

Connecticut Property Taxes 2015

Time for a Change

Connecticut is in urgent need of a property tax overhaul to correct a system that undermines economic growth, is regressive, unfair and economically inefficient.

As our state emerges from recession, it is comforting to assume that we can pick up where we left off. This assumption is misguided. For our future to be as prosperous as our past, much in our state that is broken must be fixed. At the top of the list of things needing fixing is our state tax structure. Its biggest flaw is its long-standing over-reliance on the local property tax.

We could tinker around the edges of reform, making small adjustments in the complicated formulas of state aid, but without a more fundamental rebalancing of our tax structure and commensurate spending structure, we will continue down a path of widely disparate educational opportunity, hollowed out cities, sprawling suburbs, and fleeing businesses. To create a robust economy, a solvent, stable and effective government, strong communities and a healthy environment, we must end our over-reliance on the property tax.

Policymakers at the Capitol are now addressing the state's budget problems, but it would be a serious mistake to ignore the crushing burdens of local property taxes. Since local property taxes now make up 45% of the total tax burden for Connecticut residents, tinkering with the defects in the state's revenue stream while ignoring the serious flaws in the property tax system is likely to hinder economic recovery and make overall financial conditions even worse for Connecticut taxpayers.

Toward this end, we offer the following analysis of the case for and the goals of reform, and a potential framework for tackling the long overdue challenges of reform.

A Project of 1000 Friends of Connecticut

The Property Tax Work Group

CONNECTICUT PROPERTY TAXES

Goal:

Revamp the overall state-local revenue structure in Connecticut to

- Reduce the property tax share of total taxation;
- Reduce the state's reliance on property taxes for funding public education;
- Lessen the regressive nature of property taxes by making the tax more related to taxpayers' ability to pay;
- Make the impact of property taxation fairer, so that – other things being equal – owners of property of the same value in different towns pay about the same amount, and taxpayers in different towns receive the same level of public services for the same taxes paid;
- Reduce the negative influence of property taxes on land-use decisions and spending decisions in municipalities;
- Reduce the role of disparate property taxes in decisions by people and businesses about where to live and work;
- Prevent property taxes from undermining economic growth.

CONNECTICUT PROPERTY TAXES

Statement of the Problem:

Connecticut relies on the property tax to fund government services to a far higher degree than most states. Property tax collections per capita in Connecticut are the highest in the northeastern U.S., at \$2,522 per capita in 2010, dramatically above the U.S. average of \$1,434 per capita. About 45% of all state and locally generated revenues came from the property tax in state FY 2011.¹ The high share of total state and local government revenue coming from property taxes in Connecticut distorts the overall revenue system.²

Moreover, property taxes for businesses constitute by far the largest share (30.0% in state FY 2013) of all state and local taxes paid by businesses in Connecticut.³ The high reliance on property taxes is a hurdle to economic competitiveness. Additionally, property taxes are regressive, unfair and economically inefficient.

Over-reliance on property taxes is detrimental to economic growth:

- High property taxes on businesses make interstate and international businesses less competitive.
- High property taxes on businesses drive businesses and jobs to lower property tax states.
- Property tax inequities drive businesses (especially small businesses) to lower property tax towns, where additional infrastructure (schools, roads, utilities, etc.) must often be built at indefensibly high costs for construction, maintenance and replacement.

¹ DRS Tax Incidence Study, December 2014, p. 3. Property taxes make up about 42% of total state and local revenues not shifted to out-of-state taxpayers. *Ibid.* See also, for FY 2010, Tax Foundation, "The Sources of State and Local Tax Revenues" (January 29, 2013). According to Tax Foundation data, Connecticut ranks 9th from the top, after New Hampshire, New Jersey, Vermont, Rhode Island, Texas, Illinois, Florida and Wyoming.

² If the property tax share was to be reduced to 33% of total state and local revenue, total property taxes would be reduced by about \$1.5 billion.

³ Council on State Taxation, "Total state and local business taxes: State-by-state estimates for fiscal year 2013" (August 2014)

- Property tax inequity induces companies to move jobs away from cities, where infrastructure to support existing and new businesses is already in place, and where cross-fertilization of ideas maximizes innovation.

Property taxes are regressive and inequitable, harmful to families and individuals:

- Median income taxpayers in most towns usually pay more in local property taxes on a median value home than they pay in state income taxes and sales taxes combined.
- 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.⁴
- 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%.⁵
- High property taxes, as a share of median income,⁶ discourage young people and families from staying in or relocating to Connecticut.
- Because the incidence of property taxes falls on renters as well as homeowners, high property taxes (computed as a share of income) make housing less affordable and discourage both renters and homeowners with low current income (e.g., retirees, or young professionals just starting out) from staying in or relocating to towns with high property taxes.
- Disparities among services that towns are able to provide drive some prospective homeowners and renters to uproot their families and move to find the services they need.

⁴ DRS Tax Incidence Study, December 2014, p. 21. In Connecticut, the DRS Study reports, the Suits Index, a measure of progressivity, is -0.39.

⁵ Institution on Taxation and Economic Policy, Who Pays?, January 2015, pp.41-42.

⁶ Connecticut's median property tax on owner-occupied homes amounts to 5.51% of median income, 4th highest among the 50 states. "Connecticut Property Tax Information (2014)," at www.tax-rates.org/connecticut/property-tax

- Because the fair market value of residential property is not always 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 funding for public schools produce vast educational inequities between children in richer and poorer towns. Even in the face of high local property tax rates, or at least rates that the majority of their residents cannot afford, few municipalities are able to fully compensate for the state's inadequate funding of the public schools.

Over-reliance on property taxes is detrimental to Connecticut as a whole:

- Property tax inequity, by increasing the dispersion of jobs and housing, increases transportation costs and excessive, non-productive use of energy.
- The search for additional property tax revenue drives towns to attract high valuation properties at the expense of preserving farmland and open space.
- Property tax inequity reinforces economic segregation. Property tax inequity diminishes diversity, resulting in a less vibrant, inclusive and connected society.
- The state's cost to subsidize infrastructure construction (schools, roads, utilities, etc.) puts additional strain on the state budget, diverting state funds from where they are most needed.
- A fair, balanced and sustainable system of funding the public schools is essential for the state's long-term economic prosperity, social justice, and democratic functioning. And it's required by the Connecticut Constitution.

Over-reliance on property taxes is detrimental to municipalities:

- Inter-town inequity is exacerbated by the high concentration of tax-exempt property in some towns.
- Inter-town variations in property taxes increase inter-town competition for economic development.
- Driven by over-reliance on the property tax, land-use boards make decisions based on what members believe (often incorrectly) will increase property tax revenues. Although short-term revenue growth may occur, the need for additional infrastructure (such as schools, roads, and utilities) often increases long-term costs, saddling towns with unsustainable obligations to build and maintain that infrastructure.
- Already amortized infrastructure investment in other municipalities, especially center cities, is underutilized or wasted.
- As long as they must raise the bulk of their revenue using property taxes from within their own borders, towns are discouraged from thinking beyond their borders when making decisions, no matter how much regional solutions would protect the environment, improve the economy or reduce duplicative public services.
- Since schoolchildren are an expense for towns and their property tax reliant revenues, an “anti-kid” attitude has evolved, which often prompts towns to discourage young families from moving in by using land-use decisions to “zone out” families that the towns (often incorrectly) believe may cause an increase in student population. This may be especially true when the families represent racial and/or economic diversity. Young families are critical to the future of all towns.

In summary, the current level and manner of property taxation undermines economic growth, is regressive, inequitable, and inefficient.

MOVING FORWARD

A Framework for Fair and Balanced Integration

It is important to view the state and local revenue system as a single unified whole and to make the total system rational and effective. The same is true of spending. Principled, rational revenue raising and spending control are both necessary aspects of reform.⁷

Why do we need a framework for property tax reform?

Piecemeal or *ad hoc* tinkering with the state/local revenue and spending systems without a framework can in fact exacerbate the problems. Unfair, regressive, improperly balanced, inequitable, inadequate, inefficient and ineffective systems could be made worse unless changes are made in a thoughtful and planned manner within the context of a framework that provides guidance toward achieving the goals specified above.

Control spending: Rethink how we pay for necessary services.

To do this we must:

- Develop a more effective way to improve health while reducing health care costs to the level of other developed societies.
- Invest more effectively in critical services: fund prevention rather than remediation.
 - Support prison diversion and effective anti-recidivism initiatives.
 - Support more cost-effective mental health and disability services.
 - Coordinate the mosaic of social service programs (both public and private) by instituting a common enrollment and service tracking system

⁷ Among the principles that could be applied are revenue raising principles from the National Conference of State Legislatures, and spending principles based on Results-Based Accountability standards.

[No Wrong Door / Single Point of Entry] to coordinate proper intake, oversight, and efficient service delivery.

- Collect and use data to identify better ways to deliver critical services.
- Re-invest in existing infrastructure instead of building new infrastructure.
- Improve efficiency and effectiveness in delivering local services through greater inter-municipal cooperation and collaboration. Back-office services (such as information technology, human resource management, and others not dealing directly with the public) that require special expertise, or are not labor-intensive, offer great opportunities for sharing. Regional cost sharing and regional cost reduction can often deliver services more efficiently at lower cost.
- Apply the same level of cost-and-benefit scrutiny to tax expenditures written into Connecticut's tax code that now applies to expenditures in the spending side of the state budget.⁸

**Distribute state revenue more fairly to towns and taxpayers,
for the benefit of all Connecticut taxpayers.**

Some possible tools in the toolkit for property tax reform:

1. Fully fund Payment in Lieu of Taxes (PILOT) programs for state property, private colleges and non-profit hospitals, and for manufacturing machinery and equipment.

The state has determined that these properties should be exempt from local property taxes, thus diminishing the capacity of towns in which they are located to raise revenue. Providing full reimbursement to those towns would level the playing field.

⁸ Both appropriations and tax expenditures in the state budget use up tax receipts. But the difference is that these "tax earmarks" spend tax money before it gets to the state's treasury by allowing companies to reduce their state tax payments and therefore they never receive the same level of legislative scrutiny and citizen oversight that program expenditures receive. The goal of more scrutiny is to make sure that no tax dollar is wasted— whether spent on a budget program or spent in a tax expenditure.

To begin, focus existing levels of funding on towns with the least capacity to raise revenue – that is, with the lowest levels of property wealth.

2. Close the “need-capacity gap.”

Because not all municipalities have the capacity to increase property taxes to the level needed to invest in important services and infrastructure, new state aid should be provided to close the gap between the needs of towns to provide a core package of basic services (e.g. police, fire, public works) at some average level of cost, and their capacity to address them.

“Need” should be measured by factors outside the control of local officials (such as population density, the poverty and unemployment rates, and jobs per capita).

“Capacity” should be measured by taxable property value.

This model 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).⁹

Filling the gap may be phased in over time and adjusted as the factors making up need and capacity change.

⁹ This model is based on the work of the New England Public Policy Institute, which evaluated need and capacity based on local economic and social characteristics (population density, poverty rate, unemployment rate, jobs per capita) that are outside the control of local officials, to avoid any likelihood of rewarding poor management and wasteful local spending with state aid that is needed more elsewhere. See Bo Zhao et al., “Does Springfield Receive its Fair Share of Municipal Aid?” New England Public Policy Paper Number 10-4, July 2010, which may be downloaded at <http://www.bostonfed.org/economic/neppc/wp/2010/neppcwp104.htm> and David Coyne and Bo Zhao, “Making Municipal Aid Count: Mind the Gap!” *Communities and Banking* magazine, Spring 2011, linked at <http://www.bostonfed.org/economic/neppc/in-focus/localaid.htm>

3. Increase direct state funding for the cost of special education.

Students in need of special education are not proportionally distributed among school districts, nor is their need necessarily identified in advance of a budget year. To relieve high and unexpected costs, the state should pick up a greater percentage of those costs.

4. Provide increased funding to ensure the adequacy of K-12 education.

The state Supreme Court has ruled, in *CCJEF v. Rell* (2010), that the state has the responsibility to provide an adequate education to all schoolchildren and has remanded the case back to the Superior Court to determine if the constitutional standards of adequacy and equity are being met. The state should prepare to address the kind of increased resources and tax/revenue reforms that may be required by this case, should the courts find the current state aid system unconstitutional. Funding should be provided in an adequate and equitable manner, addressing what is necessary to provide a constitutionally sufficient education for each child. A state aid formula that more closely reflects the real costs of educating students, including appropriate weightings for students with disabilities, English language learners and students from families living in poverty, is typically used.

5. Consider Circuit Breakers.

A state funded income-adjusted property tax circuit breaker for homeowners and renters provides assistance directly to taxpayers, and not to municipalities. Such a program, in place in a number of states, would do a lot to mitigate the regressive aspects of property taxes.

6. Consider Homestead Exemptions.

A homestead exemption is a fixed monetary amount that is deducted from the assessed value of a home, such that the property tax rate applies only to the assessed value in excess of that amount. But unless the value of this exemption is reimbursed to the town in some fashion, the tax burden is simply shifted to other properties.

7. Consider Property Tax Base Sharing.

Part of the tax base of each municipality in a region is shared according to a formula among all municipalities in the region, so that the disparity of tax bases among the towns is reduced. In Minnesota, 40% of the new commercial and industrial tax base goes into a pool that is distributed using a formula based on population and market value of all property in each town. After the program began in 1970, the disparity among towns, over the years, was reduced from 16.8 to 1 to 4.6 to 1.

8. Provide another source of revenue to municipalities, such as a share of the statewide income tax, sales tax or a new statewide property tax.

A formula would need to be created to distribute such revenue on an equitable basis. Such revenue could be used to equalize the property taxes imposed on motor vehicles, without depriving high-tax towns of the revenue such car taxes provide.

CONNECTICUT PROPERTY TAX CHANGE

IMPLEMENTATION AGENDA

First, do no harm.

Some proposals that appear superficially attractive prove on closer examination to be temporary, *ad hoc* reactive measures that likely will turn out to be counterproductive in the long term.

Reject such seductive proposals as the following:

- Imposing property tax caps;
- Eliminating property taxes on motor vehicles with no replacement revenue to towns/regions;
- Taxing previously tax-exempt property such as manufacturing equipment;
- Granting additional property tax exemptions without full PILOT reimbursement.

Secure sound information for decision making.

Along with the framework, an accountable, nonpartisan, transparent entity is needed to provide sound information for decision making on property tax relief and spending reform and to offer specific suggestions to advance the agenda. One option utilized in many states is a nonpartisan, broadly focused, public policy center similar to the one hosted by the Federal Reserve Bank of Boston.

Adopt a framework.

A key start to implementation would be to adopt a more integrated framework both for revenue and for spending and to take orderly steps in the direction of fulfilling the framework. *Ad hoc* and occasional fits and starts will not be sufficient to move the agenda in an orderly or timely way.

Phase the framework in over time.

Once frameworks have been adopted, the effort to move from the current system to one with a greater targeting of state resources can be done over time. The costs and benefits of implementation will be substantial and can be phased in over an appropriate multi-year timeframe.

This report is a product of the 1000 Friends Property Tax Work Group. Direct content contributors to this report include Leo Canty, William Gibes, William Curry, Jefferson Davis, Dianne DeVries, John Elsesser, Lee Erdmann, Michele Jacklin, Alex Knopp, Susan Merrow, Peter Thor and Lyle Wray.

For further information, contact: Susan Merrow

Chair, 1000 Friends of Connecticut amerrow@snet.net 860-367-1687