A RECOMMENDED PROGRAM OF TAX REFORM, TRANSPARENCY, AND TIMELY SUPPORT

CONNECTICUT VOICES FOR CHILDREN

To make Connecticut's tax system fairer, our new tax report provides a recommended program of tax reform, transparency, and timely support.

Recommended Tax Reform Program

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

- Inflation index the income tax exemption
- Inflation index the income tax brackets
- Inflation index the income tax personal credit
- Establish the Connecticut child tax credit (CT CTC) and inflation index it

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

- Increase the income tax rate on single filers making more than $500,000 and married filers making more than $1 million, and add a new top tax rate that would only apply to even wealthier families, all of which would raise revenue immediately if necessary
- Provide additional funding for the DRS to decrease the state's income tax gap, which would raise revenue over time and could supplement or replace revenue from increasing the top income tax rate if the latter is necessary for tax reform
- Require the DRS to focus its increased tax compliance oversight on the wealthy, which is the group that likely benefits the most from the income tax gap

Recommended Tax Transparency Program

To increase tax transparency, which is essential to reducing the unfair tax burden on working- and middle-class families:

- Require the DRS to either (1) confirm that it has sufficient capacity to provide comprehensive tax incidence and tax gap reports on a regular basis or (2) release a report before the start of the next legislative session detailing the additional capacity that is necessary. Once the tax analysis capacity issue is addressed, require the DRS to provide comprehensive tax incidence and tax gap reports on a regular basis.
- Require the OFA to either (1) confirm that it has sufficient capacity in-house or with the support of the DRS to provide a combination of simple and detailed tax incidence estimates of proposed and passed legislation or (2) release a report before the start of the next legislative session detailing the additional capacity that is necessary. Once the tax analysis capacity issue is addressed, require the OFA to provide simple tax incidence estimates in all fiscal notes and detailed tax incidence estimates for three key pieces of legislation—the governor's proposed tax program, the General Assembly's proposed tax program, and the tax program ultimately passed into law.

Recommended Timely Support Program

To provide timely support that will help working- and middle-class families make ends meet:

- Require the DRS to either (1) confirm that it has sufficient capacity to setup and administer a timely support program or (2) release a report before the start of the next legislative session detailing the additional capacity that is necessary. Once the tax administration capacity issue is addressed, require the DRS to setup and administer for both the existing CT EITC and, if established, the proposed CT CTC a timely support program that ensures extensive access, provides a range of timely support options, and limits the use of reconciliation.
- Require the DRS to release detailed data each year so that policymakers can improve the design of timely support moving forward if necessary

Cost Estimates

The recommended program of tax reform, transparency, and timely support to make Connecticut's tax system fairer includes a combination of tax revenue increases, tax revenue decreases, and potentially an increase in spending. The table below provides cost estimates for the recommended options.

Tax revenue increases. If it is necessary to raise revenue in the immediate term, increasing the current top income tax rate from 6.99 percent to 7.99 percent on income over $500,000 for single filers and $1 million for married filers and also creating a new top rate of 8.49 percent on income over $1 million for single filers and $2 million for married filers would generate an estimated $504 million a year. However, based on recent revenue projections and new proposals for tax cuts from policymakers, it may not be necessary to raise revenue in the immediate term to fund the recommended program.

Over time, closing Connecticut's income tax gap would generate an estimated $2.6 billion a year, or even reducing the gap by 25 percent would generate an estimated $650 million a year, which could supplement or replace the revenue from increasing the top income tax rate if the latter is necessary.

Tax revenue decreases. The cost of inflation indexing the income tax depends on the rate of inflation. A year of two percent inflation—the Federal Reserve's average inflation target—would cost an estimated $46 million, and a year of four percent inflation would cost an estimated $90 million. Establishing the Connecticut child tax credit would cost an estimated $300 million a year and inflation indexing it would add $9 million to $19 million a year depending on the rate of inflation.

Spending increase. Increasing the DRS's budget by 25 percent would cost $17 million a year. However, whether it is necessary to increase the DRS's budget and by how much depends on the department's existing capacity, which requires more information.

Moving forward, the new information from the DRS together with the new revenue from decreasing the state's income tax gap and, if necessary, from establishing and maintaining an income tax increase on the wealthy would support policymakers in further reducing the tax burden on working- and middle-class families until Connecticut's tax system is fair.

Finally, as noted above, policymakers have recently put forward tax cut proposals, two of which are briefly addressed here. First, members of the General Assembly have proposed reducing the sales tax rate. This would make the tax system fairer to some extent because the sales tax is regressive. However, a sales tax rate cut is not targeted solely to working- and middle-class families, meaning it is less effective in making the tax system fairer compared to a well-designed income tax cut.

Second, it has been reported that the governor is planning to put forward a proposal to expand the income tax-based property tax credit. As we addressed in our last report on tax reform, which included a proposal to expand the property tax credit, a number of changes are essential. Most notably, if the objective is to offset the high property tax burden for the state's working- and middle-class families, the income thresholds should be expanded to include all of those families, the credit should be made refundable rather than limited to income tax liability, and the credit should include renters, an often-overlooked group that pays the property tax indirectly. To be sure, a well-designed expansion of the property tax credit would make the tax system fairer and is a reform we support, but we recommend first establishing a child tax credit because we believe that this is the area of tax policy in which Connecticut is the greatest outlier. We also believe that this reform will be the most effective in supporting and growing the state's working- and middle-class families with children, which is the foundation of any potential economic comeback, especially one focused on growing the number of taxpayers.

Cost Estimates of Recommended Options

	Tax Revenue Increase	Tax Revenue Decrease / Spending Increase
Close CT's Income Tax Gap		
100 percent	$2.6 billion	
50 percent	$1.3 billion	
25 percent	$650 million	
Increase CT's Top Income Tax Rate		
Increase top rate from 6.99 to 7.99 percent over $500k (single), $1 million (married) Create new top rate of 8.49 percent over $1 million (single), $2 million (married)	$504 million	
Inflation Index CT's Income Tax		
4 percent inflation		$90 million
2 percent inflation		$46 million
Establish CT Child Tax Credit		
CT Child Tax Credit		$300 million
Add inflation indexing, 4 percent inflation		$19 million
Add inflation indexing, 2 percent inflation		$9 million
Increase the DRS's Budget		
25 percent		$17 million

*Data and analysis from the Internal Revenue Service, CT Office of Fiscal Analysis, Institute on Taxation and Economic Policy, and author's calculations.