



**RIPEC**

# Comments on Your Government

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## **How Rhode Island State and Local Tax Burdens Compare What Approach Should Be Used to Measure Tax Burdens?**

*RIPEC recently published a report on state and local government revenues, based on data provided by the United States Department of Commerce, Bureau of the Census. Because responsibilities between the levels of government may vary from state to state, the report combines both state and local government revenue collections. A report on expenditures will be published in July 2006.*

*This Comments provides an analysis on the recently released revenue data. It also gives an overview on some of the measures of relative state and local tax and financial burdens that are being used.*

### **Introduction**

Uniform and dependable tax collection information must be available to accurately compare state and local tax burdens. In RIPEC's opinion, the most credible source of comparative state and local tax data is *Government Finances* compiled by the United States Census Bureau. Thus, the analysis presented here, and in *How Rhode Island Compares, 2006 Edition, State and Local Taxes*<sup>1</sup>, is based on the United States Census Bureau, Government Finance, FY 2004 data.

In FY 2004 (the most recent national data) total State and local tax collections in Rhode Island amounted to \$4.2 billion. Taxes include compulsory payments that are generally not related to a specific public service. Revenues excluded from the category of tax collections are sales of commodities and services directly benefiting users (e.g., tuition and fees), enterprise revenues, and insurance payments such as unemployment and workers compensation programs.

As set forth on Table 1, Rhode Island's tax burden continues to be one of the highest in the United States. The reason for this is primarily due to the Ocean State's over-reliance on the property tax, which is 45 percent above the United States average. Property taxes accounted for 42¢ of every dollar Rhode Islanders paid in State and local taxes, whereas the sales tax paid took 19¢, and the State's personal income tax accounted for almost 22¢.

What does this comparative tax data tell us about Rhode Island's economic competitiveness and the affordability of State and local governments for middle-class families in the Ocean State?

**July 2006**

**Table 1**  
**State and Local Revenues Per \$1,000 of Personal Income and Per Capita**  
**How Rhode Island Compares to the United States Average**  
**Fiscal Year 2004**

State and Local Revenues	Per \$1,000 of Personal Income				Per Capita			
	U.S.	R.I.	Rank	% of U.S.	U.S.	R.I.	Rank	% of U.S.
Selected Tax Revenues								
Property	\$34.75	\$50.38	5	145.0%	\$1,086	\$1,629	5	150.0%
Individual Income	23.50	25.77	20	109.7%	734	833	17	113.5%
General Sales	26.74	23.04	36	86.2%	836	745	29	89.1%
Total State and Local Taxes	\$110.33	\$120.35	7	109.1%	\$3,447	\$3,891	7	112.9%
Charges and Misc. Revenues	\$49.55	\$41.10	43	82.9%	\$1,548	\$1,329	40	85.9%
Total Taxes and Charges and Misc. Rev.	159.88	161.45	26	101.0%	\$4,995	\$5,220	12	104.5%
All Revenues	\$265.92	\$276.80		104.1%	\$8,308	\$8,949		107.7%

Source: U.S. Census Bureau, Government Finance, FY 2004 Data, Bureau of Economic Analysis for personal income data, and RIPEC calculations.

Measuring interstate tax burdens is an ongoing point of discussion among economic development professionals, taxpayers, academics, and public officials. Central to this discussion is the manner by which a state's tax burden is measured. Comparisons are often made on taxes collected per \$1,000 of personal income and taxes collected per capita. Other models calculate and compare effective tax rates, i.e., the percentage of state and local taxes paid as a percentage of income, and still others measure relative tax burdens by developing taxpayer profiles, which are built upon assumptions about taxpayer behavior. Another measure of aggregate tax burden is commonly referred to as the Representative Tax System, which evaluates a state's overall tax capacity and tax effort. This is done by estimating the yield that a uniform representative tax system would produce in each state and when comparing the hypothetical yield with the actual revenue generated (tax effort).

**Table 2**  
**State and Local Taxes in RI - 2002**  
**Measured as a Percentage of Family Income**

	Lowest 20.0%	Second 20.0%	Middle 20.0%	Fourth 20.0%	Top 20 Percent		
					Next 15.0%	Next 4.0%	Top 1.0%
<b>Total Taxes</b>							
U.S. Average	11.4	10.4	9.9	9.4	8.9	8.1	7.3
Rhode Island	13.0	10.8	10.7	10.4	10.2	9.0	8.6
Massachusetts	9.3	9.2	9.2	9.3	8.8	8.2	6.8
Connecticut	10.3	10.3	10.4	10.7	9.8	8.6	6.4
<b>Total Taxes After Federal Offset</b>							
U.S. Average	11.4	10.3	9.6	8.8	7.7	6.5	5.2
Rhode Island	13.0	10.7	10.3	9.5	8.7	7.3	6.0
Massachusetts	9.3	9.1	8.6	8.2	7.3	6.2	4.6
Connecticut	10.2	10.1	9.5	9.2	7.8	6.5	4.4

Source: The Institute of Taxation and Economic Policy, January 2003.

Each of these common measures of aggregate tax burden has its own limitations and merits. Therefore, all aggregate measures of relative tax burden are useful benchmarks that are suited to a particular purpose, but they are not without limitation. A detailed discussion of issues in comparing state taxes is provided in the *New York State Tax Sourcebook*.<sup>ii</sup>

Regardless of the measure used, Rhode Island's relative State and local tax burden is high when compared to the other 49 states. For example, Table 2 shows state and local taxes as a percentage of family income<sup>iii</sup>. Also see Table 3, which provides selected tax profiles for families of the largest city in each state.<sup>iv</sup> The Tax Foundation also publishes studies of relative state and local tax burdens.<sup>v,vi</sup>

**Table 3**  
**Estimated Burden of Major Taxes for a Family of Four, 2003**  
**15 Highest Ranked Cities**  
**\$75,000**

Rank	City	State	Taxes				Burden	
			Income	Property	Sales	Auto	Amount	Percent
1	Bridgeport	CT	\$2,665	\$8,605	\$1,112	\$890	\$13,272	17.7%
2	Newark	NJ	1,041	8,581	971	296	10,889	14.5%
3	New York City	NY	5,020	3,928	1,265	277	10,490	14.0%
4	Philadelphia	PA	5,242	3,197	977	341	9,757	13.0%
5	Providence	RI	1,613	6,144	1,052	918	9,727	13.0%
6	Portland	OR	4,842	4,145	0	287	9,273	12.4%
7	Baltimore	MD	3,870	3,598	1,144	311	8,923	11.9%
8	Milwaukee	WI	2,993	3,948	1,096	403	8,439	11.3%
9	Atlanta	GA	2,521	4,029	1,328	383	8,261	11.0%
10	Detroit	MI	4,292	2,570	1,006	389	8,257	11.0%
11	Louisville	KY	4,826	1,713	1,047	367	7,954	10.6%
12	Boston	MA	3,318	3,448	597	516	7,878	10.5%
13	Chicago	IL	2,010	3,574	1,584	622	7,790	10.4%
14	Portland	ME	3,083	3,258	888	560	7,789	10.4%
15	Washington	DC	3,913	2,157	1,131	392	7,594	10.1%
	US Average <sup>1</sup>		\$2,845	\$2,836	\$1,194	\$440	\$6,832	9.1%
	US Median		\$2,901	\$2,501	\$1,144	\$398	\$6,805	9.1%

<sup>1</sup>Based on cities actually levying tax.

Source: Government of the District of Columbia, Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison, August 2004.

## **RIPEC Analysis Focuses On Tax Collections**

The Census Bureau also reports total own-source general revenue for state and local governments. Included in own-source general revenues are taxes, fees, charges and miscellaneous revenue. Therefore, the question emerges as to what revenue should be included in measuring relative revenue collections among the fifty states. For reasons that are discussed below, RIPEC focuses on tax collections in its comparative analysis because the objective of our studies has been to measure relative tax burden not discretionary spending for government activities.

In comparing the relative financial burdens state and local governments impose upon residents, some argue that total own-source general revenues, which include taxes, fees, charges, and licenses, should be taken into consideration. Own-source general revenue is a broader concept than simply measuring tax burden, because it includes non-tax revenues in its base.

Own-source general revenue excludes intergovernmental revenues and the proceeds a government may receive from insurance programs, utilities and public liquor stores. As shown on Table 1, Rhode Island's tax and local tax burden is the 7<sup>th</sup> highest in the United States when taxes are calculated as a percentage of personal income. However, if charges and miscellaneous revenues are included, state and local revenues per \$1,000 of personal income would rank the Ocean State 26<sup>th</sup> among the fifty states. State and local taxes paid by Rhode islanders are 9.1 percent above the national average, when all revenues are considered, the burden is 4.1 percent above the United States average.

Some argue that in making interstate fiscal comparisons, own-source general revenue should be used because it better reflects the price people pay for state and local government services. Proponents of using tax collections for comparative analysis point out that own-source revenue includes both compulsory and voluntary payments made by residents, and is, therefore, not the most appropriate measure of burden.

The various measures of relative state and local tax and financial burdens have their strengths and weaknesses. Therefore, several gauges should be considered in analyzing a state's competitive position. Nevertheless, RIPEC has long maintained that tax burden comparisons are the most meaningful way to assess issues of interstate tax competitiveness, burdens, and the nexus of government fiscal policy to the economy.

Why has RIPEC expounded this approach? The United States Census Bureau defines taxes as "compulsory contributions enacted by a government for public purpose." The citizens must pay the taxes imposed.

The other major component of own-source general revenue is charges including miscellaneous revenue. The Census Bureau describes current charges as:

"Charge imposed for providing current services or for the sale of products in connection with government activities."

As distinguished from taxes, all charges are not necessarily compulsory payment for government services. For example, certain charges and fees can be avoided if a resident chooses not to use the services for which a charge is imposed – e.g., admission to a zoo or museum. However, it should be recognized that a few charges for regulatory activities may be unavoidable, e.g.,

driver’s license, vehicle registration fees. An interesting exercise might be to attempt to determine which charge might be included with tax collections to develop a broader comparison of compulsory/non-discretionary cost government imposes upon its residents. Obviously, this exercise is not a proxy for measuring tax burdens.

Miscellaneous general revenue includes all other own-source general revenue, other than proceeds from state owned liquor stores, utilities and insurance trust revenue. It should be noted that miscellaneous general revenue may include assessments, which represent compulsory payment such as impact fees to fund and operate physical infrastructure such as sewers. However, other miscellaneous general revenue result from purely discretionary activities – participating in a lottery or the decision made by government managers that result in interest earning, sale of assets, etc.

Bottomline, given the myriad of charges and miscellaneous revenues, using measures broader than tax collections would result in a less focused comparative analysis of the financial burden state and local governments place on their residents. In our opinion, the basis for comparing the burden of supporting government services should be based on “compulsory contributions” made to support public services as opposed to voluntary payments.

**Property Taxes Cause of Rhode Island’s High Tax Burden**

According to the recently released RIPEC study, Rhode Island’s tax burden continues to be one of the highest in the United States. Between FY 1994 and FY 2004, Rhode Island’s total tax burden increased from the 19<sup>th</sup> highest in the Nation to 7<sup>th</sup> highest. This is in sharp contrast to neighboring Massachusetts where the tax burden declined from 22<sup>nd</sup> highest in FY 1994 to 31<sup>st</sup> in FY 2004.

**Table 4**  
**Total Tax Collections**  
**(per \$1,000 of personal income)**

	1994	Rank	2004	Rank
US	\$116.71		\$110.33	
CT	122.99	13	115.71	10
MA	116.39	22	105.77	31
RI	117.46	19	120.35	7

Source: U.S. Census Bureau, Government Finance, FY 2004  
Data, Bureau of Economic Analysis for personal income data,  
and RIPEC calculations.

As noted, the reason for this is primarily due to the Ocean State’s over-reliance on the property tax. Property taxes accounted for 42¢ of every dollar Rhode Islander paid in State and local taxes, whereas the sales tax paid took 19¢, and the State’s personal income tax accounted for almost 22¢.

**Table 5**  
**Property Tax Collections**  
**(per \$1,000 of personal income)**

	1994	Rank	2004	Rank
US	\$36.78		\$34.75	
CT	47.80	11	45.70	7
MA	40.43	18	38.43	15
RI	49.45	8	50.38	5

Source: U.S. Census Bureau, Government Finance, FY 2004  
Data, Bureau of Economic Analysis for personal income data,  
and RIPEC calculations.

**Comments**

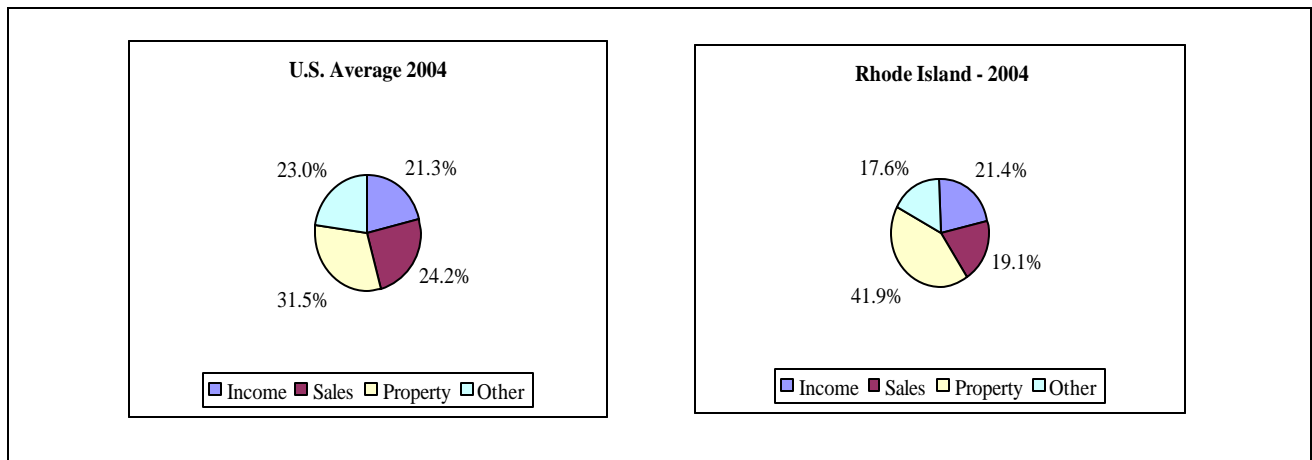
By focusing on taxes, as opposed to total revenues, RIPEC’s analysis attempts to provide decision makers with data on how the Ocean State’s tax burden compares to competitor states.

The Governor and General Assembly have recognized Rhode Island’s relatively high tax burden and as a result significant tax reform and spending control legislation was enacted during the recently completed session of the General Assembly. For example:

- a. Legislation was enacted that statutorily achieves the objective of limiting the growth in property taxes. This legislation
  - Closes a major loop hole in the State’s existing property tax cap by applying the cap to only the levy rather than the rate or the levy and reduces the cap 5.5 percent to 4.0 percent by FY 2013 in 0.25 percent increments.
  - Provides that school committee budget proposals cannot include increases in local appropriation requests beyond the cap.
  - Provides for exceptions to the cap including a loss in non-property tax revenues, debt service expenditure growth exceeding the cap, rapid growth resulting from new construction, which necessitates significant increase in the need for services and facilities, or an emergency. The legislation defines emergency to be if health care, retirement contributions and/or its utility costs increase by three times the cap.
  - To exceed the cap, the reasons outlined above, a 4/5 affirmative vote of the municipality’s governing body and in the case of a financial town meeting, a 4/5 affirmative vote of the municipality’s governing body and a majority vote of the financial town meeting is required.
  - Includes language designed to minimize the use of administrative rulemaking to pass on additional unfunded mandates to localities, and there is language attempting to limit the scope of court decisions relating to education funding.

- b. A Constitutional Amendment will be on the November ballot that limits State appropriations to 97 percent of resources (currently 98 percent) and raises the “rainy day” fund to 5.0 percent of revenue (currently 3.0 percent) and eliminates debt service as a valid use of Rhode Island Capital Plan funds.
- c. The FY 2007 State Budget provides for an alternative flat rate income tax to enhance economic competitiveness. This tax measure allows taxpayers to file an alternative flat income tax that would be reduced incrementally, replacing the current 9.9 percent rate, minus deductions, that top earners now pay. It would be reduced to 8.0 percent in FY 2006 and dropped by 0.5 percent each year until reaching 5.5 percent in FY 2011. This legislation was aimed to improve Rhode Island’s competitive position with Massachusetts, which currently has a top rate of 5.3 percent.

While progress was made in 2006 to improve Rhode Island’s tax climate and also control the rate of growth in local property taxes, there is still a need to take a comprehensive look at the overall tax structure, addressing such issues as consumption taxes, the business tax structure, school finance, which is linked to the property tax reform agenda, and questions on the distribution, fairness, and balance.



A proactive and thoughtful tax restructuring effort, distinct from a piecemeal approach will enable the establishment of a tax system that reflects the Rhode Island of tomorrow instead of the Rhode Island of yesterday. The impact that proposed tax policy changes may have on State and local spending obligations must also be considered and understood.

Tax policy changes must be carefully considered to ensure that the resulting State-local tax structure is equitable, fair, balanced and serves to strengthen the State’s economy – in both the short term as well as the long term.

<sup>i</sup> RIPEC, How Rhode Island Compares, 2006 Edition, June 2006, see [www.ripec.org](http://www.ripec.org).  
<sup>ii</sup> New York State Department of Taxation and Finance, New York State Tax Sourcebook, April 2005.  
<sup>iii</sup> Institute on Taxation and Economic Policy, Who Pays: A Distributional Analysis of the Tax System in All 50 States, January 2003.  
<sup>iv</sup> Government of the District of Columbia, Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison, August 2004.  
<sup>v</sup> Tax Foundation, Facts and Figures: How Does Your State Compare. America Celebrates Tax Freedom Day, Special Report, April 2006, No. 140.  
<sup>vi</sup> Tax Foundation, State Business Tax Climate Index, Background Paper, February 2006, No. 51.