Mr. Dyson, Mr. Nickerson, and distinguished members of the Tax Panel:

Although I address each of the taxes that are the subject of the Tax Panel's work, I focus on the property tax. The state’s overall tax structure needs to change in a more progressive direction. Because the property tax is highly regressive,

- reducing the property tax portion of the total mix of taxes – at 42%, the largest share of the entire tax incidence – and
- distributing revenue raised from other taxes in ways that reduce the property tax disparities among towns,

are important ways to improve progressivity.

I. Overall Context

First, the overall tax structure is too regressive, and any change should move the complete mix of taxes in a more progressive direction.

The Tax Incidence Study completed by DRS in December 2014 shows very clearly the regressive nature of the overall tax structure. The overall effective tax rate (ETR) for taxpaying households in the lowest income decile is 23.6%; this effective tax rate gradually diminishes through the next 9 deciles, with the ETR for the highest income decile at only 6.3%.¹ Measured by the Suits Index, the overall impact of the state’s tax system is regressive, although because of the progressive personal income tax and the estate tax, slightly less so than for some kinds of taxes.²

An analysis of Connecticut’s overall tax burden by the Institute on Taxation and Economic Policy confirms the regressivity of the state’s tax system. ITEP examined the share of family income paid in state and local taxes (enacted before December 31, 2014) by non-elderly taxpayers, by quintile. The result: taxpayers in the lowest quintile paid 10.5% of family income in taxes, with taxpayers in the next three quintiles averaging 8.9% to 10.7%. In the top quintile, taxpayers ranking in the 81st through the 95th percentile averaged 9.2%, but those in the 96th through 99th percentile averaged

only 7.6% and the top 1% of taxpayers paid only about 5.3% of family income in state taxes.\textsuperscript{3}

**Second, the property tax is an integral part of the state’s overall tax structure, so its relationship to the other taxes should be an important part of the Tax Panel’s consideration.**

If, in general, local property taxes are too high, other taxes in the overall mix should be increased to provide sufficient revenue to divert to municipalities and individuals to enable property taxes to be reduced. This is an important point, because some members of the Tax Panel have insisted that recommending a reduction of property taxes via a rebalancing of the overall, entire state revenue structure is not within the scope of the Tax Panel.\textsuperscript{4}

That position is belied by one of the important principles adopted by the Tax Panel on May 12, 2015, as a statement of the panel’s overarching philosophical framework, that “Revenue policy [is to be] understood as a part of an intergovernmental system,” and further elaborated as follows:

Connecticut revenue policy should be composed of elements that function together as a system of state and local government finance. Although the State is ultimately responsible for determining the functions of local governments and the taxes localities they levy, it should minimize actions that limit local fiscal autonomy. The State should also recognize that because it often has inherent access to more productive revenue sources than its localities, there is a necessary and important role for a well-designed and fiscally certain system of intergovernmental aid.

The contention that property taxes are not within the scope of the Tax Panel is also refuted by the General Assembly’s mandate that it is “to review the state’s overall state and local tax structure,” continuing:

The panel shall consider and evaluate options to modernize tax policy, structure and administration with respect to (1) efficiency, (2) cost of administration, (3) equity, (4) reliability, (5) stability and volatility, (6) sufficiency, (7) simplicity, (8) incidence, (9) economic development and competitiveness, (10) employment, (11) affordability, and (12) overall public policy. All such options shall include consideration and evaluation of the impact and extent of such tax policy upon business and consumer decision-making.

With respect to the foci specifically mentioned in the Panel’s mandate,

- To the extent that disparate property taxes impact locational decisions, they violate the principle of efficiency (#1).

\textsuperscript{3} Institute on Taxation and Economic Policy, “Who Pays?” (5\textsuperscript{th} edition), January 14, 2015
http://www.itep.org/whopays/ Connecticut information is at
http://www.itep.org/whopays/states/connecticut.php

\textsuperscript{4} William Nickerson, in telephone discussion by the Tax Panel on July 31, 2015, on the topic of “Local Revenues,” accessible in the archives of CT-N.
- Disparate property taxes clearly adversely affect #3, **equity** (both horizontal and vertical).
- Property taxes contribute to both **reliability** (#4) and **stability** (#5), as part of the overall structure – despite their other failings.
- Even high property taxes are not **sufficient** (#6) to meet the needs of low tax base jurisdictions.
- We know from the DRS study released in December 2014 that the **incidence** (#8) of property taxes contributes to the regressivity of the whole tax burden in Connecticut.
- Other studies, noted below, show that property taxes impact **economic development and competitiveness** (#9).
- To the extent that property taxes are based on property values, and not on income or wealth, they may not be **affordable** (#11).
- And their relevance to **overall public policy** (#12) as a criterion for modernizing "tax policy, [and] structure" is reinforced by the last sentence quoted above: "All such options shall include consideration and evaluation of the impact and extent of such tax policy upon business and consumer decision-making."

Many studies which have reviewed the overall state and local tax structure have included the property tax as part of that structure. Foremost among these studies is the state’s first Tax Incidence Study, conducted by the Department of Revenue Services, and published in December 2014,\(^5\) which reported that property taxes accounted for the largest share (42\%) of overall household tax incidence in the state.\(^6\) The Institute on Taxation and Economic Policy’s “Who Pays?” studies, the latest of which was released in January, 2015,\(^7\) incorporates property taxes as an essential part of each state’s overall state and local tax structure. And property taxes on business are an important element of the calculation of the business tax burden in each state, performed annually for the Council on State Taxation by Ernst and Young.\(^8\) In Connecticut, Ernst and Young found, property taxes constitute the largest share of business taxes in the state.\(^9\)

Finally, because the General Assembly has now established that certain revenues can now be **intercepted** and dedicated for property tax relief (for motor vehicle property taxes and PILOTs, as well as general grants for property tax relief) – as opposed to “appropriating” them for those purposes – it is very clear that state aid for property tax

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\(^9\) Ibid., at p. 23.
reductions is not a “different kettle of fish” outside the purview of the Tax Panel. Indeed, to provide for both horizontal and vertical equity, how state revenue for property tax relief is distributed is an appropriate topic for this Tax Panel to consider.

Third, the claim that “Connecticut is overtaxed” is simply wrong.

I raise this point because Joe Scarborough and his claque will probably appear at the public hearing on September 16 to re-iterate this inaccurate but widely accepted myth. Some taxes, especially property taxes, may be high relative to those in other states, but overall, the total general revenue collected by states and localities in Connecticut (own source revenue), as a share of the state’s total economic resources (measured by aggregate personal income), while no longer the fourth lowest in the country, as it was when David Osborne and Peter Hutchinson wrote The Price of Government in 2004, is still ranked 15th lowest of the 50 states and D.C.

Specifically, businesses are not overtaxed in Connecticut, compared with other states. The most recent study of business tax burdens in the fifty states conducted for the Council on State Taxation by Ernst and Young, found that in FY 2013, the total state and local tax burden on business in Connecticut, as a share of private sector gross state product, was tied with North Carolina for second lowest among all states (3.4 percent of gross state product), trailing only Oregon. Connecticut’s tax burden on business was 27 percent lower than the national average.

The same study also found that total taxes on business in Connecticut, as a share of total taxes levied by state and local government, at 28.9 percent were the lowest in the country — standing at 36 percent below the national average.

There is, in short, room to revamp Connecticut’s tax structure without fearing that the resources of the state will be exhausted – especially if some changes result in property tax reduction.

Fourth, related to the third point, no one should uncritically accept the widely accepted assertion that people and businesses are leaving the state because of high taxes.

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10 It is probably appropriate to observe that measuring revenue per capita fails to recognize that states, regardless of the number of people in each, have far different economic resources. So measures of tax burden per capita are wildly inappropriate.
12 “Own Source Revenue – State and Local,” as a share of personal income, 2012. See the link at http://www.revenue.state.mn.us/research_stats/Pages/Rankings_by_Tax_Type.aspx, developed by the Minnesota Department of Revenue.
If, in general, **businesses** are doing so, they are most likely doing so against their financial interests. As noted above, Ernst and Young has conclusively demonstrated that business taxes in Connecticut are among the lowest in the fifty states.

Also, data show that (1) there is not a widespread exodus to other states by **individuals and families**,\(^\text{14}\) and (2) people’s main reasons for interstate moves have nothing to do with taxes, but with jobs, family connections, less expensive housing, and a warmer climate.\(^\text{15}\)

II. **Specific Recommendations**

**Personal Income Tax**

- Enhance the role of the personal income tax in the overall revenue structure: gain more revenue, and make the tax, and the overall structure, more progressive. The progressivity of the income tax could be used to offset reductions in other taxes, including business taxes and property taxes.
- The top bracket of the personal income tax should be increased to the level of New York and New Jersey. (Note that because of the federal deductibility of state income taxes – the “federal offset” – even this rate increase might not be sufficient to produce vertical equity vis-à-vis lower income taxpayers.)

  (As noted above, studies show that a higher income tax rate at the level imposed by New York and New Jersey on upper income taxpayers will not be the primary reason why individuals move out of state.\(^\text{16}\))

- Control for volatility by expanding the “Rainy Day Fund,” so that revenue would be available when the income tax produces less revenue in an economic downturn.
- Replace the minimally targeted “property tax credit” with a more targeted, higher refundable EITC, and a refundable income-based property tax circuit breaker, extended to renters. If a homestead exemption is authorized, it should be

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\(^\text{14}\) See the data tables on state to state migration compiled by the U.S. Census Bureau, the latest from the 2013 American Community Survey. Click on the link for the 2013 data table at [http://www.census.gov/hhes/migration/data/acs/state-to-state.html](http://www.census.gov/hhes/migration/data/acs/state-to-state.html). Overall, that table shows that of about 180,000 moves in 2013, about 91,600 were OUT of state TO other states, and about 88,350 were IN to Connecticut FROM other states – for a net loss of 3,250 individuals. Add in moves to and from Puerto Rico, and from foreign locations INTO Connecticut, and there was a net gain of 18,531 individuals INTO the state. Among the states with a net inflow into Connecticut were New York and New Jersey (a total of about 12,000). Connecticut lost a net 2,940 to Florida, and about 1,550 to South Carolina.


\(^\text{16}\) In addition to the summary report cited above, see Michael Mazerov, “State ‘Income Migration’ Claims are Deeply Flawed,” CBPP, October 20, 2014. [http://www.cbpp.org/research/state-income-migration-claims-are-deeply-flawed](http://www.cbpp.org/research/state-income-migration-claims-are-deeply-flawed).
income-adjusted, and reimbursed by the state, to avoid shifting the property tax burden to other property owners.

- Make any adjustments (subtractions) to income (for Social Security, retiree pay, teachers pensions, military pensions, CHET, etc.) income adjusted.
- Because capital gains are included in the AGI at full value, and hence subject to the normal Connecticut income tax rate, there is no reason to supplement the income tax with a special capital gains tax.
- To improve auditability, business entities (LLPs, LLCs, S-Corps, etc.) that provide pass-through income to individuals should be required to report to DRS the names and addresses of recipients and the amounts of Connecticut-sourced pass-through income (or alternatively, to withhold Connecticut income tax on such income).
- Maintain the reachback provision to recapture revenue lost from the marginal rate phase-in for higher-income taxpayers.
- Make necessary clarifications of definitions that are currently reported to be vague, such as “domicile.” But don’t loosen the restrictions.

**Business Taxes**

- Consider replacement of the corporate income tax with a Commercial Activities Tax such as that implemented in Ohio.

Business owners who have the protections of “limited liability” extended to them by state law benefit greatly from that privilege. It’s doubtful that corporations could have grown to be such a significant share of the economy, and it’s doubtful that the economy could have expanded as much as it has, without the personal assets of their stockholders being protected from creditors.

But now only C corporations are being taxed in return for that benefit. The taxation of C corps in the modern economy, however, is fraught with much controversy – as many C corps seek with great success to minimize their tax liability. They have successfully lobbied to modify apportionment factors to reduce the amounts they must pay the state. And in recent years they have been able to shift both revenues and expenses to jurisdictions other than this state, so as to nearly escape corporate taxation here. Even the recent – and desirable – combined reporting / unitary taxation reform is likely not to produce significant amounts of new corporate income tax revenue, which has declined over the years. (Obviously, however, if the corporate income tax is retained in Connecticut, combined reporting must also be retained, in order to reduce corporate tax avoidance.)

Moreover, corporations have taken advantage of significant subsidies in the form of tax credits, other tax expenditures, and direct grants. In Connecticut, a partial
list of such subsidies since 1992 totals more than $3.9 billion. (Note that, in the future, a new GASB rule will provide much more transparency in reporting tax abatements provided by governments.)

(Interestingly, the Tax Foundation, which claims, with a methodologically suspect analysis, that Connecticut has a “tax climate” ranking among the worst states in the nation, is highly critical of states that adopt preferential tax breaks for individual businesses. As it explains in its 2011 State Business Tax Climate Index report, “The most competitive tax systems, and the ones that score best in the SBTCI [State Business Tax Climate Index], are those that create the fewest economic distortions by enforcing the most simple, pro-growth tax systems characterized by broad bases and low rates.” It is, accordingly, Connecticut’s adoption of multiple tax credits, exemptions, deductions and other special preferences in its business taxes that leads to its relatively poor tax climate ranking, according to the Tax Foundation. In other words, if Connecticut were to repeal many of its tax expenditures (broaden the tax base), its “tax climate” ranking would actually improve, particularly if rates were adjusted downward to reflect the broader base.)

At the same time, other businesses with limited liability, such as S corps, LLCs and LLPs, have been taxed only minimum amounts, as business entities. As a matter of horizontal equity, it only seems reasonable that these businesses enjoying limited liability protection should also pay directly some taxes related to their profits, rather than all profits (other than the minimal business entity tax) being passed through to individual shareholders or partners.

(It should also be observed that because these businesses are not C corps, they are not eligible for some tax credits which only C corps can access.)

Despite the benefits accruing to corporations and limited liability businesses, they have often contended that their taxes in Connecticut make them non-competitive, so that they have little incentive to expand or make any new investment in the

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17 See the very useful subsidy tracker, for Connecticut, at http://subsidytracker.goodjobsfirst.org/prog.php?statesum=CT The tool provides a link to the source of data for each subsidy listed: many come directly from the state’s open data portal, such as https://data.ct.gov/Business/Department-of-Economic-and-Community-Development-B/xnw3-nytd The summary also observes that the total amount cited above may be an underestimate: “Availability of data for earlier years varies greatly from program to program. The majority of the listings for this state are for the period since 2013.”
state, and that they may respond to incentives offered by other states and take their business to new locations.\textsuperscript{20}

Accordingly, one possible response to the problems associated with business taxes in Connecticut, as detailed above, is to consider replacement of the corporate income tax with a Commercial Activities Tax such as that implemented in Ohio. As summarized by Connecticut's Office of Legislative Research (2012),

Ohio's CAT is a tax on business gross receipts. Unlike a corporate income tax, which is imposed on a business' profits, a gross receipts tax is imposed on a business' total sales of goods and services, with no deduction for the cost of doing business. Ohio's CAT was designed as a broad-based, low rate tax that applies to most business types (e.g., retailers, service providers, and manufactures) and forms (e.g., sole proprietorships, partnerships, limited liability companies, and corporations). Businesses with "substantial nexus" with Ohio and at least $150,000 in taxable gross receipts in a calendar year must pay the tax. Taxable gross receipts include those from the sale of goods, performance of services, and rentals and leases.\textsuperscript{21}

It may be that conversion of business taxes in Connecticut to a CAT would result in an unacceptable loss of revenue. But it would restore horizontal equity among C-corps and other limited liability businesses. It would also subject many service businesses, currently exempt from the sales tax, to a minimal tax. And although it might result in pyramiding of taxation, if at a very low rate, as in Ohio, the adverse consequences of pyramiding might be acceptable. And it may, although this is unknown at this time, prove to be attractive to businesses considering locating and expanding in Connecticut.\textsuperscript{22}

**Sales and Use Taxes**

Consider broadening the base of the sales tax, especially to additional services.

- One option is to include groceries as subject to the sales tax, provided that there is a mechanism to ameliorate the impact of this tax on low- and moderate-income

individuals and families. An increase in the EITC might be one such device.\textsuperscript{23} Or just a flat grant to persons below a certain income.

(However, it’s not clear to me that these mechanisms would help those who are not working, or who otherwise do not pay taxes and thus are not on any list that would ensure that a rebate or credit would reach them. What do other states with a sales tax on groceries do? The prospect of significant revenue gain requires consideration of taxing groceries, especially since high-income and high-wealth individuals who can afford to buy high-priced food items now get a significant tax break in the absence of such a tax.)

- A sales tax on additional business services (e.g. legal, accounting) – heretofore off the table because of potential anti-competitive effects, and because of the potential for pyramiding – should also be considered. Or alternatively, applying the sales tax to all services except for specific exemptions – in the same manner as a sales tax on the sale of all goods.
- Another alternative to a sales tax on business services, mentioned above under the category of business taxes, is to apply a commercial activities tax at a low rate on all receipts of businesses.
- The state should also consider not exempting from the sales tax any sales of goods and services made by non-profit entities that are unrelated to their tax-exempt mission. (This might be analogous to payment of income tax on unrelated business income of a 501c3.)
- Sales tax holidays should be eliminated. One thing that both the Institute on Taxation and Economic Policy and the Tax Foundation agree on is that sales tax holidays are poor tax policy – for reasons extensively laid out in their recent policy papers on this topic.\textsuperscript{24}

Tax administration

- A suggestion that has been made, and perhaps has been implemented in part, is to require credit-card processing companies, wherever located, to remit the sales tax currently collected on sales in the state directly to the Department of Revenue Services, rather than sending it back to the merchant to hold until declaring and paying to DRS the amount of sales tax collected during the reporting period. This procedure might diminish the temptation to report fewer sales than actually made, and would certainly increase auditability. (An alternative would be to

require such credit-card processing companies simply to report to DRS the amount of sales tax a merchant collected on credit card purchases.)

Use tax

- In addition, the state needs to address the continuing discrimination against in-state retailers, which exists because of failure to effectively assess and collect a use tax. One option, in the absence of congressional action to overturn Quill v North Dakota, is to require, in addition to itemized declaration of, and payment of the full use tax for, items costing more than $1,000, a programmed use tax payment (when filing a Connecticut income tax) equal to a specified percentage of income, as California currently does. This goes beyond the currently required, but widely ignored, declaration of out-of-state purchases by Connecticut taxpayers. California assumes automatically that if a taxpayer has a certain income, a percentage of that must have been spent on out-of-state goods.

Estate and Gift Taxes

- The current estate tax is the most progressive tax in the state’s inventory. Nevertheless, as part of an overall strategy to retain income tax revenue in Connecticut, the Tax Panel should consider some modification. Although it’s unclear as to how many people are moving their official residences out of state to avoid the estate tax, in order to decrease any incentive for high-wealth individuals to do so, the estate tax should at least be revamped to conform to the federal estate tax, with respect to a) the exemption level, and b) portability.

Revenue from the revised estate tax would be less, although not entirely eliminated, but more revenue from the personal income tax would likely be retained in the state.

Local Taxes

[Note that this section of my statement is drawn from, and is substantially identical to, the statement of Sue Merrow, Chair of 1000 Friends of Connecticut.]

- The Tax Panel should recommend that the state continue to intercept a portion of state sales tax revenue, and distribute those funds back to the towns in ways that reduce the gaps between objectively measured needs of each town and its capacity to raise revenue locally.


26 Portability makes it possible for widows and widowers to carry over the estate tax exemption of their deceased spouse (or most recently deceased spouse, in the case of remarriage) and add it to their own. The tax law refers to the sum available for carryover as the “deceased spousal unused exclusion,” or the DSUE amount.
Specific recommendations are provided after the following analysis of the urgent
need for property tax relief.

In Connecticut, property taxes have been essentially the only source of revenue
for municipalities. But although property taxes are relatively stable, they are
highly regressive, and both horizontally and vertically inequitable.  

- In Connecticut, the ninety percent of taxpayers with the lowest incomes
  pay two to seven times higher effective property tax rates – property taxes
  as a percentage of income – than the ten percent of taxpayers with the
  highest incomes. 

- For non-elderly households, property taxes as a share of family income for
  the bottom 95% are two to four times higher than for taxpayers in the top
  5%.

- Because the fair market value of residential property is sometimes not
  commensurate with the current income of residents (both renters and
  owners), persons with limited ability to pay are often charged property
  taxes they cannot afford.

- Owners of property having the same fair market value pay vastly different
  property taxes based on the town in which they live.

- Taxpayers in different towns receive very different levels of public services
  for the same amount of taxes paid.

- Great differences in property-tax based funding for public schools produce
  vast educational inequities between children in richer and poorer towns.
  Few municipalities are able to fully compensate for the state’s inadequate
  fiscal support of the public schools – which the state is constitutionally
  responsible for maintaining.

- Disparities among towns affect locational decisions, dis-incentivizing
  investment in places that would otherwise be attractive.

One way to reduce the reliance on local property taxes is to authorize
municipalities to levy local-option sales or income taxes on taxpayers within their
jurisdictions. But such local-option taxes would be subject to the same kind of
horizontal inequities as property taxes, because “revenue capacity from new
local-option taxes is not evenly distributed across municipalities.” As an analyst
for the New England Public Policy Center put it,

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27 In general, see “Connecticut Property Taxes 2015: Time for a Change,” A Project of 1000 Friends of

28 DRS Tax Incidence Study, December 2014, p. 21. In Connecticut, the DRS Study reports, the Suits
Index, a measure of progressivity, is -0.39 for property taxes.(p. 15)

Local-option taxes are likely to exacerbate fiscal disparities, because municipalities with low existing revenue-raising capacity often lack the tax bases for new local-option taxes.\(^{30}\)

Accordingly, authorizing local-option taxes on sales and income should be rejected.

Instead, the Tax Panel should recommend the continuation of the policy adopted by the General Assembly in 2015: intercepting a portion of the state sales tax revenue before it is appropriated for state expenditures, and distributing it to municipalities in ways that diminish the disparate revenue-raising capacity of towns which currently exists because towns mainly depend on local property taxes to fund both educational and non-educational expenses.

The General Assembly in 2015 adopted an innovative mechanism for providing property tax relief to municipalities in the state: intercepting part of the state sales tax revenue before it was appropriated, and then directing it to be used to reduce the disparity in the ability of towns to raise revenue locally. In 2015, \(\frac{1}{2}\) of a percentage point (equal to about 7.9\% of total sales tax revenue) of the sales tax was designated to be used in this fashion\(^{31}\):

1. part was used to reduce the disparity in the property tax on motor vehicles\(^{32}\),
2. part was used to direct additional PILOTs to municipalities with high shares of tax-exempt state property and college and non-profit hospital property,\(^{33}\) and
3. part was allocated to provide individually-identified grants to towns.\(^{34}\)

The first two allocations did in fact address disparities, but it is unclear if the third allocation does so. A tentative formula to distribute the third allocation after the first year was enacted, but the Office of Policy and Management was directed to make recommendations for improvement and enhancement of all of the provisions for distribution, including the formula for the third allocation.\(^{35}\)

**Recommendations**

- The Tax Panel should recommend against authorization of local-option taxes on sales and income. (see above)

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\(^{31}\) PA 15-244, Section 74, as modified by PA 15-5 (June Special Session), Section 132. This percentage would be used starting in 2018. In earlier years, a smaller percentage would be intercepted.

\(^{32}\) PA 15-244, Sections 206-208, as modified by PA 15-5 (June Special Session, Section 494.

\(^{33}\) PA 15-244, Sections 183-205.

\(^{34}\) PA 15-244, Sections 207-208, as modified by PA 15-5 (June Special Session, Section 494.

\(^{35}\) PA 15-244, Section 210.
• The Tax Panel should recommend that the state continue to intercept revenue for the purpose of rebalancing the overall tax structure in Connecticut by reducing the reliance on property taxes – and if necessary in future years, increase the amount of intercepted revenue in order to do so.

• The Tax Panel should recommend that the state continue to use part of the intercepted revenue for the purpose of reducing the disparity in the property tax on motor vehicles.

• The Tax Panel should recommend that the state continue to use part of the intercepted revenue to fully fund the PILOT for state property and the PILOT for college and non-profit hospital property used for educational and medical purposes. If the state is unable to fully fund these PILOTs, the state should continue to use the new formula established in PA 15-244 to provide as much aid as possible to those towns with higher percentages of state tax-exempt property.

• The Tax Panel should recommend that the General Assembly use the remaining or additional intercepted state revenue to eliminate the gap between the non-educational “need” of a municipality and its capacity to raise revenue to pay for its non-educational needs. A distribution formula which addresses closing this “need-capacity gap” – also known as the “cost-capacity gap” or the “municipal gap” – should be developed and implemented by the General Assembly.

The research on which the last recommendation is based was conducted by analysts of the New England Public Policy Center for the General Assembly’s Program Review and Investigations Committee.36 It is important to note that the NEPPC’s “measures of costs and capacity, and therefore gap, do not represent actual spending or revenues, but instead are based on factors that are outside the control of local officials.”

Under this framework, a town that engages in wasteful spending would have higher actual expenditures but the same underlying costs as an otherwise identical town that is better managed. Likewise, two communities that have access to the same amount of economic resources have identical capacity, even if one chooses to levy a higher tax rate than the other.37

This analysis removes from the computation of the need-capacity gap any tendency by town officials to game the system by increasing spending and/or increasing taxes. It excludes factors that can distort fair distribution, such as local decisions to pay employees a higher wage or to hire more employees, or to provide a higher than average level of services (on the cost side) or to raise or lower tax rates (on the capacity side.)

37 Zhao and Weiner, pp. 1-2.
Instead, capacity is determined by the value of property in a town, and municipal costs are computed based on five key factors outside the control of local officials:

- The unemployment rate
- Population density
- Private-sector wages
- Miles of locally maintained roads, and
- Jobs per capita in the town.

Note that if state funds are distributed based on a “need-capacity gap” analysis, there is no reason to provide for a spending cap on increased local spending since need is determined not by local officials, but by underlying objectively determined factors.

- The Tax Panel should recommend that if additional state assistance is required to ensure that the education provided in each town meets state constitutional standards of adequacy and equity, steps should be taken to intercept state revenues to provide funds to meet educational costs in an adequate and equitable manner, thus addressing what is necessary to provide a constitutionally sufficient education for each child. A distribution formula that closely reflects the real costs of educating students, including appropriate weightings for additional expenditures related to students with disabilities, English language learners and students from families living in poverty, should be constructed.

- The Tax Panel should recommend the institution of a reimbursable income-based circuit-breaker for both owners and renters, to provide relief to individual taxpayers who do not have the income necessary to pay property taxes even after they have been adjusted to reflect additional state funding directed to towns to reduce inter-town inequities. Because such a circuit-breaker does not do anything to close need-capacity gaps, however, it should complement, not replace, programs to reduce property tax disparities among towns.

- The Tax Panel should recommend investigation of other types of local revenue options, such as
  - Agreements for rental/lease of rights of way
  - Franchise fees for cable and internet providers
  - Greater shares of the real estate conveyance tax
  - Development impact fees

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38 For a much fuller explanation, see Zhao and Weiner, pp. 2-5.
39 For a much fuller explanation, see Zhao and Weiner, pp. 4-8.
40 See PA 15-244, Section 207.
41 See CCJEF v. Rell, (2010). Additional funding may also be necessary to provide adequate support for Educational Cost Sharing, to meet requirements of Horton v. Meskill, and to provide for an end to racial segregation, to meet requirements of Sheff v. O’Neill.
42 See links to numerous analyses at http://www.taxcreditsforworkingfamilies.org/state-resources/property-tax-circuit-breaker/
• Increasing state-determined assessment levels for PA 490 land
• Increasing the state-determined valuations of state forest land