

The Context for Property Tax Reform in Connecticut

A Discussion Draft To Frame the Panel's November 17 Discussion

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Local governments provide the goods and services that impact the daily lives of all citizens, e.g., the road network, sewerage systems, provision of potable water, public safety, public schools, etc. The ability of local government to pursue policies and programs that respond to the preferences of local residents requires own-source revenues that a local government can use as it sees fit. The only revenue source capable of ensuring a strong and vibrant local government is the property tax, the major source of locally raised revenues in Connecticut.

The property tax base in Connecticut is broad compared to the property tax base in most other states because it includes selective personal property and motor vehicles. In addition, Connecticut provides very limited property tax relief and has avoided constraints on and distortions of the property tax including property tax caps, levy limits, assessment limits and the like.

Connecticut's state and local revenue system and local government funding depend heavily on the property tax. As a result, local governments in Connecticut have the least diversified revenue system in the U.S. The lack of revenue diversification deprives local governments of the benefits thereof.

Over reliance on property taxes also turns strengths of the property tax into liabilities. For example, one strength of the property tax is revenue stability because taxes are based on an asset value, not annual streams of income or sales. As a consequence of virtually sole reliance on the property tax for local tax revenues, a structural deficit is created where revenues grow more slowly than income but expenses grow the same as income or faster.

The 5-year assessment cycle in Connecticut undermines the equity of the property tax and distorts measures of assessment quality used to equalize differences in assessment practices between towns and distorts the allocation of education equalization grants.

In the aggregate, Net Grand Lists in Connecticut have been declining since 2009, albeit the decline is not uniform across municipalities. For example, between 2007 and 2012 sixty-four towns experienced increases in their Net Grand Lists, but 105 towns experienced declines. Between 2012 and 2013 the aggregate Net Grand Lists in Connecticut declined 2.1 percent, albeit 94 municipalities experienced increases averaging 0.6 percent and 75 municipalities experienced declines averaging 7.7 percent. Property tax revenues, however, continued to grow over this period as local governments increased mill rates.

	Net Assessed Value	%Chng Net AssessVal
2004	\$ 238,417,083,402	
2005	\$ 277,587,521,018	16.4%
2006	\$ 297,796,899,510	7.3%
2007	\$ 337,713,307,140	13.4%
2008	\$ 351,788,231,222	4.2%
2009	\$ 357,052,996,247	1.5%
2010	\$ 349,525,040,561	-2.1%
2011	\$ 344,501,534,896	-1.4%
2012	\$ 327,907,587,192	-4.8%
2013	\$ 320,949,927,688	-2.1%

	Property Tax Revenues	%change
2008	\$ 8,123,393,407	
2009	\$ 8,521,268,048	4.9%
2010	\$ 8,700,685,501	2.1%
2011	\$ 9,005,299,265	3.5%
2012	\$ 9,222,577,320	2.4%
2013	\$ 9,501,435,466	3.0%

Variation in real estate markets across municipalities since 2009 exacerbates significant fiscal disparities across municipalities in Connecticut making it difficult for many municipalities to raise sufficient revenues to provide a given level of goods and services to their citizens. For example, revenue raising capacity as measured by the Net Grand List per capita varies across municipalities from a high of \$494,018 in Greenwich to a low of \$27,873 in Hartford. There is significant variation across Connecticut municipalities in property taxes per \$1,000 personal income ranging from a high of \$123.00 in Hartford to a low of \$41.50 in Putnam.

Heavy dependence on property taxes, declining property values with increasing property tax revenues result in high and increasing effective property tax rates. The competitiveness study presented to the tax panel found that high property taxes in Connecticut may be a drag on economic growth, at least at the margin. In addition,

- a. high property rates, if not balanced by high service levels, decrease property values.
- b. high property tax rates, if not balanced by high service levels, discourage families and businesses from locating or expanding in a jurisdiction.
- c. high property rates in older city centers may contribute to urban sprawl when surrounded by suburban communities with lower property tax rates resulting in inefficiency and cost of inadequate public infrastructure such as roads, water, sewers.
- d. high property rates burden low-income homeowners.

The state, in conjunction with local governments, provides a large number of property tax relief programs, but very limited actual property tax relief. High effective property tax rates and limited property tax relief contribute to the property tax in Connecticut being regressive. In part, regressivity reflects the fact that spending on housing declines as a share of income as income increases, but it is exacerbated in

Connecticut by high effective property tax rates, which tend to be in municipalities with high concentrations of low income people, and limited property tax relief which is generally not targeted to taxpayers according to need.

One way to reduce reliance on property taxes is to increase state aid to local governments. For example, it is often argued that the state should fully fund state grants to local government that reimburse local governments for property tax revenues foregone because of state mandated property tax exemptions. While the paper prepared on exempt properties put forward an argument for why state government should reimburse a portion of property tax revenues foregone because of state mandated exemptions, it is difficult to determine what the “right” level of reimbursement should be.

Increasing state grants, if used to offset property taxes dollar for dollar, results in government revenues becoming more centralized at the state level. Such centralization means local revenues from state aid must compete with other state priorities like Medicaid, transportation and education and are vulnerable during periods of economic downturn. This converts local government advocates into special interest pleaders rather than partners in the governing system. In addition, increased dependence on state aid can result in local governments becoming less autonomous which could cause local government to be less responsive to local preferences as well as a reduction in local control and efficiency of resource allocation.

Finally, increasing state aid does not address current concerns with the property tax in Connecticut. Specifically, increasing existing state aid programs does not address the fiscal disparities across municipalities in Connecticut because current state grants do not have an equalizing component. A study of fiscal disparities across municipalities in Connecticut by the New England Public Policy Center at the Federal Reserve Bank of Boston concluded that fiscal disparities across municipalities in Connecticut are a result of differences in capacity to raise revenues. This suggests the need for a state grant program that would be equalizing across municipalities. In addition, simply increasing state aid does not address the regressivity of the tax.

Addressing the magnitude and design of state grants to local government in Connecticut is beyond the scope of this project. The panel suggests that this is an issue the state should pursue.

Five papers on various aspects of the property tax will be presented at the November 17, 2015 meeting of the tax panel. Each paper provides a set of policy options for reforming the property for consideration by the tax panel. The papers presented today are briefly summarized below.

Direct Property Tax Relief (John Anderson)

Direct property tax relief reduces the tax liabilities for individual property owners. This paper describes a variety of existing state and local programs which provide direct property tax relief to qualifying residential property owners. The discussion includes a more detailed discussion of property tax relief from use-value assessment of rural properties and the current circuit breaker in Connecticut. The paper discusses the advantages and disadvantages of circuit breakers, various design options for circuit breakers used in other states and simulations of circuit breaker options for Connecticut. The paper submits policy options to reform direct property tax relief in Connecticut by

1. considering replacing the current complex set of property tax exemptions and circuit breaker with a single unified circuit breaker mechanism that provides property tax relief to homeowners and renters whose property taxes are high relative to their household resources

2. rationalizing use-value assessment computation methods and move toward strategic use of use-value assessment to protect and preserve land that provides ecosystem services
3. modifying the current property tax deferral program.

Indirect Property Tax Relief (David Sjoquist)

Indirect property tax relief reduces reliance on property taxes generally by providing local governments access to alternative own-source revenues and/or increasing reliance on state grants. This paper documents the lack of local revenue diversity in Connecticut and concludes local governments in Connecticut have the least diverse revenue structure of any state. Diversifying local revenue systems would allow towns to better capture local revenue raising capacity, reduce reliance on the property tax, and collect revenue from tourists and commuters who impose costs on local governments but don't pay property taxes. The paper then discusses issues associated with a local option sales tax, a local option income tax and increased user charges in Connecticut. Each section includes a discussion of the arguments for and against the option, estimates of potential revenues and how much property taxes could be reduced with each option, economic effects of each option and design issues.

The paper submits policy options that address the lack of diversity in the revenue systems of local governments in Connecticut including

1. two alternatives of the local sales tax option – one in which local sales tax revenues stay in the town where they are collected and a regional sales tax is implemented in each of the nine planning districts in Connecticut (Councils of Government) in which half the revenue collected stays in the town where it is collected and half is distributed to towns on a per capita basis;
2. a local income tax based on five alternative definitions of an income tax base;
3. local option tax design issues; and
4. increased reliance on user charges and fees.

Business Personal Property Tax (Larry Walters)

Personal property category in Connecticut accounts for just over 5 percent of total taxable property in the state and generates over \$590 million in tax revenue each year. Personal exemptions in Connecticut represent 20.4 percent of total personal property taxable value. Treatment of business personal property in Connecticut does not appear to set the state apart from other states.

While there is substantial variation in tax burdens within the state, Connecticut tax rates areas similar to other jurisdictions around the country. Personal property as a percent of total taxable property varies across cities and towns in Connecticut from 0.88 percent to 24.3 percent. Mill rates also vary markedly, from 10.7 to 74.29 mills

For a majority of businesses the personal property tax is more nuisance than financial burden. Ninety-three percent of all business personal property tax accounts total only 11.5 percent of taxable value. Administration of the tax is difficult and auditing practices are highly variable.

The paper submits policy options for reforming the business personal property tax including

1. adopting an alternative tax to replace any property tax relief granted for personal property taxes
2. phase out the tax over time and do nothing to replace the lost revenue
3. pool the base from the relatively small number of very large personal property taxpayers

4. recognizing that very little revenue is generated from thousands of businesses required to complete the annual declaration, exempt taxpayers with personal property below various thresholds, e.g., if the threshold is \$10,000 it would reduce property tax revenues by 0.014 percent but exempt 46 percent of personal property accounts.

In addition, there are several policy options to improve the administration of the business personal property tax including

1. revisit the approach to depreciation and the appropriate residual value for each category
2. allow the assessment process to make adjustments for the possibility of economic obsolescence in an industry
3. improve audit procedures and frequency
4. strengthen the role of OPM in overseeing uniformity in assessment administration.

Tax on Motor Vehicles (Larry Walters)

In 2013 there were 2.9 million registered vehicles in Connecticut with an aggregate gross taxable value of \$23,690 million accounting for 6.4 percent of the aggregate Net Grand List value in Connecticut. Valuations are based on NADA data. Variations in mill rates across municipalities result in very large differences in tax obligations associated with vehicles of the same value.

Administration of the motor vehicle tax in Connecticut faces several significant challenges involving discovering all the vehicles subject to the tax, applying credits where appropriate, and valuing specialized vehicles. The majority of resources in a local assessor's office are devoted to maintaining motor vehicle accounts and values.

The paper submits policy options for reforming the property tax on motor vehicles including

1. leave the tax as it is with the changes that were passed by the legislature in the summer of 2015
2. a revenue-neutral statewide mill rate and "hold harmless" provisions to replace lost revenues in some cities
3. a statewide minimum mill rate with an additional local rate up to a maximum allowed rate
4. replace the current ad valorem tax on motor vehicles with a revenue-neutral excise tax based on the vehicle MSRP and age
5. replace the current ad valorem tax on motor vehicles with an excise tax based on MSRP and age and allow local governments to set rates within bounds set by the state
6. replace the current ad valorem tax on motor vehicles with an excise tax based on weight
7. repeal the ad valorem tax on motor vehicles without replacing the revenue

Moving away from an ad valorem tax to an excise tax will greatly reduce the cost of administering the tax. In itself, such a change will not address the larger question of balancing equity and revenue needs. Reducing the significant administrative costs associated with administering the current motor vehicle ad valorem tax is an objective worth of state attention.

Conveyance and Controlling Interest Taxes (Catherine Collins)

Real transfer taxes in Connecticut are the Real Estate Conveyance (REC) tax shared between state and local governments, and the Controlling Interest Transfer tax which is a state revenue. The Real Estate Conveyance tax is imposed when real estate is transferred and is collected when the deed is registered.

The Controlling Interest tax is imposed when real estate interests are transferred through the sale or trade of controlling interests of a corporation, partnership or similar type entity.

Combined, these two taxes account for less than 2 percent of total state revenue. Revenues for both taxes are volatile because they depend on activity in the real estate market. Revenues from both taxes declined significantly as a result of the 2008 recession and their recovery after the recess has lagged compared to previous recessions and other state revenues.

Compared to transfer taxes in neighboring states, Connecticut state and local rates are relatively modest, especially for higher value properties compared to rates in New York and New Jersey.

The paper submits policy options for reforming the property tax on motor vehicles including

1. retain both taxes in their current form with current rates
2. retain the local real estate conveyance tax and repeal the state component of the REC and the controlling interest tax
3. retain the state taxes, but repeal the local component of the real estate conveyance tax
4. upon removing the local portion of the REC, increase the state REC rate by .25 percent and earmark the increased funds to increase regional activities or for additional funding of the Community Investment Fund
5. upon removing the local portion of the REC, increase the state REC rate by .25 percent and distribute 30 percent of the increased revenues to the jurisdictions that collected the revenues
6. provide additional local optional tax rates for communities to impose a regional REC
7. Increase the Controlling Interest Tax (CIT) from 1.1 percent to 1.5 percent.