

JUST FACTS: MAKING CONNECTICUT'S TAX SYSTEM FAIRER THROUGH TAX REFORM



Connecticut's unfair tax system exacerbates income inequality and the racial income gap. This fact sheet includes proposals to make the tax system fairer.

The following is a summary of the key findings from our January 2022 report:

The Impact of Connecticut's Unfair—or Regressive—Tax System

Connecticut's unfair tax system exacerbates income inequality and the racial income gap.

Key Terms to Know

- **Unfair tax system** requires working- and middle-class families to pay a higher percentage of their income in taxes than upper-class families and the wealthiest (i.e., a regressive tax system).

The Impact of Fairer—or Proportional and Progressive—Tax Systems

A near proportional tax system would have no or little impact on income inequality and the racial income gap, and a progressive tax system would reduce income inequality and the racial income gap.

Problems with Connecticut's Income Tax and Proposals to Reform It

Connecticut's *income tax exemption* provides little or no support for some working-class families and most middle-class families. Moreover, because the tax exemption is not indexed for inflation, "tax exemption creep" operates as a built-in, or hidden, annual tax increase on working- and middle-class families.

Key Terms to Know

- **Tax exemption** indirectly reduces a tax filer's liability by reducing their taxable income.
- **Tax liability** is the tax owed by a family or business to the government.
- **Inflation** is an increase in the price of goods and services that decreases the purchasing power of money.
- **Inflation indexing** is the inclusion of automatic cost of living adjustments.
- **Tax exemption creep** is when a tax filer's income increases to keep up with inflation but that nominal increase in income decreases the tax filer's exemption, resulting in a higher income tax liability even though the tax filer's real purchasing power has not increased.
- **Built-in tax increase** is a tax increase that occurs automatically for some tax filers due to the design of the tax system and it generally works in conjunction with inflation.

Connecticut's *income tax brackets* generate the largest increase in the effective tax rate in the middle of the income distribution rather than at the top, which increases the unfair burden on middle-class families. Moreover, because the tax brackets are not indexed for inflation, "tax bracket creep" operates as a built-in, or hidden, annual tax increase on working- and middle-class families.

Key Terms to Know

- **Tax bracket** is a specific range of income subject to a specific tax rate.
- **Tax bracket creep** is when a tax filer's income increases to keep up with inflation but that nominal increase in income puts the tax filer into a higher top income tax bracket, resulting in a higher income tax liability even though the tax filer's real purchasing power has not increased.

Connecticut's *personal tax credit* provides little or no support for many middle-class families. Moreover, because the tax credit is not indexed for inflation and does not adjust for the number of dependents, "tax credit creep" operates as a built-in, or hidden, annual tax increase on working- and middle-class families and families with children pay an especially unfair share.

Key Terms to Know

- **Tax credit** directly reduces a tax filer's liability.
- **Tax credit creep** is when a tax filer's income increases to keep up with inflation but that nominal increase in income decreases their tax credit, resulting in a higher income tax liability even though the tax filer's real purchasing power has not increased.

Connecticut's *income tax gap* is likely substantial—a starting estimate of 19 percent or \$2.6 billion a year. It also likely makes the income tax less fair in primarily benefitting the wealthy and further increasing the burden on working- and middle-class families.

Key Terms to Know

- **Tax gap** is the difference between the tax owed to the government and the tax actually paid.

Altogether, from an income-group perspective, the failure to inflation index the key components of Connecticut's income tax currently harms middle-class families the most but will increasingly harm working-class families, and the failure to close the income tax gap likely further harms both working- and middle-class families. From a race-ethnicity perspective, the failure to inflation index the key components of Connecticut's income tax currently harms the median white household the most but will increasingly harm the median Black and Latino households.

To reduce the unfair tax burden on working- and middle-class families, policymakers could:

- Extend the phase out of the income tax exemption to \$100,000 for single filers and \$200,000 for married filers
- **Inflation index the current and/or extended income tax exemption**

Key Terms to Know

- **Extended tax increase** is a tax increase (or tax credit reduction) that would have expired had policymakers not extended it.

- Eliminate the “three percent tax rate phase-out add-back” for single filers making less than \$100,000 and married filers making less than \$200,000
- Reduce the tax rates for the brackets that apply to single filers making less than \$100,000 and married filers making less than \$200,000 (e.g., lower the five percent bracket to four percent or 3.5 percent)
- Inflation index the current and/or reduced income tax brackets
- Extend the phase out of the personal tax credit to \$100,000 for single filers and \$200,000 for married filers
- Inflation index the current and/or extended personal tax credit
- Establish the Connecticut child tax credit and index it to inflation

To offset the reduction in the unfair tax burden on working- and middle-class families, policymakers could:

- Increase the current top tax rate that applies to single filers making more than \$500,000 and married filers making more than \$1 million
- Add a new top tax rate that would only apply to even wealthier families (e.g., single filers making more than \$1 million and married filers making more than \$2 million)
- Provide additional funding for the Department of Revenue Services to decrease the state’s income tax gap
- Require the Department of Revenue Services to focus its increased tax compliance oversight on the wealthy (single filers making more than \$500,000 and married filers making more than \$1 million), which is the group that likely benefits the most from the income tax gap

The Impact of Connecticut's Regressive State and Local Tax System

Income Group / Household	Pre-Tax		Effective Overall Tax Rate	Post-Tax		Change in Inequality Ratio
	Average Income	Inequality Ratio		Average Income	Inequality Ratio	
Wealthy Family	\$3,083,600	-	6.50%	\$2,883,200	-	-
Upper-Class Family	\$352,800	8.7x	9.03%	\$320,900	9.0x	+0.3
Middle-Class Family	\$97,400	31.7x	13.30%	\$84,400	34.2x	+2.5
Working-Class Family	\$22,500	137.0x	18.37%	\$18,400	156.7x	+19.7
Wealthy Family	\$3,083,600	-	6.50%	\$2,883,200	-	-
Median White Household	\$85,800	35.9x	13.66%	\$74,100	38.9x	+3.0
Median Latino Household	\$49,200	62.7x	14.72%	\$42,000	68.6x	+5.9
Median Black Household	\$48,900	63.0x	14.72%	\$41,700	69.1x	+6.1

*Data from CT DRS, US Census Bureau, and author's calculations. Average income rounded to nearest hundred.

Revenue Impact of Connecticut's Tax Gap if It Mirrors the Federal Tax Gap

	Individual Income Tax				Total Tax System			
	United States		Connecticut		United States		Connecticut	
	Billions	%	Billions	%	Billions	%	Billions	%
Total True Tax Liability	\$1,398	100%	\$13.2	100%	\$2,683	100%	\$21.6	100%
Tax Paid Voluntarily	\$1,084	77.5%	\$10.2	77.5%	\$2,242	83.6%	\$18.0	83.6%
Gross Tax Gap	\$314	22.5%	\$3.0	22.5%	\$441	16.4%	\$3.6	16.4%
Nonfiling	\$31		\$0.3		\$39		\$0.3	
Underreporting	\$245		\$2.3		\$352		\$2.8	
Underpayment	\$38		\$0.4		\$50		\$0.4	
Enforced	\$43	3.1%	\$0.4	3.1%	\$60	2.2%	\$0.5	2.2%
Net Tax Gap	\$271	19.4%	\$2.6	19.4%	\$381	14.2%	\$3.1	14.2%

*Data from Internal Revenue Service, CT OFA, and author's calculations.

Impact of Connecticut's Income Tax on Working- and Middle-Class Families

Current Income Tax

Income Group	Working Class		Middle Class		Working Class		Middle Class	
	Married	Married	Married	Married	Married	Married	Married	Married
Tax Filing Status	Married	Married	Married	Married	Married	Married	Married	Married
Number of Children	0	0	0	0	2	2	2	2
Tax Exemption								
Pre-Tax Income	\$22,500	\$45,000	\$97,400	\$150,000	\$22,500	\$45,000	\$97,400	\$150,000
Exemption	\$24,000	\$24,000	\$0	\$0	\$24,000	\$24,000	\$0	\$0
Total Taxable Income	\$0	\$21,000	\$97,400	\$150,000	\$0	\$21,000	\$97,400	\$150,000
Tax Brackets								
3%: \$0 - \$20,000	-	\$600	\$600	\$600	-	\$600	\$600	\$600
5%: \$20,001 to \$100,000	-	\$50	\$3,870	\$4,000	-	\$50	\$3,870	\$4,000
5.5%: \$100,001 to \$200,000	-	-	-	\$2,750	-	-	-	\$2,750
6%: \$200,001 to \$400,000	-	-	-	-	-	-	-	-
6.5%: \$400,001 to \$500,000	-	-	-	-	-	-	-	-
6.9%: \$500,001 to \$1,000,000	-	-	-	-	-	-	-	-
6.99%: \$1,000,001 and up	-	-	-	-	-	-	-	-
3% Tax Phase-Out Add-Back	-	-	-	\$400	-	-	-	\$400
Tax Recapture	-	-	-	-	-	-	-	-
Total Liability Before Credits	\$0	\$650	\$4,470	\$7,750	\$0	\$650	\$4,470	\$7,750
Tax Credits								
Personal Tax Credit	\$0	\$98	\$313	\$0	\$0	\$98	\$313	\$0
Earned Income Tax Credit	\$228	\$0	\$0	\$0	\$1,824	\$569	\$0	\$0
Total Tax Credits	\$228	\$98	\$313	\$0	\$1,824	\$667	\$313	\$0
Income Tax Liability								
In Dollars	-\$228	\$553	\$4,157	\$7,750	-\$1,824	-\$17	\$4,157	\$7,750
Effective Tax Rate	-1.0%	1.2%	4.3%	5.2%	-8.1%	-0.04%	4.3%	5.2%

Income Tax When Including the Proposed Child Tax Credit

Change in Tax Liability								
In Dollars	\$0	\$0	\$0	\$0	-\$840	-\$840	-\$1,200	-\$1,200
Effective Tax Rate	0.0%	0.0%	0.0%	0.0%	-3.7%	-1.9%	-1.2%	-0.8%
New Tax Liability								
In Dollars	-\$228	\$553	\$4,157	\$7,750	-\$2,664	-\$857	\$2,957	\$6,550
Effective Tax Rate	-1.0%	1.2%	4.3%	5.2%	-11.8%	-1.9%	3.0%	4.4%

Income Tax If Key Components Were Initially Indexed To Inflation

Change in Tax Liability								
In Dollars	\$0	-\$553	-\$2,366	-\$869	\$0	-\$553	-\$2,366	-\$869
Effective Tax Rate	0.0%	-1.2%	-2.4%	-0.6%	0.0%	-1.2%	-2.4%	-0.6%
New Tax Liability								
In Dollars	-\$228	\$0	\$1,791	\$6,881	-\$1,824	-\$569	\$1,791	\$6,881
Effective Tax Rate	-1.0%	0.0%	1.8%	4.6%	-8.1%	-1.3%	1.8%	4.6%

*Data from CT DRS, Internal Revenue Service, CT General Assembly, and author's calculations. Numbers may not add up due to rounding.

Impact of Connecticut's Income Tax on the Median Household by Race-Ethnicity

Current Income Tax						
Median Household	Black	Latino	White	Black	Latino	White
Tax Filing Status	Married	Married	Married	Married	Married	Married
Number of Children	0	0	0	2	2	2
Tax Exemption						
Pre-Tax Income	\$48,900	\$49,200	\$85,800	\$48,900	\$49,200	\$85,800
Exemption	\$23,000	\$22,000	\$0	\$23,000	\$22,000	\$0
Total Taxable Income	\$25,900	\$27,200	\$85,800	\$25,900	\$27,200	\$85,800
Tax Brackets						
3%: \$0 - \$20,000	\$600	\$600	\$600	\$600	\$600	\$600
5%: \$20,001 to \$100,000	\$295	\$360	\$3,290	\$295	\$360	\$3,290
5.5%: \$100,001 to \$200,000	-	-	-	-	-	-
6%: \$200,001 to \$400,000	-	-	-	-	-	-
6.5%: \$400,001 to \$500,000	-	-	-	-	-	-
6.9%: \$500,001 to \$1,000,000	-	-	-	-	-	-
6.99%: \$1,000,001 and up	-	-	-	-	-	-
3% Tax Phase-Out Add-Back	-	-	-	-	-	-
Tax Recapture	-	-	-	-	-	-
Total Liability Before Credits	\$895	\$960	\$3,890	\$895	\$960	\$3,890
Tax Credits						
Personal Tax Credit	\$134	\$144	\$389	\$134	\$144	\$389
Earned Income Tax Credit	\$0	\$0	\$0	\$319	\$300	\$0
Total Tax Credits	\$134	\$144	\$389	\$453	\$444	\$389
Income Tax Liability						
In Dollars	\$761	\$816	\$3,501	\$442	\$516	\$3,501
Effective Tax Rate	1.6%	1.7%	4.1%	0.9%	1.0%	4.1%

Income Tax When Including the Proposed Child Tax Credit

Change in Tax Liability						
In Dollars	\$0	\$0	\$0	-\$840	-\$840	-\$1,200
Effective Tax Rate	0.0%	0.0%	0.0%	-1.7%	-1.7%	-1.4%
New Tax Liability						
In Dollars	\$761	\$816	\$3,501	-\$398	-\$324	\$2,301
Effective Tax Rate	1.6%	1.7%	4.1%	-0.8%	-0.7%	2.7%

Income Tax If Key Components Were Initially Indexed To Inflation

Change in Tax Liability						
In Dollars	-\$750	-\$803	-\$2,371	-\$750	-\$803	-\$2,371
Effective Tax Rate	-1.5%	-1.6%	-2.8%	-1.5%	-1.6%	-2.8%
New Tax Liability						
In Dollars	\$11	\$13	\$1,130	-\$309	-\$287	\$1,130
Effective Tax Rate	0.0%	0.0%	1.3%	-0.6%	-0.6%	1.3%

*Data from CT DRS, Internal Revenue Service, CT General Assembly, and author's calculations. Numbers may not add up due to rounding.