



**RIPEC**

# Comments on Your Government

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## Taxes and Jobs

### Do High Marginal Tax Rates Make A Difference? What do Economists Think?

#### Introduction

Do high marginal income tax rates make a difference in attracting jobs to the Ocean State and retaining high income residents?

The House leadership in the Rhode Island General Assembly has taken a position that it does. Therefore, they have proposed legislation to provide income tax relief primarily to upper income Rhode Island taxpayers. The House leadership has introduced legislation that would reduce the State's top marginal rate over a five year period. The proposal creates an alternative tax rate for top earners, whereby these taxpayers could choose to either pay income taxes under current law, which translates to a top marginal rate of 9.9 percent of their Federal taxable income, or a flat rate of 8.0 percent of their adjusted gross income (AGI) – primarily without any reductions to the Federal AGI. The new alternative tax structure would commence in 2006 and over the course of six years, would reduce the flat rate to 5.5 percent for tax year 2011.

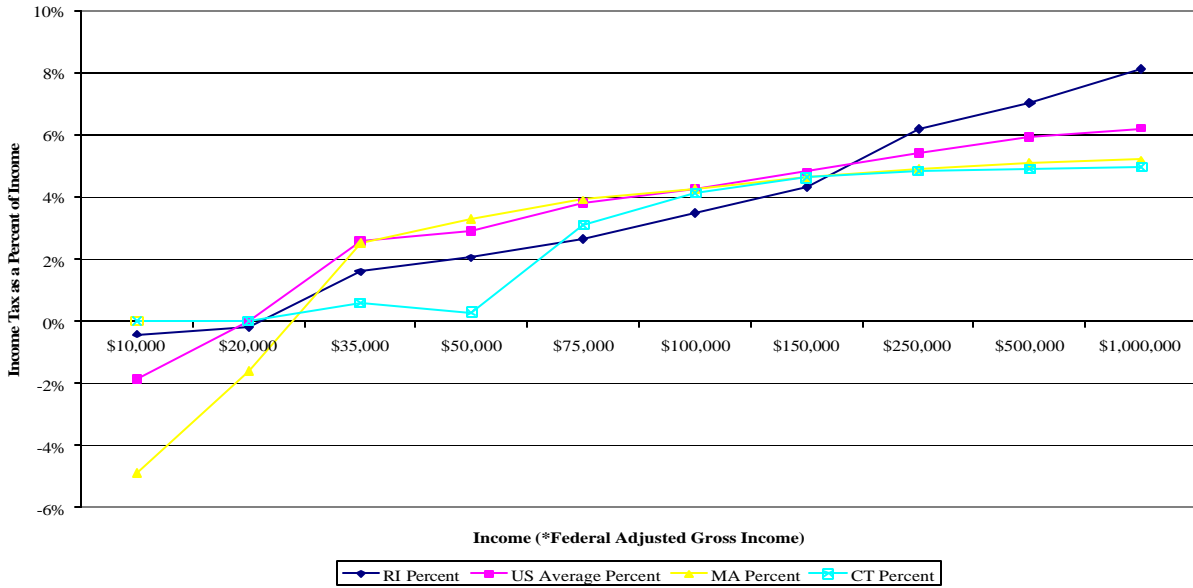
Preliminary estimates indicate that implementation of the House leadership proposal would cost approximately \$75.0 million when fully implemented before any estimates are made as to what, if any, additional tax revenues would occur as a result of job creation.

The reaction by interest groups has been predictable. Liberal policy groups and those advocating for more spending on social programs have testified that evidence suggests that a reduction in the top marginal income tax rate cannot be counted upon to create jobs in a cost-effective manner. Business interests and supply side theorists, on the other hand, have suggested that a reduction in the top marginal personal income tax rate is critical for economic competitiveness and job creation given how Rhode Island's income tax structure compares to both Massachusetts and Connecticut.

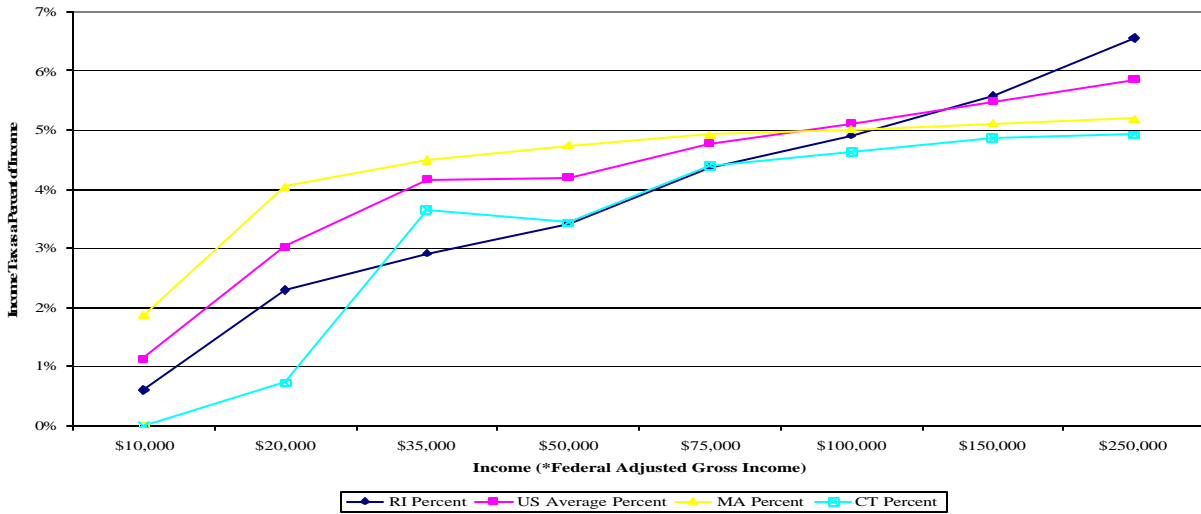
To further inform the debate over the impact marginal tax rates have on job growth and investment, it is necessary to review surveys and econometric studies that have been prepared by economists. Therefore, the objective of this discussion paper is to go beyond the predictable positions advocated by interest groups and briefly summarize the trends presented in the academic literature on effects tax policy has on creating good jobs and growing the Ocean State's economy.

**April 24, 2006**

**Chart 1**  
**Rhode Island State Income Taxes as a Percent of Income\*, 2003,**  
**Married Filing Jointly, 2 Wage Earners, 2 Dependents**



**Chart 2**  
**Rhode Island State Income Taxes as a Percent of Income\*, 2003,**  
**Single Filers, No Dependents**



## How Rhode Island Compares

Comparative studies prepared by RIPEC, RISCPA and the National Taxpayers Conference (NTC) show that the income tax paid by upper income Rhode Islanders exceeds those paid by residents of Massachusetts, Connecticut and the average for the United States.<sup>1</sup>

As measured by taxes as a percent of personal income, Rhode Island's income tax burden is more progressive than the average of the 41 income tax states and neighboring states. Charts 1 and 2 show the effective tax rates (taxes as a percent of income) at the various income levels for married joint and single filers with respect to the United States and the states of Massachusetts, Connecticut and Rhode Island.

The relative patterns of Rhode Island's income tax liabilities for married joint and single files are similar. For Rhode Island's married joint filers with AGI's of approximately \$200,000 to \$250,000 effective state income tax rates exceed the national average, as well as those in Massachusetts and Connecticut. The same is true for single filers with adjusted gross income of approximately \$150,000.

These surveys also find that Rhode Island's personal income tax liabilities for low, middle and upper-middle income families and individuals are competitive with Massachusetts, Connecticut and most other income tax states.

As noted, effective tax rates show tax liabilities as a percentage of AGI. Table 1 presents the effective tax rates by selected income groups in Rhode Island compared to Connecticut, Massachusetts and the state average for the 41 states and the District of Columbia that levy a broad-based personal income tax. This table shows the specific effective rates that are presented on Chart 1. Again, it is clear that Rhode Island's personal income tax is more progressive than in neighboring states because effective tax rates are higher as income increases.

Income Group	Rhode Island		Connecticut		Massachusetts		State Average**	
	Est. Tax	ETR	Est. Tax	ETR	Est. Tax	ETR	Est. Tax	ETR
\$ 35,000	\$ 558	1.59%	\$ 214	0.60%	\$ 878	2.51%	\$ 903	2.58%
50,000	1,021	2.04	149	0.30	1,646	3.29	1,460	2.92
75,000	1,970	2.63	2,314	3.09	2,939	3.92	2,848	3.80
100,000	3,490	3.49	4,157	4.16	4,246	4.25	4,282	4.28
150,000	6,467	4.31	6,925	4.62	6,969	4.65	7,217	4.81
250,000	15,430	6.17	12,100	4.84	12,252	4.90	13,516	5.40
500,000	35,066	7.01	24,600	4.92	25,482	5.10	29,737	5.95
1,000,000	81,274	8.13	49,600	4.96	52,013	5.20	62,123	6.21

Note: ETR = Effective Tax Rate

\*Source: RIPEC and the National Taxpayers Conference, "Comparison of 2003 Individual Income Tax Burdens By State."  
\*\*41 income tax states and District of Columbia.

Table 2 provides a summary of tax incidence calculations that were prepared by the Rhode Island Society of Certified Public Accountants (RISCPA). The calculations are based on tax year 2004. Therefore, the tax liabilities shown will differ from the results of the RIPEC/NTC taxpayer profiles. However, the relative findings reported by the RISCPA and RIPEC/NTC are consistent.

Income Group	Rhode Island		Connecticut		Massachusetts	
	Est. Tax	ETR	Est. Tax	ETR	Est. Tax	ETR
\$ 40,000	\$ 745	1.86%	\$ 312	0.78%	\$ 1,311	3.28%
75,000	1,872	2.50	3,016	4.02	3,121	4.16
100,000	3,284	3.28	4,558	4.56	4,446	4.45
150,000	6,377	4.25	7,120	4.75	7,108	4.74
200,000	9,950	4.98	9,670	4.84	9,829	4.91
250,000	14,256	5.70	12,225	4.89	12,537	5.01
500,000	36,430	7.29	24,961	4.99	25,953	5.19
1,000,000	82,736	8.27	50,400	5.04	52,983	5.30

Note: ETR = Effective Tax Rate  
Source: RISCPA & RIPEC calculations, see, "The Rhode Island Personal Income Tax: A Call for Reform," May 2005.

Rhode Island College’s Poverty Institute prepared a comparison of Rhode Island’s and Massachusetts’s personal income taxes for “Representative Joint Filers Earning \$500,000.” They concluded that the effective tax rate in Rhode Island was 5.9 percent compared to 5.7 percent in the Bay State.<sup>2</sup>

The Institute for Taxation and Economic Policy, a liberal group, reported that effective income tax rates for the top one percent of earners in Rhode Island (\$272,000 or more) was 5.7 percent compared to 4.5 percent and 4.8 percent in Massachusetts (\$413,000 or more) and Connecticut (\$471,000 or more), respectively.<sup>3</sup>

Obviously, the assumptions used to calculate tax incidence models will affect the conclusion reached. However, what is clear is that the effective income tax rate paid by upper income Rhode Islanders exceeds those paid in Connecticut, Massachusetts and the nation as a whole.

In addition to comparing effective tax rates, economic development professionals suggest that high marginal tax rates influence decisions made by entrepreneurs to invest or expand their investments in a particular state or community. As shown on Appendix A, Rhode Island’s top marginal rate of 9.9 percent is the second highest in the United States. California has the highest marginal rate of 10.3 percent for filers with incomes over \$1.0 million.

Appendix B presents an analysis of resident Rhode Island personal income tax returns for 2004. The data presented shows that tax filers with Adjusted Gross Income (AGI) of \$200,000 and more comprise about two percent of the resident filers and pay over 36 percent of state personal income taxes.

### **Reactions to the House Proposal**

The reaction to the House Leadership's plan has been predictable. Advocates for additional spending for human services programs and some public employee unions believe that cutting personal income taxes for top earners in the State is both unnecessary and unaffordable. They argue that reducing income taxes for the upper one percent does not promote economic development in an efficient manner and Rhode Island cannot afford to cut personal income taxes given the State's structural budget deficit.

To justify this position Rhode Island College's Poverty Institute sites New Jersey's experience. According to the Poverty Institute, New Jersey cut its personal income tax rates by 30 percent as an economic development strategy in the mid 1990s. An article published in the periodical *Public Finance Review* is reported to have found that New Jersey experienced no additional job growth compared to neighboring New York and Pennsylvania.<sup>4</sup> What the Poverty Institute does not tell us is whether or not New Jersey's tax policy saved jobs and if it resulted in additional investments in the Garden State.

In general, the research of liberal public policy groups suggests that when tax cuts occur at the expense of public investments they are not effective tools to expand employment and spur growth.<sup>5</sup>

Conversely, conservative groups like the Tax Foundation argue that taxes do matter when it comes to decisions affecting economic development. The Tax Foundation has concluded: "Taxes affect business decision, job creation and retention, plant location, competitiveness, and the long-term health of a state economy. Furthermore, states do not enact tax changes in a vacuum. Every tax change will in some way change a state's competitive position relative to its immediate neighbors and the region."<sup>6</sup>

The Tax Foundation further notes that when comparing competitiveness one should not only focus on how much taxes a state collects, but also on the structure of the tax system. From the Tax Foundation's point of view, "good state tax systems levy low, flat rates on the broadest base possible, and they treat all taxpayers the same."<sup>7</sup> In the Tax Foundation's *State Business Tax Climate Index*, Rhode Island's personal income tax ranked 40<sup>th</sup> in part because of its high marginal tax rate.

Anecdotal evidence gathered by RISCPA through a survey of their membership indicates that Rhode Island's relatively high marginal tax rate may have an impact on wealth creation and retention in the Ocean State. Their survey found cases where:

- Retirees were moving to lower tax states;
- Some companies were locating in low tax states and serving the Rhode Island market without establishing taxable nexus; and
- Companies with multiple locations were moving into Rhode Island, but locating higher income wage earners elsewhere.<sup>8</sup>

Representatives of the Economic Development Corporation (EDC), the State's economic development agency, have testified before legislative committees on the economic disadvantage the State faces due to its high marginal income tax rates. EDC argues that high income residents make job location decisions, create jobs with high levels of compensation and contribute a disproportionately high amount to charities and non-profits. EDC reports that between 1995 and 2002 there has been a 0.76 percent increase in Rhode Island households with incomes of \$200,000 or more compared to 5.5 percent in Massachusetts and 4.9 percent nationally and contributions from Rhode Islanders with income of \$200,000 or more declined between 2000 and 2003.<sup>9</sup>

In 1999, RIPEC in conjunction with the Economic Policy Council retained Opinion Dynamics Corporation to conduct research into Rhode Island's business attitudes regarding the effects of the State's tax system on business growth. Respondents also assessed the impact of six specific Rhode Island taxes on future business growth: the commercial tangible property tax, the commercial real property tax, the corporate income tax, the personal income tax, the residential property tax, and the sales and use tax. Large businesses, in particular, view personal income tax levels as obstacles to growth, followed by the residential property tax, the commercial tangible property tax, and the commercial real property tax. Small/Medium businesses place an equally negative rating on the personal income tax and the three property taxes.<sup>10</sup>

This survey appears to be the last one that was published regarding the opinions of the business community regarding tax policy. An update of this research could provide useful information to the Governor and legislative decision-makers.

### **Who To Believe?**

How do high marginal income tax rates impact a state's economic competitiveness? Do they make a significant difference in growing jobs and retaining investments?

In order to get beyond the positions of advocates, RIPEC has undertaken a review of the academic literature. As a point of full disclosure, it should be noted that RIPEC has supported a State personal income tax structure based on Federal AGI with flatter tax rates and wider income brackets than is currently the case in Rhode Island. Selecting literature to review can obviously be influenced by institutional biases. In this paper RIPEC has attempted to present a "balance" survey of the literature.

Economists have not always agreed on how tax affects the economic choices made by individuals and businesses. And, “peer reviewed” economic literature contains research that would support both sides of the debate as to the effect tax differential and high marginal rates have on economic development and job creation.

The following attempts to succinctly review the economic literature on this important matter.

The conservative Tax Foundation review of the economic literature referenced a 1998 survey article of post-World War II empirical tax research literature that is helpful in attempting to summarize trends in academic research. This survey divided empirical tax research literature in the following three periods:<sup>11</sup>

Period I – Taxes do not change behavior;

Period II – Taxes may or may not change business behavior depending on the circumstances; and

Period III – Taxes definitely change behavior.

Period I included a review of the literature produced in the 1950s, 1960s and early 1970s and can be summarized in the following three typical examples.

The first work by John Due in 1961 (“Studies of State-Local Tax Influence on Location and Industry,” National Tax Journal, Vol. 14, pp 163-173) found little correlation to support the hypothesis that taxes influence business decisions.

The second work by William Oakland (Local Taxes and Intraurban Industrial Location: A Survey, “Metropolitan Financing and Growth Management,” Committee on Taxation, Resources and Economic Development, University of Wisconsin, 1978) found no significant research that tax differentials influenced location decisions.

The third work by Michael Wasylenko (“The Location of Firms: The Role of Taxes and Fiscal Incentives,” Urban Affairs Annual Review, Vol. 20, 1981) did find some evidence suggesting that taxes do have an influence on business location decisions. However, the statistical significances did not equal other factors such as labor supply, and Wasylenko concluded that taxes were a secondary factor.

Period II of the early to the late 1980s. The Tax Foundation commented that during this period articles regarding the economic impact of tax policies became more sophisticated. Some of the key findings from surveying literature during this time suggested that the impact of tax policies on economic growth depended upon specific circumstances. Therefore, generalizations were not reached in academic literature to conclude that taxes did or did not affect location decisions.

For example, looking at the relationship between taxes and business location in non-manufacturing sectors, one typical study found:

Higher wages, utility prices, personal income tax rates and an increase in the overall level of taxation discourage employment growth in several industries. (Jobs and Taxes: The Effect of Business Climate on State Economic Growth Rates, National Tax Journal, Vol. 38, 1985.

The third period began in the late 1980s and continues to this day. Empirical research during this period indicates that tax changes can influence economic behavior. However, there are differences as to the degree on such influence. For example, in 1986 Papke and Papke (“Measuring Differential State-Local Tax Liabilities and Their Implications for Business Investment Location,” National Tax Journal, Vol. 39, No. 3, 1986) found evidence that tax differentials between locations may be an important factor that influences location decisions.

In 1991 Bartik (Who Benefits from State and Local Development Policies? Upjohn Institute for Employment Research) found 57 studies to base his review of the economic literature. Bartik’s findings were summarized as follows:

The large number of studies permitted Bartik to take a different approach from the other authors. Instead of dwelling on the results and limitations of each individual study, he looked at them in the aggregate and in groups. Although he acknowledged potential criticisms of individual studies, he convincingly argued that some systematic flaw would have to cut across all studies for the consensus results to be invalid. In striking contrast to previous reviewers, he concluded that taxes have quite large and significant effects on business activity.<sup>12</sup>

Robert G. Lynch’s study for the Economic Policy Institute also found that several recent econometric studies suggest that state and local tax cuts and incentives may have a positive effect on economic growth, provided that governmental services are not reduced to pay for the tax cuts.

“In a comprehensive review of econometric research on the effects of state and local taxes on economic development, Bartik (1991, 1992, 1994a, and 1994b) summarized the results of 75 studies done between 1979 and 1994. He concluded, “Most recent business location studies have found some evidence of statistically significant negative effects of state and local taxes on regional business growth. The findings of recent studies differ from those of studies in the 1950s, 1960s, and early and mid-1970s, which generally did not find statistically significant and negative effects of taxes on state and local growth” (Bartik 1991, p. 38-9).

Phillips and Goss (1995) conducted a meta-analysis of the studies reviewed by Bartik in 1991. They reported tax effects that were negative and perhaps larger than those reported by Bartik, but that varied depending on which studies they included in their analysis and whether the studies controlled for the effects of public services and other variables.

Wasylenko (1997), in the most thorough survey of recent econometric studies that included those reviewed by Bartik in 1991 and several studies done since 1991, found that the effect of state and local taxes on growth, employment, and business location was negative but somewhat smaller than that suggested by Bartik. Wasylenko concluded that state and local taxes “have a small, statistically significant effect on interregional location behavior.”<sup>13</sup>

The Economic Policy Institute, however, argues it would be an error to conclude that recent econometric research proves that tax cuts improve state economic growth and create jobs in a cost-effective manner. The most significant weakness cited is the failure of econometric studies to adequately account for the interrelationship between taxes and public services.<sup>14</sup>

An important consideration is what public service funding could be impacted by tax expenditures. For example, maintaining high tax burdens to fund welfare spending could reduce income and job growth, while maintaining high taxes for quality education and infrastructure could have a positive impact on job growth (see, Helms, “The Effect on State and Local Taxes on Economic Growth: A Time Series Cross Section Approach,” Review of Economics and Statistics, 67 (February 1985).<sup>15</sup>

Also, it is possible that the relationship between growing the tax base needed to support public services and a competitive tax structure are not mutually exclusive.

In 1992, RIPEC, the Taubman Center for Public Policy and American Institutions of Brown University, the College of Business Administrator of URI and the Rhode Island Economic Development co-sponsored a conference on *Tax Policy, Fairness and Jobs*.<sup>16</sup> Participants in the Conference included Robert Tannenwald of the Federal Reserve Bank of Boston, Michael Wasylenko of Syracuse University, the late Steven D. Gold from the Rockefeller Institute of Governor and the National Conference of State Legislatures, and George A. Plesko from Northeastern University.

On the subject of what impact the tax differentials have on economic development, the following conclusion presented 14 years ago is still worth considering.

*In summary, empirical evidence to date on this issue can not be definitive, because the results depend in part on significant tax differentials existing among states. Competition at times drives state and local taxes across states closer together, and then tax differentials affect business location decisions in a minor way. However, in periods when tax differentials become larger, their influence on economic development will become more apparent. Taxes matter, but when they matter is a complicated issue. One thing seems to be true, if your state is fiscally out of line with other states, such as having much higher tax levels, you will probably loose employment unless you have significant other locational advantages or a compensating package of public sector spending.<sup>17</sup>*

The recent economic literature indicates that taxes do influence economic choices, though there is disagreement on the degree of impact. However, large regional tax differentials may have a significant impact on economic behavior. Many believe that Rhode Island's top marginal income rate is an outlier when compared to both Massachusetts and Connecticut.

### **Do Marginal Tax Rates Rule Economic Behavior?**

Given the differential between Rhode Island's highest marginal personal income tax rate and those in neighboring states, it is important to consider empirical studies on the specific effects of marginal rates on economic choices.

A comprehensive review of economic literature on the influence of marginal rates was prepared by the House Policy Office and presented to the House Finance Committee in 2001.<sup>18</sup> The following material summarizes this testimony presented to the House Finance Committee.

From the perspective of economic efficiency, Ciminero testified that marginal rates are important because (see Gwartnet, et al., Economics: Private or Public Choice) a business considering an increase in productive capacity must calculate cash flows after taxes based on marginal (not average) tax rates. After all, the new cash flows will be on top of, or marginal to, the existing business activity, and will be taxed accordingly.

Marginal personal income tax rates also tell a household how much take-home pay a spouse would earn in becoming a second breadwinner. It's the marginal rate that applies in the calculation, not the household's average tax rate. If the household's marginal tax rate is 50 percent, the spouse will only take home 50-cents on the dollar, regardless if the household's average tax rate is 30 percent. This may mean the household is better off with just one earner.<sup>19</sup>

Accordingly, lower marginal tax rates:

- Increase the after-tax rate of return on incremental saving and investment, thereby increasing the supply of both.
- Increase the incentive to work since labor can keep a greater percentage of its marginal, taxable wages.
- Decrease leisure activities, since the opportunity cost of idleness is higher with lower marginal tax rates.<sup>20</sup>

A study by Zsolt Becsi (“Do State and Local Taxes Affect Relative State Growth?,” *Economic Review*, Federal Reserve Bank of Atlanta, March/April 1996) concluded: High Max-bracket Income Tax Rates Harmfully Affect Growth of Small Businesses. Becsi concludes, “If growth is a policy objective, one should, at the very least, assess whether tax policies are out of line with other states.”<sup>21</sup>

Ciminero’s testimony also cited work by Carroll, et al. (*Personal Income Taxes and the Growth of Small Firms*, National Bureau of Economic Research, 2000), which “indicates strong statistical evidence that higher individual tax rates on entrepreneurs cut growth of the firms they own.”<sup>22</sup>

This finding is of particular importance for Rhode Island, which has one of the highest max-bracket tax rates in the United States, and depends heavily on small business for economic growth. The author concludes, “We find that individual income taxes exert a statistically and quantitatively significant influence on firm growth rates.”<sup>23</sup>

Finally, Howard Chernick’s (see, “Tax Progressivity and State Economic Performance,” *Economic Development Quarterly*, 1997) study found that using data on states over 1977-93, finds progressivity of state income taxes “has a significant negative effect on [state] economic growth [employment].”<sup>24</sup>

Research published since the testimony cited above was presented to the House Finance Committee indicates that marginal tax rates can influence entrepreneurship. As reported by the Tax Foundation, Gentry and Hubbard found, “While the level of the marginal tax rate has a negative effect on entrepreneurial entry, the progressivity of the tax also discourages entrepreneurship, and significantly so for some groups of households” (p. 21). Using education as a measure of potential for innovation, Gentry and Hubbard found that a progressive tax system “discourages entry into self-employment for people of all educational backgrounds.” Moreover, citing Carroll, Holtz-Eakin, Rider and Rosen (2000), Gentry and Hubbard contend, “Higher tax rates reduce investment, hiring, and small business income growth” (p.7).<sup>25</sup>

## **Conclusion**

A review of the literature, particularly over the last 15 years, while not unanimous, support the findings that taxes are a factor in the economic decision-making process of both individuals and businesses. The difference in the academic research seems to primarily center on the question of not whether tax affects economic decision-making, but rather what is the degree of their significance. When there are significant tax differentials between competing states there appears to be a consensus that taxes matter. However, the effect varies based on a number of factors including the size and type of the tax differential, structure of the tax system and the types and quality of public services that support private sector development.

Appendix A

STATE INDIVIDUAL INCOME TAXES

(Tax rates for tax year 2006 - as of January 1, 2006)

State	--Tax Rates		#of	--Income Brackets--		--Personal Exemption--			Federal Tax Ded.
	Low	High		Low	High	Single	Married	Child.	
ALABAMA	2.0 -	5.0	3	500 (b) -	3,000 (b)	1,500	3,000	300	
ALASKA	No State Income Tax								
ARIZONA	2.87 -	5.04	5	0,000 (b) -	150,000 (b)	00	4,200	2,300	
ARKANSAS (a)	1.0 -	7.0 (e)	6	3,399 -	28,500	6,319 (b)	20 (c)	40 (c)	20 (c)
CALIFORNIA (a)	1.0 -	9.3 (x)	6	- 41,477 (b)			87 (c)	174 (c)	272 (c)
COLORADO 4.63 1	No State Income Tax								
CONNECTICUT	3.0 -	5.0	2	10,000 (b) -	10,000 (b)		12,750 (f)	24,500 (f)	0
DELAWARE	2.2 -	5.95	6	5,000 -	60,000			110 (c)	220 (c)
FLORIDA	No State Income Tax								
GEORGIA	1.0 -	6.0	6	750 (g) -	7,000 (g)	2,700	5,400	3,000	1,040
HAWAII	1.4 -	8.25	9	2,000 (b) -	40,000 (b)	1,040			
IDAHO (a)	1.6 -	7.8	8	1,159 (h) -	23, (h)	3,300 (d)	6,600 (d)	3,300 (d)	
ILLINOIS	3.0.		1	----- Flat rate----		2,000	4,000	2,000	1,000
INDIANA	3.4		1	----- Flat rate----		1,000			
IOWA (a)	0.36 -	8.98	9	1,269 -	57,106	40 (c)	80 (c)	40 (c)	
KANSAS	3.5 -	6.45	3	15,000(b) -	30,000(b)	2,250	4,500	2,250	
KENTUCKY	2.0 -	6.0	6	3,000 -	75,000	20 (c)	40 (c)	20 (c)	
LOUISIANA	2.0 -	6.0	3	12,500 (b) -	25,000 (b)	4,500 (i)	9,000 (i)	1,000 (i)	
MAINE (a)	2.0 -	8.5	4	4,550 (b) -	18,250 (b)	2,850	5,700	2,850	2,400
MARYLAND	2.0 -	4.75	4	1,000 -	3,000	2,400	3,575	7,150	1,000
MASSACHUSETTS (a)	5.3		1	----- Flat rate----		6,200	3,100		
MICHIGAN (a)	3.9		1	----- Flat rate----		3,300 (d)	6,600 (d)	3,300 (d)	
MINNESOTA (a)	5.35 -	7.85	3	20,510 (G) -	67,360(j)	6,000	12,000	1,500	2,100
MISSISSIPPI	3.0 -	5.0	3	5,000 -	10,000	1,200	1,900	3,800	1,900
MISSOURI	1.5 -	6.0	10	1,000 -	9,000	103 (c)	206 (c)	103 (c)	
MONTANA (a)	2.0 -	6.9	7	2,300 -	13,900	2,400			
NEBRASKA (a)	2.56 -	6.84	4	(1e) -	26,500 (k)				
NEVADA	No State Income Tax								
NEW HAMPSHIRE	State Income Tax is Limited to Dividends and Interest Income Only.								
NEW JERSEY	1.4 -	8.97	6	20,000(1) -	500,000(1)	1,000	2,000	1,500	
NEW MEXICO	1.7 -	5.3	4	5,500(m) -	16,000(m)	3,300 (d)	6,600 (d)	3,300 (d)	
NEW YORK	4.0 -	6.85	5	8,000(n) -	500,000(n)	0	0	1,000	
NORTH CAROLINA (0)	6.0 -	8.25	4	12,750(0) -	120,000-(0)	3,300 (d)	6,600 (d)	3,300 (d)	
NORTH DAKOTA	2.1 -	5.54(p)	5	29,700(P) -	326,450(P)	3,300 (d)	6,600 (d)	3,300 (d)	
OHIO (a)	0.712 -	7.185	9	5,000 -	200,000	1,300 (q)	2,600 (q)	1,300 (q)	
OKLAHOMA	0.5 -	6.25 (r)	8	1,000(b) -	10,000(b)	1,000	2,000	1,000	
OREGON (a)	5.0 -	9.0	3	2,650(b) -	6,550 (b)	159 (c)	318 (c)	159 (c)	
PENNSYLVANIA	3.07		1	----- Flat rate----					
RHODE ISLAND	25.0% Federal tax liability (t)								
SOUTH CAROLINA (a)	2.5 -	7.0	6	2,570 -	12,850	3,300 (d)	6,600 (d)	3,300 (d)	
SOUTH DAKOTA	No State Income Tax								
TENNESSEE	State Income Tax is Limited to Dividends and Interest Income Only.								
TEXAS	No State Income Tax								
UTAH	2.30 -	7.0	6	863 (b) -	4,313 (b)	2,475 (d)	4,950 (d)	2,475 (d)	
VERMONT (a)	3.6 -	9.5	5	29,900 (v) -	326,450(v)	3,300 (d)	6,600(d)	3,300(d)	
VIRGINIA	2.0 -	5.75	4	3,000 -	17,000	900	1,800	900	
WASHINGTON	No State Income Tax								
WEST VIRGINIA	3.0 -	6.5	5	10,000 -	60,000	8,840	2,000	4,000	2,000
WISCONSIN	4.6 -	6.75	4	(w) -	132,580 (w)	700	1,400	400	
WYOMING	No State Income Tax								

DIST. OF COLUMBIA	4.5 - 9.0	)	3	10,000	30,000	1,370	2,740	1,370
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Source: The Federation of Tax Administrators from various sources.

(a) 15 states have statutory provision for automatic adjustment of tax brackets, personal exemption or standard deductions to the rate of Inflation. Massachusetts, Michigan, Nebraska and Ohio indexes the personal exemption amounts only.

(b) For joint returns, the taxes are twice the tax imposed on half the income.

(c) tax credits.

(d) These states allow personal exemption or standard deductions as provided in the IRC. Utah allows a personal exemption equal to three-fourths the federal exemptions.

(e) A special tax table is available for low Income taxpayers reducing their tax payments.

(f) Combined personal exemptions and standard deduction. An additional tax credit is allowed ranging from 75% to 0% based on state adjusted gross income. Exemption amounts are phased out for higher income taxpayers until they are eliminated for households earning over \$56,500.

(g) The tax brackets reported are for single Individuals. For married households filing separately, the same rates apply to income brackets ranging from \$500 to \$5,000; and the income brackets range from \$1,000 to \$10,000 for joint filers.

(h) For joint returns, the tax is twice the tax imposed on half the income. A \$10 filing tax is charge for each return and a \$15 credit is allowed for each exemption.

(I) Combined personal exemption and standard deduction.

(j) The tax brackets reported are for single individual. For married couples filing jointly, the same rates apply for income under \$29,980 to over \$119,100.

(k) The tax brackets reported are for single individual. For married couples filing jointly, the same rates apply for income under \$4,000 to over \$46,750.

(l) The tax brackets reported are for single Individuals. For married couples filing jointly, the tax rates range from 1.4% to 8.97% (with 7 income brackets) applying to Income brackets from \$20,000 to over \$500,000.

(m) The tax brackets reported are for single Individuals. For married couples filing jointly, the same rates apply for income under \$8,000 to over \$24,000. Married households filing separately pay the tax imposed on half the income.

(n) The tax brackets reported are for single individuals. For married taxpayers, the same rates apply to income brackets ranging from \$16,000 to \$20,000.

(o) The tax brackets reported are for single Individuals. For married taxpayers, the same rates apply to Income brackets ranging from \$21,250 to \$200,000. Lower exemption amounts allowed for high income taxpayers. Tax rate scheduled to decrease after tax year 2007.

(p) The tax brackets reported are for single Individuals. For married taxpayers, the same rates apply to Income brackets ranging from \$49,600 to \$326,450. An additional \$300 personal exemption is allowed for joint returns or unmarried head of households. (q) Plus an additional \$20 per exemption tax credit.

(r) The rate range reported is for single persons not deducting federal Income tax. For married persons filing jointly, the same rates apply to income brackets that are twice the dollar amounts. Separate schedules, with rates ranging from 0.5% to 10%, apply to taxpayers deducting federal Income taxes.

(s) Deduction is limited to \$10,000 for joint returns and \$5,000 for individuals in Missouri and to \$5,000 in Oregon.

(t) Federal Tax Uablity prior to the enactment of Economic Growth and Tax Relief Act of 2001.

(u) One half of the federal income taxes are deductible.

(v) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for Income under \$49,650 to over \$326,450.

(w) The tax brackets reported are for single Individuals. For married taxpayers, the same rates apply to income brackets ranging from \$11,780 to \$176,770. An additional \$250 exemption is provided for each taxpayer or spouse age 65 or over.

(x) An additional 1 % tax is imposed on taxable income over \$1 million.

## **Appendix B**

Based on RIPEC earlier research that indicates that Rhode Island income tax burdens are competitive for taxpayers with AGIs or less than approximately \$200,000-250,000, the benefits of reducing the top marginal rate will largely impact taxpayers in the top one percent income. The following data profiles these taxpayers in relation to all resident filers.

The Rhode Island Division of Taxation reports that a total of 477,034 tax returns were filed by Rhode Island residents for tax year 2002. As shown in Appendix B, tax filers with Adjusted Gross Income (AGI) of \$200,000 comprised 2.2 percent of all filers (10,324), but accounted for 22.2 percent of AGI and 38.4 percent of resident personal income tax liability before any tax credit, and 36.6 percent net of all state tax credits.

**ANALYSIS OF RESIDENT RHODE ISLAND TAX RETURNS  
TAX YEAR 2004**

A.G.I. RANGE	Number of Returns	Percentage of Returns Filed	Adjusted Gross Income	Percentage of A.G.I.	R.I. Tax Liability	Out of State Credit	R.I. Liability Net of Out of State Credit	Percentage of	Other Credits	Net R.I. Tax	Percentage of R.I. Liability Net of All State Credits
\$0 - \$25,000	203,657	42.69%	\$2,292,788,732	0.10%	\$27,103,629	\$2,413,948	\$24,689,681	3.14%	\$2,629,622	\$22,060,059	2.92%
\$25,001 - \$50,000	116,709	24.47%	\$4,214,219,720	0.35%	\$98,342,604	\$13,000,774	\$85,341,830	10.85%	\$145,689	\$85,196,141	11.26%
\$50,001 - \$75,000	68,051	14.27%	\$4,185,835,990	0.41%	\$117,559,617	\$16,640,253	\$100,919,364	12.83%	\$106,556	\$100,812,808	13.33%
\$75,001 - \$100,000	39,552	8.29%	\$3,411,817,340	0.38%	\$110,228,682	\$16,075,794	\$94,152,888	11.97%	\$162,474	\$93,990,414	12.42%
\$100,001 - \$200,000	38,741	8.12%	\$5,082,028,409	0.72%	\$208,254,255	\$30,166,422	\$178,087,833	22.64%	\$861,146	\$177,226,687	23.43%
\$200,001 - \$500,000	8,270	1.73%	\$2,366,022,636	0.48%	\$136,564,895	\$17,054,582	\$119,510,313	15.20%	\$3,163,939	\$116,346,374	15.38%
\$500,001 - \$1,000,000	1,377	0.29%	\$929,856,595	0.23%	\$63,678,879	\$7,324,467	\$56,354,412	7.17%	\$4,455,087	\$51,899,325	6.86%
\$1,000,001 - \$5,000,000	613	0.13%	\$1,133,815,623	0.30%	\$83,548,540	\$10,715,349	\$72,833,191	9.26%	\$9,392,688	\$63,440,503	8.39%
\$5,000,001 - and greater	64	0.01%	\$1,042,030,297	0.22%	\$66,594,777	\$11,976,144	\$54,618,633	6.94%	\$9,032,079	\$45,586,554	6.03%
	<u>477,034</u>		<u>\$24,658,415,342</u>		<u>\$911,875,878</u>	<u>\$125,367,733</u>	<u>\$786,508,145</u>		<u>\$29,949,280</u>	<u>\$756,558,865</u>	

Source: RI Division of Taxation.

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- <sup>1</sup> RIPEC and RISCPA, The *Rhode Island Personal Income Tax: A Call for Reform*, May 2005.
- <sup>2</sup> Poverty Institute, *Tax Facts*, Issue #3, March 2006.
- <sup>3</sup> Institute on Taxation and Economic Policy, *Who Pays*, January 2003.
- <sup>4</sup> *Op cit.*, Poverty Institute, *Tax Facts*.
- <sup>5</sup> See, Robert G. Lynch, Economic Policy Institute, *Rethinking Growth Strategies 2004*, for an excellent presentation on the point of view.
- <sup>6</sup> Tax Foundation, “*State Business Tax Climate Index*,” Background Paper 51, February 2006, p.2.
- <sup>7</sup> *Ibid.*, p. 4.
- <sup>8</sup> *Op cit.*, RIPEC and RISCPA.
- <sup>9</sup> Rhode Island Economic Development Corporation, “*Tax Issues 2006: Working to Change Rhode Island’s Future.*” February 16, 2006.
- <sup>10</sup> Opinion Dynamics Corporation, *Rhode Island Tax Impact Statement*, RIPEC and EPC, June 1999.
- <sup>11</sup> Ladd, Helen F. (1998), *Local Government Tax and Land Use Policies in the United States. Understanding the Links*, Northampton, MA: Edward Elgar.
- <sup>12</sup> As quoted by the Tax Foundation, State Business Tax Climate Index, Background Paper No. 51, February 2006, p. 6.
- <sup>13</sup> *Op cit.*, Lynch, Economic Policy Institute, p. 26.
- <sup>14</sup> *Ibid*, Chapter 4.
- <sup>15</sup> RIPEC, Presentations Made on the Subject of Tax Policy, Fairness and Jobs, *Comments*, May 12, 1992, p. 12.
- <sup>16</sup> *Ibid*
- <sup>17</sup> Michael Wasylenko, Tax Policy and Jobs: The Role of Fiscal Policy, RIPEC, May 12, 1992, p. 14.
- <sup>18</sup> Gary Ciminero, Economics of State Taxation – Tax Structure and Recent Studies of Implications for State Economic Performance, January 31, 2001, and Economics of State Income Taxation Personnel Income Tax Structure: Implications for State Economic Performance, February 25, 2001.
- <sup>19</sup> *Ibid*, January 31, 2001, p. 4.
- <sup>20</sup> *Ibid*, p. 5.
- <sup>21</sup> *Ibid*, p. 14.
- <sup>22</sup> *Ibid*, p. 17, February 28, 2001.
- <sup>23</sup> *Ibid*, p. 16, January 31, 2001.
- <sup>24</sup> *Ibid*, p. 18.
- <sup>25</sup> Gentry, William M. and R. Glenn Hubbard (2004), “Success Taxes, Entrepreneurial Entry and Innovation,” NBER Working Paper No. W10551.

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