



# **Property Tax Reform** **If Not NOW, WHEN?**

**Executive Summary**

A Project of the Property Tax Working Group of 1,000 Friends of Connecticut

Updated, December 2022

## Property Tax Working Group

The Property Tax Working Group is a project of 1,000 Friends of Connecticut. The Property Tax Working Group's primary focus is to significantly reduce the share of total state and local revenue collected from property taxes, and to do so in a way that advances economic growth, equity and fairness and minimizes adverse land-use decisions.

[taxpolicyct.org](http://taxpolicyct.org)

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# 1. Executive Summary

Connecticut has a rare opportunity, due to its positive budget situation, to correct the greatest inadequacy and inequity in its tax structure: the longstanding over-reliance on the local property tax. Property tax reform should be focused on correcting the serious flaws associated with this tax; which now constitutes the major source of funding for municipalities, and makes up 43.2% of the total tax burden for Connecticut residents.

There are **two fundamental flaws** in Connecticut's property tax system. (1) **Horizontal inequity**: owners of property with similar values are taxed at different rates depending on which town they live in, and owners paying similar tax rates receive widely different services. (2) **Vertical inequity**: low and moderate-income households are subjected to far higher effective property tax rates<sup>1</sup> than high-income households.

**Property tax reform must be done in a way that corrects these structural flaws.** If we fail to correct both the vertical and horizontal inequities, we will continue down a path of widely disparate educational opportunity, fractured and inefficient delivery of needed services, hollowed out cities, widening racial and economic disparities, sprawling suburbs, fleeing businesses and an out-migration of the next generation of talent.

**High property taxes inhibit economic growth.** Disproportionately high effective property tax rates on low-income households diminish their capacity to pay for goods and services, suppressing the principle driver of the economy: aggregate demand. High tax rates in towns with less taxable property drive businesses to lower property tax towns, where additional infrastructure often must be built. That tends to increase long-term overall costs and induces companies to move jobs away from cities – key to economic growth – where infrastructure already exists and where cross-fertilization of ideas maximizes innovation. Property taxes on businesses in high property tax towns make interstate and international businesses less competitive and tend to spur the relocation of businesses and jobs to lower property tax states.

**Over-reliance on the property tax fosters the fragmentation of services and discourages municipalities from thinking beyond their borders to act regionally or in a shared approach** - forcing 169 cities and towns to compete with one another and interfering with logical long-

**Municipalities in Connecticut realize an average 71.8% (76.1 median) of their revenues from the local property tax** and an average of 23.5% (20.4% median) from intergovernmental revenues for FY20.

**As a percentage of state-local revenue (2018) - as opposed to taxes - property tax revenue is the third highest - 25.4% - in the nation, substantially higher than the national average of 16.6%.**

**As a share of state and local tax revenue (excluding other forms of revenue), as reported in the Tax Incidence Studies conducted by the state Department of Revenue Services (DRS) in 2014 and 2019, 41.9% and 43.2%, respectively of all state and locally generated taxes came from the property tax.**

<sup>1</sup> What Is the Effective Tax Rate? The effective tax rate is the percent of their income that an individual or a corporation pays in taxes. The effective tax rate for individuals is the average rate at which their earned income, such as wages, and unearned income, such as stock dividends, are taxed. The effective tax rate for a corporation is the average rate at which its pre-tax profits are taxed, while the statutory tax rate is the legal percentage established by law. <https://www.investopedia.com/terms/e/effectivetaxrate.asp>

term economic development and smart growth. The property tax drives land-use boards to make decisions based on what members believe (rightly or wrongly) will increase tax revenues. These attempts to attract high valuation properties are at the expense of preserving farmland and open space, and expanding housing options. The result is wide disparities in the capacity of municipalities to meet essential needs, both educational and non-educational.

“Municipal property taxes are as high as they are primarily because the state has not been able to raise enough revenue to provide municipal aid,...We are, after all, one state, and we need to look at [taxes] on a statewide basis, and not a hyper-local basis.”

Analysts at the Federal Reserve Bank of Boston have identified what they call a “**needs-capacity gap**” in many towns. All towns need non-educational services such as police, fire, and public works, but many lack the capacity to pay for them. Similarly, the Federal Reserve Bank analysts note that all school districts must pay for education which meets the needs of their students. But many school districts lack the capacity to pay – producing a “**cost-capacity gap**.”

Senate President Pro Tem Martin M. Looney  
CT Mirror, January 21, 2021

Making minor modifications to the state’s revenue stream while ignoring the failings in the property tax system is likely to undermine economic growth, worsen overall financial conditions and do nothing to lessen the fragmentation in the delivery of services. Rebalancing our tax system and ending our over-reliance on the property tax will encourage a robust economy fueled by increased demand for goods and services by low- and moderate-income families; effective local government; strong communities; and a healthy environment.

**Property tax reform requires real change, with long-term benefits - not gimmicks.** Any reforms must reject seductive proposals such as providing cities and towns with a means for revenue diversification such as a local option sales tax or local option income tax. Local option revenues are not a panacea for fiscally strapped municipalities. The competition for a robust property tax base would simply be replaced by a competition for sales tax or income tax bases, and towns that are not fiscally healthy would continue to be disadvantaged. Additionally, eliminating property taxes on motor vehicles with no replacement revenue to towns/regions is not tantamount to reform as nor is granting additional property tax exemptions without full PILOT reimbursement. Finally, capping property taxes “...hamstringing localities’ ability to provide services that boost opportunity for their residents. And they increase racial and economic inequities, in part by leading localities to use revenue sources that fall harder on lower-income people.”<sup>2</sup>

**Rebalancing is different than property tax relief.** Relief means lessening the financial weight of property tax payments made by individual families by reducing their tax payments. Rebalancing means reducing the burden of property taxes by changing the structure of the state-and-local fiscal relationship so that municipalities need to rely less on property taxes to fund essential needs. Our proposals cover both taxpayer relief and a fundamental rebalancing of the current system.

**Connecticut also lacks information as to the how its taxes (as well as any proposed changes) affect different income groups.** Connecticut conducted its first tax incidence

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<sup>2</sup>Iris J. Lav and Michael Leachman, State Limits on Property Taxes Hamstring Local Services and Should Be Relaxed or Repealed Michigan, Massachusetts, Oregon, and New York Reveal Range of Problems With Limits, Center on Budget and Policy Priorities, July 18, 2018

study in 2014 and put in place a statutory requirement that it be repeated biannually. But it was not until 2022 that the second tax incidence study was completed for FY19.

**We additionally lack a government supported nonpartisan policy center to provide lawmakers with timely, high-quality research and analysis on public policy issues critical to our state.** Such centers provide, which many states have,<sup>3</sup> provide policymakers and the public with valuable information. The General Assembly had in place the Program Review and Investigations Committee with the staffing expertise to undertake such work. Unfortunately, that committee was eliminated in 2017.

Connecticut needs a balanced tax structure to address the challenges of the property tax which hampers our economic competitiveness, encourages harmful land use decisions and fosters economic and racial inequities.

**In summary, the current level and manner of property taxation undermines economic growth, fosters inequity, impedes efficiency in delivering services.**

## Recommendations To Create A Framework For Property Tax Reform

We offer the following as achievable change to the current property tax system:

### 1. Fix structural vertical and horizontal inequity.

Put in place targeted property tax relief, with refundable property tax credits and/or circuit breakers to make the property tax more progressive in terms of overall tax burden.

### 2. Close the Needs-Capacity Gap for Municipalities

**Phase in, with a hold-harmless provision, a restructuring of municipal state-aid and provide additional new aid** consistent with the 2015 recommendations from the New England Public Policy Center to **utilize state-aid as a primary means to address fiscal disparities across communities and ensure that all localities have the resources needed to provide high-quality public services.**

### 3. Close the Cost-Capacity Gap for education.

- a. **Correct the current deficiencies in the ECS formula to resolve the Cost-Capacity Gap.** The 2021 New England Public Policy Center study<sup>4</sup> on the cost-capacity gap suggests ways to correct the current deficiencies in ECS. We suggest that policymakers examine this report and use its findings and suggestions to further modify aid for education.
- b. **Fully fund Special Education.** Such a change would provide immediate and significant local tax relief and would remove one of the largest unknown costs from each school district's budget. More importantly, it would render local discussion of the cost of Special Education moot and place the focus where it belongs -- on the needs of Special Education students.
- c. **Provide increased funding to ensure the adequacy of K-12 education.** Funding should be provided in an adequate and equitable manner that more closely reflects the real costs of educating students should include appropriate weightings for students with disabilities,

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<sup>3</sup> Example: Washington State Institute for Public Policy (WSIPP) - <https://www.wsipp.wa.gov/>

<sup>4</sup> Zho, Bo, Reforming Connecticut's Education Aid Formula to Achieve Equity and Adequacy across School Districts, New England Public Policy Center, Research Report 21-1, February 2021 -

English language learners and students from families living in poverty.

- d. **Enable towns and cities to be more collaborative in creating efficiencies, reducing costs and enhancing educational options for their students by providing school districts with a wider array of governance options that would successfully address the typical challenges that cause towns and districts to back away from or not consider regionalization and/or collaboration.**<sup>5</sup>
- 4. Commit to regional and collaborative solutions for the delivery and coordination of state and local services.**
- a. **The nine regional councils of governments and the six regional education service centers are the foundation for regional and shared services.** They must be harnessed for the delivery of services by both the state and its cities and towns.
  - b. **Review and modify statutes that are an impediment to the creation of regional, cooperative and inventive regional and shared approaches for the delivery of educational services, including special education.**
  - c. **Connecticut’s economic development approach** must be changed to one where recruitment and expansion are done on a shared and/or regional basis with consideration of both costs and revenues as well as regional impact, rather than the current town specific approach.
- 5. Provide policymakers with up-to-date facts and independent non-partisan analyses.**
- a. Reinstitute the legislature’s Program, Review and Investigations Committee.
  - b. Provide public funding for a nonpartisan, independent public policy research center.

## Paying for Reform

The cost to realize and sustain equity in the property tax system and correct both the needs-capacity gap for cities and towns and the cost-capacity gap for education is in excess of \$1 billion annually - money which we believe can be found within the state’s existing budget and revenue framework.

### 1. Seize the Moment

**New state revenue is not essential to implement the property tax reforms we propose** because there is more than sufficient surplus revenue (what we terms the “surplus-surplus”) generated by the state’s current revenue system and budget allocations to completely fund the reform package. The budget surplus that exceeds the statutorily required deposit of surplus into the Rainy Day Fund has been dedicated to prepayment of the state’s pension debt. We propose that a portion of that “surplus-surplus” be dedicated to property tax reform.

**As this report demonstrates, restructuring Connecticut’s state-local financial relationship by diminishing the burden of the property tax should be a public policy priority second to none because of its benefits for stimulating economic growth, equitably funding education, restoring affordability for our cities and reducing tax regressivity for residents.**

**We put forward for consideration that restructuring the state’s property tax system for FY24 should be viewed by state policymakers as analogous to the successful program enacted by policymakers in FY18 to restructure Connecticut’s pension debt.** The budget controls that prioritized pension debt prepayment—including the volatility cap and raising the ceiling on the Budget Reserve Fund-- had the

<sup>5</sup> [https://www.cga.ct.gov/fin/tfs/20200201\\_Task%20Force%20to%20Promote%20Municipal%20Shared%20Services/20200129/Final%20Report.pdf](https://www.cga.ct.gov/fin/tfs/20200201_Task%20Force%20to%20Promote%20Municipal%20Shared%20Services/20200129/Final%20Report.pdf)

effect of elevating debt prepayment above the typical yearly budgets. The result was, in effect, a new budget structure.

**If the current revenue structure continues to generate annual surpluses, the state's challenge in implementing property tax reforms is not to legislate new funding to finance the reforms but rather to elevate the status of property tax reforms as a policy priority to make an appropriate claim on the revenue already generated by the current tax system.** In short, balancing the policy priorities of **property tax reform and debt prepayment can BOTH be accomplished** within the parameters of the revenue generated by the FY18 budget reforms.

Despite our belief that new revenues are not key to property tax reform, if historic annual revenue surpluses do not continue, or if current policy priorities are not changed to allocate an appropriate share of the "surplus surplus" to funding reforms, where could the revenue come from to implement these reforms?

## 2. Collect What is Owed From Taxes Already in Place

According to the 2021 Connecticut CREATES Report<sup>6</sup>, there may be as much as \$1.1 billion in revenue due the state which is not now being collected and the Department of Revenue Services has stated that the number may be as high as \$2.6 billion<sup>7</sup>.

## 3. Act in Whole or in Part On the Recommendations of the Connecticut Creates Report

## 4. Regionalize Services Through the Councils of Governments and the Regional Education Service Centers

**The full report details and supports our findings and recommendations**

[www.taxpolicyst.org/](http://www.taxpolicyst.org/)

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<sup>6</sup> Connecticut Creates Report, <https://portal.ct.gov/Office-of-the-Governor/News/Press-Releases/2021/03-2021/Governor-Lamont-Receives-Report-With-Suggestions-on-Government-Efficiency>

<sup>7</sup> Connecticut Voices for Children, "Candidate Briefing Book, June 2022," p. 36. A subsequent Voices report, "State of Working Connecticut, 2022," cites DRS Deputy Commissioner John Biello, from the video recording of the "2022 Tax Incidence Report Briefing" to the Finance, Revenue and Bonding Committee on March 11, 2022. See Biello's comments on the video (<https://www.youtube.com/watch?v=q7nb5kON6cl>), starting at 1 hour 0 minutes.]