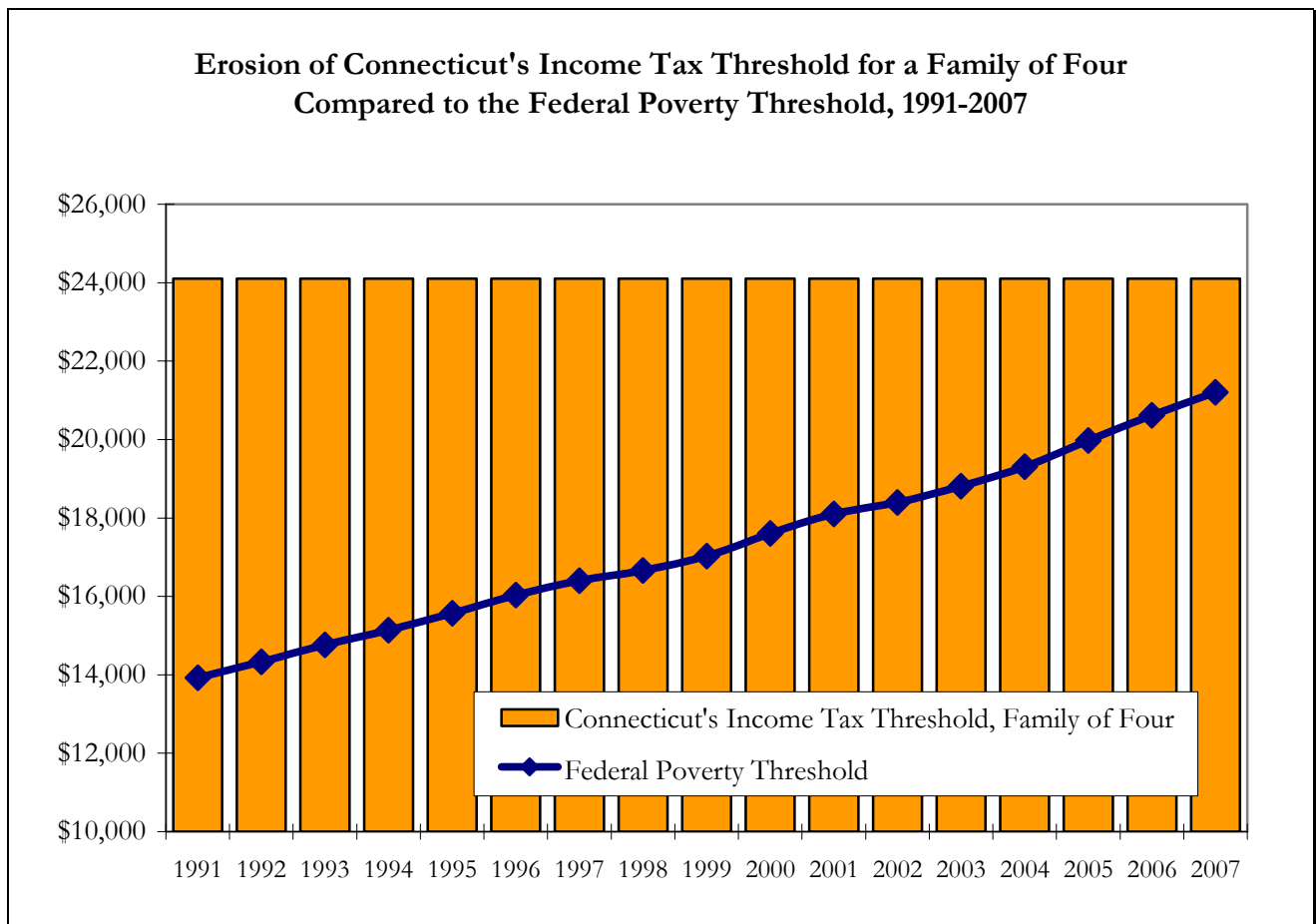


Figure 5

The reason for this relative erosion in Connecticut's tax threshold is evident. For while the federal poverty level is increased each year to adjust for inflation, Connecticut's personal exemptions for heads of household and married couples filing jointly have *not* been adjusted upward since the income tax was adopted in 1991.⁹ Had they been adjusted for inflation, the personal exemption for a head-of-household filer would be about \$30,000 now, rather than \$19,000, while the personal exemption for a married couple filing jointly would be close to \$38,000 now, rather than \$24,000. An increase in the personal exemptions merely to keep pace with inflation would reduce the tax burden on many low and low-middle income families.

Further, for tax year 2007, a 20% state refundable EITC would have reduced the *total* state and local taxes of families with incomes between \$12,000 and \$17,000 by \$940, and would have reduced by a lesser amount the *total* state and local taxes of families with incomes under \$40,000.¹⁰

Conclusion

Connecticut Voices for Children's recent report, *Pulling Apart in Connecticut: Trends in Family Income, Late 1980s to Mid 2000s*,¹¹ documents the alarming manner in which our middle and lower-income families have been falling farther and farther behind Connecticut's wealthiest families in family income. Indeed, the growth in the gap in income between Connecticut's wealthiest 20% of families and its middle 20% and between the wealthiest 20% and Connecticut's poorest 20% has exceeded *all other states*. Moreover, the gap between the state's wealthiest families and its poorest results not only from the significant increases in the incomes of Connecticut's wealthiest families, but from an actual *decline* in the real (inflation-adjusted) incomes of Connecticut's poorest families – the *largest* decline in the nation.

As Connecticut's economy slows and pressure on the state budget grows, it will be tempting in an election year to curb growth in state spending on the programs and services that disproportionately help our low and middle-income families.

Another option exists. This is to *expand* our investment in our middle and lower income families through expansion of affordable housing and foreclosure assistance, child care subsidies, need-based college scholarship aid, state aid for K-12 education, and a state EITC. These investments should be financed through a more progressive state income tax.

This set of choices will help our most vulnerable families weather the upcoming economic storms and simultaneously make our state and local tax system more equitable.

¹ A “progressive” tax system is one in which taxpayers pay a larger proportion of their income in tax as their incomes rise. A “regressive” tax system is one in which taxpayers pay a smaller proportion of their incomes in tax as their incomes rise. A “flat” tax system is one in which taxpayers pay the same proportion of their income in taxes, regardless of their incomes.

² The Institute on Taxation and Economic Policy, *Who Pays?: A Distributional Analysis of the Tax Systems in All 50 States* (3rd Edition, 2008)(forthcoming).

³ These data are based on the total income of non-elderly families (singles and couples, with and without children) because state tax systems often treat elderly families very differently than non-elderly families.

⁴ Because state income and local property taxes can be deducted in calculating federal income tax liability, the net financial impact of these taxes on a state taxpayer is reduced. This is significant both in terms of the distribution of current tax burdens in Connecticut (the deductions are more valuable to wealthier taxpayers who are subject to higher federal marginal tax rates), and also to any proposed state revenue enhancements (since increases in state income and property tax are subsidized by the federal government, while sales tax increases are not). For example, Connecticut's wealthiest 1% of families pay 4.7% of their income in state and local taxes after the federal deductions, and 6.4% before the deductions; the deductions reduce the share of income paid in tax by 1.7 percentage points. By comparison, the poorest 20% of Connecticut families receive *no* benefit from the federal deductions; they pay 10.9% of their income in state and local taxes either way.

⁵ In 2002, the average income of the wealthiest 1% of Connecticut families was \$2,406,000; average annual income of this group has increased by \$845,500 in just four years. By comparison, the average income of the poorest 20% of families was \$13,800 in 2002, and \$15,100 in 2006, an increase of just \$1,300. Median income Connecticut families had an average income gain of \$7,300 (from \$47,800 in 2002 to \$55,100 in 2006).

⁶ Robert Genuario, Secretary of the Office of Policy and Management, Testimony before the Human Services Committee, February 21, 2008. <http://www.cga.ct.gov/2008/HSdata/chr/2008HS-00221-R000900-CHR.htm>.

⁷ See Douglas Hall, *The Earned Income Tax Credit: What It Does for CT and How It Could Do Much More* (Connecticut Voices for Children, 2007), available at: www.ctkidslink.org/publications/econ07EITC.pdf. See also, Douglas Hall, *The Federal*

Earned Income Tax Credit by State Legislative District (Connecticut Voices for Children, 2008), available at: www.ctkidslink.org/pub_detail_396.html.

⁸ With one exception, Connecticut's personal exemptions (which are based on taxpayer filing status) have not been increased since the personal income tax was adopted in 1991. Public Act 99-173 included a phased-in increase in the exemption for single filers from \$12,000 in 1999 to \$15,000 in 2007. When the recession began in 2002, however, the phase-in was delayed by a total of four years (Public Act 02-1, May Special Session; Public Act 05-251). The standard deduction for single filers in this 2008 tax year is \$13,000 and will increase annually until it reaches \$15,000 in tax year 2012. However, the standard deductions for heads of households (\$19,000) and married couples filing jointly (\$24,000) have not been increased since the income tax was first adopted. If these three exemptions had been increased at the rate of inflation, they would have been, in 2007, \$18,812 for single filers, \$29,786 for head of household filers, and \$37,625 for married couples filing jointly. Note that all three personal exemptions phase out as income levels increase; the exemption is reduced by \$1,000 for every \$1,000 (or fraction thereof) by which Connecticut Adjusted Gross Income exceeds the twice the exemption. That is, for a married couple filing jointly, the \$24,000 personal exemption is reduced by \$1,000 for every \$1,000 (or part thereof) by which their CT AGI exceeds \$48,000. Conn. Gen. Stat. §12-702.

⁹ Although the General Assembly adopted a credit against the personal income tax for real and personal property taxes paid on a motor vehicle or primary residence in Connecticut, this credit only can be claimed by taxpayers who own motor vehicles or their homes. Since it is not universally available (as is the personal exemption) is not counted in determining the tax threshold.

¹⁰ Because the lowest income families have no personal income tax liability, a refundable state EITC helps offset the state and local taxes these families *do* pay, most notably for low-income families, the sales and use tax (see Table 1).

¹¹ Douglas Hall, *Pulling Apart in Connecticut: Trends in Family Income, Late 1980s to Mid 2000s* (Connecticut Voices for Children, 2008), available at: http://www.ctkidslink.org/pub_detail_408.html.