



STEPS TO A FAIRER TAX SYSTEM: **PROPOSALS FOR TAX REFORM,** **TRANSPARENCY, AND TIMELY SUPPORT**

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CONNECTICUT
VOICES
FOR CHILDREN

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GLOSSARY

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.

Effective tax rate is the total amount of taxes that a family pays as a percentage of its income.

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

Fair tax system either, at minimum, requires all families to pay the same percentage of their income in taxes (i.e., a proportional tax system) or, ideally, requires upper-class families and the wealthiest to pay a higher percentage of their income in taxes than working- and middle-class families (i.e., a progressive tax system). It also generally requires tax transparency.

Income is the flow of money that a family receives over a given period of time, and it is derived from an array of sources, including salaries and wages, business income, rental income, investment income, and government transfers.

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.

Middle-class family is a family in the 50th to 90th percentile of the income distribution.

Racial income gap is the difference in income among populations grouped by race or ethnicity.

Refundable tax credit is paid to a tax filer regardless of their tax liability.

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.

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.

Tax exemption indirectly reduces a tax filer's liability by reducing their taxable income.

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.

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

Tax incidence is the tax burden on families after businesses have shifted their own tax liability.

Tax liability is the tax owed by a family or business to the government.

Tax reform is shifting the disproportionate tax burden on working- and middle-class families to the wealthy.

Tax transparency is knowing the necessary amount of the disproportionate tax burden to shift, the impact of proposed and passed tax legislation, and the size of the tax gap.

Timely support is providing working- and middle-class families the option of receiving refundable tax credits in installments.

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).

Wealthy family is a family in the top one percent of the income distribution.

Working-class family is a family in the bottom 50 percent of the income distribution.



INTRODUCTION

Last year in Connecticut, half of the state’s families had difficulty paying their usual expenses (e.g., food, housing, utilities). The percentage of families struggling was even higher for certain subgroups, especially working-class and lower-middle-class families (77 percent and 55 percent), Black and Latino families (65 percent and 70 percent), and families with children (62 percent).¹

Although Connecticut has the second highest level of per capita personal income in the U.S., making it exceptionally wealthy overall, many families consistently struggle because Connecticut also has the second highest level of income inequality and a substantial racial income gap, meaning a small, disproportionately white portion of the population primarily benefits from the state’s overall wealth. Specifically, in the immediate term, income inequality and the racial income gap make it difficult for working- and middle-class families, especially families of color, to make ends meet; and over time, through both the “investment” and “stress” pathways, income inequality and the racial income gap negatively impact the children from working- and middle-class families, especially families of color, in “virtually every dimension, from physical and mental health, to educational attainment and labor market success, to risky behaviors and delinquency.”² These problems in turn weaken Connecticut’s economy and thereby decrease the state’s ability to pay down long-term obligations and make critical investments, which is especially important due the state’s below-average level of economic growth and above-average level of long-term obligations.³

At least three features of Connecticut’s approach to taxation contribute to the above problems. First, establishing a fairer tax system through tax reform involves shifting the current disproportionate tax burden on working- and middle-class families to the wealthy so that the tax system either has no impact on income inequality and the racial income gap or reduces both. However, rather than adopt that approach, Connecticut’s fiscal year 2022–23 budget maintains an unfair tax system, meaning it continues to exacerbate income inequality and the racial income gap. For example, although a majority of working- and middle-class families struggled to pay their usual expenses last year due in part to their higher effective state and local tax rate compared to the wealthy, the new budget failed to incorporate a state child tax credit that would have reduced those families’ tax burden by up to \$600 per child. Also troubling, the budget included a mix of extended and built-in tax increases on working- and middle-class families notwithstanding the general belief that the budget did not include a “broad-based tax increase.”⁴

Extended tax increases on working- and middle-class families. An extended tax increase is simply a tax increase (or tax credit reduction) that would have expired had policymakers not extended it. For example, when applying the state’s official assessment of who ultimately pays each tax (i.e., the tax incidence report), three policies in the new budget—renewing the corporation business surtax, delaying the phase out of the capital base tax, and renewing the limit on the property tax credit—operate together as a \$75 million tax increase on working- and middle-class families in FY 2022. This more than offsets the small tax cuts included in the budget as well as the expansion of the Connecticut earned income tax credit, which was an important but insufficient step.⁵

Built-in tax increase on working- and middle-class families. A built-in tax increase is a tax increase that occurs automatically due to the design of the tax system, and it generally works in conjunction with inflation, which is an increase in the price of goods and services that decreases the purchasing power of money. Based on one leading measure, prices were 7 percent higher in 2021 compared to a year earlier, making it the largest 12-month increase since 1982, or nearly a decade before the creation of Connecticut’s broad-based income tax in 1991. This high level of inflation harms working- and middle-class families in one of two ways. Either it decreases the purchasing power of their income, or if their income increases to keep up with inflation, that nominal increase in income increases their income tax burden because Connecticut’s income tax is not indexed to inflation. The cumulative impact of this built-in, or hidden, annual tax increase is substantial. For example, the average middle-class family in Connecticut currently pays about \$4,200 a year in the state income tax, but that family would pay only about \$1,800—or \$2,400 less—if policymakers had initially inflation indexed the income tax in 1991.⁶

The second problematic feature of Connecticut’s approach to taxation is *insufficient tax transparency*, which, at minimum, requires knowing the necessary amount of the disproportionate tax burden to shift, the impact of proposed and passed tax legislation, and the size of the tax gap. Consider below the impact of all three components on the budget-making process during the past legislative session.

Outdated estimate of the current tax incidence. Before developing tax proposals for the FY 2022–23 budget, policymakers in Connecticut relied upon an increasingly out of date tax incidence report, meaning, even if they desired to establish a fair tax system, they did not know the precise amount of the current disproportionate tax burden on working- and middle-class families to shift to the wealthy.⁷

No estimate of the tax incidence for proposed and passed legislation. Before voting on tax proposals, the Office of Fiscal Analysis provided policymakers a fiscal note that included a revenue estimate but no tax incidence estimate, meaning there was no assessment of whether the proposals would make the tax system less fair by increasing the burden on working- and middle-class families or more fair by decreasing their burden. There was also no tax incidence estimate once the budget passed. This lack of tax transparency together with the complexity of the tax system reinforced the general belief that the budget was balanced without a “broad-based tax increase” even though, as noted, the budget actually included a mix of extended and built-in tax increases on working- and middle-class families.⁸

No estimate of the current tax gap. The primary opposition to tax reform is not cutting taxes for working- and middle-class families but rather raising taxes on the wealthy to offset the former. One solution is to fund tax reform by decreasing Connecticut’s income tax gap, which is the difference between the income tax owed to the government and the income tax actually paid. According to the Internal Revenue Service (IRS), the federal income tax gap is due largely to both the underreporting of “opaque income sources that accrue disproportionately to higher earners” and the IRS’s limited, decreasing resources for ensuring tax compliance. Unlike the federal government and some states, Connecticut does not provide an estimate of its own income tax gap. However, if we apply the IRS’s current estimate of the federal tax gap to Connecticut—a reasonable starting point given the state’s above-average reliance on “opaque income sources that accrue disproportionately to higher

earners” and the substantial reduction in the Department of Revenue Services’s staff over the last two decades—the estimated total tax gap in Connecticut is \$3.1 billion and the estimated income tax gap component is \$2.6 billion. Reducing Connecticut’s income tax gap is therefore potentially sufficient to fully fund the reforms necessary to make the tax system fairer, but developing and implementing such a program requires knowing the size of the income tax gap and the state’s capacity to reduce it.⁹

The third problematic feature of Connecticut’s approach to taxation is the *lack of timely support*, which involves providing working- and middle-class families the option of receiving refundable tax credits in installments. Currently, eligible families receive the Connecticut earned income tax credit (CT EITC) in a single payment after filing their tax return. For example, the average working-class family with two children receives about \$1,800 from the CT EITC and would receive a total of about \$2,700 if Connecticut passed the state child tax credit (CT CTC) included in the Finance, Revenue, and Bonding Committee’s revenue package last year. This is a substantial level of financial support—equivalent to nearly 12 percent of the above family’s pre-tax income—and the objective is to offset the state’s highly regressive taxes, such as the sales tax, which is paid throughout the year when purchasing goods and services, and the property tax, which homeowners pay directly and renters pay indirectly throughout the year. The effectiveness of the state’s financial support, however, is diminished if a family pays a substantial amount in bank overdraft fees or relies upon high-interest loans to make ends meet while waiting for an annual tax refund. This is not an insignificant concern. As noted, the majority of working- and lower-middle-class families in Connecticut struggled to pay their usual expenses last year. This occurred even as the majority of working- and middle-class families in Connecticut that received monthly federal Advance CTC payments—the federal government’s adoption of timely support in 2021—mostly spent those payments on usual expenses. These simultaneous developments demonstrate that timely support in general is helpful and that timely support at the federal level is not a sufficient substitute for timely support at the state level.¹⁰

Altogether, the problems reviewed here show that making Connecticut’s tax system fairer requires tax reform, transparency, and timely support, and that, in simple terms, a fairer tax system would put more money in the pockets of working- and middle-class families, especially families of color. More specifically, in the immediate term, a fairer tax system would reduce income inequality and the racial income gap, which would help working- and middle-class families, especially families of color, make ends meet; over time, it would benefit the children from working- and middle-class families, especially families of color, in “virtually every dimension” of life through both the “investment” and “stress” pathways; and those developments in turn would strengthen Connecticut’s economy, thereby increasing the state’s ability to pay down long-term obligations and make critical investments.

To explain the above process, this report proceeds in five sections. The first section provides an overview of income inequality and its negative impact. The second section provides an overview of Connecticut’s unfair tax system and proposals to reform it. The third section provides an overview of Connecticut’s tax transparency problem and proposals to increase tax transparency. The fourth section provides an overview of Connecticut’s tax credit payment problem and proposals for timely support. The fifth section provides a recommended program of tax reform, transparency, and timely support.



AN OVERVIEW OF INCOME INEQUALITY AND ITS NEGATIVE IMPACT

This section provides an overview of income inequality and its negative impact. In particular, it updates and expands the similar analysis in our last report on tax reform, and it proceeds in three parts. The first part provides both a historical overview of income inequality in the U.S. as a whole and a current overview of income inequality across the states. The second part provides a current overview of income inequality in Connecticut. The third part provides an overview of the negative impact of income inequality.¹¹

The following is a summary of the key findings:

A Historical and 50-State Overview of Income Inequality

Income inequality has been rising for several decades in the United States, and Connecticut has the second highest level out of all 50 states during this period of historic income inequality.

Income Inequality in Connecticut

The average wealthy family in Connecticut has a pre-tax income of nearly \$3.1 million. Moreover, the focus on the top one percent (i.e., average wealthy family) rather than the top 0.1 percent or top 0.01 percent significantly understates the level of income inequality due to the exponential increase in income at the top of the distribution.

In comparison to the average wealthy family, the average working-class family in Connecticut has a pre-tax income of about \$22,500 and the average middle-class family has a pre-tax income of about \$97,400.

A substantial racial income gap further exacerbates income inequality for families of color, which disproportionately fall into the working class. Specifically, the median Black and Latino households have pre-tax incomes of about \$49,000, compared to a pre-tax income of about \$86,000 for the median white household.

The Negative Impact of Income Inequality

Income inequality negatively impacts children in working- and middle-class families, especially those in the poorest families, in “virtually every dimension, from physical and mental health, to educational attainment and labor market success, to risky behaviors and delinquency.” This occurs through both the “investment” and “stress” pathways.

Income inequality also negatively impacts the economy, which decreases a state’s ability to pay down long-term obligations and make critical investments. This is especially important in Connecticut due to its below-average level of economic growth and above-average level of long-term obligations.

A Historical and 50-State Overview of Income Inequality

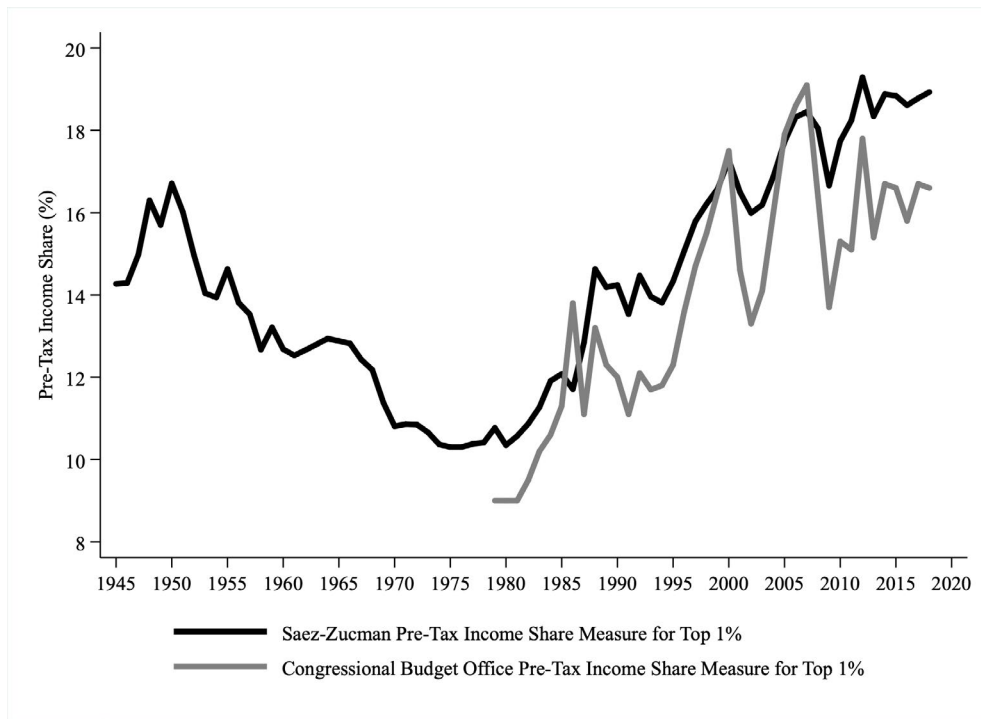
Income inequality has been rising for several decades in the United States. The Congressional Budget Office (CBO) is a nonpartisan agency that provides the federal government’s leading analysis of income inequality in an annual report titled “The Distribution of Household Income.” In the 2021 edition—which examines the period from 1979 through 2018, the most recent year available at the federal level—the CBO explains, “Between 1979 and 2018, average income, both before and after means-tested transfers and federal taxes, grew for all quintiles (or fifths) of the distribution, but it increased most among households in the highest quintile.”

For a more detailed overview of pre-tax income inequality from 1979 to 2018, the CBO provides the following breakdown using real (inflation-adjusted) 2018 dollars: For the bottom 20 percent of households, pre-tax income increased from an average of \$16,100 to \$22,500, a total growth of 40 percent; and for the middle 60 percent of households, pre-tax income increased from an average of \$59,000 to \$80,800, a total growth of 37 percent. In contrast, for the top one percent of households, pre-tax income increased from an average of \$584,900 to \$2 million, a total growth of 242 percent; for the top 0.1 percent of households, pre-tax income increased from an average of \$1.3 million to \$5.8 million, a total growth of 332 percent; and for the top 0.01 percent of households, pre-tax income increased from an average of \$8.1 million to \$44.5 million, a total growth of 452 percent.

Using the data from the CBO’s analysis, **Figure 1** shows the increase in the share of pre-tax income going to the top 1 percent of households. The figure also includes one of the leading academic measures of income inequality, which is useful because it spans a considerably longer time frame. Although the precise estimates of income inequality differ across the two datasets due to their different research methodologies, the key finding is that income inequality has been rising for several decades.¹²

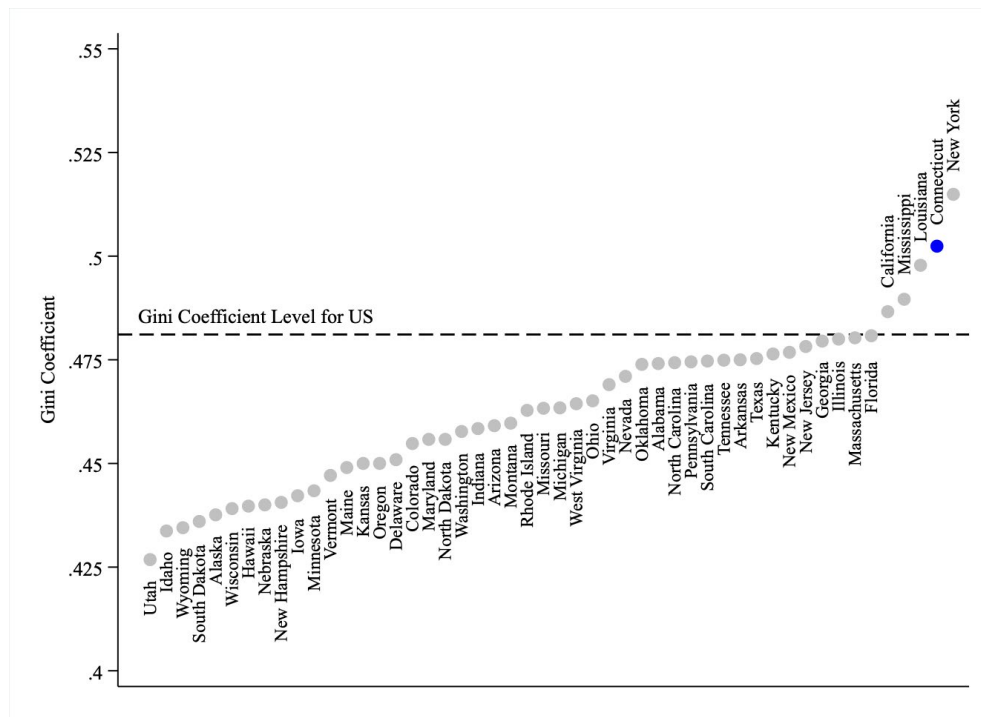
Connecticut has the second highest level of income inequality out of all 50 states during this period of historic income inequality in the U.S. as a whole. In addition to examining the pre-tax income share for the top one percent of households, the CBO explains that another “standard measure of income inequality is the Gini coefficient, which summarizes an entire distribution in a single number that ranges from zero to one. At the theoretical extremes, a value of zero means that income is distributed equally among all income groups, whereas a value of one indicates that all income is received by the highest-income group, and none is received by any of the lower-income groups.” Using this standard measure of income inequality for each state, **Figure 2** shows that in 2019—the most recent year available for a cross-state examination—Connecticut had a Gini coefficient of 0.502. This is the second highest level of income inequality at the state level and well above the level for the US as a whole.¹³

Figure 1. The Rise of Pre-Tax Income Inequality in the United States



*Data from Congressional Budget Office and Saez and Zucman.

Figure 2. Ranking of Pre-Tax Income Inequality at the State Level, 2019



*Data from US Census Bureau.

Income Inequality in Connecticut

To better understand the level of income inequality in Connecticut, **Table 1** shows the pre-tax income distribution in 2019, the most recent year data are available from the Department of Revenue Services (DRS). **Table 2** then provides a summary of four primary income groups: (1) the bottom 50 percent of the distribution, referred to as working-class families; (2) the next 40 percent of the distribution, referred to as middle-class families; (3) the next 9 percent of the distribution, referred to as upper-class families; and (4) the top one percent of the distribution, referred to as the wealthy. To be clear, the original DRS data come in 29 income rows, which are then divided into the four primary income groups, meaning the divisions here are as close as possible, but not exact. Also, the data combine all tax filers—single, head of household, married filing separately, and married filing jointly.¹⁴

The average wealthy family has a pre-tax income of nearly \$3.1 million. Using the top two income rows from the DRS data, we know that the top 0.7 percent of tax filers have an average federal adjusted gross income (AGI) of \$3.4 million a year and an average Connecticut AGI of \$3.5 million. Adding the data from the third highest income row, we estimate that the top one percent of tax filers have a federal AGI of \$3.0 million and CT AGI of \$3.1 million. The focus throughout this report is CT AGI because that is used to calculate the state and local tax burden.¹⁵

Focusing on the top one percent rather than the top 0.1 percent or top 0.01 percent significantly understates the level of income inequality due to the exponential increase in income at the top of the distribution. The top income row from the DRS data includes tax filers making more than \$2 million. This accounts for the top 0.3 percent of the income distribution and the average CT AGI is \$6.7 million, more than two-times greater than the average income for the top one percent. To further appreciate the exponential increase at the top of the distribution, **Figure 3** provides an overview of the average income for all 29 rows from the DRS data. However, even this analysis understates income inequality because it is capped at the average for top 0.3 percent and—as the CBO analysis showed—the top 0.1 percent and top 0.01 percent have exponentially higher average incomes.¹⁶

The average working-class family has a pre-tax income of about \$22,500 and the average middle-class family has a pre-tax income of about \$97,400. In comparison to the average wealthy family, which has a CT AGI of \$3.1 million, the average working-class family has a CT AGI of about \$22,500 and the average middle-class family has a CT AGI of about \$97,400. Put in relative terms, the average wealthy family's income is 137-times greater than the average working-class family's income and more than 31-times greater than the average middle-class family's income.¹⁷

A substantial racial income gap further exacerbates income inequality for families of color. Using data from the US Census Bureau, **Table 3** shows that in 2019 the median Black and Latino households in Connecticut both had a pre-tax income of about \$49,000, just above the cutoff for the working class. In comparison, the median white household had a pre-tax income of about \$86,000, which is solidly in the middle class. This substantial racial income gap—due to a mix of historical and ongoing discrimination—puts a disproportionate percentage of families of color into the working class.¹⁸

Table 1. Connecticut's Pre-Tax Income Distribution, 2019

Income	All Tax Filers		Income Group	Tax Filers by Group		Average Income by Group	
	#	Cumulative %		#	%	Federal AGI	CT AGI
Less than \$5,000	94,935	5.7%	Working Class	843,128	50.6%	\$24,500	\$22,500
\$5,000 to \$10,000	95,617	11.4%					
\$10,000 to \$12,000	40,890	13.9%					
\$12,000 to \$15,000	60,107	17.5%					
\$15,000 to \$19,000	76,796	22.1%					
\$19,000 to \$20,000	18,766	23.2%					
\$20,000 to \$24,000	74,988	27.7%					
\$24,000 to \$25,000	18,607	28.8%					
\$25,000 to \$30,000	90,079	34.2%					
\$30,000 to \$34,000	69,315	38.4%					
\$34,000 to \$35,000	16,625	39.4%					
\$35,000 to \$40,000	77,920	44.1%					
\$40,000 to \$44,000	56,212	47.4%	Middle Class	680,860	40.8%	\$101,500	\$97,400
\$44,001 to \$45,000	13,288	48.2%					
\$45,001 to \$48,000	38,983	50.6%					
\$48,001 to \$50,000	24,602	52.0%					
\$50,000 to \$60,000	105,861	58.4%					
\$60,000 to \$74,000	118,198	65.5%	Upper Class	131,078	7.9%	\$353,700	\$352,800
\$74,000 to \$75,000	7,411	65.9%					
\$75,000 to \$96,000	133,329	73.9%					
\$96,000 to \$100,000	20,570	75.2%					
\$100,001 to \$150,000	180,740	86.0%	Wealthy	12,197	0.7%	\$3,381,600	\$3,455,500
\$150,001 to \$200,000	90,149	91.4%					
\$200,001 to \$250,000	45,316	94.1%					
\$250,001 to \$350,000	40,627	96.6%					
\$350,001 to \$500,000	23,921	98.0%					
\$500,000 to \$1,000,000	21,214	99.3%					
\$1,000,001 to \$2,000,000	7,401	99.7%					
\$2,000,001 and over	4,796	100.0%					
					Top 1%	\$3,018,700	\$3,083,600

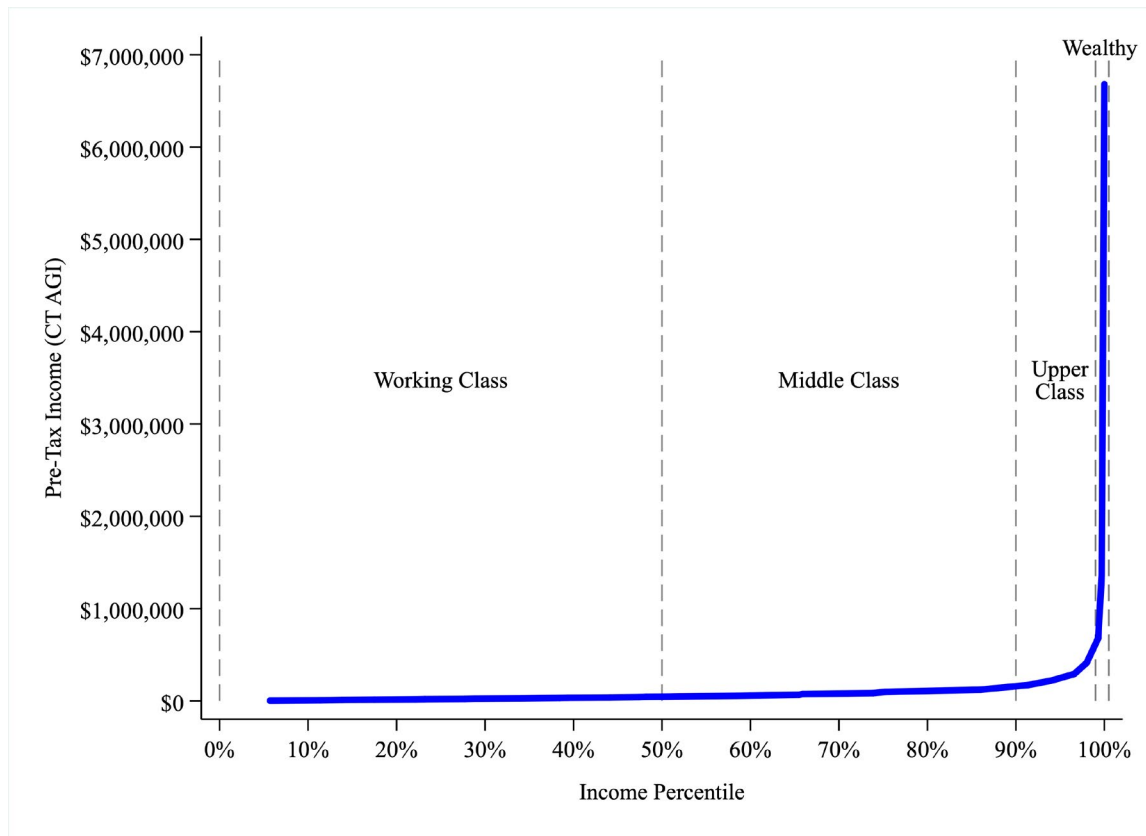
*Data from CT DRS and author's calculations. Average income rounded to nearest hundred.

Table 2. Income Inequality in Connecticut by Income Group, 2019

Income Group	Pre-Tax	
	Average Income	Inequality Ratio
Wealthy Family	\$3,083,600	-
Upper-Class Family	\$352,800	8.7x
Middle-Class Family	\$97,400	31.7x
Working-Class Family	\$22,500	137.0x

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

Figure 3. Overview of Connecticut's Pre-Tax Income Distribution, 2019



*Data from CT DRS and author's calculations.

Table 3. Income Inequality in Connecticut By Race and Ethnicity, 2019

Income Group / Household	Pre-Tax	
	Average Income	Inequality Ratio
Wealthy Family	\$3,083,600	-
Median White Household	\$85,800	35.9x
Median Latino Household	\$49,200	62.7x
Median Black Household	\$48,900	63.0x

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

The Negative Impact of Income Inequality

The National Academy of Sciences (NAS)—a nonprofit society of scholars charged with providing objective advice to the government—released a 600-plus-page, “evidenced-based report” in 2019 that reviewed the negative impact of poverty on children. Although poverty and income inequality are closely related, they are not identical. Poverty is when a family’s income is insufficient to provide a minimum standard of living and therefore generally involves families at the bottom of the income distribution, essentially a portion of working-class families. Income inequality contributes to poverty and involves the uneven distribution of income across the entire population—most notably, working- and middle-class families compared to the wealthy.

Building upon the approach employed in the NAS report, which examines the negative impact of poverty on a continuum that includes deep poverty, conventional poverty, and near poverty, the analysis here reviews the key findings in terms of the negative impact of income inequality on a continuum. For example, based on the federal poverty threshold, a family of four in Connecticut earning the average working-class income of \$22,500 lives in poverty and likely experiences many of the problems highlighted in the NAS report. To take another example, a family of four earning the median Black household income of \$49,000 makes the cutoff for the middle class in Connecticut, but the family’s income falls below 200 percent of the poverty threshold, meaning the family likely has little economic security and its children likely experience to a reduced degree many of the same problems as children living in poverty, similar to how children living in poverty experience to a reduced degree many of the same problems as children living in deep poverty.¹⁹

The following is an overview of several key findings from the NAS report:

Income inequality negatively impacts children in working- and middle-class families, especially those in the poorest families, in “virtually every dimension, from physical and mental health, to educational attainment and labor market success, to risky behaviors and delinquency.” Based on an extensive review of “research on the linkages between children’s poverty and their childhood health and education as well as their later employment, criminal involvement, and health as adults”—and giving the greatest weight to “the most methodologically sound and prominent studies in key fields, primarily in developmental psychology, medicine, sociology, and economics”—the NAS report concludes,

We find overwhelming evidence from this literature that, on average, a child growing up in a family whose income is below the poverty line experiences worse outcomes than a child from a wealthier family in virtually every dimension, from physical and mental health, to educational attainment and labor market success, to risky behaviors and delinquency.²⁰

For a more detailed breakdown, the review of the leading research is divided into correlational studies and causal studies. Regarding the correlational studies, the NAS report explains,

[M]any studies show significant associations between poverty and child maltreatment, adverse childhood experiences, increased material hardship, worse physical health, low birth weight, structural changes in brain development, mental health problems, decreased educational attainment, and increased risky behaviors, delinquency, and criminal behavior in adolescence and adulthood. As for the timing and severity of poverty, the literature documents that poverty in early childhood, prolonged poverty, and deep poverty are all associated with worse child and adult outcomes.²¹

Regarding the causal studies, the NAS report explains that “the weight of the ... evidence indicates that income poverty itself *causes* negative child outcomes, especially when it begins in early childhood and/or persists throughout a large share of a child’s life.”²²

Income inequality negatively impacts children in working- and middle-class families, especially those in the poorest families, through both the “investment” and “stress” pathways. Addressing the two major pathways through which income inequality negatively impacts children, the NAS report explains,

Economists, sociologists, developmental psychologists, and neuroscientists each emphasize different ways poverty may influence children’s development. Two main mechanisms have been theorized to describe these processes. One emphasizes what money can buy—in other words, how poverty undermines parents’ ability to procure the goods and services that enhance children’s development. An alternative mechanism emphasizes the detrimental impact on families of exposure to environmental stressors as a key pathway by which poverty compromises children’s development. ...

An “investment” perspective may be adopted in addressing the challenge of poverty reduction by building on an analysis of the foregoing problems, emphasizing that higher income may support children’s development and well-being by enabling poor parents to meet such basic needs. As examples, higher incomes may enable parents to invest in cognitively stimulating items in the home (e.g., books, computers), in providing more parental time (by adjusting work hours), in obtaining higher-quality non-parental child care, and in securing learning opportunities outside the home (Bornstein and Bradley, 2003; Fox et al., 2013; Raver, Gershoff, and Aber, 2007). Children may also benefit from better housing or a move to a better neighborhood. Studies of some poverty alleviation programs find that these programs can reduce material hardship and improve children’s learning environments (Huston et al., 2001; Morris, Gennetian, and Duncan, 2005).

The alternative, “stress” perspective on poverty reduction focuses on the fact that economic hardship can increase psychological distress in parents and decrease their emotional well-being. Psychological distress can spill over into marriages and parenting. As couples struggle to make ends meet, their interactions may become more conflicted (Brody et al., 1994; Conger et al., 1994). Parents’ psychological distress and conflict have in fact been linked with harsh, inconsistent, and detached parenting. Such lower-quality parenting may harm children’s

cognitive and socioemotional development (Conger et al., 2002; McLoyd, 1990). All of this suggests that higher income may improve child well-being by reducing family stress.

Investing in children and relieving parental stress are two different mechanisms, but they overlap and reinforce each other. For example, both increased economic resources and improved parental mental health and family routines may result in higher-quality child care, more cognitively enriching in-home and out-of-home activities, and more visits for preventive medical or dental care. Better child development, in turn, can encourage more investment and better parenting; for example, more talkative children may trigger more verbal interaction and book reading from their parents, especially if parents can afford to spend the necessary time.²³

Income inequality negatively impacts the economy. Addressing the relationship between income inequality and the economy, the NAS report explains,

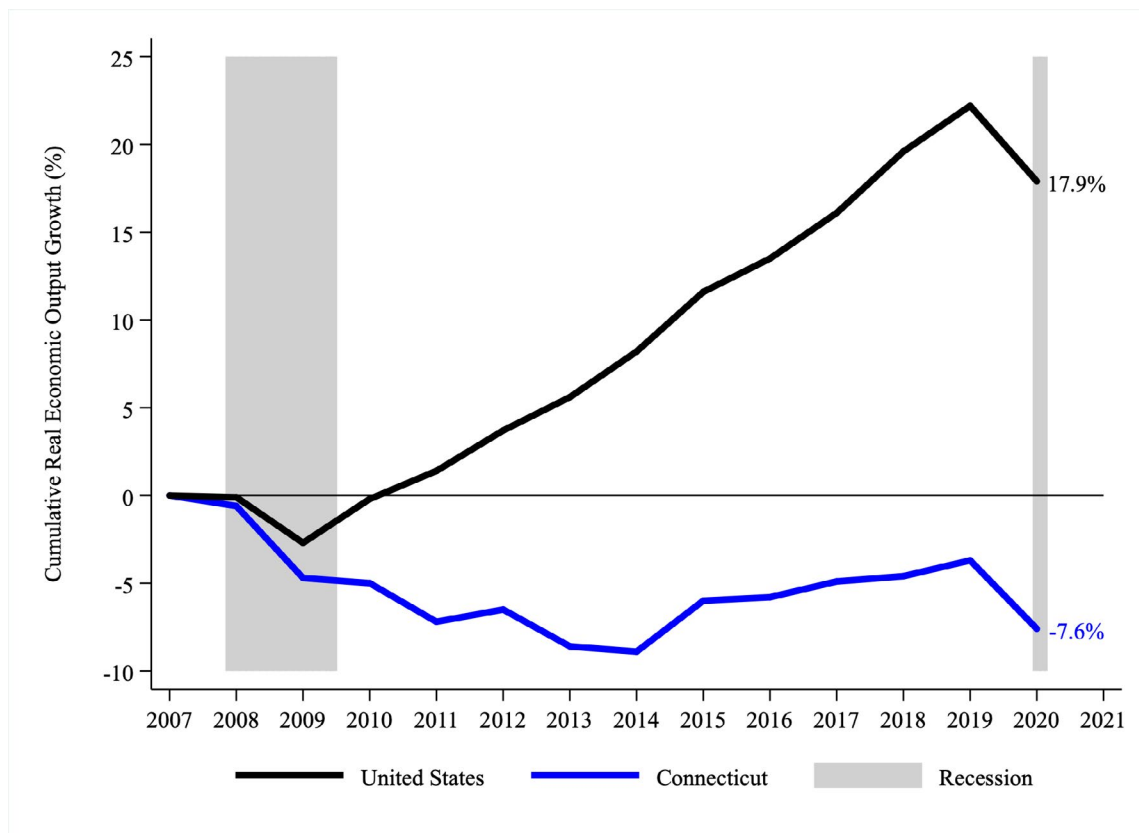
The first element of the committee’s Statement of Task also calls for a review of evidence on the macroeconomic costs of child poverty in the United States. Procedures for estimating these costs are very different from the experimental and quasi-experimental methods adopted in studies of the microeconomic costs of poverty, reviewed above. Holzer et al. (2008) base their cost estimates on the correlations between childhood poverty (or low family income) and outcomes across the life course, such as adult earnings, participation in crime, and poor health. ... The bottom line of the Holzer and colleagues (2008) estimates is that the aggregate cost of conditions related to child poverty in the United States amounts to \$500 billion per year, or about 4 percent of the Gross Domestic Product (GDP). The authors estimate that childhood poverty reduces productivity and economic output in the United States by \$170 billion per year, or by 1.3 percent of GDP; increases the victimization costs of crime by another \$170 billion per year, or by 1.3 percent of the GDP; and increases health expenditures, while decreasing the economic value of health, by \$163 billion per year, or by 1.2 percent of GDP.

McLaughlin and Rank (2018) build on the work of Holzer and colleagues (2008) by updating their estimates in 2015 dollars and adding other categories of the impact of childhood poverty on society. They include increased corrections and crime deterrence costs, increased social costs of incarceration, costs associated with child homelessness (such as the shelter system), and costs associated with increased childhood maltreatment in poor families (such as the costs of the foster care and child welfare systems). Their estimate of the total cost of childhood poverty to society is over \$1 trillion, or about 5.4 percent of GDP. This compares to the approximately 1 percent of GDP constituted by direct federal expenditures on children (Isaacs et al., 2018).

These calculations ... make it clear that there is considerable uncertainty about the exact size of the costs of child poverty. Nevertheless, whether these costs to the nation amount to 4.0 or 5.4 percent of GDP—roughly between \$800 billion and \$1.1 trillion annually in terms of the size of the U.S. economy in 2018—it is likely that significant investment in reducing child poverty will be very cost-effective over time.²⁴

The negative impact of income inequality on the economy is especially important in Connecticut due to its below-average level of economic growth and above-average level of long-term obligations. Economic growth is important because it increases the tax base and thereby strengthens a state's ability both to pay down long-term obligations (i.e., debt and unfunded pension liabilities) and to make critical investments. This process is especially important in Connecticut due to the state's below-average level of economic growth and above-average level of long-term obligations. More specifically, as **Figure 4** shows and as one of our recent report explains in detail, the US economy grew in real (or inflation-adjusted) terms by 17.9 percent from the Great Recession of 2007–09 through the pandemic-induced recession of 2020. In contrast, Connecticut's economy contracted by 7.6 percent, which was the second worst economic performance out of all 50 states during this period and contributed to a 25.5 percentage point economic growth gap compared to the US as a whole.²⁵

Figure 4. Cumulative Real Economic Growth, 2007–2020



*Data from the US Bureau of Economic Analysis.



MAKING CONNECTICUT'S TAX SYSTEM FAIRER THROUGH TAX REFORM

The preceding section showed that Connecticut has a historic level of income inequality and a substantial racial income gap that harms working- and middle-class families, especially families of color, which in turn harms the economy. This section first shows how Connecticut's unfair tax system exacerbates those problems and then provides proposals to make the tax system fairer. In particular, the analysis updates the overview of Connecticut's unfair tax system included in our last report, it expands the selection of tax reform proposals, and it proceeds in four parts. The first part provides an overview of the three types of tax systems. The second part provides an overview of the impact of Connecticut's unfair—or regressive—tax system as a whole. The third part provides an overview of the impact of fairer—or proportional and progressive—tax systems. The fourth part provides an overview of problems with Connecticut's income tax and proposals to reform it.²⁶

The following is a summary of the key findings:

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

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

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.

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.

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.

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.

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
- 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:

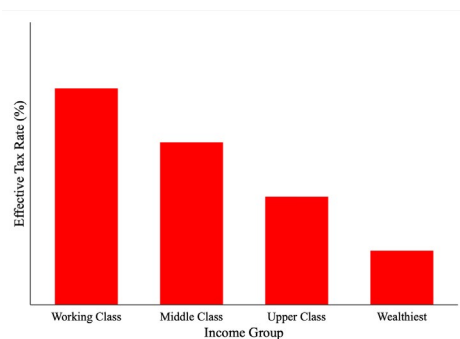
- Increase the current top tax rate that applies to single filers making more than \$500,000 and married filers making more than \$1 million
- Add a new top tax rate that would only apply to even wealthier families (e.g., single filers making more than \$1 million and married filers making more than \$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 Three Types Of Tax Systems

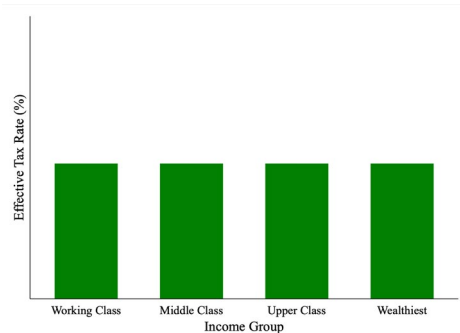
A family's effective tax rate is the total amount of taxes that it pays as a percentage of its income. Variation in this key rate across income groups reveals three basic types of tax systems. As **Figure 5** shows, a regressive tax system requires working- and middle-class families to pay a higher percentage of their income in taxes than upper-class families and the wealthiest families, a proportional tax system requires all families to pay the same percentage of their income in taxes, and a progressive tax system requires upper-class families and the wealthiest families pay a higher percentage of their income in taxes than working- and middle-class families.

Support for a progressive tax system is based on the principle of “ability to pay,” which maintains that the key factor of tax policy is not the dollar amount that a family pays but rather the burden imposed as a percentage of the family's income.

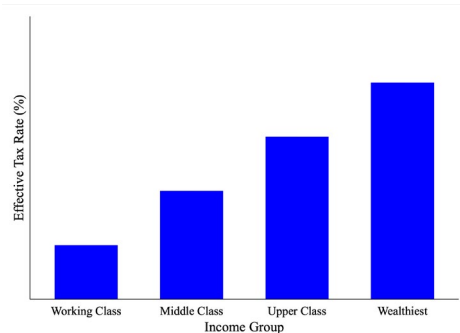
Figure 5. The Three Types of Tax Systems



A **regressive 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 families.



A **proportional tax system** requires all families to pay the same percentage of their income in taxes.



A **progressive tax system** requires upper-class families and the wealthiest families to pay a higher percentage of their income in taxes than working- and middle-class families.

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

The Connecticut Department of Revenue Services (DRS) released a tax incidence report in 2014 showing that Connecticut's state and local tax system as a whole is regressive, meaning it requires working- and middle-class families to pay a higher percentage of their income in taxes than the wealthiest families. The 2014 report (the most recent to date) uses income tax data from 2011 (updated here to 2019 dollars to match the 2019 tax filing data), and it presents the overall findings in two ways: by income deciles (each decile has an equal share of CT AGI) and by population deciles (each decile has an equal share of households). **Table 4** shows the effective tax rates for both approaches. For the income deciles approach, the effective tax rate decreases from 23.6 percent for the lowest decile to 6.3 percent for the highest decile. For the population deciles approach, the effective tax rate decreases from 26.6 percent for the second-lowest decile to 8.2 percent for the highest decile. The latter approach does not include a tax rate for the lowest decile because, as the report explains, it “reflects an overstated value resulting from Connecticut residents who file federal but not state income tax returns.”²⁷

Using the DRS data and incorporating the four income groups as well as the racial and ethnic groups reviewed earlier, **Table 5** shows the impact of Connecticut's regressive tax system. The two key findings are reviewed below:

Connecticut's regressive tax system exacerbates income inequality. The average wealthy family in Connecticut has a pre-tax income of \$3.1 million, which is 137-times greater than the pre-tax income of \$22,500 for the average working-class family. Exacerbating that high level of income inequality, the average wealthy family has an effective state and local tax rate of 6.5 percent, whereas the average working-class family has an effective state and local tax rate of 18.37 percent. As a result, the wealthy family has a post-tax income that is more than 157-times greater than the post-tax income of the working-class family, a nearly 20 point increase in the income inequality ratio. A similar process occurs for the average wealthy family compared to the average middle-class family: the income inequality ratio increases from 31.6-times greater before taxes to 34.1 times-greater after taxes, a 2.5 point increase in the income inequality ratio.²⁸

Connecticut's regressive tax system exacerbates the racial income gap. The average wealthy family in Connecticut has a pre-tax income of \$3.1 million, which is 63-times greater than the pre-tax income of \$48,900 for the median Black household. Exacerbating that high level of income inequality that includes a substantial racial income gap, the average wealthy family has an effective state and local tax rate of 6.5 percent, whereas the median Black household had an effective state and local tax rate of 14.7 percent. As a result, the wealthy family has a post-tax income that is more than 69-times greater than the post-tax income of the median Black household, a more than six point increase in the income inequality ratio. In comparison, the regressive state and local tax system increases the income inequality ratio by three points for the median white household, which has an effective state and local tax rate of 13.7 percent.²⁹

Table 4. Effective State and Local Tax Rate by Income and Population Deciles

Income Decile	CT Adjusted Gross Income (in 2011 dollars)	CT Adjusted Gross Income (updated to 2019 dollars)	Effective Tax Rate
1	\$0 to \$47,948	\$0 to \$54,622	23.62%
2	\$47,949 to \$74,427	\$54,623 to \$84,786	13.93%
3	\$74,428 to \$101,827	\$84,787 to \$116,000	13.35%
4	\$101,828 to \$134,527	\$116,001 to \$153,251	12.87%
5	\$134,528 to \$182,087	\$153,252 to \$207,430	11.93%
6	\$182,088 to \$287,629	\$207,431 to \$327,662	10.53%
7	\$287,630 to \$612,040	\$327,663 to \$697,226	9.03%
8	\$612,041 to \$2,019,383	\$697,227 to \$2,300,447	7.69%
9	\$2,019,384 to \$13,194,828	\$2,300,448 to \$15,031,324	6.50%
10	\$13,194,829 and up	\$15,031,325 and up	6.28%

Population Decile	CT Adjusted Gross Income (in 2011 dollars)	CT Adjusted Gross Income (updated to 2019 dollars)	Effective Tax Rate
1	\$0 to \$5,532	\$0 to \$6,302	Not provided
2	\$5,533 to \$16,245	\$6,303 to \$18,506	26.62%
3	\$16,246 to \$26,511	\$18,507 to \$30,201	18.37%
4	\$26,512 to \$37,419	\$30,202 to \$42,627	15.67%
5	\$37,420 to \$50,198	\$42,628 to \$57,185	14.72%
6	\$50,199 to \$64,971	\$57,186 to \$74,014	13.99%
7	\$64,972 to \$84,935	\$74,015 to \$96,757	13.66%
8	\$84,936 to \$112,904	\$96,758 to \$128,618	13.30%
9	\$112,905 to \$165,393	\$128,619 to \$188,413	12.38%
10	\$165,394 and up	\$188,414 and up	8.18%

*Data from CT DRS and author's calculations.

Table 5. 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

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

To further understand the impact of different tax systems, the following is an overview of Minnesota’s near proportional state and local tax system as well as Minnesota’s progressive state tax system, which is the primary component of its overall near proportional state and local tax system. Minnesota is used here as example due to both the distributional design of its tax system and, as addressed in the next section, the state’s high level of tax transparency.

The Impact of a Near Proportional Tax System

Table 6 incorporates Connecticut’s income distribution and the effective tax rates under Minnesota’s near proportional state and local tax system. The two key finds are reviewed below:

A near proportional tax system would have no or little impact on income inequality. Connecticut’s regressive tax system increases the income inequality ratio by nearly 20 points for the average working-class family and 2.5 points for the average middle-class family. In contrast, Minnesota’s near proportional tax system—if implemented in Connecticut—would have no impact on the income inequality ratio for the average working-class family and it would have almost no impact on the income inequality ratio for the average middle-class family.³⁰

A near proportional tax system would have no or little impact on the racial income gap. Connecticut’s regressive tax system increases the income inequality ratio by more than six points for the median Black household compared to three points for the median white household. In contrast, Minnesota’s near proportional tax system—if implemented in Connecticut—would increase the income inequality ratio by only 0.2 points for the median Black household and 0.3 points for the median white household.³¹

Table 6. The Impact of a Near Proportional Tax System

Applying Minnesota’s State and Local Tax System to Connecticut’s Income Distribution

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	-	11.60%	\$2,725,900	-	-
Upper-Class Family	\$352,800	8.7x	11.90%	\$310,800	8.8x	+0.1
Middle-Class Family	\$97,400	31.7x	12.10%	\$85,600	31.8x	+0.1
Working-Class Family	\$22,500	137.0x	11.50%	\$19,900	137.0x	0.0
Wealthy Family	\$3,083,600	-	11.60%	\$2,725,900	-	-
Median White Household	\$85,800	35.9x	12.10%	\$75,400	36.2x	+0.3
Median Latino Household	\$49,200	62.7x	11.80%	\$43,400	62.8x	+0.1
Median Black Household	\$48,900	63.0x	11.80%	\$43,100	63.2x	+0.2

*Data from CT DRS, US Census Bureau, Minnesota Department of Revenue, and author’s calculations. Average income rounded to nearest hundred.

To be clear, Minnesota’s state and local tax system is near proportional rather than exactly. An exactly proportional tax system would have no impact on income inequality and the racial income gap. However, even if policymakers prefer a proportional tax system over a regressive tax system, it is difficult to have an exactly proportional tax system every year because effective tax rates vary based on both the statutory design of tax laws and the distribution of income, the latter of which varies in part based on economic business cycles.

Also important, although a proportional tax system would have no absolute impact on income inequality and the racial income gap, moving to a proportional tax system would reduce income inequality and the racial income gap relative to the level under a regressive tax system.

The Impact of a Progressive Tax System

Table 7 incorporates Connecticut’s income distribution and the effective tax rates under Minnesota’s progressive state-level tax system. The two key findings are reviewed below:

A progressive tax system would reduce income equality. Connecticut’s regressive tax system increases the income inequality ratio by nearly 20 points for the average working-class family and 2.5 points for the average middle-class family. In contrast, Minnesota’s progressive tax system—if implemented in Connecticut—would reduce the income inequality ratio by five points for the average working-class family and nearly one point for the average middle-class family.³²

A progressive tax system would reduce the racial income gap. Connecticut’s regressive tax system increases the income inequality ratio by more than six points for the median Black household compared to three points for the median white household. In contrast, Minnesota’s progressive tax system—if implemented in Connecticut—would reduce the income inequality ratio by nearly two points for the median Black household and nearly one point for the median white household.³³

Table 7. The Impact of a Progressive Tax System
Applying Minnesota’s State-Level Tax System to Connecticut’s Income Distribution

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	-	10.10%	\$2,772,200	-	-
Upper-Class Family	\$352,800	8.7x	9.10%	\$320,700	8.6x	-0.1
Middle-Class Family	\$97,400	31.7x	8.30%	\$89,300	31.0x	-0.7
Working-Class Family	\$22,500	137.0x	6.50%	\$21,000	132.0x	-5.0
Wealthy Family	\$3,083,600	-	10.10%	\$2,772,200	-	-
Median White Household	\$85,800	35.9x	8.00%	\$78,900	35.1x	-0.8
Median Latino Household	\$49,200	62.7x	7.40%	\$45,600	60.8x	-1.9
Median Black Household	\$48,900	63.0x	7.40%	\$45,300	61.2x	-1.8

*Data from CT DRS, US Census Bureau, Minnesota Department of Revenue, and author’s calculations. Average income rounded to nearest hundred.

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

At minimum, a fairer tax system in Connecticut would not exacerbate income inequality and the racial income gap; and, ideally, it would reduce income inequality and the racial income gap, especially when taking into account the exceptionally high level of pre-tax inequality in the state. Establishing such a tax system requires tax reform, which involves shifting the current unfair tax burden on working- and middle-class families to the wealthy.

Based on the income distribution in Connecticut reviewed earlier, working- and middle-class families are those that make \$200,000 or less a year, approximately the bottom 90 percent of tax filers, and wealthy families are those that make \$1 million or more a year, approximately the top one percent of tax filers. Importantly, these income divisions incorporate all tax filers.

When adjusting for tax filing status for wealthy families, the income floor is the range of \$250,000 to \$350,000 for single tax filers and \$1 million to \$2 million for married tax filers—the DRS does not provide a more precise estimate. An effective approach for limiting tax increases to the wealthy while maintaining the state's general practice of doubling the income level for married tax filers is to use the income floor of \$500,000 for single tax filers and \$1 million for married tax filers.

When adjusting for tax filing status for working- and middle-class families, the income ceiling is the range of \$75,000 to \$96,000 for single tax filers and \$250,000 to \$350,000 for married tax filers. An effective approach for limiting tax cuts to working- and middle-class families while maintaining the state's general practice of doubling the income level for married tax filers is to use the income ceiling of \$100,000 for single tax filers and \$200,000 for married tax filers.

Put together, tax reform involves raising taxes on single filers making more than \$500,000 a year and married filers making more than \$1 million (i.e., the wealthy) and lowering taxes for single filers making less than \$100,000 and married filers making less than \$200,000 (i.e., working- and middle-class families). To be sure, some flexibility in these income ceilings and floors is reasonable given the wide income ranges they are based on and the differences in the income distributions based on tax filing status. For example, a tax credit that begins to phase out at \$200,000 for married tax filers and provides a reduced credit for those making up to \$250,000 is still targeted to the bottom 90 percent of married tax filers and may be reasonable given the high cost of living in the state, especially for families with children.³⁴

The remainder of this section provides an overview of problems with the key components of Connecticut's income tax (the exemption, brackets, personal credit, and tax gap), it shows the impact of Connecticut's income tax as a whole on several groups (working- and middle-class families, the median household by race and ethnicity, and the wealthy), and it provides several tax reform proposals throughout. Although the income tax is the largest revenue source at the state level and one of only two progressive taxes comprising Connecticut's overall regressive tax system, it is possible to make this tax much fairer, which in turn would make the overall state and local tax system fairer.

Connecticut's Income Tax Exemption

An income tax exemption or deduction indirectly reduces a tax filer's liability by reducing their taxable income. As **Table 8** shows, Connecticut's income tax exempts a maximum of \$15,000 for single filers and \$24,000 for married filers.³⁵

Two problems with Connecticut's income tax exemption are reviewed below:

Connecticut's income tax exemption provides little or no support for some working-class families and most middle-class families. Connecticut's income tax exemption begins to phase out by \$1,000 for each \$1,000 increase in income above \$30,000 for single filers and \$48,000 for married filers. The exemption is then fully phased out for single filers making more than \$44,000 and married filers making more than \$71,000. As a result, some working-class families and most middle-class families receive either little or no exemption, which makes Connecticut's income tax an outlier compared to the federal income tax and many other states. For example, Minnesota's income tax exempts \$8,000 for single filers and \$16,050 for married filers, the exemption is then only reduced for single filers making more than \$99,925 and married filers making more than \$199,850, and the exemption reduction is capped at 80 percent rather than fully phased out.³⁶

Because the income 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. Inflation is a decrease in the purchasing power of money due to an increase in the price of goods and services, and "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. To prevent this annual tax increase on working- and middle-class families, the federal government and many states index their exemptions to inflation, meaning the amount of the exemption increases each year based on the rate of inflation. Connecticut's income tax exemption, however, is not indexed to inflation and the real value has decreased considerably over time. For example, when Connecticut established a broad-based income tax in 1991, it included an exemption of \$12,000 for single filers and \$24,000 for married filers. Since then, the state has occasionally increased the exemption for single filers, eventually reaching \$15,000, but it has never increased the exemption for married filers. If the state had indexed the exemption in 1991 to the consumer price index—the most prominent measure of inflation—the maximum exemption in 2021 would be about \$23,700 for single filers and about \$47,500 for married filers.³⁷

Tax Reform Proposals

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**

Table 8. Connecticut's Income Tax Exemption

Summary of Original Parameters if Inflation Indexed in 1991

Single Tax Filer		Married Tax Filer	
Income	Exemption	Income	Exemption
<i>In 1991 Dollars</i>		<i>In 1991 Dollars</i>	
\$0 to \$24,000	\$12,000	\$0 to \$48,000	\$24,000
\$35,001 and up	\$0	\$71,001 and up	\$0
<i>In 2021 Dollars</i>		<i>In 2021 Dollars</i>	
\$0 to \$47,500	\$23,700	\$0 to \$94,900	\$47,500
\$69,201 and up	\$0	\$140,401 and up	\$0

Detailed Overview of Actual Parameters in 2021

Single Tax Filer		Married Tax Filer	
Income	Exemption	Income	Exemption
\$0 to \$30,000	\$15,000	\$0 to \$48,000	\$24,000
\$30,001 to \$31,000	\$14,000	\$48,001 to \$49,000	\$23,000
\$31,001 to \$32,000	\$13,000	\$49,001 to \$50,000	\$22,000
\$32,001 to \$33,000	\$12,000	\$50,001 to \$51,000	\$21,000
\$33,001 to \$34,000	\$11,000	\$51,001 to \$52,000	\$20,000
\$34,001 to \$35,000	\$10,000	\$52,001 to \$53,000	\$19,000
\$35,001 to \$36,000	\$9,000	\$53,001 to \$54,000	\$18,000
\$36,001 to \$37,000	\$8,000	\$54,001 to \$55,000	\$17,000
\$37,001 to \$38,000	\$7,000	\$55,001 to \$56,000	\$16,000
\$38,001 to \$39,000	\$6,000	\$56,001 to \$57,000	\$15,000
\$39,001 to \$40,000	\$5,000	\$57,001 to \$58,000	\$14,000
\$40,001 to \$41,000	\$4,000	\$58,001 to \$59,000	\$13,000
\$41,001 to \$42,000	\$3,000	\$59,001 to \$60,000	\$12,000
\$42,001 to \$43,000	\$2,000	\$60,001 to \$61,000	\$11,000
\$43,001 to \$44,000	\$1,000	\$61,001 to \$62,000	\$10,000
\$44,001 and up	\$0	\$62,001 to \$63,000	\$9,000
		\$63,001 to \$64,000	\$8,000
		\$64,001 to \$65,000	\$7,000
		\$65,001 to \$66,000	\$6,000
		\$66,001 to \$67,000	\$5,000
		\$67,001 to \$68,000	\$4,000
		\$68,001 to \$69,000	\$3,000
		\$69,001 to \$70,000	\$2,000
		\$70,001 to \$71,000	\$1,000
		\$71,001 and up	\$0

*Data from CT DRS, US Bureau of Labor Statistics, and author's calculations.

Connecticut's Income Tax Brackets

Income tax brackets include ranges of income subject to specific tax rates. Excluding the exemption, **Table 9** shows that Connecticut's income tax has seven brackets ranging from three percent on the first \$10,000 of taxable income for single filers and \$20,000 for married filers to 6.99 percent on taxable income over \$500,000 for single filers and \$1 million for married filers. To understand how this works, consider a married filer that makes \$45,000: the first \$24,000 is exempt, the next \$20,000 is taxed at a rate of three percent, and the final \$1,000 is taxed at a rate of five percent.³⁸

Two problems with Connecticut's income tax brackets are reviewed below:

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. In addition to the primary tax brackets, Connecticut's income tax has a process that the DRS labels the "three percent tax rate phase-out add-back." Specifically, once a single filer makes more than \$56,500 and a married filer makes more than \$100,500, the three percent bracket begins to phase out and is replaced by the five percent bracket. Along with the phase out of the exemption, this operates as a hidden tax increase on middle-class families and generates a large increase in the effective tax rate in the middle of the income distribution. Consider a married filer that makes \$150,000: the \$24,000 exemption is fully phased out; the first \$20,000 is taxed at three percent, the next \$80,000 is taxed at five percent, the final \$50,000 is taxed at 5.5 percent, and a \$400 income tax is added, which is the equivalent of taxing the first \$20,000 at a rate of five percent rather than three percent. This results in an effective tax rate of 5.2 percent. In comparison to the above upper-middle-class family, an upper-working-class family with no children that makes \$45,000 has an effective tax rate of 1.2 percent, and the effective tax rate is even lower if the family has children.

Similar to the three percent tax rate phase-out add-back, the income tax includes a "tax recapture" process that only applies to upper-class and wealthy families. Specifically, tax recapture phases in between \$200,000 and \$540,000 for single filers and between \$400,000 and \$1.1 million for married filers and it ultimately replaces all of the brackets with the top bracket of 6.99 percent. This process is not of concern here because of the income levels at which it applies. Without additional higher brackets, however, the top of the income distribution does not have a progressive rate structure despite the exponential growth in income at that level. For example, a family earning \$1.5 million has an effective income tax rate of 6.99 percent, which is the same rate for a family making either \$3.1 million (the average for the top one percent), \$6.7 million (the average for the top 0.3 percent), or tens or hundreds of millions of dollars (the average for the top 0.1 percent or higher).

Altogether, the effective income tax rate increases from 1.2 percent for an upper-working-class family to 5.2 percent for an upper-middle-class, which is a four percentage point increase in the effective tax rate based on an increase of \$110,000 in income; and the effective income tax rate then only increases to 6.99 percent for a family making, for example, \$10 million, which is a 1.79 percentage point increase based on an increase of more than \$9 million in income.³⁹

Because Connecticut's income 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. Similar to tax exemption creep, "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. To prevent this annual tax increase on working- and middle-class families, the federal government and many states index their tax brackets to inflation, meaning the income levels for the tax brackets increase each year based on the rate of inflation. Connecticut's income tax brackets, however, are not indexed to inflation and that has significantly increased the tax burden on many families over time. Consider the five percent tax bracket, which impacts both working- and middle-class families. Since 2003, the tax bracket has applied to taxable income above \$10,000 for single filers and \$20,000 for married filers. If policymakers had initially indexed the tax bracket to the consumer price index, in 2021 it would only apply to income above about \$14,500 for single filers and about \$28,900 for married filers.⁴⁰

Table 9. Connecticut's Income Tax Brackets, 2021

Primary Tax Brackets		
Tax Rate	Taxable Income Base	
	Single Tax Filer	Married Tax Filer
3.00%	\$0 to \$10,000	\$0 to \$20,000
5.00%	\$10,001 to \$50,000	Over \$20,000
5.50%	\$50,001 to \$100,000	Over \$100,000
6.00%	\$100,001 to \$200,000	Over \$200,000
6.50%	\$200,001 to \$250,000	Over \$400,000
6.90%	\$250,001 to \$500,000	Over \$500,000
6.99%	Over \$500,000	Over \$1,000,000

Three Percent Tax Rate Phase-Out Add-Back		
	Single Tax Filer	Married Tax Filer
Income Threshold	\$56,501 and up	\$100,501 and up
Additional Tax Liability	\$20 per \$5,000 over income threshold	\$40 per \$5,000 over income threshold
Maximum Tax	\$200	\$400

Tax Recapture		
	Single Tax Filer	Married Tax Filer
Income Threshold	\$200,001 and up	\$400,001 and up
Additional Tax Liability	\$90 per \$5,000 over income threshold	\$180 per \$10,000 over income threshold
Maximum Tax	\$3,150	\$6,300

*Data from CT DRS.

To create fairer income tax brackets—specifically, inflation-indexed brackets that do not generate the largest increase in the effective income tax rate in the middle of the income distribution—policymakers could increase the tax rates that apply to the wealthy, decrease the tax rates that apply to working- and middle-class families, and inflation index all of the brackets. The primary argument against increasing income tax rates on the wealthy is that Connecticut already has a high top income tax rate due to earlier rate increases and that further increasing the top income tax rate would lead the wealthy to leave, which would hurt the state’s economy.

FOUR PROBLEMS WITH THE PRIMARY ARGUMENT AGAINST INCREASING INCOME TAX RATES ON THE WEALTHY ARE REVIEWED BELOW:

Connecticut does not have a high top income tax rate. When including both state income taxes and local income taxes, **Table 10** shows that 18 states have a higher top income tax rate than Connecticut. The average top income tax rate is 6.1 percent for all states and 7.2 percent when excluding states without an income tax, which confirms that Connecticut’s top income tax rate is about average and therefore the state has capacity to increase it without becoming an outlier.⁴¹

The top income tax rate has essentially no relationship to economic growth. Using two decades of economic growth data from the US Bureau of Economic Analysis (BEA), **Figure 6** shows that the correlation between the top income tax rate and the economic growth rate is essentially zero. To be sure, Florida is often used to highlight the economic benefits of not having an income tax—the state had a modestly above-average annual economic growth rate (1.96 percent) compared to the US as a whole (1.73 percent). Equally notable, however, some states without an income tax had below-average annual economic growth rates, such as Wyoming (1.49 percent) and Alaska (1.10 percent), and some states with a high top income tax rate had above-average annual economic growth rates, such as California (2.39 percent) and Oregon (2.38 percent). When examining all of the states systematically over a 20 year period, there is no meaningful relationship between a state’s top income tax rate and economic growth rate. This finding also holds when applying more advanced statistical methods.⁴²

The tax filers lost to migration account for less than one percent of Connecticut’s tax filers and the overwhelming majority of that relatively small group are working- and middle-class families. Using the most recent data available from the Internal Revenue Service (IRS), **Table 11** shows that overall Connecticut lost tax filers from 2018 to 2019 due to migration. However, the net loss of tax filers (less than 9,000) is equal to only 0.6 percent of all tax filers (1.46 million), and 86 percent of the tax filers comprising that relatively small group make less than \$200,000 a year, meaning the state is primarily losing working- and middle-class families. The main counterargument is that the percentage of upper-class and wealthy tax filers lost to migration (14 percent) is greater than their share of all tax filers (10 percent), meaning the state is disproportionately losing upper-class and wealthy tax filers. This finding is not surprising considering that it takes a certain level of financial resources to move. More importantly, however, when looking at *where* tax filers are moving—the next step of the analysis—it becomes clear that there is no significant relationship between the top income tax rate and migration in or out of the state.⁴³

The top income tax rate has no significant relationship to migration in or out of Connecticut. Using additional data from the IRS, **Table 12** shows the top 10 states for migration in and out of Connecticut. Starting with out-migration, the top state is New York, which has a top combined state and local income tax rate of 12.696 percent, well above Connecticut's top rate of 6.99 percent. The out-migration list also includes several other states with a higher top income tax rate (California, New Jersey, South Carolina) and several states with a top income tax rate that is within 1 to 2 percentage points of Connecticut's top rate (Massachusetts, North Carolina, Pennsylvania, Virginia), suggesting the reduction in income tax liability is not likely large enough to be the primary driver of migration, which often entails considerable costs, both financial and personal. Only two states (Florida, Texas) have no income tax and those states account for less than 20 percent of total tax filer migration, whereas the other eight states account for more than 50 percent.

Turning next to in-migration, the top state is New York, which has a higher top income tax rate than Connecticut. Two other states in the top 10 also have a higher top income tax rate (California, New Jersey). This is potentially evidence that tax filers from those three states (a total of 16,375) are moving to lower their state income tax liability. However, nearly as many tax filers move from Connecticut to those same three states (13,005). Also notable, the other seven states in the top 10 all have a lower top income tax rate than Connecticut and they account for more than 36 percent of total tax filer migration (14,377), which is not much less than the 41 percent of total tax filer migration from the three states with a higher top income tax rate and further undercuts the argument that the top income tax rate is a meaningful driver of migration.⁴⁴

Tax Reform Proposals

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

- 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

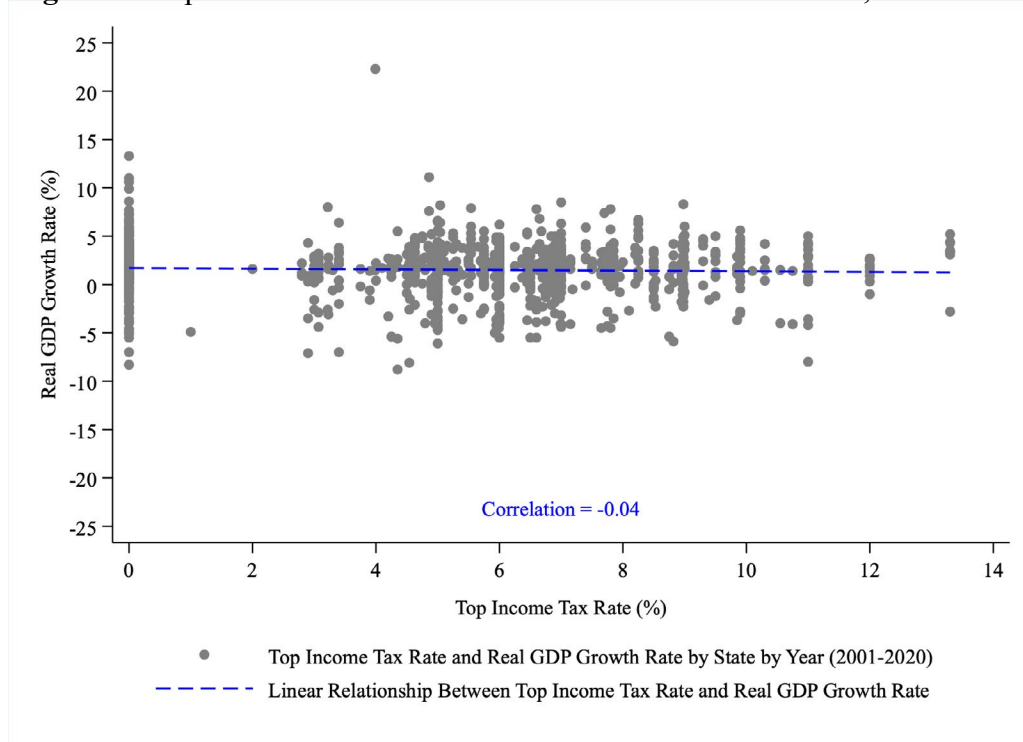
To offset the reduction in the unfair tax burden on working- and middle-class families, policymakers could:

- 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)

Table 10. Ranking of Top State and Local Income Tax Rate

Rank	State	Top State Income Tax	Top Local Income Tax	Top State and Local Income Tax
1	California	13.30%	0.38%	13.68%
2	New York	8.82%	3.876%	12.696%
3	New Jersey	10.75%	1.00%	11.75%
4	Hawaii	11.00%		11.00%
5	Oregon	9.90%	0.6918%	10.5918%
6	Minnesota	9.85%		9.85%
7	Iowa	8.53%	1.00%	9.53%
8	Maryland	5.75%	3.20%	8.95%
9	Vermont	8.75%		8.75%
10	Arizona	8.00%		8.00%
11	Kansas	5.70%	2.25%	7.95%
12	Delaware	6.60%	1.25%	7.85%
13	Ohio	4.797%	3.00%	7.797%
14	Wisconsin	7.65%		7.65%
15	Kentucky	5.00%	2.50%	7.50%
16	Maine	7.15%		7.15%
17	Alabama	5.00%	2.00%	7.00%
18	South Carolina	7.00%		7.00%
19	Connecticut	6.99%		6.99%
20	Pennsylvania	3.07%	3.8809%	6.9509%

*Data from Tax Foundation and author's calculations.

Figure 6. Top State Income Tax Rate and Economic Growth Rate, 2001–2020

*Data from US Bureau of Economic Analysis, Tax Foundation, and author's calculations.

Table 11. Connecticut Migration by Income Level, 2018–19

Adjusted Gross Income	Number of Tax Filers			Net Migration		
	All	Outflow	Inflow	Number	% of All Tax Filers	% of Net Migration
\$1 to under \$10,000	86,778	3,719	3,242	-477	0.03%	5.4%
\$10,000 to under \$25,000	220,134	8,607	7,517	-1,090	0.07%	12.4%
\$25,000 to under \$50,000	332,190	11,227	9,696	-1,531	0.11%	17.4%
\$50,000 to under \$75,000	231,335	7,840	6,425	-1,415	0.10%	16.1%
\$75,000 to under \$100,000	160,192	4,956	3,821	-1,135	0.08%	12.9%
\$100,000 to under \$200,000	282,302	7,540	5,624	-1,916	0.13%	21.8%
\$200,000 or more	142,545	4,349	3,119	-1,230	0.08%	14.0%
Total	1,455,476	48,238	39,444	-8,794	0.60%	100%

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

Table 12. Connecticut Migration by State, 2018–19

Rank	State	Outflow			State	Inflow		
		# of Tax Filers	% of Outflow	Top Tax Rate		# of Tax Filers	% of Inflow	Top Tax Rate
1	New York	8,463	17.4%	12.696%	New York	12,431	31.2%	12.696%
2	Florida	7,688	15.8%	0%	Massachusetts	4,782	12.0%	5.0%
3	Massachusetts	5,462	11.2%	5.0%	Florida	3,796	9.5%	0%
4	California	2,627	5.4%	13.68%	California	2,035	5.1%	13.68%
5	North Carolina	2,313	4.7%	5.25%	New Jersey	1,909	4.8%	11.75%
6	New Jersey	1,915	3.9%	11.75%	Rhode Island	1,501	3.8%	5.99%
7	Texas	1,796	3.7%	0%	Pennsylvania	1,248	3.1%	6.95%
8	South Carolina	1,565	3.2%	7%	Texas	1,096	2.7%	0%
9	Pennsylvania	1,550	3.2%	6.95%	North Carolina	996	2.5%	5.25%
10	Virginia	1,433	2.9%	5.75%	Virginia	958	2.4%	5.75%

*Data from Internal Revenue Service, Tax Foundation, and author's calculations. Top tax rate includes top state and local income tax rate.

Connecticut's Personal Tax Credit

Unlike a tax exemption or deduction, which indirectly reduces a tax filer's liability by reducing their taxable income, a tax credit directly reduces a tax filer's liability. As **Table 13** shows, Connecticut's income tax includes a personal tax credit that reduces a tax filer's liability by a maximum of 75 percent for single filers with an income between \$15,000 and \$18,800 and for married filers with an income between \$24,000 and \$30,000. Above those income levels, the credit gradually decreases and is entirely phased out once a single filer's income exceeds \$64,500 and a married filer's income exceeds \$100,500. To understand how this tax credit works, consider a married filer that makes \$45,000: the first \$24,000 is exempt, the next \$20,000 is taxed a rate of three percent, and the final \$1,000 is taxed at a rate of five percent, which results in an initial tax liability of \$650. The filer then receives a personal credit of 15 percent of their initial tax liability, which results in a final tax liability of \$553.⁴⁵

Three problems with Connecticut's personal tax credit are reviewed below:

Connecticut's personal tax credit provides little or no support for many middle-class families. The personal tax credit is entirely phased out for single filers making more than \$64,500 and married filers making more than \$100,500, meaning the credit excludes many middle-class families. This is especially problematic when combined with the three percent tax rate phase-out add-back and the phase out of the exemption. Consider a married filer that makes \$150,000: the \$24,000 exemption is phased out; the first \$20,000 is taxed at three percent, the next \$80,000 is taxed at five percent, the final \$50,000 is taxed at 5.5 percent, and a \$400 income tax is added, which is the equivalent of taxing the first \$20,000 at a rate of five percent rather than three percent. This results in an initial tax liability of \$7,750, which is also then the final tax liability because the filer receives no personal tax credit.⁴⁶

Because the personal tax credit is not indexed for inflation, "tax credit creep" operates as a built-in, or hidden, annual tax increase on working- and middle-class families. Similar to tax exemption creep and tax bracket creep, "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. To prevent this annual tax increase on working- and middle-class families, the federal government and many states index their tax credits to inflation, meaning the income levels for the tax credits increase each year based on the rate of inflation. Connecticut's personal tax credit, however, is not indexed to inflation and that has increased the tax burden on many working- and middle-class families over time. For example, when the state established a broad-based income tax in 1991, it included a personal tax credit that entirely phased out only for single filers making more than \$48,000 and married filers making more than \$96,000. If policymakers had indexed the original tax credit to the consumer price index, in 2021 it would not entirely phase out until a single filer makes more than \$94,900 and a married filer makes more than \$189,900.⁴⁷

Table 13. Connecticut's Personal Tax Credit

Summary of Original Parameters if Inflation Indexed in 1991

Single Tax Filer		Married Tax Filer	
Income	Personal Credit	Income	Exemption
<i>In 1991 Dollars</i>		<i>In 1991 Dollars</i>	
\$12,001 to \$15,000	75%	\$24,001 to \$30,000	75%
\$48,001 and up	0%	\$96,001 and up	0%
<i>In 2021 Dollars</i>		<i>In 2021 Dollars</i>	
\$23,701 to \$29,700	75%	\$47,501 to \$59,300	75%
\$94,901 and up	0%	\$189,901 and up	0%

Detailed Overview of Actual Parameters in 2021

Single Tax Filer		Married Tax Filer	
Income	Personal Credit	Income	Personal Credit
\$15,000 to \$18,800	75%	\$24,000 to \$30,000	75%
\$18,801 to \$19,300	70%	\$30,001 to \$30,500	70%
\$19,301 to \$19,800	65%	\$30,501 to \$31,000	65%
\$19,801 to \$20,300	60%	\$31,001 to \$31,500	60%
\$20,301 to \$20,800	55%	\$31,501 to \$32,000	55%
\$20,801 to \$21,300	50%	\$32,001 to \$32,500	50%
\$21,301 to \$21,800	45%	\$32,501 to \$33,000	45%
\$21,801 to \$22,300	40%	\$33,001 to \$33,500	40%
\$22,301 to \$25,000	35%	\$33,501 to \$40,000	35%
\$25,001 to \$25,500	30%	\$40,001 to \$40,500	30%
\$25,501 to \$26,000	25%	\$40,501 to \$41,000	25%
\$26,001 to \$26,500	20%	\$41,001 to \$41,500	20%
\$26,501 to \$31,300	15%	\$41,501 to \$50,000	15%
\$31,301 to \$31,800	14%	\$50,001 to \$50,500	14%
\$31,801 to \$32,300	13%	\$50,501 to \$51,000	13%
\$32,301 to \$32,800	12%	\$51,001 to \$51,500	12%
\$32,801 to \$33,300	11%	\$51,501 to \$52,000	11%
\$33,301 to \$60,000	10%	\$52,001 to \$96,000	10%
\$60,001 to \$60,500	9%	\$96,001 to \$96,500	9%
\$60,501 to \$61,000	8%	\$96,501 to \$97,000	8%
\$61,001 to \$61,500	7%	\$97,001 to \$97,500	7%
\$61,501 to \$62,000	6%	\$97,501 to \$98,000	6%
\$62,001 to \$62,500	5%	\$98,001 to \$98,500	5%
\$62,501 to \$63,000	4%	\$98,501 to \$99,000	4%
\$63,001 to \$63,500	3%	\$99,001 to \$99,500	3%
\$63,501 to \$64,000	2%	\$99,501 to \$100,000	2%
\$64,001 to \$64,500	1%	\$100,001 to \$100,500	1%
\$64,501 and up	0%	\$100,501 and up	0%

*Data from CT DRS, US Bureau of Labor Statistics, and author's calculations.

Because the personal tax credit does not adjust for the number of dependents, working- and middle-class families with children pay an especially unfair share. To offset the high cost of raising children, the federal income tax and nearly every other state income tax includes a dependent exemption or credit—often in the form of a child tax credit or child and dependent care tax credit. The failure of Connecticut’s income tax to adjust for dependents puts an unfair burden on working- and middle-class families with children. In particular, it harms working-class families because even though they generally qualify for the Connecticut earned income tax credit (CT EITC), which adjusts for children (up to a maximum of three), that credit is primarily designed to offset regressive taxes at the state and local level. The failure to adjust for dependents also harms middle-class families because they generally make too much to qualify for the CT EITC and therefore receive no support at all, with the possible exception of property tax credit, which the state has reduced substantially over time and currently provides little or no support for many working- and middle-class families, especially renters.⁴⁸

Below is an overview of the EITC and the child tax credit (CTC), two of the most important credits for supporting working- and middle-class families.

Earned Income Tax Credit

Established in 1975, the federal EITC is a refundable, inflation-indexed tax credit that primarily helps working-class families and is designed to offset the regressive federal payroll tax. The credit equals a percentage of a tax filer’s income for each dollar earned until the credit reaches its maximum level for a specific income range. If a tax filer’s income exceeds that specified income range, the credit decreases for each additional dollar earned until the credit is no longer available. The phase-in rate, maximum credit, and phase-out rate depend on tax filing status and number of children.⁴⁹

In 2011, Connecticut established a state-level EITC (CT EITC) that currently mirrors the federal credit at a rate of 30.5 percent. Similar to the federal EITC, the CT EITC primarily helps working-class families and is designed to offset regressive state and local taxes, such as the sales tax and property tax. **Figure 7** shows the key parameters, which depend on tax filing status and number of children. To understand how the CT EITC works, consider a married filer with two children: the credit phases in as the tax filer’s income increases to \$14,950; the tax filer receives the maximum credit of \$1,824 if their income is between \$14,950 and \$25,470; the credit phases out as the tax filer’s income increases to \$53,865; and the tax filer receives no credit if their income exceeds that amount.⁵⁰

As noted, the federal EITC is inflation indexed and refundable. The CT EITC also includes both features because it mirrors the federal credit. “Inflation indexed” means that the maximum credit and income thresholds are adjusted each year to account for increases in the cost of living. “Refundable” means that if the credit exceeds a tax filer’s income tax liability, the government refunds (i.e., pays) the tax filer the difference. Because many working-class families pay more in the payroll tax than the income tax at the federal level and also pay more in the property tax and sales tax than the income tax at the state and local level, it is essential not to limit the EITC to a tax filer’s income tax liability if the objective is to offset regressive taxes that exacerbate income inequality and the racial income gap.

Child Tax Credit

Established in 1997, the federal CTC is a refundable tax credit that primarily helps working- and middle-class families and is designed to offset the cost of raising children. Under the Tax Cut and Jobs Act (TCJA) of 2017, the CTC works as follows: after exceeding an income threshold of \$2,500, the credit equals a percentage of a tax filer's income for each dollar earned until the credit reaches its maximum level for a specific income range. If a tax filer's income exceeds that specified income range, the credit declines for each additional dollar earned until the credit is no longer available. The maximum credit is \$2,000 per child but only \$1,400 is refundable. The American Rescue Plan Act (ARPA) of 2021 made several temporary changes. Most notably, it eliminated the initial income threshold and phase in, and instead provided the maximum credit to tax filers under a specified income level. ARPA also made the credit fully refundable and increased the maximum amount to \$3,600 for children under six and \$3,000 for children six and older.⁵¹

Following a recommendation in our last report on tax reform, the Connecticut Finance, Revenue, and Bonding Committee passed a revenue package in 2021 that included a state-level child tax credit (CT CTC). The design of the proposed state credit—a maximum of \$600 per child up to three children—includes features of both the TCJA- and ARPA-based credit. Like the TCJA-based credit, it includes a phase-in and is partially refundable. Like the ARPA-based credit, it has no initial income threshold. **Figure 8** shows the key parameters, which depend on tax filing status and number of children. To understand how the proposed CT CTC works, consider a married filer with two children: the credit phases in as the tax filer's income increases to \$18,667; the tax filer receives the maximum refundable credit of \$840 (\$420 per child) if their income is between \$18,677 and \$49,750; the nonrefundable portion of the credit then phases in as the tax filer's income increases to \$53,000; the tax filer receives the maximum nonrefundable credit of \$1,200 (\$600 per child) if their income is between \$53,000 and \$200,000; the credit phases out as the tax filer's income increases to \$210,000; and the tax filer receives no credit if their income exceeds that amount.⁵²

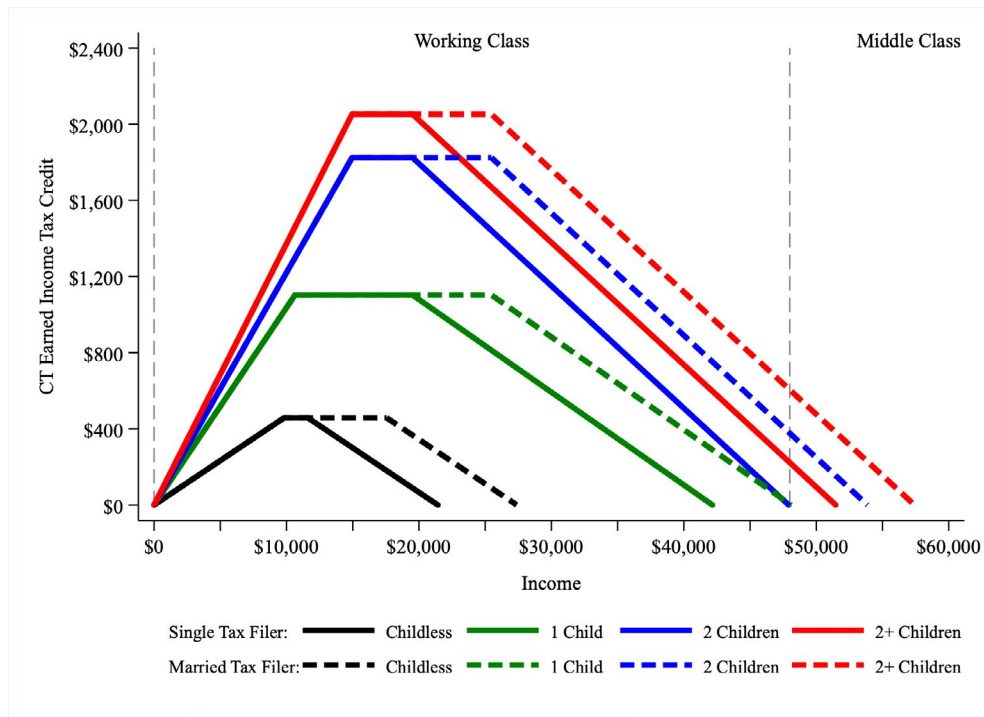
Unlike the CT EITC, the proposed CT CTC is not inflation indexed and only partially refundable. “Partially refundable” in this case means that the government will refund (i.e., pay) up to \$420 of the \$600 maximum credit per child if it exceeds the tax filer's income tax liability.⁵³

Tax Reform Proposals

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

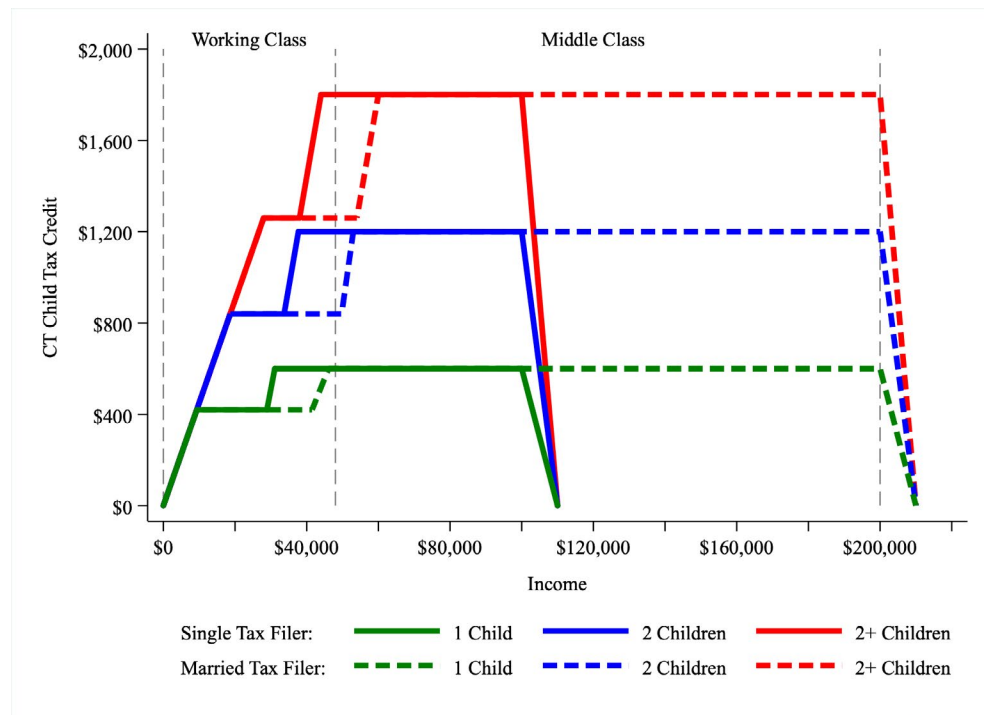
- Extend the phase out of the personal tax credit to \$100,000 for single filers and \$200,000 for married filers
- Inflation index the current and/or extended personal tax credit
- Establish the Connecticut child tax credit and index it to inflation

Figure 7. The Connecticut Earned Income Tax Credit, 2021



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

Figure 8. The Proposed Connecticut Child Tax Credit



*Data from CT DRS, CT General Assembly, and author's calculations.

Connecticut's Income Tax Gap

The key components of Connecticut's income tax include not only the exemption, brackets, and personal credit but also the income tax gap, which is the difference between the income tax owed to the government and the income tax paid. To be clear, the income tax gap is the focus here, but it is only one component of the total tax gap, which is the difference between the total tax owed to the government from all tax sources and the total tax paid.

Problems with Connecticut's income tax gap are reviewed below:

Connecticut's income tax gap is likely substantial—a starting estimate of 19 percent or \$2.6 billion. 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. According to the Treasury Department—which houses the Internal Revenue Service (IRS), the bureau responsible for collecting taxes—the federal income tax gap has three components: 10 percent is due to nonfiling (i.e., failing to file tax returns in a timely manner); 78 percent is due to underreporting (i.e., underreporting income or overclaiming deductions and credits); and 12 percent is due to underpayment (i.e., underpaying taxes despite reporting obligations in a timely manner).⁵⁴

The Treasury Department highlights two key causes of the federal income tax gap: “opaque income sources that accrue disproportionately to higher earners” and the IRS's limited, decreasing resources to ensure tax compliance. Addressing the first key cause, the Treasury Department explains,

For some, but not all, categories of income, the IRS can crosscheck taxpayer filings because it receives information reports from third parties, like employers, and this information can be used to verify that taxpayers are accurately reporting income and deductions. When taxpayers know that their tax information is being reported to authorities, their voluntary compliance rate increases. For ordinary wage and salary income, where employers share a Form W-2 with both employees and the IRS (as well as automatically withhold income taxes), compliance is very high, with only an estimated 1% misreporting rate. ... [C]ompliance drops off with a decline in third party information reporting. For income subject to substantial information reporting, but not withholding, estimated misreporting rates are 5%. For income subject to some limited information reporting, misreporting rises to 17%. In stark contrast, for opaque income sources that accrue disproportionately to higher earners—like proprietorship income and rental income—misreporting is estimated to be 55%.⁵⁵

To understand more fully the importance of “opaque income sources that accrue disproportionately to higher earners,” the Treasury Department provides research showing that the top five percent of tax filers are responsible for more than 50 percent of the tax gap, and the top one percent of tax filers are responsible for nearly 30 percent of the tax gap.⁵⁶

Table 14. Composition of Personal Income, 2020

Personal Income Source	United States	Connecticut	Information Reporting
Wages and Salaries	48.1%	43.0%	Substantial
Supplements to Wages and Salaries	10.8%	9.5%	Substantial
Contributions for Government Social Insurance	-7.4%	-6.5%	Substantial
Personal Current Transfer Receipts	21.6%	17.2%	Substantial
Dividends, Interest, and Rent	18.4%	20.3%	Substantial (D, I) Little or No (R)
Proprietors' Income	8.5%	10.0%	Little or No
Adjustment for Residence	0.0%	6.6%	-
Total	100%	100%	-

*Data from US Bureau of Economic Analysis

The problem of a tax gap that primarily benefits the wealthy due to limited information reporting appears to be even greater in Connecticut than in the US as a whole when comparing the composition of personal income. As **Table 14** shows, Connecticut has a higher share of “opaque income sources that accrue disproportionately to higher earners.”—specifically, 10 percent of the state’s income is from proprietors’ income, compared to 8.5 percent for the US, and 20.3 percent of the state’s income is from dividends, interest, and rent, compared to 18.4 percent for the US. At the same time, Connecticut has a lower share of income from sources for which “compliance is very high”—specifically, 43 percent of Connecticut’s income is from wages and salaries and 9.5 percent is from supplements to wages and salaries (i.e., employer contributions to pensions, insurance funds, and government social insurance), compared to 48.1 percent and 10.8 percent, respectively, for the US.⁵⁷

Addressing the other key cause of the tax gap, the Treasury Department explains,

The IRS, like all federal agencies, is best suited to provide the services Americans deserve when it has the resources it needs to do so. At present, IRS funding deficiencies have directly resulted in an inability for the IRS to meet its mission of administering a fair and effective tax system.

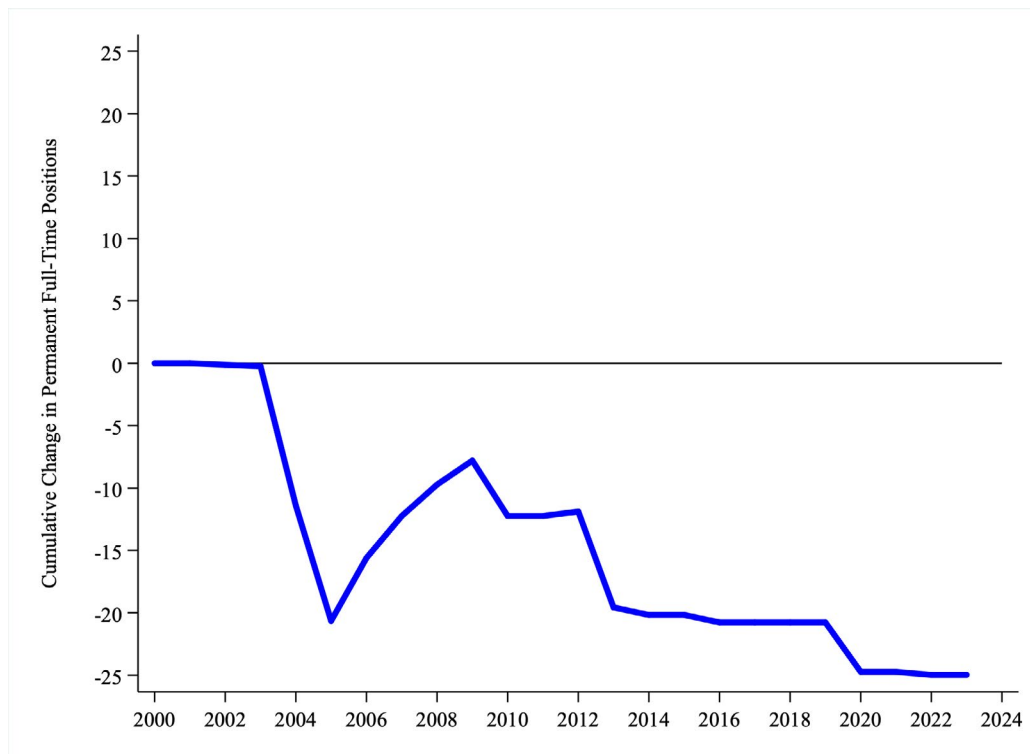
Despite preexisting needs to modernize outdated systems and to detect increasingly complex evasion, the last decade shows a decrease—rather than an increase—in IRS resources. In real terms, the IRS’s overall budget declined by 18.5% between FY 2010 and FY 2021. The IRS’s enforcement budget decreased by 15% over this time period, leading to a 20% decline in the IRS workforce. These losses have been most significant for revenue officers who collect taxes (50% decrease) and revenue agents who audit complex returns (35% decrease). Today, the IRS has fewer auditors than at any time since World War II. As experienced employees have retired, the IRS has been unable to replace departing workers with new revenue officers and with agents of comparable training and skills necessary to pursue the most complicated noncompliance cases. Consequently, the share of audited returns has declined by nearly 45% between 2010–2018.⁵⁸

The Treasury Department also makes clear that increasing the IRS’s resources would work to decrease the tax gap, explaining,

Given the current magnitude of the tax gap in the United States, large compliance initiatives will have benefits that far exceed costs. One illustration of the large potential return on these resource investments is provided by the IRS, which estimates that \$1 spent on tax enforcement typically yields at least \$4 in direct revenue (for example, increased tax payments collected from high-income nonfiler audits). This direct increase in additional tax revenue that the IRS is able to collect from compliance efforts does not include the indirect effects of greater enforcement activities, as evidence suggests that taxpayers are more likely to be compliant in the presence of visible, robust enforcement efforts.⁵⁹

The same resource dynamics appear to be at work in Connecticut. As **Figure 9** shows, the size of the DRS’s staff has decreased substantially over the last two decades. The FY 2022–23 budget funds 625 full-time positions through the General Fund, down from 660 as recently as FY 2019, and down from 833 in FY 2000. This 25 percent reduction in the DRS’s staff has almost certainly diminished Connecticut’s tax compliance capacity, which is especially important considering the state’s above average reliance on “opaque income sources that accrue disproportionately to higher earners.”⁶⁰

Figure 9. Percent Change in Full-Time Positions at the DRS, FY 2000–23



*Data from CT Office of Fiscal Analysis and author’s calculations.

Two other developments are also notable. First, the DRS has routinely administered tax amnesty programs, which is a clear acknowledgement that Connecticut has a tax gap. For example, to generate an estimated \$40 million in FY 2022, the new budget spends \$1.1 million to establish “a tax amnesty program for individuals, businesses, or other taxpayers that owe Connecticut state taxes Under the program, eligible taxpayers may receive a 75% reduction in the interest that would otherwise be due.”⁶¹

Second, like the IRS and the federal tax gap, the DRS has made clear that increasing its resources would work to decrease Connecticut’s tax gap. Most notably, the FY 2022–23 budget

[provides] funding of \$750,000 in FY 22 and \$1.13 million in FY 23 for a Data Analytics Initiative comprising software costs of \$750,000 each year and Personal Services costs for five positions (one Program Manager and four Economists) totaling \$380,000 in FY 23.

The Data Analytics team will be responsible for developing data-centric compliance projects that segment the taxpaying population, prioritize tax return examinations and provide suggestions on the appropriate treatment strategy. Analytics, including predictive modeling, will transform how DRS conducts audits and debt collections by creating early intervention methods which ensure full collection of the tax that is due.⁶²

Connecticut estimates that this \$1.13 million annual increase in funding beginning in FY 2023 will generate \$40 million a year—a \$35 return for each \$1 spent. This is substantially greater than the IRS’s estimate of a \$4 direct return for the each additional \$1 spent. It also suggests that Connecticut could collect substantially more revenue by further increasing the DRS’s tax compliance capacity. To be sure, in estimating the impact on federal revenue of increasing the IRS’s tax compliance capacity, the Congressional Budget Office concluded that the tax agency would likely “prioritize the enforcement activities that it thinks will have the highest average return” and therefore “additional enforcement spending would ... have lower returns than previous spending.” However, to the extent that a decreasing return on investment (ROI) eventually operates as a constraint on closing the tax gap, this appears to be a much weaker constraint for Connecticut due to the state’s significantly higher estimated starting ROI.⁶³

Putting together the components of the tax gap overview here, the federal income tax gap is substantial and primarily benefits the wealthy due to both the “opaque income sources that accrue disproportionately to higher earners” and the IRS’s limited, decreasing resources for ensuring tax compliance. This process in turn harms working- and middle-class families. As the Treasury Department explains, the tax gap is “a de facto punitive tax on compliant taxpayers as those who pay their fair share will have their taxes increased or government services reduced because evaders are not paying.” The Treasury Department also concludes that “[g]iven the current magnitude of the tax gap in the United States, large compliance initiatives will have benefits that far exceed costs.”⁶⁴

Table 15. 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.

The same overall process appears to be at work in Connecticut. Specifically, Connecticut’s income tax gap is likely substantial and likely primarily benefits the wealthy due to the state’s above-average share of “opaque income sources that accrue disproportionately to higher earners” and the DRS’s limited, decreasing resources for ensuring tax compliance. This process in turn likely operates as “a de facto punitive tax on compliant taxpayers” that primarily harms working- and middle-class families. For example, as detailed earlier, rather than rely on closing the income tax gap, the state’s new budget includes a mix of extended and built-in tax increases on working- and middle-class families. Moreover, like the IRS, the DRS believes that increasing its resources will “transform how [the] DRS conducts audits and debt collections” and “ensure full collection of the tax that is due.”

To develop a starting estimate of Connecticut’s tax gap, **Table 15** shows the IRS’s official tax gap estimate: the federal income tax gap is \$271 billion (19.4 percent) and the total federal tax gap is \$381 billion (14.2 percent). Applying the same tax gap percentages to Connecticut—a reasonable starting point based on the preceding analysis and lack of an official estimate from the state—the income tax gap in Connecticut is an estimated \$2.6 billion (19.4 percent) and the total tax gap is an estimated \$3.1 billion (14.2 percent). Other states provide similar state-level estimates. For example, the Oregon Department of Revenue estimates that its income tax gap is 17.8 percent.⁶⁵

Tax Reform Proposals

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

- 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 Income Tax As A Whole

As the preceding analysis of the individual components shows, reforming Connecticut's income tax would make the tax system fairer. For a more comprehensive overview, this part of the analysis shows the current and potential impact of Connecticut's income tax as a whole on three groups: working- and middle-class families; the median household by race and ethnicity; and the wealthy.

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

Table 16 provides an overview of the current and potential effective income tax rate and tax liability in dollars for multiple working- and middle-middle-class families. The working-class families include the average family making \$22,500 a year and a family at the higher end making \$45,000. The middle-class families include the average family making \$97,400 and a family at the higher end making \$150,000. The overview also shows the variation in the effective income tax rate and tax liability in dollars for the above families based on whether they have no children or two children.⁶⁶

Two key findings are reviewed below:

Establishing a refundable child tax credit would make the tax system fairer for working- and middle-class families with children. The effective income tax rate is lower for working-class families with children compared to those without children due to the CT EITC, but the effective income tax rate is the same for middle-class families with or without children because those families do not qualify for the CT EITC. Establishing the CT CTC would further lower the effective income tax rate for working-class families, which would make the tax system fairer because those families generally have the highest total effective state and local tax rate. At the same time, the CT CTC would lower the effective income tax rate for middle-class families with children, which would make the tax system fairer because a family with children has higher expenses and therefore a lower ability to pay taxes compared to a family with the same income but no children. Specifically, with the CT CTC, the effective income tax rate (tax liability in dollars) would decrease by 3.7 percentage points (\$840) and 1.9 percent points (\$840), respectively, for the average working-class family with two children and the upper-working-class family with two children; and the effective income tax rate (tax liability in dollars) would decrease by 1.2 percentage points (\$1,200) and 0.8 percentage points (\$1,200), respectively, for the average middle-class family with two children and the upper-middle-class family with two children.⁶⁷

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. If policymakers had initially inflation indexed the key components of Connecticut's income tax—the exemption, brackets, and personal credit—the effective income tax rate would be the same for the average working-class family because that family currently has no income tax liability. However, the effective income tax rate (tax liability in dollars) would be 1.2 percentage points (\$553) lower for the upper-working-class family, 2.4 percentage points (\$2,366) lower for the average middle-class family, and 0.6 percentage points (\$869) lower for the upper-middle-class family.⁶⁸

The reason the difference in the effective income tax rate (tax liability in dollars) is substantially greater for the average middle-class family is because exemption creep has entirely phased out the exemption for that family, and bracket creep and tax credit creep have both exacerbated that development. The reason the difference in the effective income tax rate (tax liability in dollars) is not as great for the upper-middle-class family is largely because that family never received the benefits of the tax exemption and personal tax credit in the first place, meaning the initial design of the income tax harmed upper-middle-class families more than the absence of inflation indexing. Also important, although the failure to inflation index the income tax currently harms the average middle-class family more than working-class families, it will increasingly hurt the latter as inflation continues to generate exemption creep, bracket creep, and tax credit creep. For example, the upper-working-class family is quickly approaching the \$48,000 income threshold that initiates the phase out of the exemption.

To be clear, the analysis here is designed to show the cumulative impact of built-in, or hidden, annual tax increases on working- and middle-class families due to inflation. If policymakers had initially inflation indexed the key components of the income tax, subsequent policymakers may still have raised taxes on working- and middle-class families. That process, however, would have been far more transparent. For example, when policymakers raised the top income tax rate to 6.5 percent in 2009, 6.7 percent in 2011 and 6.99 percent in 2015, those tax increases received considerable attention. In contrast, the inflation-based tax increase that occurs each year is not transparent and therefore receives little or no attention. It also disproportionately harms working- and middle-class families because the wealthy have a fixed top effective income tax rate and therefore are not affected by exemption creep, bracket creep, and tax credit creep.⁶⁹

Table 16. 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	
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.

Table 17 provides an overview of the current and potential effective income tax rate and income tax liability in dollars for the median household by race and ethnicity. This includes the median Black household that makes \$48,900 a year, the median Latino household that makes \$49,200 a year, and the median white household that makes \$85,800 a year. The overview also shows the variation in the effective income tax rate and tax liability in dollars for the above households based on whether they have no children or two children.⁷⁰

Two key findings are reviewed below:

Establishing a refundable child tax credit would make the tax system fairer for the median Black, Latino, and white households with children. The effective income tax rate is lower for the median Black and Latino households with children compared to those without children due to the CT EITC but the effective income tax rate is the same for the median white household with or without children because that household does not qualify for the CT EITC. Establishing the CT CTC would further lower the effective income tax rate for the median Black and Latino households, which would make the tax system fairer because those households have a higher total effective state and local tax rate. At the same time, the CT CTC would lower the effective income tax rate for median white household with children, which would make the tax system fairer because a household with children has higher expenses and therefore a lower ability to pay taxes compared to a household with the same income but no children. Specifically, with the CT CTC, the effective income tax rate (tax liability in dollars) would decrease by 1.7 percentage points (\$840) for the median Black and Latino households with two children and by 1.4 percentage points (\$1,200) for the median white household with two children. Note also that the CT CTC would make the effective income tax rate negative for the median Black and Latino households, which shows the importance of making the credit refundable to support the households that have a low income tax burden but a high total state and local tax burden due to the property tax, sales tax, and other regressive taxes.⁷¹

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. If policymakers had initially inflation indexed the key components of Connecticut's income tax, the effective income tax rate (tax liability in dollars) would be 1.5 percentage points (\$750) lower for the median Black household, 1.6 percentage points (\$803) lower for the median Latino household, and 2.8 percentage points (\$2,371) lower for the median white household. The reason the difference in the effective income tax rate (tax liability in dollars) is substantially greater for the median white household is because exemption creep has entirely phased out the exemption for that household, and bracket creep and tax credit creep have both exacerbated that development. Also important, although the failure to inflation index the income tax currently harms the median white household the most, it will increasingly harm the median Black and Latino households as inflation continues to generate exemption creep, bracket creep, and personal tax credit creep. For example, the median Black and Latino households now receive a reduced exemption—\$23,000 and \$22,000, respectively—due to exemption creep.⁷²

Table 17. 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.

Table 18 provides an overview of the current and potential effective income tax rate and income tax liability in dollars for the wealthy.⁷³

The key finding is reviewed below:

Closing Connecticut's income tax gap would make the tax system fairer. Although the income tax gap has three components—nonfiling, underreporting, and underpayment—the analysis here is limited to underreporting income. To understand the impact of this process, consider three cases where the average wealthy family's actual income (\$3.1 million) is the same but its reported income varies. First, if the average wealthy family reports all of its income and therefore has no income tax gap, the reported effective income tax rate and the actual effective income tax rate are both 6.99 percent. Second, if the average wealthy family does not report all of its income and has an income tax gap of 14 percent (the size of the total federal tax gap), the family's reported effective income tax rate is 6.99 percent but its actual effective income tax rate is 6.01 percent—a reduction in the effective income tax rate (tax liability in dollars) of 0.98 percentage points (\$30,176). Third, if the average wealthy family does not report all of its income and has an income tax gap of 19 percent (the size of the federal income tax gap), the family's reported effective income tax rate is 6.99 percent but its actual effective income tax rate is 5.66 percent—a reduction in the effective income tax rate (tax liability in dollars) of 1.33 percentage points (\$40,955). Put in more general terms, as the size of the income tax gap increases due largely to “opaque income sources that accrue disproportionately to higher earners,” the actual effective income tax rate for the wealthy decreases, making the tax system as a whole less fair.⁷⁴

Table 18. Impact of Connecticut's Income Tax on the Wealthy

Income Group Tax Filing Status	Wealthy		
	Married	Married	Married
Income			
Actual Pre-Tax Income	\$3,083,600	\$3,083,600	\$3,083,600
Reported Pre-Tax Income	\$3,083,600	\$2,651,900	\$2,497,700
Compliance Rate	100%	86%	81%
Income Tax Liability			
In Dollars	\$215,444	\$185,268	\$174,489
Actual Effective Tax Rate	6.99%	6.01%	5.66%
Reported Effective Tax Rate	6.99%	6.99%	6.99%
Income Tax Gap			
Income Tax Gap	0%	14%	19%
In Dollars	\$0	-\$30,176	-\$40,955
In Effective Tax Rate	0.00%	-0.98%	-1.33%

*Data from CT DRS and author's calculations.



MAKING CONNECTICUT'S TAX SYSTEM FAIRER THROUGH TAX TRANSPARENCY

The preceding section showed that, at minimum, a fairer tax system in Connecticut would not exacerbate income inequality and the racial income gap, and establishing such a tax system requires tax reform. This section shows that tax reform in turn requires tax transparency—knowing the necessary amount the disproportionate tax burden to shift, the impact of proposed and passed tax legislation, and the size of the tax gap. The analysis proceeds in two parts. The first part provides an overview of Connecticut's tax transparency problems. The second part provides an overview of tax transparency proposals.

The following is a summary of the key findings:

Connecticut's Tax Transparency Problems

Connecticut's tax incidence report is considerably out of date at this point. Moreover, independent of its outdatedness, Connecticut's tax incidence report provides limited information.

Connecticut provides no tax incidence estimate of proposed and passed tax legislation. Relatedly, the state's new budget included a mix of extended and built-in tax increases on working- and middle-class families notwithstanding the general belief that there was no "broad-based tax increase."

Connecticut provides no tax gap estimate.

Tax Transparency Proposals

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

- 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.

Connecticut's Tax Transparency Problems

The following is an overview of Connecticut's tax transparency problems.

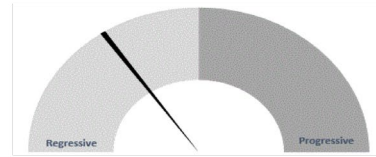
Connecticut's tax incidence report is considerably out of date at this point. As discussed earlier, a tax incidence report shows the effective tax rate by income and/or population groups. In Connecticut, the most recent report was published in 2014 and it uses tax data from 2011, which is now a decade old. To demonstrate its outdatedness, the report estimates that a family making \$3.1 million has an overall effective tax rate of 6.5 percent, which was the number used earlier to show that Connecticut's tax system as a whole exacerbates income inequality and the racial income gap by taxing the wealthy at a lower rate than working- and middle-class families, especially families of color. However, as the analysis in the previous section shows, a family making \$3.1 million a year now has a reported effective tax rate of 6.99 percent for the income tax alone, meaning the average wealthy family obviously no longer has a total reported effective tax rate of 6.5 percent. At the same time, the income tax analysis shows that inflation has generated a substantial tax increase on working- and middle-class families and therefore the effective income tax rate for those families has increased as well. Many other tax changes have also occurred over the last decade. For example, the government has diminished both the estate tax and the property tax credit, the former of which operates as a tax cut for wealthy families, whereas the latter operates as a tax increase on working- and middle-class families. Overall, the key point is that the tax incidence report is useful for showing in general how the state's regressive tax system exacerbates income inequality and the racial income gap, but the numbers are out of date and therefore policymakers do not currently know the precise amount of the disproportionate tax burden to shift off of working- and middle-class families in order to establish a fair tax system.⁷⁵

Independent of its outdatedness, Connecticut's tax incidence report provides limited information. Compared to the Minnesota Department of Revenue's tax incidence reports, the leading model of tax transparency at the state level, Connecticut's tax incidence report provides limited information in at least three key areas. First, Connecticut's tax incidence report does not provide information on the composition and impact of each major tax's components. Consider the property tax, the largest overall tax revenue source. As **Table 19** shows, Connecticut's report provides a regressive score for the property tax overall (a Suits Index of -0.39 on a continuum where -1 is the most regressive tax possible and 1 is the most progressive tax possible). Also, for the portion of the property tax that is retained in the state, the report provides a high-level overview of tax incidence: most of the tax is borne by owners of residential property (66.5 percent) and a substantial portion is shifted onto labor (17.4 percent). In contrast, as **Table 20** shows, Minnesota's report provides the state property tax burden and local property tax burden both as initially imposed and after it is shifted from businesses to households, and it does so for each major component: homeowners, rental housing, commercial, industrial, farms, property tax refunds for homeowners, property tax refunds for renters. The report also provides a regressive or progressive score (i.e., Suits Index) for each component. For example, it shows that the local property tax is more regressive for renters than homeowners, but the income-based state property tax refund (or credit) is more progressive for renters than homeowners, which helps to offset the impact of the local property tax.⁷⁶

Table 19. Connecticut's Tax Incidence: The Property Tax

Property Tax: General Overview

Suits Index	-0.39
Overall Effective Tax Rate	4.84%
% of Total CT Tax Burden	41.91%



Property Tax Burden (in millions)		
Property Tax Total	Tax Exported	Burden on CT Households
\$9,462.5	\$2,147.3	\$7,315.2

Labor	\$1,273,180,818	17.4%
Capital	318,045,197	4.3%
Consumption	326,895,751	4.5%
Land	18,764,449	0.3%
Residential	4,862,081,644	66.5%
Land Use	15,123,356	0.2%
Motor Vehicles	501,137,704	6.9%
Total	\$7,315,228,919	100.0%

* Source: CT DRS.

Table 20. Minnesota's Tax Incidence: The Property Tax (in millions)

Tax Type	Total	As Imposed			After shifting		Full-Sample Suits Index
		MN HH's	NR	Business	Minnesota	Exported	
Taxes on Property							
State Property Tax	\$818	\$34	\$8	\$775	\$413	\$405	-0.071
Residential recreational property	43	34	8		34	8	-0.138
Commercial ²	506			506	275	231	-0.052
Industrial	157			157	33	124	0.124
Utility	112			112	69	42	-0.207
Motor vehicle registration tax	793	666		127	755	38	-0.206
Mortgage and deed taxes	249	149		101	208	42	-0.003
Total Property Taxes	\$1,860	\$849	\$8	\$1,002	\$1,375	\$485	-0.135
Property Tax Refunds							
Homeowners	-\$501	-\$501			-\$501		+0.634
Renters	-223	-223			-223		+0.878
Total Property Tax Refunds	-\$723	-\$723			-\$723		+0.709
Local Taxes							
Taxes on Property	\$9,350	\$4,720	\$70	\$4,560	\$7,651	\$1,699	-0.170
General Property Tax	9,211	4,684	70	4,457	7,599	1,612	-0.170
Homeowners (before PTR)	4,398	4,398			4,398		-0.181
Residential recreational & 2 nd homes ³	356	285	70		285	70	-0.039
Commercial ²	1,730			1,730	941	789	-0.052
Industrial	527			527	112	415	0.124
Farm (other than residence) ⁴	630			630	629	2	-0.166
Rental Housing (before PTR) ⁵	1,171			1,171	986	185	-0.299
Utility ⁶	399			399	248	151	-0.207

*Source: Minnesota Department of Revenue.

Second, for the analysis of the tax system as a whole, Connecticut’s tax incidence report does not provide information on household characteristics or an overall effective tax rate for every population decile. As **Table 21** shows, the report only provides the overall effective tax rate for nine population deciles, and it fails to provide even that limited information for the bottom decile. In contrast, as **Table 22** shows, Minnesota’s report provides detailed information on household characteristics by population decile. This includes the percentage of tax filers that are homeowners, married, seniors, or have children, and it also includes the average market value of a home or monthly rent, all of which policymakers can use to design more effective tax reforms. Additionally, whereas Connecticut’s report excludes the overall effective tax rate for the bottom population decile—only noting that “it reflects an overstated value resulting from Connecticut residents who file federal but not state income tax returns”—and then provides no explanation for why the second decile is such an outlier, Minnesota’s report provides the overall effective tax rate for all of the population deciles and addresses in detail why the overall effective tax rate for the first population decile is an outlier.⁷⁷

Third, Connecticut’s tax incidence report does not provide information on those at the very top of the income distribution. It also does not provide a historical overview or projection of the overall effective tax rate for any part the population. In contrast, as **Table 23** shows, Minnesota’s report provides for all even years dating back to 1990 the overall effective tax rate for all population deciles as well as for the top five percent and top one percent of the population. This historical information and breakdown of the top decile are both critical for understanding the impact of the tax system. As the report explains, “Although the historical changes in the degree of regressivity are due partly to changes in tax laws, the role of the business cycle may be even more important. During the past two decades, income inequality has generally risen during times of rapid growth and fallen during economic contractions.” Also notable, Minnesota’s report provides a projection for 2023 so that “policymakers [have] a view of the state and local tax system that reflects tax law changes enacted into law to date. Studies that concentrate only on history would not reflect the most recent changes to Minnesota’s tax system.”⁷⁸

Table 21. Connecticut’s Tax Incidence: Effective Tax Rate by Population Decile

Decile	2011 Connecticut AGI	Households	Aggregate CT AGI	Total CT Tax Burden	% of Total CT Tax Burden	Overall Effective Tax Rate
1	up to \$5,532	150,200	\$ 147,242,742	\$ 989,881,505	5.7%	**
2	5,533 - 16,245	150,063	1,656,113,142	439,383,210	2.5%	26.62%
3	16,246 - 26,511	150,127	3,214,379,161	588,847,703	3.4%	18.37%
4	26,512 - 37,419	150,219	4,783,322,948	747,337,535	4.3%	15.67%
5	37,420 - 50,198	150,033	6,551,395,173	961,904,432	5.5%	14.72%
6	50,199 - 64,971	150,129	8,581,638,624	1,199,411,989	6.9%	13.99%
7	64,972 - 84,935	150,127	11,187,844,749	1,526,305,871	8.7%	13.66%
8	84,936 - 112,904	150,128	14,695,567,114	1,952,390,475	11.2%	13.30%
9	112,905 - 165,393	150,128	20,325,378,589	2,513,939,114	14.4%	12.38%
10	165,394 and up	150,128	79,885,981,397	6,534,713,231	37.4%	8.18%
TOTAL		1,501,282	\$151,028,863,639	\$17,454,115,067	100.0%	11.57%

* Source: CT DRS.

Table 22. Minnesota's Tax Incidence: Effective Tax Rate by Population Decile, 2018

HOUSEHOLD CHARACTERISTICS	Population Decile										Total
	One	Two	Three	Four	Five	Six	Seven	Eight	Nine	Ten	
Number of Households	278,751	278,751	278,751	278,751	278,751	278,751	278,751	278,751	278,751	278,751	2,787,506
Average Household Income	\$7,787	\$16,984	\$25,683	\$34,909	\$45,345	\$58,154	\$75,367	\$98,965	\$135,241	\$376,374	\$87,481
Maximum Household Income	\$12,826	\$21,235	\$30,194	\$39,804	\$51,162	\$65,832	\$86,043	\$113,534	\$164,719		
Percent with Earned Income ¹	47%	57%	71%	79%	81%	81%	82%	85%	88%	92%	76%
Average Earned Income ¹	\$9,542	\$15,235	\$23,349	\$31,627	\$39,643	\$48,856	\$61,946	\$79,281	\$107,133	\$224,757	\$71,505
Homeowners ²	15%	20%	29%	35%	47%	62%	74%	84%	89%	93%	55%
Married	7%	8%	11%	15%	23%	35%	53%	71%	83%	88%	39%
Seniors	17%	25%	25%	22%	24%	29%	29%	27%	23%	20%	24%
Households with Children	15%	20%	24%	26%	23%	23%	28%	35%	44%	52%	29%
Average Market Value	\$196,016	\$147,677	\$155,926	\$165,109	\$165,334	\$194,195	\$199,194	\$214,630	\$259,724	\$373,654	\$231,190
Average Monthly Rent	\$192	\$367	\$552	\$673	\$776	\$902	\$960	\$1,118	\$1,295	\$1,518	\$624
AVERAGE TAX BURDENS											
Local Property Tax											
All Households											
Total Tax	\$378	\$522	\$755	\$922	\$1,208	\$1,646	\$1,965	\$2,448	\$2,975	\$4,575	\$1,739
-Property Tax Refund	-166	-292	-354	-356	-364	-389	-325	-283	-56	-10	-260
Tax after PTR	\$212	\$230	\$401	\$566	\$844	\$1,257	\$1,640	\$2,165	\$2,919	\$4,565	\$1,479
Renters Only											
Total Tax on Rental Unit	\$576	\$1,037	\$1,392	\$1,643	\$1,851	\$2,099	\$2,200	\$2,561	\$2,955	\$3,472	\$1,532
Renters Share of Tax	222	399	536	632	712	808	847	985	1,137	1,336	590
-Property Tax Refund	-229	-425	-427	-411	-343	-222	-35	-4	0	0	-300
Tax after PTR	-\$7	-\$26	\$109	\$221	\$369	\$586	\$812	\$981	\$1,137	\$1,336	\$290
Homeowners Only											
Total Tax on Home	\$1,811	\$1,689	\$1,837	\$1,929	\$2,069	\$2,299	\$2,465	\$2,778	\$3,237	\$4,849	\$2,878
-Property Tax Refund	-412	-514	-616	-575	-545	-534	-431	-335	-63	-11	-328
Homeowners Tax after PTR	\$1,399	\$1,175	\$1,221	\$1,354	\$1,524	\$1,765	\$2,034	\$2,443	\$3,174	\$4,838	\$2,550
State Income Tax	-\$50	-\$114	\$61	\$520	\$1,168	\$1,847	\$2,741	\$4,116	\$6,291	\$24,257	\$4,084
State Sales Tax	408	529	622	706	800	934	1,153	1,435	1,781	3,379	1,175
State Excise Taxes	291	319	348	372	385	399	429	468	506	568	409
Other Taxes	260	340	442	537	690	860	1,049	1,288	1,636	2,892	999
Business Taxes ³	1,128	812	1,072	1,164	1,326	1,610	2,039	2,440	3,128	8,643	2,336
Total State and Local Tax Burden	\$2,250	\$2,115	\$2,945	\$3,866	\$5,215	\$6,908	\$9,052	\$11,913	\$16,259	\$44,304	\$10,483
Effective Tax Rate for all Taxes	28.9%	12.5%	11.5%	11.1%	11.5%	11.9%	12.0%	12.0%	12.0%	11.8%	12.0%

*Source: Minnesota Department of Revenue

Table 23. Minnesota's Tax Incidence: Effective Tax Rate by Population Decile, 2018–2023

Decile	1990	1992	1994	1996	1998	2000	2002	2004	2006	2008	2010	2012	2014	2016	2018	2023 (est.)
First	17.9%	16.1%	17.3%	17.8%	20.2%	17.4%	18.2%	18.9%	25.2%	31.4%	31.1%	28.3%	29.9%	32.1%	28.9%	24.7%
Second	11.1%	12.0%	12.3%	12.0%	11.3%	9.8%	10.5%	11.3%	13.2%	12.7%	13.5%	12.9%	13.9%	13.4%	12.5%	11.5%
Third	10.7%	12.1%	11.8%	12.2%	10.8%	10.6%	10.1%	10.5%	12.0%	11.3%	11.9%	11.5%	11.9%	11.9%	11.5%	10.8%
Fourth	11.3%	12.1%	12.8%	12.5%	12.0%	11.1%	11.0%	11.5%	11.9%	11.5%	11.3%	11.4%	11.5%	11.5%	11.1%	10.5%
Fifth	11.1%	12.2%	12.8%	13.0%	12.1%	11.5%	11.4%	11.9%	12.7%	11.8%	11.8%	12.3%	12.1%	11.9%	11.5%	11.2%
Sixth	11.8%	12.3%	13.2%	13.1%	13.1%	12.3%	11.9%	12.2%	12.4%	12.0%	12.1%	12.2%	12.3%	12.3%	11.9%	11.8%
Seventh	12.0%	12.2%	13.0%	13.1%	12.9%	12.0%	12.0%	12.3%	12.3%	11.8%	11.9%	12.2%	12.4%	12.6%	12.0%	11.9%
Eighth	11.9%	12.0%	13.0%	13.0%	12.9%	12.0%	11.8%	12.3%	12.0%	11.9%	11.8%	12.1%	12.2%	12.4%	12.0%	11.9%
Ninth	11.8%	11.9%	13.0%	13.0%	12.5%	11.9%	11.7%	12.3%	11.8%	11.5%	11.5%	11.8%	11.9%	12.3%	12.0%	12.1%
Tenth	11.7%	11.9%	12.6%	12.2%	10.6%	10.3%	10.7%	10.9%	10.1%	10.2%	10.2%	10.5%	11.5%	11.6%	11.8%	11.6%
Total	11.8%	12.1%	12.9%	12.7%	11.8%	11.2%	11.3%	11.6%	11.4%	11.3%	11.3%	11.5%	12.0%	12.2%	12.0%	11.8%
Top 5%	11.6%	11.8%	12.3%	11.9%	10.1%	9.9%	10.5%	10.5%	9.7%	9.9%	10.0%	10.2%	11.3%	11.6%	11.8%	11.6%
Top 1%	11.2%	11.6%	11.8%	11.0%	8.3%	8.4%	9.0%	9.6%	8.9%	9.8%	9.5%	9.8%	11.5%	11.8%	11.50%	11.3%

*Source: Minnesota Department of Revenue

Connecticut provides no tax incidence estimate of proposed and passed tax legislation. In addition to relying on an out of date tax incidence report to develop tax proposals for the FY 2022–23 budget, **Table 24** shows that before voting on the final proposed tax program, policymakers received a fiscal note from the Office of Fiscal Analysis (OFA) that included a revenue estimate but no tax incidence estimate, meaning there was no official assessment of whether the proposed program would make the tax system less fair by increasing the burden on working- and middle-class families or more fair by decreasing the burden on those families. There was also no official tax incidence estimate once the budget passed. Together, this lack of tax transparency and the complexity of the tax system reinforced the general belief that the budget was balanced without a “broad-based tax increase” even though, as detailed below, the budget actually included a mix of extended and built-in tax increases on working- and middle-class families.⁷⁹

Connecticut’s new budget included extended tax increases on working- and middle-class families. An extended tax increase is simply a tax increase (or tax credit reduction) that would have expired had policymakers not extended it. Consider two examples—the extension of business taxes and the extension of the restriction on the property tax credit. First, the OFA’s fiscal note shows that extending the 10 percent corporation business surtax and delaying the phase out of the capital base tax will generate \$101 million (\$80 million and \$20.9 million, respectively) in fiscal year 2022. Moreover, Connecticut’s tax incidence report shows that 56 percent of the burden for corporate taxes is exported out of Connecticut, 46 percent is paid by Connecticut residents, and working- and middle-class families pay 50 percent of the latter portion because the tax is largely shifted to workers and consumers. These policies therefore constitute an estimated \$22 million tax increase on working- and middle-class families in FY 2022. Second, the property tax credit applies to single filers making less than \$109,501 and married filers making less than \$130,501 (i.e., almost entirely working- and middle-class families), and the OFA’s fiscal note shows that extending the restriction on the property tax credit to property-owning families that are seniors or that have a dependent will generate \$53 million in revenue in FY 2022. Put together, this estimated \$75 million tax increase on working- and middle-class families due to three policies—renewing the corporation business surtax, delaying the phase out of the capital base tax, and renewing the restriction on the property tax credit—more than offsets the small tax cuts included in the budget as well as the expansion of the Connecticut earned income tax credit, which was an important but insufficient step.⁸⁰

Connecticut’s new budget included a built-in, or hidden, tax increase on working- and middle-class families. A built-in tax increase is a tax increase that occurs automatically due to the design of the tax system, and it generally works in conjunction with inflation. Like past budgets, the FY 2022–23 budget fails to inflation index the income tax. Although the OFA’s fiscal note does not provide a revenue estimate of this built-in tax increase, the earlier analysis in this report shows that failing to inflation index the income tax operates as a substantial tax increase on working- and middle-class families over time. For example, the average middle-class family in Connecticut currently pays about \$4,200 a year in the state income tax, but that family would only pay about \$1,800—or \$2,400 less—if policymakers had initially inflation indexed the key components of the income tax.⁸¹

Table 24. Connecticut's Budget for FY 2022–23: Estimated Revenue Impact (in millions)

Fund	FY 22 \$	FY 23 \$	FY 24 \$	FY 25 \$	FY 26 \$
General Fund (GF)	1,041.8	1,621.9	163.1	144.5	92.9
Special Transportation Fund (STF)	-	2.5	2.5	2.5	2.5
Tourism Fund	3.1	-	-	-	-

Sections	Policy	Fund	FY 22 \$	FY 23 \$
7	Implement a repayment schedule of bond funds issued on behalf of the Paid Family Medical Leave Authority	GF	-	1.7
81-86	Transfer iLottery revenue to Debt Free Community College account – out years impact	GF	-	-
458, 459, 461	Maintain the corporation business tax surcharge through Income Year 2022	GF	80.0	50.0
460, 461	Adjust the capital base tax method	GF	20.9	29.2
462	Restore the R&D tax credit to 70% of liability	GF	(6.5)	(17.2)
463	Adjust the carryforward of new R&D tax credits – out years impact	GF	-	-
464	Raise the aggregate cap on the Insurance Reinvestment (Invest CT) Fund – out years impact	GF	-	-
465	Expand potential use of the film production tax credit (at a discount)	GF	2.2	4.3
466	Adjust the earned income tax credit rate	GF	(34.1)	(34.1)
468	Maintain limits on property tax credits through Income Year 2022	GF	53.0	53.0
469	Extend the existing tax exemption for pensions/annuities to income from IRAs out years impact	GF	-	-
470	Repeal the admissions tax for certain types of venues	GF	(11.0)	(11.0)
471	Exempt breast-feeding supplies from sales tax	GF	(0.5)	(0.5)
471	Exempt breast-feeding supplies from sales tax – minimal revenue loss	STF/MRSA		
472	Allow certain businesses to keep a portion of the sales tax they collect on sales of meals and beverages for FY 22	GF	(7.0)	-
473	Reduce the alcohol excise tax rate on beer – out years impact	GF	-	-
474-479	Impose a convenience fee for credit/debit card use	GF	-	2.5
474-479	Impose a convenience fee for credit/debit card use	STF	-	2.5
480-485	Transfer from the Municipal Revenue Sharing Account (MRSA) to support municipal transition (i.e., car tax) grants and expanded PILOT spending in the General Fund	GF	262.7	276.3
486	Implement a temporary tax amnesty program	GF	40.0	(4.0)
487	Transfer from the General Fund to the Tourism Fund	GF	(3.1)	-
487	Transfer from the General Fund to the Tourism Fund	Tourism	3.1	-
488	Delay historical GAAP (Generally Accepted Accounting Principles) deficit payment to FY 24	GF	85.1	85.1
489	Transfer from American Rescue Plan (ARP) federal funds	GF	559.9	1,194.9
490-495	Ban flavored vaping products	GF	(1.3)	(2.5)
496-502	Limit public assistance recoveries	GF	(6.0)	(6.0)
501-512	Implement a captive insurers initiative	GF	7.5	0.2
513	Establish a sales tax exemption for beer supplies – out years impact	GF	-	-
516-522	Reduce tax rates for Ambulatory Surgical Centers – out years impact	GF	-	-

*Source: CT OFA.

Connecticut provides no tax gap estimate. Along with relying on an outdated estimate of the current tax incidence and providing no estimate of the tax incidence for proposed and passed legislation, Connecticut provides no estimate of the state’s total tax gap or its income tax gap. This is important because, as previously discussed, the tax system becomes less fair as the income tax gap increases, meaning if, like the federal government, Connecticut has a substantial income tax gap that primarily benefits the wealthy, the state’s tax system is even less fair than a tax incidence estimate will show. Moreover, reducing the tax gap is potentially sufficient to fully fund the reforms necessary to make the tax system fair, but developing and implementing such a program requires knowing the size of the tax gap and the state’s existing capacity to reduce it. In contrast to Connecticut, as **Table 25** shows, Oregon’s Department of Revenue provides a detailed estimate of its income tax gap, which is 17.8 percent, slightly smaller than the federal income tax gap of 19.4 percent.⁸²

Table 25. Oregon’s Income Tax Gap

Oregon Personal Income Tax Gap Estimate TY 2010 (\$ Millions)	
Tax return line item misreporting by visibility category:	
Substantial information reporting and withholding ¹	\$67
Substantial information reporting ²	\$62
Some information reporting ³	\$291
Little or no information reporting ⁴	\$905
Tax credits	\$122
Adjustment due to GAO findings	-\$199
Total misreporting gap	\$1,247
<i>Nonfiling gap</i>	\$133
<i>Underpayment gap</i>	\$155
Gross tax gap	<u>\$1,536</u>
<i>Voluntary withholding payments not claimed on timely returns</i>	-\$250
<i>Other receipts beyond reported tax</i>	-\$148
Net tax gap	<u>\$1,137</u>
Net tax gap as % of true liability	17.8%

*Source: Oregon Department of Revenue.

Tax Transparency Proposals

The following is an overview of proposals to improve tax transparency in Connecticut.

Providing Comprehensive Tax Incidence and Tax Gaps Reports on a Regular Basis

Minnesota's superior tax incidence report cost \$105,000. In comparison, Connecticut appropriated \$375,000 for its upcoming tax incidence report in 2022. The difference in cost is because Minnesota develops its report in-house, whereas Connecticut hires a consultant. In addition to a lower cost, developing Connecticut's report in-house would provide two benefits. First, once the DRS has sufficient capacity, it would be more difficult to block the report because that would no longer simply involve removing a budget line item for a consulting service. Second, the DRS could assist the Office of Fiscal Analysis in analyzing proposed and passed tax legislation, which is addressed shortly.

The proposal here does not include a cost estimate for Connecticut to develop tax incidence and tax gap reports in-house because the DRS's existing tax analysis capacity is not known. As mentioned earlier, however, it is known that the DRS is implementing the "Data Analytics Initiative" to "ensure full collection of the tax that is due." This may provide sufficient in-house capacity for the DRS to provide tax incidence and tax gap reports. But even if the DRS needs to further increase its capacity, that should not be a concern for at least two reasons. First, the DRS's staff decreased by 25 percent over the last two decades. Along with the decrease in government jobs more generally, this has contributed to Connecticut's poor job growth and shrunken economic output. In contrast, increasing the DRS's staff would create important, good paying jobs that would strengthen the state's economy and help make it fairer. Second, the DRS estimates that the new Data Analytics Initiative will generate \$40 million annually beginning in FY 23, meaning further expanding the DRS's tax analysis capacity would likely generate revenue for the state rather than require new or higher taxes.⁸³

Tax Transparency Proposal

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

- **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.**

The "comprehensive" requirement means the tax incidence report would mirror as closely as possible Minnesota's report, and the tax gap report would mirror as closely as possible the IRS's report. The "regular basis" requirement means the DRS would release the reports no less than every two years, ideally in even years so that the most up-to-date analysis is available for creating the biennium budget in odd years.

Providing A Tax Incidence Estimate of Proposed and Passed Legislation

Currently, the OFA is responsible for “analyzing and preparing critiques of the Governor’s proposed budget,” “preparing the fiscal notes ... upon favorably reported bills which require expenditure of state or municipal funds or affect state or municipal revenue,” and “preparing at the end of each fiscal year a compilation of all fiscal notes on legislation and agency regulations taking effect in the next fiscal year, including the total costs, savings and revenue effects estimated in such notes.”⁸⁴

Adding a tax incidence estimate to the OFA’s existing responsibilities would significantly increase tax transparency. In particular, it would be most effective for the OFA—with the support of the DRS, if necessary—to provide simple tax incidence estimates (i.e., identify whether a tax is regressive, proportional, or progressive) in all fiscal notes and also provide detailed tax incidence estimate (i.e., include the overall effective tax rate by income and population deciles) for three key pieces of legislation: (1) the governor’s proposed tax program; (2) the General Assembly’s proposed tax program; and (3) the tax program ultimately passed into law.

If these new responsibilities require the OFA to increase its capacity, policymakers could use a portion of the new \$40 million revenue stream from the new Data Analytics Initiative to cover that cost, meaning the proposal here would not require new or higher taxes.

Tax Transparency Proposal

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

- 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.

The “simple” requirement means that the OFA would identify whether a tax is regressive, proportional, or progressive. The “detailed” requirement means the OFA would provide the overall effective tax rate by income and population deciles.



MAKING CONNECTICUT'S TAX SYSTEM FAIRER THROUGH TIMELY SUPPORT

The preceding sections showed that, at minimum, a fairer tax system in Connecticut would not exacerbate income inequality and the racial income gap, and establishing such a tax system requires tax reform, which in turn requires tax transparency. This section shows that a tax system is even fairer when it includes timely support—providing working- and middle-class families the option of receiving refundable tax credits in installments to help make ends meet. The analysis proceeds in two parts. The first part provides an overview of Connecticut's tax credit payment problem. The second part provides an overview of timely support proposals.

The following is a summary of the key findings:

Connecticut's Tax Credit Payment Problem

Connecticut's tax credits are not as effective as they could be in helping families make ends meet because the timing of the payments does not align with the needs of many working- and middle-class families, especially working-class families, which disproportionately includes families of color.

The federal government's Advance Child Tax Credit helped Connecticut's working- and middle-class families with children. At the same time, many of Connecticut's working- and middle-class families still struggled to make ends meet, indicating the need for timely support at the state level in addition to at the federal level.

Timely Support Proposals

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

- 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.

Connecticut's Tax Credit Payment Problem

The following is an overview of Connecticut's tax credit payment problem.

Connecticut's tax credits are not as effective as they could be in helping families make ends meet because the timing of the payments does not align with the needs of many working- and middle-class families, especially working-class families, which disproportionately includes families of color. Currently, eligible families in Connecticut receive the state's earned income tax credit (CT EITC) in a single payment after filing their tax return. For example, the average working-class family with two children receives about \$1,800 from the CT EITC and would receive a total of about \$2,700 if Connecticut passed the child tax credit (CT CTC) proposed in the Finance, Revenue, and Bonding Committee's revenue package last year. This is a substantial level of financial support—equivalent to nearly 12 percent of the above family's pre-tax income—and the objective is to offset the state's highly regressive taxes, such as the sales tax, which is paid throughout the year when purchasing goods and services, and the property tax, which homeowners pay directly and renters pay indirectly throughout the year. The effectiveness of the state's financial support, however, is diminished if a family pays a substantial amount in bank overdraft fees or relies upon high-interest loans to make ends meet while waiting for their annual tax refund. To understand the extent of this problem, **Table 26** shows that 50 percent of Connecticut's families last year had difficulty paying their usual expenses (e.g., food, housing, utilities). The percentage of families struggling was even higher for certain subgroups, especially working-class and lower-middle-class families (77 percent and 55 percent), Black and Latino families (65 percent and 70 percent), and families with children (62 percent).⁸⁵

Table 26. Difficulty Paying Usual Household Expenses in Connecticut, 2021

Total Population		50%	
By Income Group		By Race and Ethnicity	
Working-Class Families	77%	Black	65%
Less than \$25,000	84%	Latino	70%
\$25,000 - \$34,999	80%	White	44%
\$35,000 - \$49,999	69%		
Middle-Class Families	40%		
\$50,000 - \$74,999	55%		
\$75,000 - \$99,999	40%		
\$100,000 - \$149,999	34%		
\$150,000 - \$199,999	29%		
Upper-Class Families	16%	By Presence of Children	
\$200,000 and above	16%	Children	62%
		No children	44%

*Data from US Census Bureau and author's calculations.

The federal government’s Advance child tax credit helped Connecticut’s working- and middle-class families with children. In 2021, the Treasury Department began to issue half of the expanded federal CTC in advanced monthly payments and, as **Table 27** shows, the Census Bureau collected and released data on how households used those payments. There are two key, related findings. First, the data show that 70 percent of families in Connecticut that received the monthly CTC payments mostly spent them, and the number increases to 77 percent of the working-class families and 75 percent of lower-middle-class families. Second, the data show that those families largely spent the payments on usual expenses, especially food (51 percent of families), clothing (28 percent), utilities (25 percent); and school books and supplies (20 percent).⁸⁶

Many of Connecticut’s working- and middle-class families still struggled to make ends meet, indicating the need for timely support at the state level in addition to at the federal level. In 2021, while the majority of working- and middle-class families in Connecticut that received the Advance CTC payments were largely using them on usual expenses, the majority of working- and lower-middle-class families still struggled to make ends meet. This indicates that providing timely support at the federal level is helpful but not a sufficient substitute for providing timely support at the state level.

Table 27. Use of Advance CTC in Connecticut, 2021

Mostly Spent		Spending Category	Families
Total	70%		
Working-Class Families	77%	Food	51%
Less than \$25,000	77%	Clothing	28%
\$25,000 to \$34,999	72%	Utilities and telecommunications	25%
\$25,000 to \$34,999	72%	School books and supplies	20%
\$35,000 to \$49,999	83%	Savings or investments	17%
Middle-Class Families	70%	Debt	16%
\$50,000 to \$74,999	75%	Childcare	13%
\$75,000 to \$99,999	73%	Rent	13%
\$100,000 to \$149,999	66%	Mortgage	13%
\$150,000 to \$199,999	67%	Vehicle payments	10%
Upper-Class Families	56%	School tuition	6%
\$200,000 and over	56%	Recreational goods	5%

*Data from US Census Bureau and author’s calculations. Mostly spent includes mostly used to pay off debt.

Timely Support Proposals

The following is an overview of proposals to provide timely support in Connecticut. It addresses the four major components of developing and implementing such a program: administration, eligibility and participation, disbursement, and reconciliation.

Administration. The DRS's existing administrative capacity is not known. It is known, however, that along with implementing the "Data Analytics Initiative" to "ensure full collection of the tax that is due," the DRS is implementing "a multi-year, multi-phase information technology (IT) modernization initiative" that includes the creation of "myconnectCT," an "online portal to file tax returns, make payments, and view your filing history." The DRS may therefore already have sufficient capacity to provide timely support. But even if the DRS needs to further increase its capacity, that it should not be a concern for two reasons already addressed. First, the DRS's staff decreased by 25 percent over the last decades, and reversing that process would add important, good paying jobs that would strengthen the state's economy and help make it fairer. Second, the budget estimates that the new Data Analytics Initiative will generate \$40 million annually beginning in FY 23 and the DRS could use a portion of that new revenue stream to increase its tax administration capacity, meaning the proposals here would not require new or higher taxes.⁸⁷

Eligibility and participation. Providing refundable tax credits in installments rather than a single payment requires establishing eligibility guidelines and a participation default. Connecticut could limit eligibility, for example, to tax filers that received the credit in the previous year, or it could expand eligibility to include any tax filer that provides a declaration of anticipated year-end eligibility for the credit. For the participation default, there are two options: either opt-in or opt-out. An opt-in default would keep the existing annual payment as the standard and eligible tax filers would need to take action to receive timely support. An opt-out default would make receiving timely support the standard and eligible tax filers would need to take action to receive only an annual payment.⁸⁸

Disbursement. The disbursement of timely support includes three components: frequency, amount, and basis of calculation. Frequency is the timeline of the payments (e.g., monthly, bimonthly, quarterly). Amount is the percentage of the credit made available for advanced payments (e.g., 25 percent, 50 percent, 75 percent). Basis of calculation is the method for estimating the total amount of the annual credit. There are three approaches to this last component: a backward-looking approach estimates the total amount of the tax credit based on a tax filer's previous tax returns; a forward-looking approach estimates the total amount of the tax credit based on a tax filer's expected income; and a hybrid approach estimates the total amount of the tax credit based on a tax filer's previous tax returns but also requires the tax filer to update their information as necessary throughout the year.⁸⁹

Reconciliation. If a tax filer receives more in advanced payments than the total credit they were eligible to receive due to changes in income, marital status, or number of qualifying children, it is necessary to reconcile the difference. There are three approaches: a full repayment reconciliation requires tax filers to repay the entire excess credit, possibly through a reduction in subsequent advanced payments or some other payment plan; a safe harbor reconciliation allows tax filers to keep the excess credit or repay only part; and a phase-out safe harbor process allows some tax filers (e.g., those below a

certain income level) to keep the excess credit or repay only part but requires other tax filers (e.g., those above a certain income level) to repay the entire excess credit.⁹⁰

In 2021, the federal government designed the Advanced CTC program as follows: The Treasury Department oversaw the program. Tax filers that received the credit in 2020—or 2019 if their 2020 income tax data were unavailable—were eligible. The program had an opt-out default for eligible tax filers, and newly eligible tax filers had the option to sign up. The Treasury Department made monthly payments during the second half of the year (the equivalent of a bimonthly annual program). The monthly payments totaled 50 percent of the annual credit. The basis of calculation was hybrid. And overpayments are reconciled through a phase-out safe harbor process that takes into account family structure and income level.⁹¹

For an overview of a timely support option in Connecticut, **Table 28** shows the amount that working- and middle-class families and the median household by race and ethnicity would receive in bimonthly support that totals 50 percent of the refundable tax credits—the CT EITC and proposed CT CTC. For example, with three or more children, the average working-class family would receive a bimonthly payment of \$255 and the average middle-class family would receive \$150. This would help pay for food, housing, utilities, and any of the other usual expenses that a majority of working- and middle-class families struggled to afford last year due to the state’s historic level of pre-tax income inequality, a substantial racial income gap, and an unfair tax system that exacerbates both problems.⁹²

Timely Support Proposals

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

- 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.

The “ensures extensive access” requirement means all tax filers that attest that they will qualify for the annual credit are eligible. The “provides a range of timely support options” requirement means tax filers can select both their preferred overall level of advanced support, up to a maximum of 50 percent of the annual credit, and whether they receive support monthly (12 payments), bimonthly (six payments,) or quarterly (four payments). The “limits the use of reconciliation” requirements means the design of the program, especially the 50 percent maximum advanced support, will prevent tax filers from needing to payback an excess credit.

- Require the DRS to release detailed data each year so that policymakers can improve the design of timely support moving forward if necessary.

Table 28. Timely Support Option for CT EITC and Proposed CT CTC

Working- and Middle-Class Families

	2 Children		2+ Children	
	Dollars	% of Income	Dollars	% of Income
Working-Class Family				
Income	\$22,500	100%	\$22,500	100%
Total Refundable Credits (CT EITC + CT CTC)	\$2,664	11.8%	\$3,065	13.6%
Total Timely Support (50%)	\$1,332	5.9%	\$1,532	6.8%
Bimonthly Support (6 payments)	\$222	1.0%	\$255	1.1%
Working-Class Family				
Income	\$45,000	100%	\$45,000	100%
Total Refundable Credits (CT EITC + CT CTC)	\$1,409	3.1%	\$2,058	4.6%
Total Timely Support (50%)	\$705	1.6%	\$1,029	2.3%
Bimonthly Support (6 payments)	\$117	0.3%	\$172	0.4%
Middle-Class Family				
Income	\$97,400	100%	\$97,400	100%
Total Refundable Credits (CT EITC + CT CTC)	\$1,200	1.2%	\$1,800	1.8%
Total Timely Support (50%)	\$600	0.6%	\$900	0.9%
Bimonthly Support (6 payments)	\$100	0.1%	\$150	0.2%

Median Household by Race and Ethnicity

	2 Children		2+ Children	
	Dollars	% of Income	Dollars	% of Income
Median Black Household				
Income	\$48,900	100%	\$48,900	100%
Total Refundable Credits (CT EITC + CT CTC)	\$1,159	2.4%	\$1,807	3.7%
Total Timely Support (50%)	\$580	1.2%	\$904	1.8%
Bimonthly Support (6 payments)	\$97	0.2%	\$151	0.3%
Median Latino Household				
Income	\$49,200	100%	\$49,200	100%
Total Refundable Credits (CT EITC + CT CTC)	\$1,140	2.3%	\$1,767	3.6%
Total Timely Support (50%)	\$570	1.2%	\$884	1.8%
Bimonthly Support (6 payments)	\$95	0.2%	\$147	0.3%
Median White Household				
Income	\$85,800	100%	\$85,800	100%
Total Refundable Credits (CT EITC + CT CTC)	\$1,200	1.4%	\$1,800	2.1%
Total Timely Support (50%)	\$600	0.7%	\$900	1.0%
Bimonthly Support (6 payments)	\$100	0.1%	\$150	0.2%

*Data from CT DRS, US Census Bureau, and author's calculations.



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

To make Connecticut's tax system fairer, the preceding sections provided proposals for tax reform, transparency, and timely support. This section incorporates several of those proposals into a recommended program.

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. **Table 29** 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.⁹³

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.⁹⁴

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.⁹⁵

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.⁹⁶

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.⁹⁷

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.⁹⁸

Table 29. 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)	\$504 million	
Create new top rate of 8.49 percent over \$1 million (single), \$2 million (married)		
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.





CONCLUSION

Last year in Connecticut, half of the state's families had difficulty paying their usual expenses (e.g., food, housing, utilities). The percentage of families struggling was even higher for certain subgroups, especially working-class and lower-middle-class families (77 percent and 55 percent), Black and Latino families (65 percent and 70 percent), and families with children (62 percent).

Although Connecticut has the second highest level of per capita personal income in the US, making it exceptionally wealthy overall, many families consistently struggle because Connecticut also has the second highest level of income inequality and a substantial racial income gap, meaning a small, disproportionately white portion of the population primarily benefits from the state's overall wealth. Specifically, in the immediate term, income inequality and the racial income gap make it difficult for working- and middle-class families, especially families of color, to make ends meet; and over time, through both the "investment" and "stress" pathways, income inequality and the racial income gap negatively impact the children from working- and middle-class families, especially families of color, in "virtually every dimension, from physical and mental health, to educational attainment and labor market success, to risky behaviors and delinquency." These problems in turn weaken Connecticut's economy and thereby decrease the state's ability to pay down long-term obligations and make critical investments, which is especially important due to the state's below-average level of economic growth and above-average level of long-term obligations.

In response to the above problems, which Connecticut's tax system currently exacerbates, this report provides proposals for tax reform, transparency, and timely support that would make Connecticut's tax system fairer, meaning, in simple terms, it would put more money in the pockets of working- and middle-class families, especially families of color. More specifically, in the immediate term, a fairer tax system would reduce income inequality and the racial income gap, which would help working- and middle-class families, especially families of color, make ends meet; over time, it would benefit the children from working- and middle-class families, especially families of color, in "virtually every dimension" of life through both the "investment" and "stress" pathways; and those developments in turn would strengthen Connecticut's economy.

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