

Testimony Partially Supporting and Partially Opposing  
**Senate Bill 1116, An Act Concerning the State Personal Income Tax and Other Revenues**

Testimony of Shelley Geballe, JD, MPH, Douglas Hall, PhD, & Mary Glassman, JD  
Finance, Revenue and Bonding Committee  
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Senator Daily, Representative Staples and distinguished members of the Finance Revenue and Bonding Committee:

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**We support the Governor's proposal to increase the revenues of the state by an increase in the personal income tax, but would prefer a more progressive rate structure than she proposes.**

**We support the proposed increase in the cigarette tax but urge that it be coupled with enactment of a state EITC to offset its regressive character.**

**We support Connecticut's efforts to conform its sales and use tax to comply with the requirements of the Streamlined Sales and Use Tax Agreement so that Connecticut can begin to collect some of the \$520 million in sales and use taxes it is losing through Internet and catalog sales.**

**1. Connecticut needs additional revenues.** This Session is distinguished by its many significant, and essential, proposals for increased public investment, including (but not limited to): the Governor's proposals for K-12 financing reform and new investments in early care and education and need-based scholarship aid for higher education; the Democratic leaderships' proposals for health care reform; citizen-led efforts to expand the supply of affordable housing and the House Speaker's proposal to rehabilitate the existing stock of affordable housing; and the Governor's proposals for developing alternative fuels and for energy conservation and other efforts to reduce energy costs. Less discussed, but also important, is the need to catch up on current unfunded state obligations (e.g., state employee and retiree pensions and health insurance costs and teachers' retirement and health insurance costs), pay down some of our bonded debt (among the highest in the nation) and provide long-overdue inflationary increases to those individuals and providers who rely on state funding. For example, the monthly cash assistance grant for a low-income parent raising two children has not been increased since 1991 – it remains at \$543/month. Many providers of essential state services cannot maintain services at current levels unless state grants keep pace with inflation.

It would appear that Connecticut is under-funded. In fact, Connecticut's public spending as a share of its economy has declined – from about 9.8% of our Gross State Product (GSP) in 1994 to about 8.75% in 2003. Total government spending in Connecticut as a percentage of GSP is now 4<sup>th</sup> lowest among all

states, second lowest among Northeastern states, and substantially below the United States average (11.9%).<sup>1</sup> If spending now were the same share of our GDP as in 1994, Connecticut's state and local spending would be about \$1.76 *billion* greater.

How this has occurred is no surprise. In the late 1990s, when the stock market was exceptionally strong and the state enjoyed temporary budget surpluses, Connecticut amended its tax code multiple times, cutting annual state taxes by more than \$2 billion. Tax and fee increases since that time have not fully restored these revenues.

The Governor's proposals to increase the income tax, the cigarette tax, and begin a course to recover sales and use tax revenues helps address our structural deficit. While we agree with the need to increase state revenues, we disagree somewhat with how the Governor proposes to do so.

**2. The Governor's proposed rate increase imposes too much burden on lower and middle-income families. Adopting a more progressive rate structure could generate equivalent revenues while making Connecticut's tax code more, rather than less, equitable.** The Governor's proposed rate increase keeps Connecticut's personal income tax relatively flat, compared to taxes with a more graduated rate structure (such as the federal income tax). While Connecticut's relatively high filer exemptions and low-income credit create *some* progressivity for lower-income families, there is little progressivity in the personal income tax beyond this.<sup>2</sup>

In fact, Connecticut's income tax threshold (the income level at which a filer becomes subject to the tax taking into account all *universally* available deductions, exemptions and credits) has not increased since the income tax was adopted in 1991. In 1991, when our income tax was passed, this threshold for a family of four was 73% over the federal poverty level. It is now just 16% over the poverty level. Without inflationary adjustments to the exemptions and the low-income credit, an increasing proportion of Connecticut's lower income taxpayers are becoming subject to the income tax generally, and to even being taxed at the higher 5% rate. Twelve states now have an income tax threshold that exceeds Connecticut's, including Massachusetts, Maine, New York, Maryland, Rhode Island, Minnesota, Pennsylvania, Vermont, California, Wisconsin, Kansas, and South Carolina.<sup>3</sup>

Further, Connecticut provides *no* supplemental deductions or exemptions for dependents, putting families who are raising children, or providing care to elderly parents, at a tax disadvantage.<sup>4</sup> The new income tax deduction enacted last Session for contributions to the Connecticut Higher Education Trust (CHET)

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<sup>1</sup> Legislative Program Review & Investigations Committee, *Connecticut's Tax System* (January 19, 2006), p.42.

<sup>2</sup> Joint filers with adjusted gross income under \$40,000 pay no income tax. Those with AGI between \$40,000 and \$75,000 (Connecticut's median family income) have an effective tax rate that ranges from 0.1% (for \$40,000 AGI) increasing to 3.4% (for \$75,000 AGI). Above this AGI, the effective tax rate increases far more slowly. The effective tax rate at \$100,000 AGI is 4.0%, at \$200,000 AGI is 4.6%, at \$500,000 AGI is 4.9% and at \$1 million AGI and above is 5.0%. That is, the effective tax rate increases by 3.4 percentage points between \$0 and \$75,000 AGI, but only increases by 1.6 percentage points for incomes between \$75,000 and \$1 million or more. FY 2008-FY 2009 Biennium Governor's Budget (PowerPoint February 7, 2007), p. 73.

<sup>3</sup> J. Levitis and N. Johnson, *The Impact of State Income Taxes on Low-Income Families in 2005* (Center on Budget and Policy Priorities, February 22, 2006).

<sup>4</sup> See S. Geballe, *Making Children Visible in Connecticut's Tax Code* (1999), available at [www.ctkidslink.org](http://www.ctkidslink.org).

program further reduces the progressivity of the tax, since few low income taxpayers will be able to make contributions to the CHET program and take full advantage of this deduction.<sup>5</sup>

Currently, Connecticut's personal income tax is not sufficiently progressive to offset the regressivity of its other taxes. Our wealthiest 1% of taxpayers (with average income of \$2.4 million) in 2002 paid just 4.4% of their income in state and local taxes (taking into account federal income tax deductions), compared to the 9.5% of income paid by the taxpayers in our middle quintile (average income of \$47,800) and the 10.2% of income paid by our poorest quintile families (average income \$13,800).<sup>6</sup> The Governor's proposal does nothing to address this inequity.

Other options that incorporate a more graduated rate structure (requiring higher income filers to pay more than lower income filers) could raise revenues comparable to the Governor's proposal but in a manner that makes our overall tax system more equitable. For example, Option 1, below, that taxes joint filers at the following rates (with other filing brackets adjusted accordingly) would raise about the same amount in new revenues as the Governor's proposal, but by requiring more of our highest income taxpayers and less of our less advantaged taxpayers. The two options are presented side by side in the following table:

Joint filers' taxable income	Rate under Governor's proposal (in FY 09)	Rate under Option 1 (in FY 09)
\$0-\$20,000	3.0%	3.0%
\$20,000-\$500,000	5.50%	5.25%
\$500,000-\$750,000	5.50%	5.50%
\$750,000-\$1,000,000	5.50%	5.75%
\$1,000,000-\$2,000,000	5.50%	6.00%
Over \$2,000,000	5.50%	6.25%

If the 5.5% bracket in Option 1 began at \$150,000 rather than \$500,000, the rate increases on higher incomes could be reduced some without a significant loss of revenues, given the income distribution in Connecticut. Alternatively, the higher rates could be maintained and additional income tax revenues garnered to meet essential state needs.

**3. An increase in the cigarette tax to \$2 per pack promotes important public health purposes while raising needed revenues, but is not a stable source of revenues. Because it is a regressive tax, its enactment should be coupled with a refundable EITC.** The Governor's proposed increase would be the third increase in the cigarette tax since FY 02. PA 02-1 increased the tax from 50 cents per pack to \$1.11 and PA 03-2 (June Special Session) increased the tax to the current \$1.51 per pack.

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<sup>5</sup> P.A. 06-186 allows taxpayers to deduct contributions to the Connecticut Higher Education Trust (CHET), Connecticut's state-sponsored college savings plan, from their Connecticut gross income in calculating income subject to state income tax. Single filers may deduct up to \$5,000 per year and joint filers up to \$10,000 per year, but taxpayers may carry forward any unused deductions for contributions on or after January 1, 2006 for the five following years as long as each deduction does not exceed the annual maximum. This new deduction is projected to result in a \$6.6 million revenue loss in FY 07 and a \$7.5 million loss in FY 08, providing tax benefit only to those taxpayers with sufficient income to make such tax-deductible contributions.

<sup>6</sup> Institute on Taxation and Economic Policy, *Who Pays?* (January 2003), available at: [www.itepnet.org/whopays.htm](http://www.itepnet.org/whopays.htm). Note, this report relies on data that pre-dates various tax changes enacted beginning in FY 02 to address our deficit. ITEP expects to release updated numbers in the near future.

Discouraging cigarette smoking is a worthy public health goal and research shows that increases in the cost of cigarettes *are* associated with a decline in smoking (particularly among low-income persons, including youth).

There are, however, some problems with relying on cigarette taxes as a major source of revenue in state budgets:<sup>7</sup>

- Cigarette tax revenues will decline over time as more persons stop smoking; they are not a stable and adequate revenue stream to fund program in state budgets whose costs *increase* over time.
- The tax falls most heavily on low income persons because smoking is more prevalent among low income persons. One 1995 study of smoking behavior found that 29% of persons with family incomes under \$15,000/year smoked, and 27% of persons with family incomes between \$15,000 and \$25,000/year, compared to just 17% of persons with family incomes over \$50,000. Of course, to the extent low income persons *stop* smoking because of rising cigarette taxes, there will be cost-savings to publicly-funded health insurance programs like Medicaid which provide health care to low-income persons through averted cases of lung cancer and other smoking and tobacco-related illnesses.
- The tax is regressive, in that a larger share of the income of low-income persons is spent on cigarettes than of higher income persons.

To offset the regressive character of this tax, its enactment should be coupled with enactment of a refundable EITC, which would make our tax code more progressive.

**4. Connecticut should join the many states that are conforming their sales and use taxes to the requirements of the Streamlined Sales and Use Tax Agreement to facilitate collection of sales and use taxes that are due to Connecticut.** It is not clear that further study of this issue, as the Governor proposes, is necessary. The weight of evidence suggests that Connecticut should conform its laws to the requirements of the Streamlined Sales and Use Tax Agreement (SSUTA) and become a SSUTA member state, so we can begin to stem the substantial – and increasing – loss of sales tax revenues resulting from e-commerce/Internet and mail order/catalog sales, and protect our home-town retailers.

As of a year ago, according to an OLR report,<sup>8</sup> of the 45 states with sales taxes, 21 had already adopted the legislation needed to comply with the Agreement and have or will become SSUTA members. Another 22 states had adopted legislation that allows them to conclude multi-state tax agreements to implement the SSUTA's goals. The latter states have not applied for formal membership and have not changed their state laws to comply with the agreement. Connecticut is one of two states with a sales tax that has done neither. With a structural deficit looming, Connecticut cannot afford to forgo more than \$500 million in sales and use tax revenues.

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<sup>7</sup> For a comprehensive summary of these points, see I. Lav, *Cigarette Tax Increases: Cautions and Considerations* (Center on Budget and Policy Priorities, July 1, 2002), available at [www.cbpp.org](http://www.cbpp.org).

<sup>8</sup> J. Lohman, *Streamlined Sales and Use Tax Agreement* (Office of Legislative Research, 2006-R-0558)(March 19, 2006)