CONNECTICUT VOICES FOR CHILDREN

CONNECTICUT'S 2022 TAX INCIDENCE REPORT:
A HIGH-LEVEL OVERVIEW AND COMPARISON TO THE 2014 REPORT

Patrick R. O'Brien, Ph.D.
Research and Policy Fellow

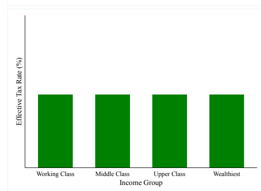
Tax incidence is an estimate of the total tax burden on families (or households)—specifically, the direct tax burden on families plus the indirect tax burden that comes from businesses that shift their own tax liability to families through higher prices and/or lower compensation.

A tax incidence report generally divides the population into income deciles (i.e., ten groups that each have the same amount of total income) or population deciles (i.e., ten groups that each have the same amount of families), and the report then shows the total tax burden for each decile. The tax burden is generally measured in dollars and effective tax rate, which is the tax burden as a percentage of income.

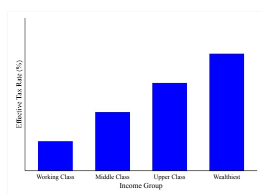
To simplify the analysis of tax incidence by income deciles and/or population deciles, it is possible to reorganize the data into four major income groups: working-class families, defined as the bottom 50 percent of the income distribution (i.e., families making up to $48,000 a year); middle-class families, defined as the next 40 percent of the income distribution (i.e., families making between $48,001 and $200,000 a year); upper-class families, defined as the next nine percent of the income distribution (i.e., families making between $200,001 and $1 million a year); and wealthy families, defined as the top 1 percent of the income distribution (i.e., families making more than $1 million a year).

Variation in the effective tax rate across the major income groups or the more numerous income and population deciles generates three basic types of tax systems. An unfair (or 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 wealthy. A fairer (or proportional) tax system requires all families to pay the same percentage of their income in taxes. The fairest (or progressive) tax system requires upper-class families and the wealthy to pay a higher percentage of their income in taxes than working- and middle-class families.

Unfair tax system (or regressive)



Fairer tax system (or proportional)



Fairest tax system (or progressive)

In 2014, Connecticut's Department of Revenue Services (DRS) released a tax incidence report that used tax data from 2011 and showed that Connecticut had an unfair state and local tax system. In 2022, the DRS released an updated report that uses tax data from 2019 and shows that Connecticut still has an unfair state and local tax system.

This brief report provides a high-level overview of the DRS' new tax incidence report and a comparison to the older report. Specifically, **Table 1** shows by major income group and by race and ethnicity the impact of Connecticut's unfair tax system in 2019, **Table 2** shows by income decile the total effective state and local tax rate in 2011 and 2019, and **Table 3** shows by income decile the components comprising the total effective state and local tax rate in 2011 and 2019. Below is an overview of the key findings and policy recommendations.

Table 1. Impact of Connecticut's Unfair—or Regressive—Tax System

Average Family / Median Household	Pre-Tax Income	Pre-Tax Inequality Ratio	Effective State & Local Tax Rate	Post-Tax Income	Post-Tax Inequality Ratio	Change in Inequality Ratio
Average Wealthy Family	$3,083,600	-	7.08%	$2,865,300	-	-
Average Upper-Class Family	$352,800	**8.7x**	10.35%	$316,300	**9.1x**	**+0.4**
Average Middle-Class Family	$97,400	**31.7x**	15.50%	$82,300	**34.8x**	**+3.1**
Average Working-Class Family	$22,500	**137.0x**	25.96%	$16,700	**171.6x**	**+34.6**
Average Wealthy Family	$3,083,600	-	7.08%	$2,865,300	-	-
Median White Household	$85,800	**35.9x**	15.50%	$72,500	**39.5x**	**+3.6**
Median Latino/a/x Household	$49,200	**62.7x**	19.55%	$39,600	**72.4x**	**+9.7**
Median Black Household	$48,900	**63.1x**	19.55%	$39,300	**72.9x**	**+9.8**

*Data from CT DRS, U.S. Census Bureau, and author's calculations. Pre- and post-tax incomes rounded to nearest hundred.

Connecticut's unfair tax system continues to exacerbate income inequality. Using data from the DRS' annual income tax report for 2019, the average wealthy family in Connecticut has a pre-tax income of nearly $3.1 million, which is 137-times greater than the pre-tax income of $22,500 for the average working-class family. Using data from the DRS' new tax incidence report, a family with an income of $3.1 million has an effective state and local tax rate of 7.08 percent, compared to 25.96 percent for a family with an income of $22,500. As a result of Connecticut's unfair tax system, the average wealthy family's post-tax income increases to 171.6-times greater than the post-tax income of the working-class family, which is a 34.6-point increase in the income inequality ratio that was already exceptionally high.

A similar process occurs for the average middle-class family. Using the same data sources, the average wealthy family has a pre-tax income that is 31.7-times greater than the pre-tax income of $97,400 for the average middle-class family. Moreover, the average wealthy family has an effective state and local tax rate of 7.08 percent, compared to 15.50 percent for a family with an income of $97,400. As a result of Connecticut's unfair tax system, the average wealthy family's post-tax income increases to 34.8-times greater than the post-tax income of the middle-class family, which is a 3.1-point increase in the income inequality ratio that was already high.[1]

Connecticut's unfair tax system continues to exacerbate the racial income gap. Adding data from the U.S. Census Bureau, the average wealthy family in Connecticut has a pre-tax income that is 63.1-times greater than the pre-tax income of $48,900 for the median Black household. Moreover, the average wealthy family has an effective tax rate of 7.08 percent, compared to 19.55 percent for a household with an income of $48,900. As a result of Connecticut's unfair tax system, the average wealthy family's post-tax income increases to 72.9-times greater than the post-tax income of the median Black household, which is a 9.8-point increase in the income inequality ratio that was already exceptionally high due in large part to a substantial racial income gap. In comparison, Connecticut's unfair tax system increases the income inequality ratio by 3.6 points for the median white household, which has an effective state and local tax rate of 15.50 percent.[2]

Both before and after adjusting for the different taxes analyzed in the two tax incidence reports, the effective tax rate increased for every income decile from 2011 to 2019, and it increased the most for working- and middle-class families. When simply comparing the overall effective tax rate by income decile as presented in the two tax incidence reports, the tax rate increased for all deciles, especially the first four deciles, which are comprised of working- and middle-class families. However, a more accurate comparison requires adjusting for the different taxes analyzed in the two reports. The 2022 tax incidence report analyzes four major taxes: (1) the personal income tax, (2) the property tax, (3) sales and excises taxes, and (4) the corporation business tax. This excludes four taxes that were included in 2014 tax incidence report and that are still in effect: (1) the gross earnings tax, which is regressive; (2) the insurance tax, which is regressive; (3) the estate and gift tax, which is progressive; and (4) the real estate conveyance tax, which is regressive. After adjusting for the different taxes analyzed in the two reports (i.e., removing from the 2011 calculation the four excluded taxes, three of which are regressive), the effective tax rate increased even more for every income decile, and it increased the most for working- and middle-class families that already had a higher effective tax rate than upper-class families and the wealthy. In particular, the effective tax rate increased by 3.73 percentage points for the first income decile (families making up to about $45,000), it increased by 6.15 percentage points for the second income decile (families making between about $45,000 and $75,000), it increased by 2.64 percentage points for third income decile (families making between about $75,000 and $108,000), and it increased by 3.32 percentage points for fourth income decile (families making between about $108,000 and $148,000).[3]

Like the older tax incidence report, the new tax incidence report understates the unfairness of Connecticut's tax system and broader revenue system. Both tax incidence reports provide an overall score of the unfairness of the tax system using the Suits Index, which ranges from negative one, the most regressive tax system possible, to one, the most progressive tax system possible. The 2014 report gave Connecticut's tax system a score of -0.22 and the 2022 report gives it a score of -0.19. As noted, however, the 2022 report excludes four taxes that were in the 2014 report, and three of the four excluded taxes are regressive, meaning the exclusion of those taxes from the new report understates the unfairness of Connecticut's tax system relative to the older report. Two other exclusions are also important. First, both tax incidence reports fail to provide an estimate of the tax gap—the difference between the tax owed to the government and tax actually paid—and the impact of the tax gap on the fairness of the tax system. This exclusion is critical because, as our 2022 tax report shows, the state's income tax gap is an estimated $2.6 billion a year and likely primarily benefits the wealthy. Second, both tax incidence reports fail to provide a distributional analysis of non-tax revenue, such as fees, fines, and other service charges, all of which are likely regressive and therefore further disproportionately burden working- and middle-class families.[4]

The property tax is still the most unfair component of Connecticut's tax system, and it increased the most for working-class and lower-middle-class families. The new tax incidence report shows that the bottom two income deciles (families making up to about $75,000) have far and away the highest overall effective tax rate and the property tax alone accounts for more than half of that tax burden. Moreover, a comparison of both tax incidence report shows that the effective property tax rate increased from

12.52 percent to 16.89 percent for the first decile (families making up to about $45,000) and it increased from 7.65 percent to 11.27 percent for the second decile (families making between about $45,000 and $75,000 a year), meaning the most unfair component of Connecticut's unfair tax system increased the most for the state's working-class and lower-middle-class families.[5]

The corporation business tax is still largely passed through to consumers and workers and therefore continues to make Connecticut's tax system unfair, though less so than the property tax and sales and excise taxes. There is an ongoing debate among economists over whether corporate income taxes are either progressive because the tax burden primarily falls on owners of capital or regressive because the tax burden is primarily passed onto workers and consumers. According to the DRS, Connecticut's corporation business tax is regressive because it is "passed through to employees and consumers in the form of higher prices for goods and services, lower wages, or other adjustments." In particular, the new tax incidence report estimates that the Suits Index for the corporation business tax is -0.18, and the effective tax rate ranges from 0.32 percent for first decile (families making up to $45,000) to 0 percent for the tenth deciles (families making more than $8.2 million a year). Also notable, the corporation business tax remains less regressive than the other regressive taxes included in the new tax incidence report: the property tax (a Suits Index of -0.41), the sales tax (-0.29), and the excise tax (-0.36).[6]

The income tax is still only moderately progressive—or nearly proportional—and therefore continues to fall short in offsetting the many unfair components of Connecticut's tax system. Due largely to Connecticut's Earned Income Tax Credit (CT EITC) and relatively substantial income tax exemption (before the phase out goes into effect), the average effective income tax rate for the first decile (families making up to about $45,000 a year) is only 0.73 percent. However, due to the phase out of the CT EITC, the phase out of the income tax exemption, the structure of the income tax brackets, and the phase out of personal tax credit—all of which is addressed in detail in our January 2022 tax report—the income tax overall is only moderately progressive, or nearly proportional, across the other income deciles. It therefore continues to fall short in offsetting the many unfair components of Connecticut's tax system.

It is also important to highlight that the new tax incidence report shows that the average effective income tax rate is higher for some middle-class families compared to some wealthy families once all tax credits and deductions are applied. For example, a family that makes $150,000 a year has an average effective income tax rate of 4.82 percent, which is higher than the average effective income tax rate of 4.78 percent for a family that makes between $1.6 million and $8.2 million a year. The lower reported effective income tax rate for the wealthy family is likely due to a combination of the credit for tax paid to other jurisdictions and the pass-through-entity tax credit, both of which disproportionately apply to wealthy families. However, the new tax incidence report provides no information on this issue, nor does it address the fact that families with business income are more likely to substantially underreport their total income and therefore may have a *real* effective income tax that is substantially lower than their *reported* effective income tax rate, which is addressed in our recent tax report and underscores the need for Connecticut to provide greater tax transparency.[7]

Table 2. Comparison of Total Effective Tax Rate by Income Decile

Income Decile	Connecticut Adjusted Gross Income	Households	Effective Tax Rate 2011	Effective Tax Rate 2019	Change: Included Taxes	Change: Same Taxes**
1	$0 to $44,758	850,332	23.62%	25.96%	+2.34 pp	+3.73 pp
2	$44,758 to $74,688	308,221	13.93%	19.55%	+5.62 pp	+6.15 pp
3	$74,688 to $107,823	199,666	13.35%	15.50%	+2.15 pp	+2.64 pp
4	$107,823 to $148,081	142,306	12.87%	15.73%	+2.86 pp	+3.32 pp
5	$148,081 to $205,199	103,736	11.93%	12.23%	+0.30 pp	+0.77 pp
6	$205,200 to $316,507	71,895	10.53%	11.47%	+0.94 pp	+1.40 pp
7	$316,513 to $602,253	42,689	9.03%	10.35%	+1.32 pp	+1.70 pp
8	$602,263 to $1,631,362	19,672	7.69%	8.99%	+1.30 pp	+1.61 pp
9	$1,631,481 to $8,246,680	5,746	6.50%	7.08%	+0.58 pp	+1.33 pp
10	$8,249,490 to $387,821,183	772	6.28%	6.64%	+0.36 pp	+0.84 pp

*Data from CT DRS and author's calculations. **The DRS' calculation of the 2019 effective tax rate excludes four taxes that still exist and that are included in the calculation of the 2011 effective tax rate. The "same taxes" column is the change in the effective tax rate from 2011 to 2019 when comparing the taxes included in both tax studies.

Table 3. Comparison of Effective Tax Rate Components by Income Decile

Income Decile	Property Tax 2011	Property Tax 2019	Personal Income Tax 2011	Personal Income Tax 2019	Sales and Excise Taxes 2011	Sales and Excise Taxes 2019	Corporation Bus. Tax 2011	Corporation Bus. Tax 2019
1	12.52%	16.89%	1.11%	0.73%	8.30%	8.02%	0.18%	0.32%
2	7.65%	11.27%	2.97%	3.65%	2.64%	4.46%	0.12%	0.17%
3	6.68%	7.19%	3.69%	4.34%	2.37%	3.79%	0.11%	0.18%
4	5.84%	7.43%	4.20%	4.72%	2.25%	3.43%	0.11%	0.16%
5	4.98%	4.08%	4.51%	4.82%	1.85%	3.26%	0.11%	0.07%
6	4.03%	3.78%	4.49%	4.80%	1.42%	2.86%	0.12%	0.03%
7	2.88%	3.24%	4.49%	4.85%	1.14%	2.25%	0.12%	0.01%
8	1.82%	2.16%	4.40%	5.05%	1.05%	1.77%	0.12%	0.01%
9	1.10%	1.08%	4.18%	4.78%	0.37%	1.22%	0.11%	0.01%
10	0.92%	0.54%	4.52%	5.48%	0.18%	0.61%	0.17%	0.00%

Income Decile	Gross Earnings Tax 2011	Gross Earnings Tax 2019	Insurance Tax 2011	Insurance Tax 2019	Estate and Gift Tax 2011	Estate and Gift Tax 2019	Real Estate Conv. Tax 2011	Real Estate Conv. Tax 2019
1	1.01%	Not	0.34%	Not	0.00%	Not	0.04%	Not
2	0.36%	included	0.13%	included	0.00%	included	0.04%	included
3	0.31%	in	0.11%	in	0.00%	in	0.07%	in
4	0.28%	the	0.10%	the	0.00%	the	0.08%	the
5	0.29%	report	0.10%	report	0.00%	report	0.08%	report
6	0.27%	-	0.10%	-	0.00%	-	0.09%	-
7	0.24%	-	0.09%	-	0.00%	-	0.05%	-
8	0.18%	-	0.07%	-	0.02%	-	0.04%	-
9	0.08%	-	0.04%	-	0.62%	-	0.01%	-
10	0.07%	-	0.03%	-	0.37%	-	0.01%	-

*Data from CT DRS.

To begin to make Connecticut's tax system fairer, Connecticut Voices for Children recommends that policymakers establish a program of tax reform, transparency, and timely support. The initial recommendations are listed below and addressed in detail in our 2022 reports, "Steps to a Fairer Tax System"[8] and "The Case for a Connecticut Child Tax Credit."[9]

Recommended Tax Reform Program

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

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

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 Department of Revenue Services (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
- 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 provide in-house comprehensive tax incidence and tax gap reports on a regular basis
- Require the Office of Fiscal Analysis to provide in-house—or with the support of the DRS—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 setup and administer a timely support program for both the existing Connecticut Earned Income Tax Credit and, if established, the Connecticut Child Tax Credit
- Require the DRS to release detailed data each year so that policymakers can improve the design of timely support moving forward if necessary

References

[1] Connecticut Department of Revenue Services. (2021). "2019 Individual Income Tax Data Report"; Connecticut Department of Revenue Services. (2022). "Connecticut Tax Incidence Study Tax – Year 2019."

[2] Connecticut Department of Revenue Services. (2021). "2019 Individual Income Tax Data Report"; U.S. Census Bureau. (2021). ACS: Median Income in the Past 12 Months (S1903), 2019, 1-Year Estimates; Connecticut Department of Revenue Services. (2022). "Connecticut Tax Incidence Study Tax – Year 2019."

[3] Connecticut Department of Revenue Services. (2014). "Connecticut Tax Incidence"; Connecticut Department of Revenue Services. (2022). "Connecticut Tax Incidence Study Tax – Year 2019."

[4] Connecticut Department of Revenue Services. (2014). "Connecticut Tax Incidence"; Connecticut Department of Revenue Services. (2022). "Connecticut Tax Incidence Study Tax – Year 2019."

[5] Connecticut Department of Revenue Services. (2014). "Connecticut Tax Incidence"; Connecticut Department of Revenue Services. (2022). "Connecticut Tax Incidence Study Tax – Year 2019."

[6] Connecticut Department of Revenue Services. (2014). "Connecticut Tax Incidence"; Connecticut Department of Revenue Services. (2022). "Connecticut Tax Incidence Study Tax – Year 2019."

[7] Connecticut Department of Revenue Services. (2014). "Connecticut Tax Incidence"; Connecticut Department of Revenue Services. (2022). "Connecticut Tax Incidence Study Tax – Year 2019."

[8] Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children.

[9] Patrick R. O'Brien. (2022). "The Case for the Connecticut Child Tax Credit." Connecticut Voices for Children.