

For Connecticut Tax Panel Discussion

December 3, 2015

PROPERTY TAXES IN CONNECTICUT

Findings and List of Policy Options

OVERVIEW OF BACKGROUND AND FINDINGS

The following discussion first presents information on the context for property tax reform in Connecticut and then discusses the policy options put forward by the authors of the papers examining various dimensions of the property tax in Connecticut including:

- Property tax administration
- Exempt properties
- Direct property tax relief
- Indirect property tax relief (local revenue diversification)
- Personal property tax
- Motor vehicle tax, and
- Conveyance and controlling interest taxes.

The intent of this summary note is to inform the policy discussion at the panel meeting on December 8, 2015.

The following findings provide a context for property tax reform in Connecticut:

1. The property tax base in Connecticut is generally broader than the property tax base in many other states because it includes selected personal property and motor vehicles. In addition, Connecticut provides very modest property tax relief.
2. Both the Connecticut state and local revenue system, and local revenue systems are more dependent on property taxes than most other states.
3. Over reliance on property taxes 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.
4. In addition, heavy reliance on property taxes
 - a. Undermines political balance between opposing philosophies of tax equity – ability to pay principle and benefits received principle of taxation
 - b. Undermines the realization of the benefits of revenue diversification since individual revenue sources differ in terms of their revenue raising capacity, stability over the business cycle, growth rate, equity, ease of administration, economic effects and acceptability by citizens
 - c. Results in Connecticut having the least diverse local revenue system in the U.S.
5. The 5-year assessment cycle in Connecticut undermines the equity of the property tax and distorts measures of assessment quality which are used to equalize between towns for differences in assessment practices. The 70 percent fractional assessment in Connecticut undermines transparency.
6. The state provides 22 full property tax exemptions for certain types/uses of property (colleges, hospitals, churches, etc.); 66 partial exemptions based on the characteristics of the owner and property (veterans, blind, elderly, etc.); 15 exemptions intended to promote economic and

housing development; and 11 miscellaneous exemptions. Most are not used extensively and, as a result, property tax relief provided to taxpayers is very modest.

7. The state provides 38 property tax relief options to local governments with 73.7 percent of these tax relief measures being used by 3 or fewer municipalities. No local option relief measure is used by a majority of municipalities. Locally provided property tax relief is very modest.
8. Significant fiscal disparities exist 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.
 - a. There is significant variation across Connecticut municipalities in the relative importance of the property tax as a share of total local revenues ranging from 39.2 percent in Putnam to 94.3 percent in Warren.
 - b. Revenue raising capacity as measured by the Net Grand List per capita varies across municipalities in Connecticut from a high of \$494,018 in Greenwich to a low of \$27,873 in Hartford – the highest capacity is nearly 18 times the lowest capacity.
 - c. There is significant variation across Connecticut municipalities in property taxes per \$1,000 personal income ranging from a high of \$279.58 in New Canaan to a low of \$24.48 in Winchester.
9. In the aggregate, Net Grand Lists in Connecticut have been declining since 2009, albeit the decline is not uniform across municipalities -- 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.

	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%

10. Property tax revenues, however, continued to grow over this period as local governments are forced to increase mill rates to generate revenues needed to provide goods and services to their citizens.

	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%

11. 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.
12. Property taxes in Connecticut are regressive. According to a study by the Connecticut Department of Revenue Services, the 752,202 households with the lowest income in the state pay 25.9 percent of all property taxes and they pay 12.5 percent of their income in property taxes. This is in contrast to the 357 households with the highest incomes which pay 1.9 percent of all property taxes and only 0.92 percent of their income in property taxes. This regressivity is confirmed by a study from the Institute on Taxation and Economic Policy.
13. High effective property tax rates and limited property tax relief exacerbate the tendency for the property tax to be regressive because high effective property tax rates tend to be in municipalities with high concentrations of low income people and limited property tax relief is not targeted to taxpayers according to need.
14. 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.
15. 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.
16. 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.

OPTIONS RELATING TO PROPERTY TAX ADMINISTRATION

Policy Option 1: Eliminate the 70 percent fractional assessment and define assessed value as 100 percent of estimated fair market value. When this transition is made, all municipalities should be required to lower their property tax mill rates to raise the same amount of revenue as they raise currently.

Fractional assessment in Connecticut is an historical artifact from the early 1970s. Assessment ratios varied widely by municipalities across the state and were generally well below 100 percent of market value. The state imposed the 70 percent fractional assessment to bring uniformity to assessment levels across the state. Fractional assessment undermines transparency, results in inequities, and hurts taxpayer understanding of property taxes. Therefore, eliminating fractional assessment

- reduces the possibility of sloppy, politically oriented or corrupt assessments;
- increases uniformity, thereby improving horizontal equity of the property tax;
- eliminates “undervaluation illusion” that covers up apparent inequities;
- promotes taxpayer understanding since taxpayers are likely to be familiar with market values; and
- assigns political responsibility for increased property taxes to elected officials who set the tax rate.

There is no argument advanced for keeping fractional assessment.

Policy Option 2: Eliminate the 5-year assessment cycle and institute annual assessment so that all properties are valued on the same schedule.

Under the 5-year assessment cycle assessed values are determined at a point in time and then maintained for the next 4 years. This creates significant inequities across towns, across land uses in each town and within each land use in a town as the market changes at a different pace in different communities, but the assessed value stays the same. Fairness is undermined when a certain class of property, or a certain section of town, is either appreciating or depreciating at a different rate than other properties in town.

In addition to undermining the equity of the property tax, the 5-year assessment cycle also distorts the usefulness of the assessment/sales ratio done annually by OPM because it distorts the analysis so that

it does not capture differences in assessment practices. The Equalized Net Grand List used to allocate state education aid does not adjust for differences in assessment quality.

Most municipalities have their own computer assisted mass appraisal model and could conduct annual assessments.

Some assessors in Connecticut do not like the idea of annual assessment. The state has many really small towns with limited capacity in the assessor's office. They argue that if they were required to perform annual updates, it would likely be cheaper to hire additional staff members in house rather than contract out. But this would be a great expense to many smaller municipalities who might only have a part time assessor now.

These concerns could be mitigated by phasing the change to annual assessment over a five-year period. When it is time for a municipality to revalue in its five-year cycle it then moves to annual assessment. In order to save costs for small municipalities, the valuation process could be done on a regional basis or, like the state of Maryland, it could be done at the state level, thereby relieving each small town of the responsibility of valuing annually; their sole responsibility would be keeping the Grand List up to date which they do currently.

Policy Option 3: The Tax Study Panel's mandate is to study the Connecticut state and local tax structure. At the panel meeting in May 2015 a decision was taken that the panel would not look into state or local expenditure policy. Thus, addressing the magnitude and design of state grants to local government in Connecticut is beyond the scope of this project. However, **the panel concludes that state grant policies should be re-examined in an effort to further relieve pressure on the property tax and to equalize fiscal disparities across municipalities.**

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PROPERTIES EXEMPT FROM PAYING PROPERTY TAXES IN CONNECTICUT

The Tax Study Panel adopted a set of criteria for evaluating changes in the system of financing state and local governments in Connecticut. The criteria included

- Taxes should be designed to avoid unintended interference with private economic decisions; and
- The structure of the tax system should treat taxpayers in similar circumstances similarly.

Exempting individual properties from paying the real property tax violates these criteria because

- eliminating property taxes for some uses and property owners violates the neutrality criteria because it provides an incentive to buy more real property, or more expensive real property, than would be the case if the property were not exempt from paying property taxes; and
- exempting some properties from paying property taxes means the cost of providing government services must be spread across a smaller tax base requiring a higher tax rate to collect a given amount of revenue resulting in higher taxes, on properties not receiving preferential treatment, than they would pay if the property tax had a broader tax base and collected the same revenue with a lower tax rate. As a result, two similar properties, one exempt the other not, are not treated equally.

In a recent national study, Connecticut was identified as one of only two states that reimburse local governments for a portion of property tax revenues foregone because of state mandated exemptions -- Rhode Island was the other. These reimbursement programs are state expenditures which go through the normal budget and appropriation process. The focus of policy options in this section are on how to address violations of the panel's neutrality and equity criteria.

Policy Option 1: Maintain the Status Quo

- Stakeholders in the current system – owners of exempt property, the state of Connecticut and local governments in the state – are familiar with the current system and have made decisions in the context of that system.
- The current system does not address the neutrality and equity concerns associated with property tax exemptions.

Policy Option 2: Develop a traditional PILOT program along the lines of the program in Boston which has been characterized as “best practices.”

Connecticut should development of a traditional PILOT program to generate revenues from tax exempt properties to help finance the delivery of public services benefiting those properties. Developing such a program along the lines of the Boston model which has been identified as “best practices” will

- provide transparency of the PILOT program;
- improve the public image of non-profits paying the PILOT;
- provide certainty for the exempt organizations on what exactly their responsibilities will be;

- better align property tax revenues foregone by local governments with benefits to local residents and businesses provided by organizations with exempt property;
- reduce property taxes on for-profit businesses and other non-exempt properties which, in turn, could increase employment in the private sector; and
- improve the neutrality and equity of the system of granting property tax exemptions to nonprofit organizations.

Boston has a PILOT program intended to better match the property tax revenue foregone because of a tax exemption and the benefits received by the community from the exempt organization. By contributing to the cost of publicly provided goods and services benefiting the exempt organization the City's PILOT program reduces the inefficiencies and inequities in the system of property tax exemptions.

The City starts a conversation with a non-profit with the view that tax exempt organizations should contribute some amount toward their consumption of publicly provided services such as police and fire protection and public works such as street cleaning and snow removal. This is the *quid pro quo* argument for tax exemption. A tax exempt organization may have its proposed property tax payment reduced if the services they provide

- directly benefit Boston residents;
- support the City's mission and priorities;
- are quantifiable; and
- emphasize ways in which the City and the institution can collaborate to address shared goals.

Examples of such services include academic scholarships, free medical care, volunteer workshops, youth employment, job initiatives, and job training programs (City of Boston 2009). Deducting from a proposed PILOT in exchange for community services allows cities to improve their residents' quality of life, while simultaneously allowing exempt organizations to reduce the amount of money they are expected to contribute.

In order to minimize or eliminate any burden on small charitable organizations providing services directly to local citizens, the first \$1,000,000 of value could be totally exempt from the requirement of paying 25 percent of what the property tax would be if the property were totally taxable.

Policy Option 3: Limit the value of real property exempt from taxation for individual properties.

One possibility for limiting property tax revenues foregone because of exemptions would be to broaden the property tax base by simply including some portion of the estimated market value of tax exempt property in the taxable property tax base, e.g., 25 percent of the estimated market value. The owner of the exempt property would make a payment to the local government based on the value of the property. This would be a required payment, not a voluntary PILOT.

The table below compares the state grant payment for state owned exempt property in FY 2016 to the revenue each of the 19 representative cities examined here would raise if they assessed their 2016 mill rate on 25 percent of the value of their state owned property. A number of municipalities have their state owned PILOT go to zero in 2016 as a result of a recent reduction in state grants for state owned *PILOTS of* \$12 million.

Alternative Measures of Payments for State Owned Exempt Properties, FY2016				
	GL2014; FY2016			GL2013/FY2016 *
Municipalities	State Owned Total		Tax on	State Owned
	Parcels	Values	25% Value	Current PILOT
Large Cities				
Bridgeport	112	\$ 252,171,940	\$2,660,288	\$ 2,353,126
Hartford	169	\$ 843,708,504	\$15,669,776	\$ 13,887,253
Small Cities				
Manchester	39	\$ 96,419,200	\$949,729	\$ 566,228
Torrington	48	\$ 31,853,590	\$364,325	\$ 104,211
Wealthy Suburbs				
Glastonbury	54	\$ 6,258,700	\$56,485	-
Guilford	34	\$ 3,283,890	\$23,184	-
Litchfield	46	\$ 13,119,240	\$85,931	\$ 28,313
New Canaan	28	\$ 10,889,410	\$43,517	-
Mixed Base				
Hamden	114	\$ 104,711,810	\$1,069,893	\$ 715,955
Middletown	75	\$ 329,782,480	\$2,298,584	\$ 3,252,694
Norwich	63	\$ 120,983,900	\$1,237,060	\$ 910,659
Windsor	97	\$ 8,042,580	\$62,169	-
Rural				
Bozrah	12	\$ 971,540	\$6,558	-
Durham	30	\$ 2,546,810	\$21,482	-
Killingly	53	\$ 41,401,760	\$282,671	\$ 60,358
North Canaan	28	\$ 4,119,040	\$28,318	\$ 8,147
Plainfield	48	\$ 10,006,240	\$70,944	-
Union	53	\$ 4,472,660	\$33,098	\$ 23,968
Washington	14	\$ 9,287,880	\$31,927	-

*A dash (-) in column 5 indicates a zero amount

In addition, this approach would impact the distribution of property tax liabilities across individual land uses within municipalities. For example, if exempt properties paid property taxes on 25 percent of their property value it would reduce the combined residential and commercial share of property tax liabilities, shifting property taxes to some exempt properties, directly impacting equity of the property tax. The table below indicates that under such a scenario (Scenario 2 in the table) the combined residential and commercial share of property tax liabilities would be reduced by 20 percent in Hartford, 9 percent in Middletown and 5.5 percent in Norwich compared to the current situation.

Allocation of Property Tax Liabilities for Residential and Commercial Properties Under Two Scenarios								
Municipalities	Exempt Share of Total		Scenario 1: Current System		Scenario 2: Some Exempt Properties Pay on 25% of Value			
	No. Parcels	Value	Share of Prop Taxes		Share of Prop Taxes		Res + Comm	
			Residential	Commercial	Residential	Commercial	Scenario 1	Scenario 2
Large Cities								
Bridgeport	5.5%	33.9%	68.3%	14.5%	65.0%	13.8%	82.8%	78.8%
Hartford	6.4%	59.1%	29.7%	45.7%	23.6%	36.4%	75.4%	60.0%
Small Cities								
Manchester	3.2%	11.9%	94.8%	3.4%	92.8%	3.3%	98.2%	96.1%
Torrington	2.6%	12.3%	92.7%	4.4%	90.8%	4.3%	97.0%	95.1%
Wealthy Suburbs								
Glastonbury	3.9%	6.7%	92.4%	0.6%	92.2%	0.6%	93.0%	92.8%
Guilford	5.3%	5.3%	92.1%	6.7%	91.7%	6.6%	98.8%	98.3%
Litchfield	6.2%	13.9%	87.9%	1.3%	85.3%	1.3%	89.2%	86.6%
New Canaan	3.1%	6.7%	95.0%	2.4%	94.2%	2.4%	97.4%	96.7%
Mixed Base								
Hamden	2.8%	16.6%	95.2%	3.0%	91.9%	2.9%	98.2%	94.8%
Middletown	6.3%	32.4%	80.4%	10.3%	73.1%	9.4%	90.7%	82.5%
Norwich	6.3%	27.1%	83.4%	9.0%	78.8%	8.5%	92.4%	87.3%
Windsor	3.7%	10.3%	93.6%	1.7%	92.1%	1.7%	95.3%	93.8%
Rurual								
Bozrah	3.8%	7.0%	82.7%	1.0%	81.3%	1.0%	83.7%	82.3%
Durham	4.4%	6.8%	78.2%	1.2%	77.2%	1.2%	79.4%	78.4%
Killingly	3.7%	15.1%	82.7%	3.0%	81.2%	3.0%	85.8%	84.2%
North Canaan	0.0%	0.0%						
Plainfield	3.0%	14.1%	83.9%	0.7%	82.9%	0.7%	84.6%	83.6%
Union	11.6%	11.3%	82.4%	0.5%	80.6%	0.5%	82.9%	81.1%
Washington	6.9%	14.7%	90.3%	1.5%	87.0%	1.4%	91.8%	88.4%

Not all exempt properties would have sufficient resources to make such a required payment. As a result, the number of exempt properties and the level and quality of services available to citizens in the community could be reduced if some nonprofits paid a portion of property taxes due on their property. This potential problem could be mitigated by exempting the first \$5 million of value from these calculations.

This option should be implemented in a revenue neutral manner, requiring local governments to reduce their mill rate to generate the same amount of revenue from the broadened tax base as they do now. The policy should be phased in over a 5-year period starting in 2020. Also, this responds to the mandate of the enabling legislation creating the tax panel to look for ways consider creating a tiered property tax payment system for currently exempt properties.

It should be remembered that these payments by exempt organizations would not substitute for state grant programs that reimburse local governments for a portion of property tax revenues foregone as a result of state mandated exemptions.

Policy Option 4: Phase out property tax exemptions for selected properties.

Connecticut should re-examine certain tax exemptions for specific categories or uses of property. For example, property tax exemptions might be retained for federal, state and municipal properties, as well as religious and educational organizations, hospitals and non-profit organizations providing services to local residents. Other property tax exemptions could be reexamined. For example, PA 15-5 SS, Section 244, which became effective October 1, 2015 provides for the taxation of residential real property (not dormitories with 20 beds or more) held by private nonprofit institutions of higher learning.

Kenyon and Langley (2010) identify several considerations in developing a rationale for exempting some real estate from paying local property taxes. Their main argument for granting exemptions is referred to as the quid pro quo argument which says that since nonprofits provide benefits to society, including some services that might typically be provided by government, they should be subsidized to some extent. This notion has become increasingly popular as states review and tighten their determination of which properties will receive a property tax exemption.

This approach relies on a narrower definition of which organizations should be eligible for exemption than those used at the federal level. This is particularly important, as Kenyon and Langley argue, because too often the benefits of being exempt from the local property tax go to nonprofits with the most valuable property, not those providing the greatest public benefits. They also argue there can be a geographic mismatch between the benefits provided by nonprofits, which can be geographically dispersed throughout a metropolitan area, and the cost of the exemption foregone by one local government.

Such an approach might limit the number and types of properties being classified as exempt emphasizing those that provide direct benefits to local citizens. Limiting the number of tax exempt organizations would reduce revenues foregone by local governments, thereby reducing the effective tax rate paid by non-exempt properties. As a result, such an approach would broaden the property tax base thereby addressing directly the neutrality and equity concerns associated with exempting some properties from paying property taxes.

Such a change would need to be phased in over a period of time so if any organizations lose all or part of their exemptions they can make necessary adjustments. Thus, their tax exempt status could be phased out at 10% annually over a 10-year period. To allow for adjustments, the phase out might start in 5 years – 2020.

DIRECT PROPERTY TAX RELIEF

Efforts to reduce property tax liabilities include both direct and indirect property tax relief for property owners. Direct property tax relief reduces the tax liabilities for individual property owners. Connecticut has a plethora of existing programs, both state and local, designed to provide direct property tax relief to eligible households by reducing assessments. For example, the main programs include

- state funded circuit breaker for the elderly and disabled.
- Income tax credit for property taxes paid through the Connecticut personal income tax.
- Disability programs reduce property taxes for homeowners who are disabled to various degrees – the reduction depends on the degree of disability.
- Veterans programs to receive exemptions under two programs, one reimbursed by the state and one not reimbursed by the state.
- A number of municipal options for providing additional property tax relief including exemptions for
 - The disabled
 - The blind
 - Veterans (standard and additional exemptions)
 - Disabled veterans
 - Severely disabled veterans
 - Property deferral programs.

The vast array of programs to reduce property taxes for qualifying homeowners in Connecticut actually provide very modest actual reductions in property taxes. The new maximum for the income tax credit for property taxes paid will cost the state about \$143 million in foregone income tax revenues and all the other programs to reduce property taxes by reducing assessments of qualified homeowners will reduce property taxes by about \$46.1 million in FY2012 or about .5 percent.

Another form of direct property tax relief is provided in Connecticut through the use-value assessment law known as Public Act 490 (PA490). Under this program some landowners pay tax based on the current use value of their property rather than based on the “highest and best use,” or market value of the property.

There are no minimum acreage requirements or specific income requirements for farmland to qualify for PA490 preferential tax treatment. The income capitalization method is used to estimate use-value assessments in Connecticut, as is done in most states. There are two difficulties with this method of estimating use value. First, by relying on a survey of rental values, there may be a systematic downward bias in the use-value estimation. Rental values for land may be systematically lower than net incomes generated by owner-operators. Second, the capitalization rate used is 12.5 percent and in 2010 bears no direct resemblance to the actual opportunity cost of capital in that market circumstance.

The effect of these estimation methods is to produce use values that are very low, reducing the property tax base and shifting the property tax burden to other classes of property.

The direct relief paper then then discusses in depth the alternative of providing property tax relief through an expanded circuit breaker. Circuit breakers are tax mechanisms that provide income-based property tax relief for households that are overburdened with property taxes.

The primary advantage of a circuit breaker is that state resources are targeted specifically to those who need the relief the most. The result is that for a given amount of property tax relief provided by the state (\$100 million, say), more substantial relief for those who need it most can be provided using a circuit breaker. Alternatively, we can say that the circuit breaker is a less expensive way to provide property tax relief because it does not waste relief on those who do not need it.

Policy Option 1: Replace 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. Implement a single threshold type circuit-breaker credit on the Connecticut income tax to provide targeted relief (a modification of the current CT property tax credit).

There are several advantages and disadvantages related to this approach in providing property tax relief.

Advantages:

- Tax relief is targeted to those most needing assistance, and that targeting is based on means-testing rather than other criteria
- Relief is provided regardless of other taxpayer or household characteristics (elderly, disabled, veterans, etc.), making implementation much simpler
- The circuit breaker mechanism adds a degree of progressivity to the state income tax
- The cost of the program can be determined explicitly by the state

Disadvantages:

- State revenues are required to pay for the credits, which involves using general fund revenues generated from other sources such as the state income or sales taxes
- The credit mechanism lowers the tax price of local public goods (e.g. schools) for credit recipients, which may encourage them to demand more public goods.

The cost of two variations of a circuit breaker were provided by Anderson (2015). The cost of a single-threshold circuit breaker was estimated assuming that 60 percent of the property tax in excess of 3.5 percent of total household resources, subject to a cap of \$1,200. For renters, 20 percent of rent is counted as property taxes paid. Households with total resources in excess of \$50,000 are not eligible for the circuit breaker.

In the first version of the circuit breaker 195,409 households would receive the tax credit, benefits to 149,937 of those households would be constrained by the cap, and the total cost to the state would be \$211 million. In a second version the income and tax thresholds are the same, but the share of tax paid in excess of the threshold is reduced to 40 percent and the credit cap is \$1,000. Under this scenario the number of households eligible for the credit is unchanged at 195,409, the number of households subject to the cap falls to 129,202 and the cost of the program falls to \$168 million.

Between the current property tax credit in the personal income tax and the estimated cost of the other programs designed to reduce property taxes for some households by reducing assessments, the total cost of property tax reduction is approximately \$189 million -- \$143 million for the \$200 tax credit and \$46 million for the other programs designed to reduce property taxes. Thus, this option is essentially revenue neutral.

Any additional funding needed would come from general revenues generated by state income and sales taxes, as well as with increased revenues from the elimination of other relief mechanisms (e.g. State-funded exemptions, and increased revenue from tightening PA490 provisions).

Policy Option 2: Tighten PA490 provisions to target tax relief

The administration of the PA490 use value assessment program should be revamped by

- Implementing an objective test for agricultural use (e.g. de minimus level of net income from agricultural production)
- Rationalizing use-value assessment (UVA) computation methods used—a more accurate income measure and a more realistic capitalization rate
- Moving away from general tax relief for agriculture broadly and move toward strategic use of UVA to protect and preserve land that provides ecosystem services that are a form of public good or generates positive externalities.

Policy Option 3: Modifications to the current property tax deferral program

- *Reduce the threshold level of tax relative to income from eight percent to, perhaps, five percent*
- *Hold local governments harmless by having the State provide a low interest loan secured by a lien on the property that pays the property tax to the local government units.*

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INDIRECT PROPERTY TAX RELIEF (LOCAL NON- PROPERTY TAXATION)

Efforts to reduce property tax liabilities include both *direct* and *indirect* property tax relief for property owners. *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 explores the implications of local income and sales tax options for local governments in Connecticut as well as increased reliance on user charges.

Arguments For and Against Local Revenue Diversification (Local

The principal reasons for adopting a local option tax or increasing charges and fees is that they will diversify the local revenue structure and can reduce the property tax burden. The Advisory Commission on Intergovernmental Relations (1988) outlined several arguments supporting or justifying local revenue diversification. Allowing use of alternative revenue sources would allow towns to better capture local revenue raising capacity, would reduce reliance on the property tax, and would collect revenue from tourists and commuters who impose costs on local governments but do not pay any property taxes to the local government. There are counter arguments, the principal one being that if a local government gains access to additional revenue options, it will increase revenue, and thus expenditures, beyond what the citizen truly desire; however, the empirical evidence on this possibility is mixed.

Policy Option 1: Allow Local Governments to Adopt a Local Sales Tax

Two alternative local sales taxes options were considered: a local sales tax where the revenue collected in a town is allocated to that town, and a regional sales tax in which total local sales tax revenue across all towns in each of the nine planning districts (i.e., Councils of Government) is allocated to the towns in the planning district using a formula in which half of the revenue is allocated to the town from which the revenue was generated and half is allocated on a per capita basis.

It is estimated that a one percent local sales tax would generate \$603.9 million and the state sales tax revenue would decline by \$36.4 million. If used to provide property tax relief such a tax could reduce property taxes by about 6.1 percent on average.

In addition, a one percent local sales tax would

- potentially cause Connecticut border cities to lose some sales to Massachusetts, and they might experience a small drop in sales that are made to buyers from New York.
- lead to competition between local jurisdictions for sales tax base as well.
- not reduce the fiscal disparities between towns.
- have a small administrative cost if structured as an add-on to the state sales tax.
- generate tax revenue from commuters and visitors thereby offsetting some of the service costs associated with commuters and visitors.

Policy Option 2: Allow Local Governments to Adopt a Local Income Tax

Four alternative definitions of the income tax base were considered:

- Connecticut adjusted gross income (AGI)
- Connecticut tax liability
- A tax on earned income imposed by place of work, which we refer to as the “Payroll Tax”
- A tax on earned income split equally between place of work and place of residence, which we refer to as the “Split Earnings Tax”.

Revenue per capita differs widely across towns for each option; per capita revenue range from \$40 to \$271 for the tax on AGI, from \$31 to \$273 for the tax based on tax liability, for the payroll tax ranges from \$22 to \$162, and for the Split Earnings Tax ranges from \$97 to \$236. The local income tax, in the aggregate, would generate sufficient revenue to reduce total property taxes by about 11.5 percent.

In considering whether to recommend allowing local governments to use local income taxes, the following factors are relevant. In addition,

- It is expected that a local income tax could have a small, negative effect on hours worked and to the extent local income tax rates differ across towns, it is expected that the tax differential could cause migration of the tax base from the towns with the higher income tax rates to those towns with lower tax rates, but with the tax rates proposed, the effect will be small.
- Adopting an income tax provides an incentive for towns to compete more strongly for high wage households or high wage jobs, and somewhat less for property.
- Any of the local income tax options will be less regressive than either property taxes or sales taxes.
- the adoption of local income taxes will not offset existing fiscal disparities.
- The administrative costs of such an option vary by how the base is defined and will be lower if the local tax is “piggy-backed” on the state income tax.

Local Option Tax Design Issues

If Connecticut chooses to allow cities to adopt a local sales tax or a local income tax, the state will have to specify the design of the tax structure, which means selecting one of the options for each of several parameters or features. In particular, the state will have to:

- Define of the tax base;
- Specify the allowable tax rate;
- Determine whether the tax is optional or mandated;
- Determine whether the town’s elected officials can adopt the tax on their own or whether to require voter approval through a referendum;
- Determine whether the administration of the tax will be done by the state or by each town;
- Determine whether the revenue can be used only for specific purposes or for any activity allowed by law;
- Specify the extent to which the revenue collected in a town is allocated to that town.

Policy Option 3: Increase Reliance on User Charges and Fees

On average, local governments in the U.S. generate 22.9 percent of their own-source revenues from current charges. The high is 51.1 percent in Mississippi and the low is 8.6 percent in Connecticut. Local governments should move to increase their reliance on user charges by

- supporting state legislation reviewing limits the state imposes on fees to determine whether they are still appropriate.
- pursuing actions that would encourage greater use of user charges and fees such as funding a comparative interstate study of the use, design, and fee levels of user charges or a campaign to promote the increase use of charges.
- encourage local governments to adopt a fee structure for services such as solid waste collection and disposal that is based on the volume of waste a resident puts in the system and that is not as regressive as a flat per household charge.
- authorizing the use of impact fees which are one-time charges on new development in order to pay for the construction or expansion of off-site capital improvements that are necessitated by and benefit the new project and could raise local revenues that range between \$33.4 million and \$45.2 million.

If Connecticut increased its current charge revenue sufficiently to cover the same percentage of each expenditure category as the U.S., Connecticut could increase its current service revenue by between \$349 million and \$867 million, or between 48.1 percent and 96.0 percent. If used to reduce property taxes, towns in Connecticut could reduce property taxes by between 3.8 percent and 9.3 percent.

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PERSONAL PROPERTY TAX

Connecticut has a personal property tax (PP) which includes tangible personal property owned or leased by businesses, but it excludes motor vehicles, business inventories and intangible personal property. The personal property category accounts for just over 5% of total taxable property in Connecticut and generates over \$590 million in revenue annually.

Personal property exemptions in Connecticut currently represent 20.4% of total personal property taxable value. The personal property tax is challenging to administer because of the difficulty in identifying personal property, valuing it for tax purposes and auditing to insure compliance.

Mill rates vary across municipalities resulting in tax burdens placed on personal property that also vary significantly across municipalities. In 13 jurisdictions studied, there were over 30,000 individual personal property accounts, but 89% of taxable personal property value is found in only 7.2% of personal property accounts.

Policy Option 1: Provide Compliance Relief to Taxpayers

- 1) Exempt taxpayers with \$5,000 or less in taxable PP.
 - a. Revenue impact: 0.42% of total revenue from PP (less than 0.03% of total property tax revenue)
 - b. Accounts affected: 35% of all PP accounts
- 2) Exempt taxpayers with \$7,500 or less in taxable PP.
 - a. Revenue impact: 0.68% of total revenue from PP
 - b. Accounts affected: 42%
- 3) Exempt taxpayers with \$10,000 or less in taxable PP.
 - a. Revenue impact: 0.97% of total revenue from PP
 - b. Accounts affected: 46%
- 4) Leave the system as is.

Policy Option 2: Improve Administration of the PP Tax

- 1) Revisit depreciation schedules, especially the 30% residual value. These schedules come mostly from the state and don't make many distinctions. The 30% residual value is particularly problematic for many property categories.
- 2) Improve audit procedures while regulating contingency audits. Audits are performed very irregularly and in many instances are contracted out. When the contract is given on a contingency basis, taxpayers feel they are being abused.
- 3) Strengthen the role of OPM in overseeing uniformity of assessment administration. OPM needs to play a more active role in assuring uniformity in assessment administration.
- 4) Estimate obsolescence in at least Chemical products manufacturing. The evidence is that this industry pretty much collapsed in the state after 2009 and has never recovered. To the extent they have specialized equipment that cannot be readily converted to other uses, there may be economic and functional obsolescence. Assessors need to look for it and not just rely on standard depreciation schedules. The Finance industry has also suffered, but I suspect their equipment is less specialized and can be converted to other uses, so obsolescence is less likely.

MOTOR VEHICLE TAX ('CAR TAX')

Connecticut includes motor vehicles in the property tax base. Motor vehicles account for 6.4% of the Grand List value in Connecticut. There are 2.9 million registered vehicles in Connecticut with an aggregate gross taxable value of \$23,690 million. Variation in mill rates across towns result in very large differences in the tax obligation associated with vehicles of the same value.

The tax has serious equity, efficiency and administrative challenges. The equity and efficiency concerns have been partially addressed with the change this summer that put a ceiling on the mill rate that can be applied to motor vehicles. The majority of resources in a local assessor's office are devoted to maintaining motor vehicle accounts and values.

Eleven states levy an ad valorem tax on motor vehicles like Connecticut. Twelve states levy an excise tax based on age-adjusted Manufacturer's Suggested Retail Value. Nine states have variations of these two approaches and the remaining states (18) levy no tax on motor vehicles beyond motor registration fees.

Policy Option 1: Continue with the current system

This would continue the equity, efficiency and administrative problems of the current system.

Policy Option 2: Establish a revenue-neutral statewide mill rate and "hold harmless" provision to replace the lost revenue in some cities.

The required mill rate would be 28.1 mills. Importantly, 73 communities would see taxes on motor vehicles increase by an average of about 28.9% and 96 communities would receive tax reductions of about 15.4% on average. There would be little change in about 20% to 30% of cities.

This would improve the equity of the motor vehicle tax, but many taxpayers would see their motor vehicle tax increase and it does not completely address the equity and efficiency concerns with the current tax.

Policy Option 3: The same as Policy Option 2, but apply local mill rate and let local governments collect the revenue directly.

Policy Option 4: Replace the current ad valorem tax with a revenue neutral excise tax.

- a. MSRP times an original assessment ratio (could be 70%)
- b. Reduce the assessed value by a fixed percentage each year
- c. Apply a fixed statewide tax rate
- d. State collection in conjunction with registration
- e. State remits to local government.

This would greatly improve equity with substantial savings in administrative costs. Many taxpayers may see their motor vehicle taxes increase.

This could be structured so that local governments set the tax rate within bounds established by the state. This approach could also be applied to antique cars, which would dramatically lower the cost of administering the tax.

Policy Option 5: Replace the current ad valorem tax with an excise tax based on the weight of the vehicle.

The tax rate would be set by the local government within bounds set by the state and would be collected in conjunction with registration and remitted to the local government.

This would improve equity and result in substantial savings in administrative costs. Some local governments could experience significant declines in revenue.

Policy Options 6: Eliminate the motor vehicle tax

This option would need to be phased in so that local governments can adjust to allow local governments to increase the tax on the remaining property, reduce spending, some combination of both, or develop new local revenue sources. This would clearly improve equity and efficiency and eliminate onerous administrative costs. However, local governments would lose \$600 to \$700 million in revenue with limited ways to replace the revenue.

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REAL ESTATE CONVEYANCE AND CONTROLLING INTEREST TRANSFER TAXES

In Connecticut, real estate transfer taxes are comprised of the Real Estate Conveyance Tax and the Controlling Interest Transfer Tax, with the Real Estate Conveyance tax shared by the state and local government. As these taxes are a tax on the conveyance of property, the revenues are sensitive to real estate market conditions. The tax yield is a function of both the number of transactions and value of the property transferred.

Real Estate Conveyance (REC) tax is imposed only when real estate is transferred, specifically at the time the deed is registered. The town clerk collects both the state and local portions and transmits the state tax revenues to the state Department of Revenue Services.

The Controlling Interest Transfer (CIT) tax is imposed by the state when Connecticut real estate interests are transferred through the sale or trade of controlling interests of a corporation, partnership or similar type entity. By design, the tax applies to those transfers that are not covered by the REC. By imposing both the REC and CIT, all Connecticut real estate transfers are taxed by the state, regardless of how the transaction is structured. The CIT is only a state tax and all revenues are state revenues.

Municipal REC flat rate was last raised in 2003 to 0.25 percent on a temporary basis and made permanent in 2011. The applicable state rate is not a flat rate and depends on the use of property with a graduated rate for single family properties. The maximum state rate, applied to the value of residential property in excess of \$800,000 and all non-residential property, is 1.25 percent. All other transfers are taxed at 0.5 percent.

The state REC generates between \$126 and \$172 million annually and the local REC generates about \$40 million annually.

Policy Option 1: Retain the three components of the Real Estate Conveyance (REC) tax – state, municipal, and targeted investment communities—and the state Controlling Interest Transfer (CIT) tax at current rates.

There is no revenue impact, other than the impact of economic conditions that may change over time.

Policy Option 2: Retain the local tax including the optional rate for the targeted investment communities and repeal the state component of the REC. Retain the state CIT tax.

- With repeal of the state rates, provide optional rates for municipalities.
 - Pro argument
 - Retaining the Controlling Interest Transfer Tax, maintains the horizontal equity, taxing transactions both by transferring controlling interest and transferring deeds although the companion state tax Real Estate Conveyance tax is repealed.
 - Retaining the local tax provides some local alternative revenue diversity. The revenue impact of the current rate of 0.25 percent is approximately \$40 million annually.

- Retaining the optional rate for the targeted investment communities allows some local flexibility.
 - Extending optional rates provides all municipalities with a small degree of flexibility in determining their local revenue mix.
 - Deed registration is a local responsibility with the municipalities providing the service. They should retain all the revenues.
- Con argument
 - Repealing the state REC will not remove the local responsibility to provide the state with information about consideration paid for real estate.
 - The repeal of the state portion of the REC could reduce state revenues by between \$126 million to \$172 million.

Policy Option 3: Retain the state taxes (REC and CIT) but repeal the REC local components, including authority for the optional tax in the targeted investment communities.

- Pro arguments
 - Retaining the two state taxes assures that all property transfers are subject to a transfer tax.
 - Information critical for property tax administration is still available as the state REC would continue to be collected locally when the deed is registered.
 - Horizontal equity between properties transferred in targeted investment communities and in all other municipalities is restored.
 - At the local level, the loss of the REC does not have a substantial impact on local revenues as property taxes can be raised to replace the local REC revenues no longer available.
 - There may be a shift of the overall local tax burden to the extent that the residential share of the REC was greater than its share of the property tax.
 - Any impact on the real estate markets resulting from the targeted investment communities' additional rate is mitigated.
- Con arguments
 - Local property taxes would have to be raised to replace the REC revenue or other budget adjustments made. The midrange estimate of revenue from the local REC tax is \$41 million.
 - Municipal revenue diversification, as limited as it is with the REC, would no longer exist.
 - Eliminating the optional rate for targeted investment communities reduces the modest amount of taxing flexibility these communities have.

Policy Option 4: Upon removing the local portion of the tax in the previous option, increase the state REC rates by the 0.25 percent local rate and permanently earmark the increased revenues attributed to the rate increase for regional activities or for additional funding of the Community Investment Fund (the state fund financed with revenues from document registration fees).

- Pro arguments
 - The 0.25 percent rate increase is revenue neutral to the seller of property, except in the targeted investment communities in which case, the new rate is lower.
 - Several options for earmarking would complement existing state efforts such as to encourage local involvement in regional approaches, to reinstate REC funding to the Municipal Relief fund, or to combine with registration fees currently earmarked to the Community Investment Fund.
- Con arguments
 - Local property taxes would have to be raised to replace the REC revenue or other budget adjustments made. The midrange estimate of revenue from the local REC tax is \$41 million.
 - Targeted investment communities would sustain a revenue loss.
 - Municipal governments may perceive the shift as a state takeover without the state providing adequate replacement.
 - Revenues for earmarked spending may not reflect local preferences.
 - Earmarking revenues may not prevent future diversion of funds for other state purposes.