Investing in Connecticut's Families:
Making Children Visible in Connecticut's Tax Code

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I. Summary

Children are largely invisible in Connecticut's tax code. While it is generally recognized that a family's ability to pay taxes is reduced as the number of its dependents increases and associated work-related and other expenses rise (e.g., child care; food, shelter, clothing costs), Connecticut's tax code makes no meaningful adjustments for the number of dependents in a family. For example:

- A married Connecticut couple with children pays the same amount in state income taxes as a childless couple with the same income

- A single Connecticut parent raising children pays <u>more</u> in state income taxes than a childless married couple with the same income

Why is this the case? Connecticut lacks many of the family-specific tax relief measures that have been adopted by the federal government and other states that take into account the additional expenses incurred by families who are raising children.

Just as Connecticut has successfully used its tax code to promote business investments, so too it should consider using the tax code to invest in its children – the employees of the 21st century. The association between low family income and a child's poor cognitive growth, poor health, and other adverse outcomes is far too strong not to employ all tools available to address the increasing economic pressures on our Connecticut families raising children.

This short report urges Connecticut to eliminate the implicit "child penalty" in its tax code, by making children visible through adoption of one, or more, of the following:

- a refundable child tax credit (to compensate for Connecticut lacking any dependent exemptions)
- a refundable child and dependent care credit
- a refundable earned income tax credit set at a meaningful proportion of the federal earned income tax credit
- expansion of Connecticut's property tax circuit-breaker to all low income families who own or rent their homes.
- a refundable sales tax credit
- a refundable dependent education expense credit or expense deduction.

I. Children are invisible in Connecticut's tax code

While many changes in the labor market and in family structure have contributed to the increased economic pressure on many Connecticut families with children, it is also true that Connecticut's tax code does not do all it could to support these hard-working, but still struggling, families.

On the positive side, Connecticut has a high income tax threshold,[1] a low-income tax credit that phases out as income increases, and a property tax credit. As a result, Connecticut's lowest income families with children pay no state income tax.

Connecticut's state and local taxes, however, remain regressive overall. The relative, but modest, progressivity of Connecticut's state income tax cannot offset the regressivity of our sales and property taxes. In Connecticut, the percentage of a family's income that is paid in state and local taxes <u>increases</u> as the family's income <u>decreases</u>. The poorest families among us bear the greatest burden of Connecticut state and local taxes.

In addition:

- **Exemptions from the Connecticut income tax.** While Connecticut provides personal exemptions from the income tax that differ based on the filing status of the taxpayer (a $24,000 exemption for a married couple filing jointly, $19,000 for a head of household, and $12,000 for a single filer or married couple filing separately)[2], and these exemptions are quite high relative to other states, Connecticut provides no additional exemptions for dependents in the household. In most states, the total exemption amount depends on the number of persons in the household. At least seven states now provide a higher exemption for children than for adults in the household, while others provide personal exemptions for dependents that are roughly equal in amount to the exemption for a single filer. [C.G.S. §12-702]

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[1] The Center on Budget and Policy Priorities in Washington, DC has calculated state income tax thresholds as of 1998. Its threshold measure reflects the income at which a family with a single wage earner and income wholly from earnings begins to owe state income tax, taking into account the state's personal and dependent exemptions, standard deductions, state earned income tax credit, and other deductions or credits that are available to *all* low-income families. Among all states, Connecticut has the seventh highest income tax threshold for a two-parent family of four (CA, MN, VT, RI, PA, and MD have higher thresholds) and the tenth highest threshold for a single parent family of three (CA, MN, MD, VT, RI, NY, AZ, KS, and MA have higher thresholds). Center on Budget and Policy Priorities. *State Income Tax Burdens on Low-Income Families in 1998: Assessing the Burden and Opportunities for Relief* (March, 1999). Connecticut's position relative to other states has slipped. In 1997, Connecticut had the third highest income tax threshold for a two-parent family of four and the seventh highest threshold for a single parent family of three.

[2] . P.A. 99-173 increases the standard deduction for single filers from $12,000 to $15,000 over eight years, beginning January 1, 2000.

- **3% rate.** The proportion of income that is to be taxed at 3% rather than 4.5% is determined by Connecticut adjusted gross income [CT AGI] and taxpayer filing status only; the number of children and other dependents in the household is not taken into account, though ability to pay tax is reduced as household size increases. [C.G.S. §12-700]

- **Low-income tax credit.** The amount of Connecticut's low-income tax credit is determined by CT AGI and taxpayer filing status only; the number of children and other dependents in the household is not taken into account. . [C.G.S. §12-703]

- **Property tax credit.** The recently-enhanced credit for property taxes paid on a residence or motor vehicle is determined by CT AGI and taxpayer filing status; the number of children and other dependents is not taken into account. [P.A. 99-173, P.A. 98-110, P.A. 97-309, P.A. 97-322]

- **Property tax circuit-breaker.** Connecticut's property tax circuit-breaker for low-income elderly and disabled homeowners and renters has not been extended to low-income families raising children. [C.G.S. §§12-170d, 12-170aa]

Connecticut's lowest income families with children also did not benefit from the tax relief provided with the 1998 General Fund surplus. For example, the 1998 income tax rebates ($115 million) provided no benefit at all to our lowest income families with children; they had no state income tax liability so were not eligible for the rebates. The supplemental payments to low-income elderly renters and homeowners who currently qualify for property tax relief ($8 million) also did not benefit young families raising children.

By comparison, in 1999, the sales tax rebate program ($109.5 million) was expanded to include many of our lowest income families including, *inter alia*, Connecticut residents who filed a 1998 federal income tax return and Connecticut residents who were eligible for the federal Earned Income Tax Credit in the 1998 tax year. Expansion of the property tax credit to $500 by January 1, 2000, however, did not benefit our lowest income families who have no state income tax liability. [P.A. 99-173]

Because Connecticut children are invisible in its income tax code, the following occurs:

- At any given CT AGI, a couple raising children will pay the same amount in state income tax as a couple who is not raising children. For example, a couple with CT AGI of $40,000/year and four children pays the same amount in state income tax as a childless couple with the same income.

- At any given CT AGI (above CT's income tax threshold), a single parent (filing as head of household) will pay <u>more</u> in state income tax than a couple, even if the single parent is raising several children and the couple has no children. For example, a single mother raising three children would pay more in state income tax than a couple without children and the same income.

II. The importance of eliminating Connecticut's "child penalty"

The need to begin to make children visible in Connecticut's tax code is more pressing than ever.

Median income of Connecticut families with children has fallen. The state's recent economic recovery has not lifted all boats equally. Median household income for Connecticut families raising children fell from $50,800 in 1989 to $47,117 in 1991 to $41,755 in 1996 (in 1996 dollars)[Bureau of the Census, Current Population Survey]. The majority of Connecticut families raising children have seen their inflation-adjusted incomes decrease since the mid-1980s.

The "Real" Income of the Majority of CT Families with Children Has Fallen

Category	Mid 1970s-Mid 1990s	Mid 1980s-Mid 1990s
Lowest fifth	-$6,140	-$4,650
Middle fifth	+$4,670	-$3,320
Top fifth	+$50,810	+$14,920

Sources: Bureau of the Census; Current Population Survey; Center on Budget and Policy Priorities; Summary of Poverty and Income Statistics (Income in 1996 dollars).

Child poverty in Connecticut has markedly increased. Children living in our lowest income families, in particular, have lost much economic ground, both in absolute dollars and relative to similarly-situated children in other states. In 1989, Connecticut's child poverty rate was 7%. Now, at a time of similarly low unemployment and a strong economy, it stands at 17%. Connecticut's child poverty rate was second lowest in the United States from 1985 through 1991; it now ranks 23rd on this basic measure of child well-being, with nearly one in five children living in families with incomes below the federal poverty line ($16,700/year for a family of four in 1999)[3].

Welfare reform efforts can be enhanced. Connecticut's "Jobs First" program is placing increasing numbers of Connecticut families with children into the workforce. Many now hold low-wage and/or less than full-time jobs, making it difficult to make ends meet when all cash assistance is terminated.

Connecticut has increasing income inequality among its families with children. The income gap between Connecticut's low income families with children and its most wealthy has grown faster since the mid-1970s than in any other state. Now, Connecticut's most wealthy 20% of families raising children have an income 14.2 times greater than the poorest 20% -- the 5th widest gap in the US -- and up from 8.8 times greater in 1985-7.[4] The income gap between Connecticut's most wealthy 20% of families raising children and families in the middle of our income distribution has also grown; it is now the 11th widest gap in the US.[5]

Regressivity of Connecticut's state and local taxes exacerbates income inequality by placing greater tax burden on our lower-income families. The overall regressivity of Connecticut's state and local taxes exacerbates this inequality; Connecticut's poorest families pay *nearly twice* as much of their income in state and local taxes than do those with greater incomes.[6]

3 By comparison, a March, 1998 poll by the Center for Survey Research and Analysis at the University of Connecticut found that Connecticut citizens thought it took $45,000/year for a family of four to "get by financially" in Connecticut. This is nearly three times greater than the federal poverty level.

4 . Center on Budget and Policy Priorities. *Pulling Apart: A State-by-State Analysis of Income Trends* (December, 1997).

5. Center on Budget and Policy Priorities, *Pulling Apart: A State-by-State Analysis of Income Trends* (December, 1997).

6 . This table is based on taxes paid by non-elderly married CT couples in 1995. Recent expansions in the proportion of income subject to the 3% rate for CT state income tax and in the property tax credit would reduce, somewhat, the proportion of income paid in income taxes from what is shown here. Note, however, that neither change was targeted uniquely to our lowest-income taxpayers; CT's most wealthy taxpayers also benefit from both the property tax credit and the expansion of taxable income subject to the 3% rate.

CT's Tax Burden Is *Not* Shared Equally.

Lowest 20% - Average income:$26,800	
Sales/excise tax	4.9%
Property tax	6.0%
Income tax	0.6%
Total Tax	**11.5%**

Top 5%- Average income:$326,000	
Sales/excise tax	1.1%
Property tax	2.2%
Income tax	4.3%
Total Tax	**7.6%**

Middle 20%-Average income:$64,700	
Sales/excise tax	3.2%
Property tax	4.1%
Income tax	3.4%
Total Tax	**10.7%**

Top 1% - Average income: $1,705,000	
Sales/excise tax	0.8%
Property tax	1.6%
Income tax	4.4%
Total Tax	**6.8%**

* By income group as % of gross income for non-elderly married couples in 1995

Source: Citizens for Tax Justice and The Institute for Taxation and Economic Policy

III. Options Exist

Other states have adopted a variety of measures to make children visible in their tax codes. Rather than penalizing families for raising children, they invest in their young families through tax relief that acknowledges, and adjusts for, a household's increased costs when it is raising children. Many states specifically target relief to lower-income families. Among the options that Connecticut might consider are:

- **A refundable child tax credit (sufficiently large to compensate for Connecticut not having dependent exemptions).** This could be modeled after the recently-enhanced federal child tax credit, which declines in value as income increases.

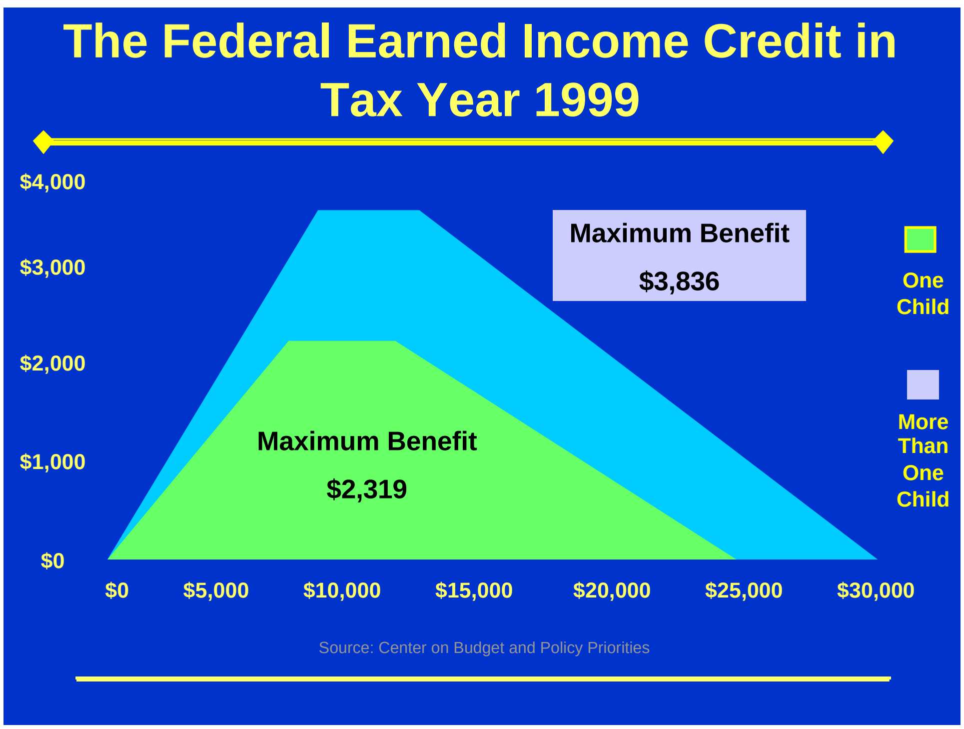
- **A refundable child and dependent care credit.** 28 states have a child and dependent care credit. Of them, about 1/3 have a refundable credit. Credit is available only for cost of *un*subsidized child care. Example: Minnesota has refundable child care credit for employment-related child care expenses for care of children under age 13.

- **A refundable[7] earned income tax credit, set at a meaningful proportion of the federal credit and that takes into account the number of dependents.** Ten states now have earned income tax credits. Of them, seven have refundable credits (KS,

[7]. A refundable tax credit ensures that the family receives the full amount of the credit, even if the credit amount exceeds the family's income tax liability. The amount by which the credit exceeds taxes owed is paid as a refund. If a family has no income tax liability, the family receives the entire credit as a refund.

MD, MA, MN, NY, VT, WI). Each builds on the federal earned income tax credit, which has been cited as being the single best targeted tax measure to lift low-income families with children out of poverty.[8] The Wisconsin credit varies depending on family size (the state credit equals 4% of the federal EITC for one child, 14% for two children, and 43% for three or more children). The earned income tax credits in other states are just a set proportion (10-30%) of the federal credit.

In 1998, 143,551 Connecticut families claimed the federal credit, receiving a total of $193,000,000 in federal tax relief.[9] Recent research shows that more than half the recipients of the federal EITC use their refunds to improve their social mobility – to purchase a more reliable car, pay tuition, or improve their housing. The other half (largely families with more dependent children) use the refunds to help make ends meet.[10]



- **expansion of Connecticut's property tax circuit-breaker to low income families who own or rent their homes.** At least nine states have made their circuit-breaker

8 . Center on Budget and Policy Priorities, *Rising Number of States Offer Earned Income Tax Credits*. (September, 1998)

9 . Internal Revenue Service Master File, 1998. This exceeds the preceding year, when 140,434 Connecticut families claimed the credit, receiving about $175 million in federal tax relief.

10 . Smeeding T & Ross K, 1999, *The Economic Impact of the Earned Income Tax Credit* (The Maxwell School, Syracuse University)

programs available to lower-income renters and homeowners of *any* age. This expansion is particularly helpful because housing is a particularly significant expense for Connecticut families raising children.

- **a refundable sales tax credit.** At least 8 states have a refundable sales tax credit, to offset its regressivity. In some states the credit is taken against the income tax, and can be refunded if it exceeds income tax liability. In others, the credit is administered independently of the income tax. The size of the credit is commonly determined by household size rather than actual sales tax payments.

- **a dependent education expense refundable credit or deduction.** Beginning in 1998, Minnesota began implementing a refundable education tax credit (limited to families with incomes under $33,500, with a credit of $1,000/child, up to $2,000/family), as well as an education expense deduction (with no income limit). Families cannot deduct expenses for the same items for which they receive a tax credit. Allowable expenses include such things as textbooks, tutoring, academic summer school and camps, instructional materials, and up to $200 of the cost of a computer or education-related software.

IV. General Concerns

In considering how best to provide tax relief to Connecticut families who are raising children, it is important to consider the following principles:

- All credits must be refundable, so our lowest-income families can share in the relief, even if the credit exceeds their state income tax liability.

- Relief should be designed so that large families receive benefits that are proportionally larger than the benefits provided to smaller families.

- Overall cost can be reduced by targeting relief through credits that are phased out as income increases.

- Relief measures should be indexed to inflation, or periodically reviewed to adjust for inflation, so that they continue to provide needed support to our Connecticut families.

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