CONNECTICUT'S TAX SYSTEM

BACKGROUND

Connecticut's state and local tax system relies heavily on a few major taxes to fund most of its state and local services. The bulk of the revenue comes from the state income tax, local property tax, state sales and use tax, state excise taxes, and business taxes. Recently, concerns have been expressed that Connecticut's overall tax system is too reliant on the property tax to support needed public services. Such was a finding of the legislatively mandated *Blue Ribbon Commission on Property Tax Burdens and Smart Growth Incentives* in 2003.

There have been studies of various aspects of Connecticut's state and local tax system in the past several years. However, there has not been a comprehensive look at the entire system since the state personal income tax, a significant system change, was enacted in 1991. The concurrent creation of the Connecticut State Tax Review Commission appeared to contemplate such reviews, but the commission has been dormant for some time.

Currently, there is interest in conducting an overall examination of the entire tax system used in Connecticut now -- rather than when the state is facing a severe budget crisis and needs to take significant measures to balance the budget -- to evaluate how well the system is performing in providing a well-balanced, reliable revenue stream to fund services in the 21st century.

AREA OF FOCUS

A two-phased approach is contemplated for this study. The first phase will examine Connecticut's state and local tax structure to determine how well the system performs based upon nationally recognized criteria. Depending on the outcome and findings in the first phase and the desire of the committee, the second phase may examine various alternatives for change, their potential benefits and drawbacks, and how different options might impact various taxpayers in the state.

AREAS OF ANALYSIS

- Provide background information on tax policy and state tax structures.

- Describe and analyze Connecticut's tax structure focusing on: 1) personal income tax; 2) state sales and use tax; 3) business taxes including taxes on corporations, public service companies, insurance companies, and oil companies; 4) local property tax; 5) state excise taxes including those on cigarettes, alcohol, and motor fuels; and 6) the inheritance and estate tax. The examination would include revenues generated, the proportion of revenues generated by each and trends over time, and the proportion of state vs. local revenues that are used for major categories of state and local services.

- Describe and analyze who pays each of these taxes, how they are collected, the level of compliance, and the efficiency of administering the taxes.

- Describe and analyze the major exemptions and credits associated with each tax component.

- Identify and examine models, best practices, and evaluation criteria for tax systems. Using such criteria, including the nine principles established by the National Conference of State Legislatures (NCSL) for a high-quality state revenue system, the study would analyze and evaluate how well Connecticut's system incorporates the following features:

  - Complementary -- using various elements of local and state revenues to finance services;
  - Reliability and adequacy -- stability, certainty, and sufficiency are achieved in raising revenues, without the need for continuous or drastic changes in the tax rates, the tax base, or major spending modifications;
  - Balanced -- using a diverse range of different taxes with a broad base, and appropriate proportionality exists in the revenue system;
  - Equitable -- distributing the tax burden fairly across taxpayers, imposing a similar burden on people with similar circumstances, and minimizing the amounts that lower-income groups must pay;
  - Promotes compliance -- avoids complex forms and filing requirements, minimizes the number of exemptions and credits, and includes policies and practices that are recognized as fair, understandable, and uniformly applied;
  - Fairly administered -- promotes fair, efficient, and effective methods in assessing, applying, and collecting taxes in a cost-effective and efficient manner;
  - Economic competitiveness -- recognizes that the tax system is integral to promoting economic development, especially when compared with neighboring states, but that tax burden is only one factor affecting the competitive nature of the business climate;
  - Neutral -- separate from spending decisions, minimizing use of tax exemptions, credits, or earmarking of revenues, and closely monitors these modifications to ensure they are having the appropriate outcomes; and
  - Accountable to taxpayers -- ensuring that tax laws are clear, that all aspects of revenues raised (or forgone in the form of tax expenditures) are reported, that proposed changes are well publicized, and that taxpayers have an opportunity for input.

Areas of Analysis Excluded or Limited

The study would rely on existing incidence information and would not conduct a comprehensive primary incidence analysis on how any one of the taxes, or the system as a whole, impacts different income groups. The committee may wish to explore the need for conducting such a tax incidence analysis, as well as how such an analysis might be undertaken. Also, the study would not examine the adequacy of current state and local expenditures.