CT BUDGET CHOICES

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THE CONNECTICUT CHILD INVESTMENT CREDIT

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The Challenge

The Self-Sufficiency Report for Connecticut quantifies, for the first time, the additional annual costs incurred by families who are raising children – for housing, child care, food, health care, education, and the like. For these families, economic self-sufficiency requires a much higher annual income than for adults who are not raising children.

For example, household expenses nearly double for a single adult when that adult begins raising an infant (increasing, for example, from $13,740/year to $26,400/year in the Hartford region, and from $19,500/year to $37,980/year in the Stamford-Norwalk region). Said another way, a single parent raising an infant has between $12,660 and $18,480 in added expenses each year associated with raising that infant (in the Hartford and Stamford-Norwalk regions, respectively).

And while the annual cost of raising a teenager is less than that of an infant, a single parent raising a teen still incurs up to $6,000/year in additional expenses (with the precise amount depending on the region).

If one averages the additional household costs associated with meeting the basic needs of a child across the lifetime of that child, one finds that the average annual cost for a Connecticut parent to raise a child is about $8,000/year per child in the Hartford region and $8,900/year in the Stamford-Norwalk region.

Said another way, a Hartford parent spends at least $144,000 and a Stamford parent spends at least $160,000 meeting the essential needs of each child that they support and raise from birth to age 18.

Though child-rearing expenses unquestionably reduce a family's capacity to pay tax, Connecticut makes no adjustment in tax liability for family size.[1]

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[1] The state income tax code provides personal exemptions that differ in amount based on the filing status of the taxpayer (married couple filing jointly, head of household, single filer or married couple filing separately) but provides no additional exemptions for dependents in the household [CGS 12-702]. In addition, the proportion of income taxed at the 3% rather than the 4.5% rate [CGS 12-700], the amount of the low-income tax credit [CGS 12-703] and the amount of the credit for property taxes paid on a primary residence or motor vehicle [CGS 12-704c] are all based on taxpayer filing status and Adjusted Gross Income; the number of children and other dependents in the household is not taken into account.

Connecticut's tax code lacks any of the family-specific tax relief measures that have been adopted by the federal government[2] and *all* other states with a graduated income tax.[3] As a result, for example:

- A married Connecticut couple with one or more children pays the same amount in state income taxes as a childless couple with the same income, despite their additional costs of child-rearing.

- A single Connecticut parent raising children pays *more* in state income taxes than a childless married couple with precisely the same income.

Over the last several years, Connecticut has made significant investments in Connecticut businesses to promote the "growing" of jobs in our state – through reduced corporate tax rates, redeemable research and development tax credits and the like. And Connecticut is now seeing the fruits of these investments. We have regained all of the jobs lost in our last recession (and added some) and diversified our economic base. Now, Connecticut's continued economic growth is challenged by a workforce shortage. In particular, Connecticut has a dire need for more workers in areas such as nursing, education, information technology and biotechnology. With record low unemployment, it is essential now to make new investments in our workforce.

A Solution

A Connecticut Child Investment Credit represents a state commitment to workforce investment by helping Connecticut *families* who are struggling financially to "grow" the *next* generation of workers. This credit against the state income tax would not only help the state's current workers to remain in the workforce by offsetting some of their work-related child-rearing expenses, but also make our tax code more equitable and "child-friendly" for *all* families by adjusting tax liability to account for family-size.

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[2] Federal tax relief measures include the dependent exemption ($2,750 for tax year 1999), the child credit (a non-refundable credit of $500/child and an additional refundable child credit of $500 if there are three or more children), the non-refundable child and dependent care credit and the deduction of up to $5,000 in child care expenses annually for workers in firms offering flexible spending plans.

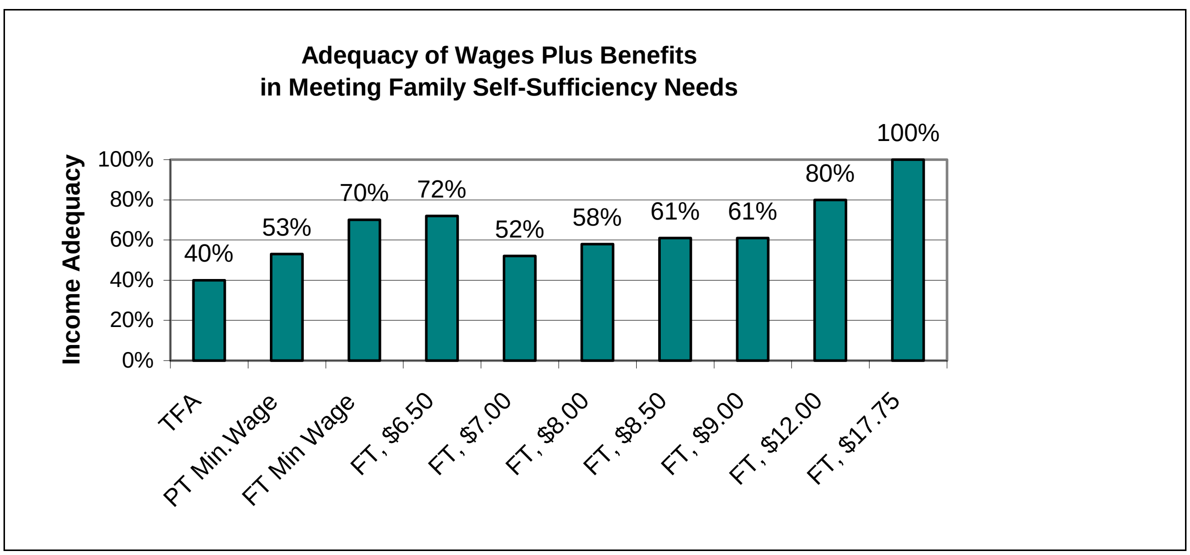
[3] Of the 41 states with a state income tax, 23 states (and the District of Columbia) provide a personal exemption for each child (including Maine, Massachusetts, New York, and New Jersey). Another 6 states provide a $2,750 standard deduction as provided in the Internal Revenue Code, and 8 states provide a tax credit for each child (with Ohio providing both a personal exemption *and* a tax credit for each child). Colorado and Pennsylvania have a flat tax with no personal exemptions, while Rhode Island and Vermont set their state income tax rate as a percentage of the federal tax liability (implicitly including the federal exemptions for children) [Federation of Tax Administrators, *State Individual Income Tax Rates, Tax rate for tax year 2000 – as of January 1, 2000*] In addition, at least 26 states and the District of Columbia (including New York, Massachusetts, Vermont, Rhode Island, and Maine) have enacted child care credits or deductions against the state income tax, to help offset child care costs. Most set the credit at a given percentage of the federal credit. Arkansas has a child credit equal to 10% of the federal, unless the 3-5 year old for whom the credit is claimed is enrolled in state quality-approved child care center; for these children the credit is doubled to 20%. Minnesota's refundable child and dependent care credit is generous (100% of the federal credit if family income is under $16,050) and is available even for families whose income is too low to claim the federal credit. In addition, 14 states and the District of Columbia have enacted Earned Income Tax Credits that provide targeted tax relief to lower-income families with children.

An $800/year credit against the state income tax for each child[4] would offset about 10% of a family's minimum annual child-rearing expenses. This credit should:

- **Be well-targeted.** To target the credit to families who are struggling to attain economic self-sufficiency (including families in lower-wage service sector jobs so essential to our economy – such as child day care, home health care and the like), the full $800/year/child credit should be available to families with incomes between about 100% and 200-250% of the federal poverty level.[5]

  It is over this income range, according to the Self-Sufficiency Report, that families lose entitlement to various state and federal benefits and therefore actually *lose* some of the economic ground they would otherwise gain through increased hourly earnings.

  The following chart illustrates this "cliff" effect for a three-person family – a parent raising a one pre-school and one school-age child living in the Stamford-Norwalk region. For this family, an increase in the parent's hourly wage from $6.50/hour to $7.00/hour puts the family's earned income about the federal poverty threshold, making the family ineligible for TFA benefits. Since the $0.50/hour increase in wages is much less than the loss of TFA benefits ($636/month), the family's wages as a percentage of the total income necessary to attain economic self-sufficiency falls from 71% to 54% -- a precipitous "cliff." As wages continue to increase, loss of food stamps, child care, and other income-related benefits as wages continue to increase further challenge the family's climb to economic self-sufficiency.



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[4] The family would be allowed to claim the child investment credit only for children claimed as dependents on their federal income tax return for that year, reducing the administrative burden on the CT Department of Revenue Services.

[5] The federal poverty level for a three-person family is a little less than one-third (30%) of the self-sufficiency standard in the Stamford-Norwalk region, the state's most expensive region. Even in the less expensive rural areas, such as the Northeast Region, the federal poverty threshold is only about 40% of the self-sufficiency measure.

The Child Investment Credit, when targeted to this income range, can help smooth the benefits' cut-off "cliff" into a more gentle slope, rewarding a parent's additional work efforts.

To reduce the total cost of the credit, the credit can and should phase out as family income increases. The credit could also "phase-in" – a smaller credit would also be appropriate for families with incomes below the federal poverty level who are eligible for other subsidies.

- **Be available to *all* families within the eligible-income range.** Because of Connecticut's relatively high state income tax threshold[6], a significant number of the families eligible for the Child Investment Credit may have little or no state income tax liability. To assure that these families too receive the financial benefits of the credit, the credit should be refundable – that is, treated like the state's recently-adopted[7] redeemable research and development credit for smaller businesses with little or no corporate tax liability.[8] Both small, start-up companies and "start-up" families need special help. Making credits refundable/redeemable allows both to receive the full financial benefits of tax credits that are intended to offset some of their "development" costs, despite their low earnings.

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6 Connecticut's state income tax threshold for a single-parent family of three in 1999 was $19,100 and for a two-parent family of four $24,100. The threshold is the lowest income level at which a family has state income tax liability. [Center on Budget and Policy Priorities, 2000, *State Income Tax Burdens on Low-Income Families in 1999*]

7 P.A. 99-173, sec. 38.

8 The refundable part of the Child Investment Credit, just like the research and development credits "sold back" at 65% of value to the state by smaller companies with no corporate tax liability against which to take the credit, would be a refund of taxes, rather than an expenditure subject to the state spending cap.

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