CONNECTICUT VOICES FOR CHILDREN

Testimony Regarding

H.B. #6557: AN ACT CONCERNING THE INCOME TAX AND THE ESTATE TAX

Testimony of Dr. Douglas Hall[1]
To the Committee on Finance, Revenue and Bonding
March 2, 2009

Senator Daily, Representative Staples, and distinguished Members of the Finance, Revenue, and Bonding Committee,

I am testifying on behalf of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to promote the well-being of Connecticut's children, youth, and families. I submit this testimony because the manner in which Connecticut raises and spends its revenues is of great importance to the state's children and families.[2]

Connecticut Voices for Children supports HB 6557, An Act Concerning the Income Tax and the Estate Tax. This Bill addresses two critical facts.

The first is that Connecticut faces a dire fiscal situation, comprised of both a structural deficit and a deficit resulting from the current economic crisis. These crises will require significant new revenues in the short, and longer, term to avoid crippling important state programs and services or further undermining the strength of the Connecticut economy.

The second is that Connecticut's overall state and local tax structure is fundamentally unfair, asking far more of low and middle income families as a share of their family income than it asks of those at the top of the income scale. The measures in HB 6557 take positive steps towards making Connecticut's overall tax structure both fairer, and more adequate.

Connecticut's Fiscal Situation

A year ago, Connecticut's Office of Fiscal Analysis (OFA) was projecting a structural deficit of $551.2 million for FY10. OFA's February projections show Connecticut facing a deficit of $3.97B for FY10, followed by even larger deficit projections for FY11 ($4.71B) and FY12 ($4.82B).

These ballooning deficit projections compound a fiscal situation that is dire in other respects. Connecticut faces long-term debt and other obligations (unfunded health, pension, and other post-retirement benefits) of $57.6 billion, translating to more than $16,600 for every man, woman and child in Connecticut. To put these numbers in context, Connecticut's debt burden in 2006 ranked third highest in the nation on a per capita basis, and seventh highest in the nation as a proportion of personal income. Connecticut's willingness to rely on future generations – our children and grandchildren – to cover the costs of today's programs and services, must be curtailed.

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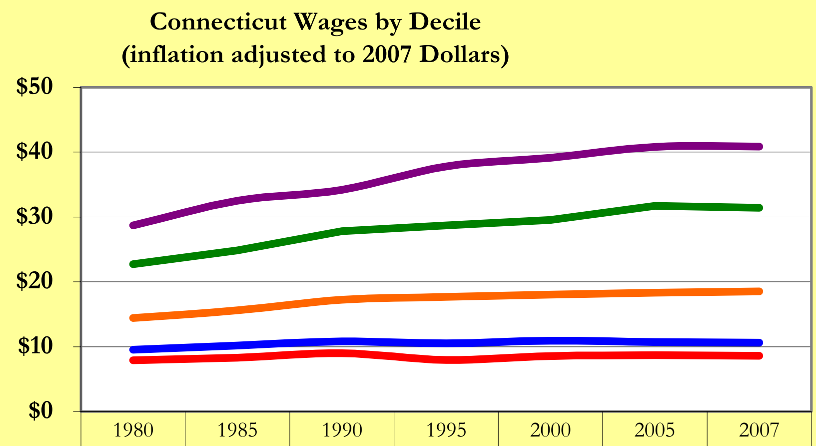
[1] Douglas Hall is Acting Managing Director of Connecticut Voices for Children.

[2] This testimony draws heavily on two documents; Better Choices for Connecticut, *Better Choices for Connecticut: State Budget Proposal*, (Better Choices for Connecticut, February 2009), and Connecticut Voices for Children, *Connecticut Revenues In Context: The Governor's Proposed FY 10 Budget*, (Connecticut Voices for Children, February 2009).

Significant Wage and Income Trends

As seen in Figure 1 below, the wages of those in the top income deciles (those at the 80th and 90th percentiles) have increased dramatically over the past three decades, while those of lower income earners have essentially stagnated.



	1980	1985	1990	1995	2000	2005	2007
90th percentile	$28.70	$32.50	$34.21	$37.81	$39.12	$40.83	$40.85
80th percentile	$22.71	$24.84	$27.83	$28.72	$29.54	$31.72	$31.40
50th percentile (Median)	$14.43	$15.62	$17.26	$17.68	$18.03	$18.32	$18.51
20th percentile	$9.53	$10.17	$10.80	$10.53	$10.94	$10.73	$10.61
10th percentile	$7.90	$8.31	$8.98	$7.97	$8.55	$8.72	$8.59

Figure 1. Source: Joachim Hero, Douglas Hall, and Shelley Geballe, *The State of Working Connecticut, 2008: Wage Trends*, (Connecticut Voices for Children, 2008).

Similar trends are evident in Connecticut's family income data. Between the late 1980s and the mid 2000s, the gaps in average, inflation-adjusted ("real") income between wealthy and poor Connecticut families and between wealthy and middle-income families have grown more in Connecticut than in any other state in the country. While real income for the poorest families in the state has declined since the late 1980s by 17%, the largest drop of any state, the wealthiest families have enjoyed an increase in their real income of 45%. Middle-income families have seen little change in their real incomes, which increased by only 5.1%. This modest increase for middle-income residents was the lowest among all states, as cited in a Connecticut Voices for Children report, *Pulling Apart in Connecticut: Trends in Family Income: Late 1980s to Mid 2000s.* [3]

Another recent report shows that Connecticut and New York lead the nation in household income inequality, followed by Mississippi, Louisiana, Texas, and Tennessee. Connecticut's highest-income households -- the top 5% -- received a quarter (24.9%) of all the income in the state. The poorest 20% of the households in Connecticut received only 3.3% of all income in the state. In addition to having the second-most unequal household income distribution in the country, Connecticut, out of all 50 states, has had the greatest *growth* in household income inequality over the past several decades. Moreover, income inequality *within* Connecticut continues to grow, with every county except

[3] Douglas Hall and Shelley Geballe, *Pulling Apart in Connecticut: Trends in Family Income: Late 1980s to Mid 2000s,* (Connecticut Voices for Children, 2008), http://www.ctkidslink.org/pub_detail_408.html .

Windham county experiencing increased income inequality between 1990 and 2007. Fairfield County is by far the most inequitable county in Connecticut, and in fact is the third most inequitable county in the nation.[4]

Debunking Some Myths About the Connecticut Income Tax

1. Proposals to increase the income tax rate on those with higher incomes are often met with claims that "they are already paying a huge share of the state's taxes." This is correct. However, it is also correct that this reflects their greater share of Connecticut's income. In fact, looking at 2007 income tax data, the top 1% of tax filers (those earning $850,000 and up) accounted for 34.5% of Connecticut AGI, and only a slightly higher proportion (36.6%) of total Connecticut personal income tax paid. This slightly disproportionate share of income tax does not come even close to countering the significant regressivity of Connecticut's other major state and local tax sources, the sales tax and the property tax, seen in Figure 2 below.

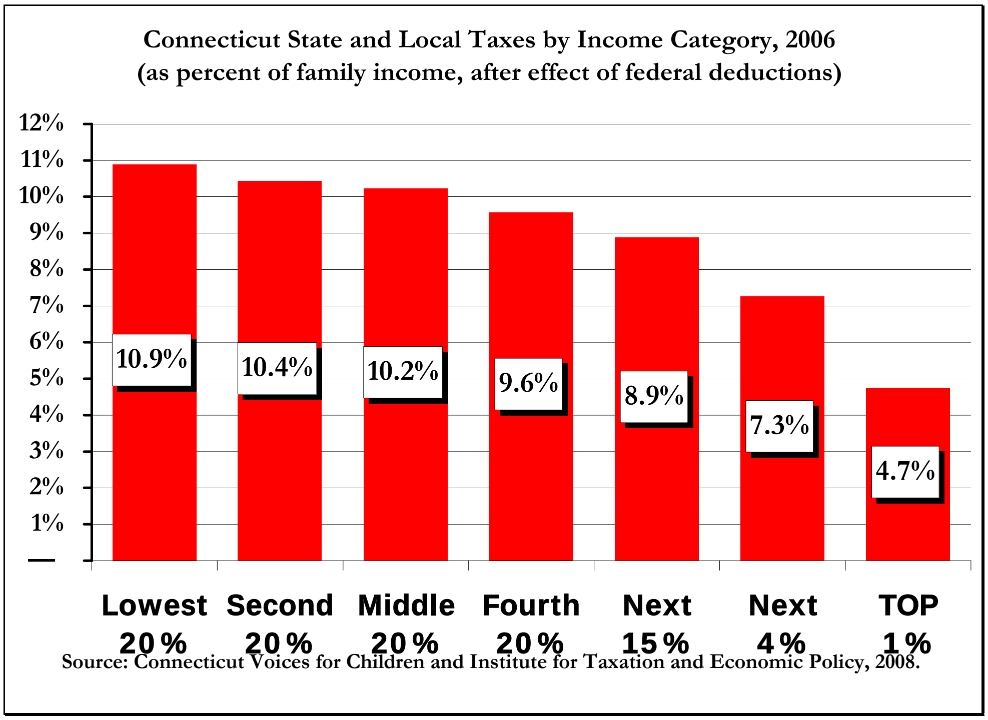


Figure 2

Connecticut's state and local tax system is unfair to middle- and low-income residents. These middle-income and low-income residents pay close to 11 percent of their income in state and local taxes, while the richest families pay less than 5 percent (after incorporating the effect of deducting state taxes when calculating federal income taxes). Figure 2 presents data on the distribution of tax burdens across families with different incomes in 2006. Based on data from the Institute on Taxation and Economic Policy, this analysis illustrates that the highest income families in Connecticut pay a lower proportional share of their income in state and local taxes when sales,

[4] Joachim Hero, *Connecticut Leads the Nation in Multiple Measures of Income Inequality: 2007*, (Connecticut Voices for Children, 2009).

excise, property, and income taxes are reviewed collectively. Given the regressive nature of sales, excise, and property taxes, Connecticut's relatively flat income tax structure is fundamentally unfair.

2. We are often cautioned that increased reliance on the personal income tax (particularly through increased rates on top-income earners) can lead to an unacceptable degree of volatility in Connecticut's revenue stream. There is no question that revenues from Connecticut's personal income tax fluctuate significantly from year to year, magnifying the cycles of the overall economy and market fluctuations. Recent experience with the state's Budget Reserve (or "Rainy Day") Fund highlights the importance of building up reserves during periods of economic expansion. While the Governor's budget proposes completely spending down the Budget Reserve Fund over the course of three fiscal years, the fund balance of $1.38 billion is inadequate to cover more than a small fraction of the deficits projected over that period (14% of the combined FY09, FY10, and FY11 deficits projected by OFA in November)[5]. Increasing the statutory target for our Budget Reserve Fund from 10% of General Fund appropriations to 15% (or higher) and then replenishing the Fund during periods of economic expansion would be a responsible approach to fiscal management.

3. Increases to the top income tax rate often raise fears that the wealthy would leave the state, fleeing to avoid the increase in their personal income taxes. This argument sells short their attachment to friends, community and state, hugely underestimates the importance of family connections, and unfairly paints Connecticut's wealthy residents as selfish individuals unconcerned with the collective well-being of the state. Moreover, it discounts the fact that Connecticut's marginal tax rate is very competitive with other states, and would remain so even with modest increases. See Table 1 below. Further, the fact that neighboring states also face significant deficits suggests that their personal income tax rates also will increase, to rates higher than shown in Table 1 below.

Table 1. Marginal Rates at Various Taxable Income Thresholds for a Married Couple Filing Jointly (2008).[6]

State/Locality	$85K	$100K	$150K	$200K	$500K	$1M
New York City	10.4	10.5	10.5	10.5	10.5	10.5
New Jersey	5.3	5.3	6.4	6.4	9.0	9.0
Rhode Island	7.0	7.0	8.0	8.0	9.9	9.9
Connecticut	5.0	5.0	5.0	5.0	5.0	5.0
Massachusetts*	5.3	5.3	5.3	5.3	5.3	5.3

*In addition to a flat 5.3% income tax, Massachusetts applies a 12% rate to income from short-term capital gains, long- and short-term capital gains on collectibles, and pre-1996 installment sales classified as capital gain income for Massachusetts purposes. Taxpayers have the choice of paying an optional higher rate of 5.85% that is applied to both earned income and capital gains.

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[5] Including the FY12 deficit projection of $4.822B, the Rainy Day Fund covers just 9% of the projected deficit.

[6] Calculations from: Tax Foundation, State Individual Income Tax Rates, 2000-2009, *available at*: http://www.taxfoundation.org/files/state_individualincome_rates-20090106.xls; 2008 NJ-1040 Tax Rate Schedules, *available at*: http://www.state.nj.us/treasury/taxation/pdf/other_forms/tgi-ee/2008/njtaxratesch08.pdf; 2008 Rhode Island Tax Computation Worksheet, *available at*: http://www.tax.state.ri.us/forms/2008/Personal/2008%20Tax%20Computation%20Worksheet.pdf; New York City Tax Rate Schedule, *available at* http://www.tax.state.ny.us/pdf/2008/inc/nyc_tax_rate_150_201.pdf.

The Provisions of HB 6557

There are two primary elements to HB 6557, *An Act Concerning the Income Tax and the Estate Tax*. The first provision creates two new income tax brackets, with increased rates for filers in those brackets. The first bracket increases the rate by half a percentage point to 5.5% for [married filing jointly] filers with incomes between $250,000 and $500,000, while the second bracket further increases the rate to 6% for filers with incomes above $500,000.

The second provision places a temporary 30% surcharge on the estate tax for taxes paid during the 2009, 2010, or 2011 tax years.

Connecticut Voices for Children supports both provisions of this bill. Together, these provisions will raise significant revenues, though we are concerned that the revenues raised will fall far short of the current need. The "Better Choices" income tax proposal outlined below creates three rather than two new brackets, and increases the marginal rates by full percentage points when moving from one bracket to the next. We estimate that the Better Choices income tax proposal would raise between $0.8B and $1.2B in additional revenue. With fewer new brackets and new rates of 5.5% and 6.0% compared with Better Choices' rates of 6%, 7%, and 8%, the revenues from the income tax proposal in HB6557 will fall considerably short of that range.

The "Better Choices" Income Tax Proposal

The centerpiece of the Better Choices budget proposal is an increase in the income taxes paid by those who can best afford it – the state's wealthiest residents. We estimate that by creating additional tax brackets with increased rates, Connecticut would collect an additional $0.8billion to $1.2 billion in personal income taxes. We propose the creation of additional brackets for top earners. Specifically, we offer the following new brackets for married couples filing jointly:

- Marginal rate of 6.0 percent on taxable income greater than $200,000.
- Marginal rate of 7.0 percent on taxable income greater than $500,000.
- Marginal rate of 8.0 percent on taxable income greater than $1 million.

[The tax brackets for taxpayers filing as singles, married couples filing separately, and heads of household would maintain the same ratio in relation to the brackets for married couples filing jointly].

Under this progressive income tax proposal, Connecticut's marginal rates for high income families would remain significantly lower than the *current* rates of most neighboring states. Of all 41 states with income taxes, only seven have a lower top marginal rate than Connecticut.

The Better Choices proposal would not only produce significant additional revenue for Connecticut, it would also make Connecticut's entire state and local tax system fairer.

Thank you for consideration of this testimony, and for all this Committee is doing to ensure that Connecticut has adequate revenues to meet the needs of Connecticut's children, families, and communities.