



# Comments on Your Government

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**RIPEC**

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## Tax Policy

### RIPEC Analysis of Governor's Proposed Tax Changes FY 2010

There are several proposed tax structure changes, proposed by Governor Donald Carcieri as a part of his FY 2010 budget submission, currently before the Rhode Island General Assembly. They are in three broad areas:

- Article 37      Modifications to the Business Corporations Tax
- Article 38      Modifications to the Personal Income Tax
- Article 36      Modifications to the Estate Tax

There were other tax changes recommended in the FY 2009 supplemental budget enacted by the General Assembly including an increase in the Cigarette Tax.

As noted above, the articles are contained in the FY 2010 budget submission. The articles are a result of the Governor's Tax Working Group recommendations and are part of an overall review of the current Rhode Island tax structure. It should be noted that RIPEC was a member of the Working Group.

The following RIPEC Comments provides an overview of the proposed modifications to the tax structure as well as their fiscal impact. This report also provides information regarding the relative tax burden in the State in comparison to other states in the region.

This report is divided into two sections:

- I. Explanation of the Articles
- II. Overall State tax burden.

May 15, 2009

**I. RIPEC Analysis of Governor’s Proposed Tax Changes FY 2010**

In the Governor’s FY 2010 Budget submission he included a variety of tax changes including:

- Cigarette Tax Increase \$30.2 m
- Health Care Insurer Gross Premium Rate Increase and Base Expansion \$13.6 m
- Group Home Tax Elimination \$(11.1) m
- Estate Tax Reduction due to Increased Exemption Amount \$(1.50) m
- Business Corporation Tax Rate Reduction \$(14.5) m

The latter two proposals came from the Governor’s Tax Policy Strategy Workgroup headed by Gary Sasse. These recommendations, along with others, were submitted by the Governor on Monday, March 9, 2009. Other recommendations were not submitted, but are being considered for separate introduction. These include, among others, changes to the property tax system in Rhode Island.

The following lists the changes the Governor has proposed. They are in three broad areas:

- Business Corporations Tax (Article 37)
- Personal Income Tax (Article 38)
- Estate Tax (Article 36)

**Business Corporations Tax (Article 37)**

According to a January, 2009 Ernst and Young report, businesses currently pay a large portion of Rhode Island taxes. The State has also been ranked by the Tax Foundation as having the 46<sup>th</sup> worst business climate within the United States.

Table 1 shows how Rhode Island compares with a sampling of other states in terms of the amount of business taxes paid as a percent of gross state product (GSP).

Based on the findings by Ernst & Young, Rhode Island’s business tax burden ranked 11<sup>th</sup> highest in the nation in FY 2008. Further, the State experienced a 52.7 percent growth rate from FY 2002 to FY 2008, compared to the national average of 45.6 percent. Connecticut saw a 26.5 percent growth rate and Massachusetts experienced a 41.8 percent increase.

State	% GSP
<b>Rhode Island</b>	<b>5.7%</b>
New Hampshire	5.4%
New Jersey	5.0%
Massachusetts	4.2%
Connecticut	3.7%
Virginia	3.9%
North Carolina	3.6%
Delaware	3.8%
US Average	4.9%
<small>SOURCE: "Total State and Local Business Taxes", January 2009, Council on State Taxation and Ernst &amp; Young</small>	

In an effort to more closely align Rhode Island’s business tax burden with that of its neighbors and the national average, the Governor’s proposal is to phase-out the business corporation tax by reducing the tax rate from 9.0 percent to:

- 7.5 percent (effective January 1, 2010)
- 6.0 percent (effective January 1, 2011)
- 4.0 percent (effective January 1, 2012)
- 2.0 percent (effective January 1, 2013)

On January 1, 2014 the business corporation tax would be fully eliminated. The estimated cost in FY 2010 is \$14.5 million.

In addition to phasing out the business corporation tax, the Governor proposes to institute a tiered minimum tax based on a corporation’s net income, effective January 1, 2014. The payments are shown on Table 2. According to the Division of Taxation, the estimated net revenue gain is \$2.2 million over the projected amount of \$28.0 to \$30.0 million.

<b>Table 2</b>	
<b>Proposed Franchise Tax</b>	
<b>Payment Structure</b>	
	<b>Tax</b>
LLCs & S-Corporations	\$450
<hr/>	
<b>Taxable Income</b>	
< \$9,999	\$450
\$10,000 - \$24,999	500
\$25,000 - \$49,999	750
\$50,000 - \$74,999	1,000
\$75,000 - \$99,999	1,500
\$100,000 - \$249,999	2,000
\$250,000 - \$499,999	3,000
\$500,000 - \$999,999	5,000
\$1,000,000 - \$2,499,999	7,500
\$2,500,000 +	10,000
SOURCE: Rhode Island Department of Revenue	

The Governor’s business corporations tax bill also reduces the percent rate reduction in the Jobs Development Act as the business corporations tax rate is phased-out.

## Personal Income Tax (Article 38)

The Governor is proposing to reform the State's personal income tax system, effective January 1, 2011. The proposed reforms would bring Rhode Island's personal income tax system more in line with Connecticut and Massachusetts.

The reformed personal income tax would be based on the Federal Adjusted Gross Income (AGI) with fewer modifications than currently allowed. Under the proposed tax, the only modifications to AGI would be a standard deduction and personal exemptions indexed for inflation. Income from all sources, including capital gains, would be taxed as ordinary income. Table 3 lists the Standard Deductions and Exemptions by filing status.

Filing Status	Standard Deduction	Exemption Type	Exemption Amount
Married Join/Widow(er)	\$15,000	Personal	\$2,500
Single/Married Separate	\$7,500	Dependent	\$2,500
Head of Household	\$11,250		

SOURCE: Rhode Island Department of Revenue

In conjunction with the change in deductions, the proposal calls for four income tax brackets that range from 3.5 percent to 5.5 percent shown on Table 4.

Taxable Income	Tax Rate
\$0 - \$54,999	3.5%
\$55,000 - \$109,999	4.0%
\$110,000 - \$174,999	4.5%
\$175,000+	5.5%

SOURCE: Rhode Island Department of Revenue

In addition to the above changes, the Governor also proposes the elimination of most of the current personal income tax credits, effective after December 31, 2010. Although the majority of credits would be eliminated, the Governor proposes retaining the four credits listed below:

- Income taxes paid to other states;
- Refundable Earned Income Tax Credit at 15.0 percent of Federal EITC;
- Property Tax Relief Credit; and
- Lead Paint Abatement Credit.

The Governor's proposal also includes several carry-forward amounts for certain tax credits used in prior years that could still be used under the reformed personal income tax proposal. They are:

- Historic Structures Tax Credits (HSTC), purchased from developers with qualified projects, could be used against liabilities incurred under the reformed personal income tax proposal. HSTC amounts used would be reimbursed from the HSTC Fund established by the 2008 General Assembly.
- Carry-forward amounts of all other unused credits as allowed under the current law.
- Motion Picture Production Tax Credits for motion picture productions completed prior to January 1, 2011.

According to a report by the Department of Revenue (DOR), the number of resident tax filers with itemized deductions and capital gains income that would see a tax increase under the proposed income tax reform is 14,421, while 22,752 resident filers with itemized deductions and capital gains income would receive a tax decrease.

The number of resident tax filers with itemized deductions and **no** capital gains income that would incur a tax increase under the proposed income tax reform is 74,412. The Department estimates that 104,810 resident filers with itemized deductions and **no** capital gains income would have lower taxes.

The DOR estimates that 1,129 resident tax filers with **no** itemized deductions and capital gains income that would have a tax increase under the proposed income tax reform. However, 6,833 resident filers with **no** itemized deductions and capital gains income would see their taxes decrease.

The number of resident tax filers with **no** itemized deductions and **no** capital gains income who would experience an increase in taxes under the proposed income tax reform is 7,851, while 189,945 resident filers with **no** itemized deductions and **no** capital gains income would pay lower taxes.

*Individual Tax Profiles*

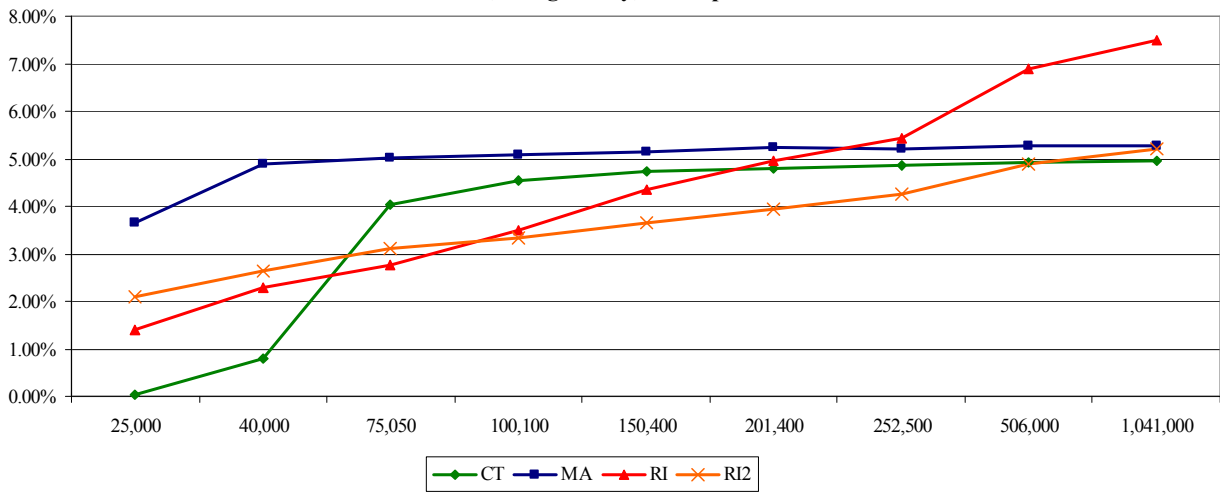
The following tables and charts illustrate taxes paid as a percentage of income for various taxpayers in Connecticut, Massachusetts, the current Rhode Island tax structure and the newly proposed tax system.

**Table 5**  
**2007 Income Tax Burdens for MARRIED FILING JOINTLY, NO DEPENDENTS**

	25,000 Tax	40,000 Tax	75,050 Tax	100,100 Tax	150,400 Tax	201,400 Tax	252,500 Tax	506,000 Tax	1,041,000 Tax
Connecticut	\$7	\$312	\$3,016	\$4,558	\$7,120	\$9,670	\$12,225	\$24,959	\$51,650
Massachusetts	915	1,958	3,768	5,093	7,753	10,558	13,165	26,600	54,955
<b>Rhode Island</b>	<b>350</b>	<b>912</b>	<b>2,080</b>	<b>3,494</b>	<b>6,547</b>	<b>10,003</b>	<b>13,727</b>	<b>34,911</b>	<b>78,075</b>
<b>Rhode Island New</b>	<b>525</b>	<b>1,050</b>	<b>2,327</b>	<b>3,329</b>	<b>5,493</b>	<b>7,952</b>	<b>10,763</b>	<b>24,705</b>	<b>54,130</b>

SOURCE: Calculations based on data from the Rhode Island Department of Revenue

**Chart 1**  
**Taxes as a Percentage of Personal Income:**  
**Married, Filing Jointly, No Dependents**

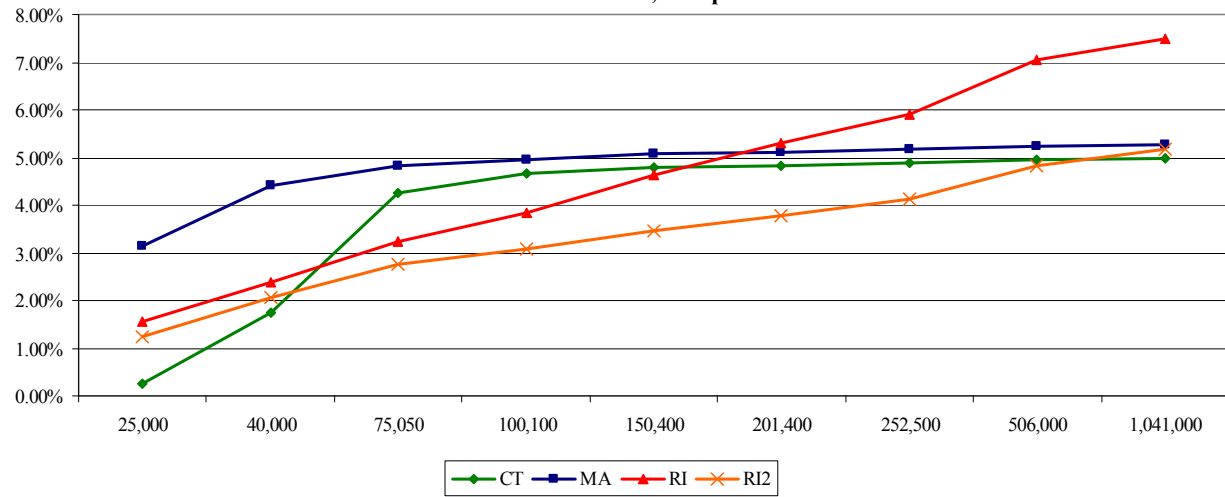


**Table 6**  
**2007 Income Tax Burdens for HEAD OF HOUSEHOLD, 1 DEPENDENTS (age 5)**

	25,000 Tax	40,000 Tax	75,050 Tax	100,100 Tax	150,400 Tax	201,400 Tax	252,500 Tax	506,000 Tax	1,041,000 Tax
Connecticut	\$63	\$704	\$3,191	\$4,684	\$7,200	\$9,750	\$12,305	\$24,980	\$51,730
Massachusetts	782	1,770	3,625	4,950	7,616	10,319	13,027	26,463	54,818
<b>Rhode Island</b>	<b>389</b>	<b>952</b>	<b>2,421</b>	<b>3,835</b>	<b>6,949</b>	<b>10,658</b>	<b>14,945</b>	<b>35,609</b>	<b>78,075</b>
<b>Rhode Island New</b>	<b>306</b>	<b>831</b>	<b>2,077</b>	<b>3,079</b>	<b>5,212</b>	<b>7,608</b>	<b>10,419</b>	<b>24,361</b>	<b>53,786</b>

SOURCE: Calculations based on data from the Rhode Island Department of Revenue

**Chart 2**  
**Taxes as a Percentage of Personal Income:**  
**Head of Household, 1 Dependent**

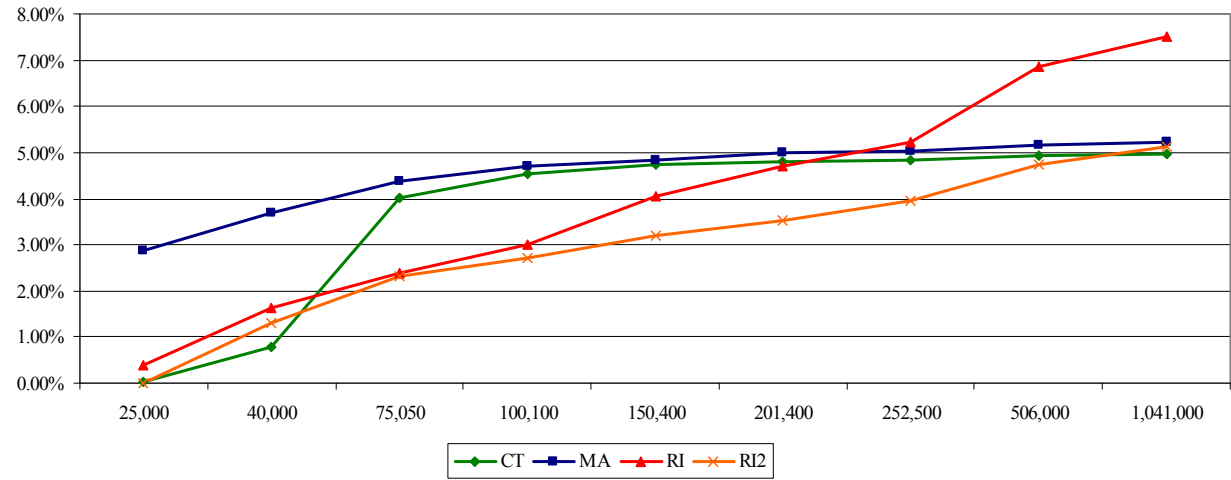


**Table 7**  
**2007 Income Tax Burdens for MARRIED FILING JOINTLY, 2 DEPENDENTS (ages 5 and 3)**

	25,000 Tax	40,000 Tax	75,050 Tax	100,100 Tax	150,400 Tax	201,400 Tax	252,500 Tax	506,000 Tax	1,041,000 Tax
Connecticut	\$7	\$312	\$3,016	\$4,558	\$7,120	\$9,670	\$12,225	\$24,959	\$51,650
Massachusetts	715	1,470	3,280	4,706	7,266	10,070	12,677	26,112	54,467
<b>Rhode Island</b>	<b>95</b>	<b>657</b>	<b>1,784</b>	<b>3,018</b>	<b>6,071</b>	<b>9,476</b>	<b>13,208</b>	<b>34,686</b>	<b>78,075</b>
<b>Rhode Island New</b>	<b>0</b>	<b>525</b>	<b>1,752</b>	<b>2,729</b>	<b>4,818</b>	<b>7,127</b>	<b>9,938</b>	<b>23,880</b>	<b>53,305</b>

SOURCE: Calculations based on data from the Rhode Island Department of Revenue

**Chart 3**  
**Taxes as a Percentage of Personal Income:**  
**Married, Filing Jointly, 2 Dependents**

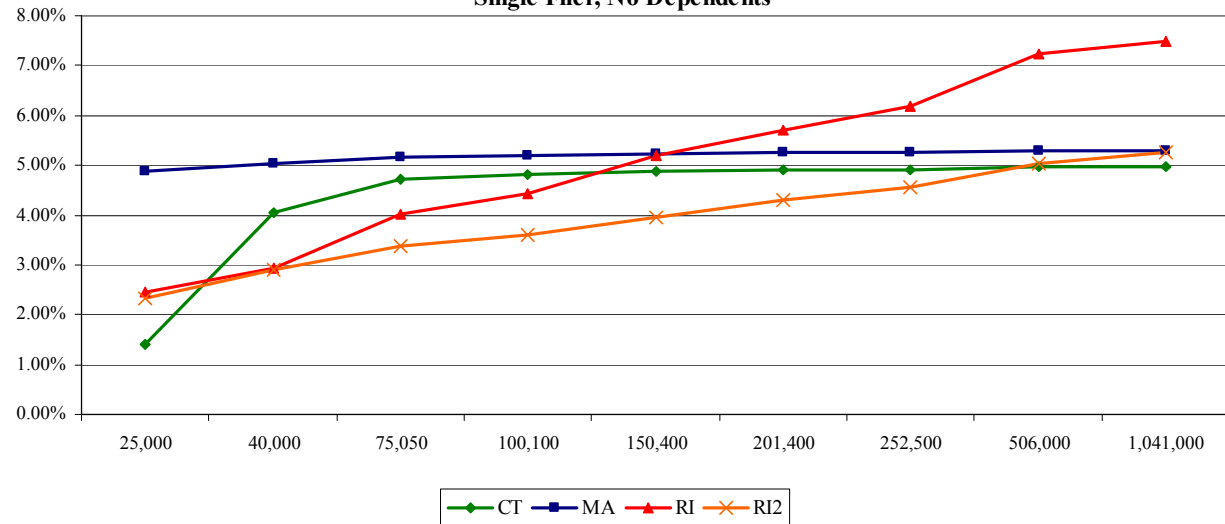


**Table 8**  
**2007 Income Tax Burdens for SINGLE FILER, NO DEPENDENTS**

	25,000 Tax	40,000 Tax	75,050 Tax	100,100 Tax	150,400 Tax	201,400 Tax	252,500 Tax	506,000 Tax	1,041,000 Tax
Connecticut	\$350	\$1,619	\$3,551	\$4,804	\$7,320	\$9,870	\$12,425	\$25,100	\$51,850
Massachusetts	1,223	2,014	3,869	5,194	7,860	10,563	13,271	26,707	55,009
<b>Rhode Island</b>	<b>610</b>	<b>1,173</b>	<b>3,010</b>	<b>4,431</b>	<b>7,811</b>	<b>11,497</b>	<b>15,642</b>	<b>36,538</b>	<b>78,075</b>
<b>Rhode Island New</b>	<b>585</b>	<b>1,155</b>	<b>2,545</b>	<b>3,610</b>	<b>5,952</b>	<b>8,688</b>	<b>11,498</b>	<b>25,441</b>	<b>54,866</b>

SOURCE: Calculations based on data from the Rhode Island Department of Revenue

**Chart 4**  
**Taxes as a Percentage of Personal Income:**  
**Single Filer, No Dependents**



## Estate Tax (Article 36)

The Governor has proposed to increase the exemption amount for Rhode Island Estate Tax purposes from the current limit of \$675,000 to \$1,000,000, effective January 1, 2010. The current exemption amount is one of the lowest in the United States, while the proposed exemption amount would be equal to the Massachusetts estate tax exemption amount. The higher exemption amount would eliminate the payment of estate taxes for 44.8 percent of Rhode Islanders subject to the estate tax at a cost of \$1,487,980 in FY 2010.

Table 9 shows the number of resident estate tax returns filed and the estate taxes paid by Rhode Island residents in FY 2008 for estates with gross taxable estate values of \$1.0 million or less through \$3.5 million or less.

<b>Gross Taxable Estate Value</b>	<b>Number of Returns</b>	<b>% of Total Returns</b>	<b>Estate Taxes Paid</b>	<b>% of Total Estate Taxes</b>
≤ \$1,000,000	146	44.8%	\$3,237,130	11.1%
≤ \$2,000,000	279	85.6%	10,882,315	37.4%
≤ \$3,000,000	300	92.0%	13,613,268	46.8%
≤ \$3,500,000	308	94.5%	15,251,805	52.4%

SOURCE: Rhode Island Division of Taxation

## Cost Impact

Table 10 shows the impact of the proposed tax changes. Under the proposal, tax revenues would be reduced by approximately \$15.6 million in FY 2010 and \$51.2 million in FY 2011.

<b>Tax</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
Personal Income Tax		(\$20.1)	(\$42.2)	(\$43.9)	(\$45.7)
Corporate Tax	(14.1)	(28.1)	(46.9)	(65.6)	(84.4)
Estate Exemption Increase	(1.5)	(3.0)	(3.0)	(3.0)	(3.0)
Franchise Fee					2.2
<i>Total</i>	<i>(\$15.6)</i>	<i>(\$51.2)</i>	<i>(\$92.1)</i>	<i>(\$112.5)</i>	<i>(\$130.9)</i>

SOURCE: Rhode Island Department of Revenue

The foregone tax revenue (for the AGI range of \$1 to \$30,000), which is where the majority of the EITC beneficiaries are, is \$17.9 million. One must keep in mind that some of the foregone revenue is attributable to the lower marginal tax rate (3.5 percent vs. 3.75 percent) and the higher combined standard deduction and exemption amounts compared to the current law.

## II. Rhode Island Tax Burden

The following section provides an overview of the relative tax burden for the State of Rhode Island. The data is from the United States Census Bureau for FY 2006, the most recent year for which nationally comparable data is available.

Rhode Island's overall State and local tax burden, measured as a percent of personal income, was 12th highest in the country in FY 1996; in FY 2006, it increased to 10th highest. In contrast, both Connecticut and Massachusetts have dropped in the rankings to 19th highest and 36th highest, respectively. As shown on the chart below, Rhode Island's State and local tax collections per \$1,000 of personal income, when measure as a percent of the United States average, were higher than both Connecticut and Massachusetts. In contrast, the State was only slightly higher than Massachusetts in FY 1996 and was lower than Connecticut.

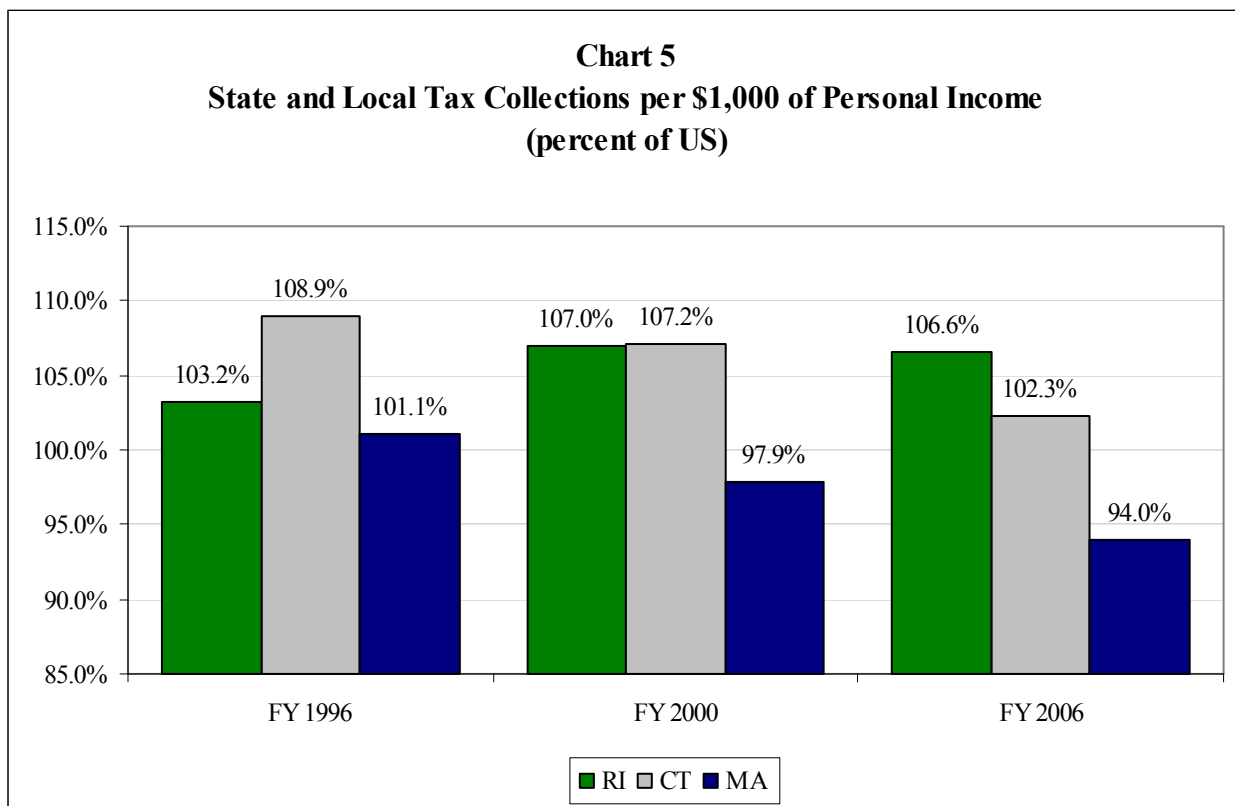


Table 12 outlines selected taxes measured as a percent of total tax collections in FY 2006 and FY 1996 for Rhode Island and neighboring states. As shown on the table, property taxes account for the largest share of the total State and local tax burden in Rhode Island. In FY 2006, property taxes accounted for 40.3 percent of all taxes paid by Rhode Islanders. This was the fourth highest share of total taxes of the 11 states examined.

Income taxes accounted for 21.8 percent of all Rhode Island State and local taxes paid in FY 2006. This was relatively the same share as in FY 1996 and was slightly lower than the United States average. Of the 11 states included in this analysis, income taxes accounted for a smaller share of total taxes in New Hampshire (1.8 percent of total taxes), and Vermont (19.7 percent of total

taxes). One should note that the share of taxes does not represent the overall tax burden, but rather, shows how that burden is distributed across different types of taxes.

In FY 2006, sales tax accounted for 18.3 percent of State and local taxes paid by Rhode Islanders. While this was lower than the national average of 23.6 percent of total state and local taxes, it was the highest in the region. This represents a change from FY 1996 when Connecticut, Maine, New York, and Pennsylvania all relied on sales tax collections to fund government more than Rhode Island.

**Table 12**  
**Selected Taxes as a Percent of Total State and Local Tax Collections**

	Property		Income		Sales		Other	
	FY 2006	FY 1996	FY 2006	FY 1996	FY 2006	FY 1996	FY 2006	FY 1996
United States*	30.0%	30.4%	22.5%	21.3%	23.6%	24.5%	23.9%	23.8%
Connecticut	38.1%	37.1%	29.1%	20.8%	15.3%	19.5%	17.5%	22.5%
Delaware	14.7%	14.6%	29.8%	32.5%	0.0%	0.0%	55.6%	52.9%
Maine	38.1%	41.8%	23.6%	22.0%	17.9%	20.4%	20.4%	15.8%
Maryland	23.1%	26.9%	38.2%	37.4%	13.1%	14.2%	25.6%	21.6%
Massachusetts	35.3%	33.9%	34.2%	35.1%	13.1%	13.6%	17.3%	17.4%
New Hampshire	61.6%	67.4%	1.8%	2.0%	0.0%	0.0%	36.7%	30.6%
New Jersey	43.4%	46.7%	22.2%	17.3%	14.5%	15.7%	19.9%	20.2%
New York	29.5%	32.1%	31.2%	29.5%	17.6%	18.1%	21.7%	20.3%
Pennsylvania	29.0%	28.7%	25.1%	24.2%	17.5%	19.2%	28.4%	27.9%
<b>Rhode Island</b>	<b>40.3%</b>	<b>42.4%</b>	<b>21.8%</b>	<b>21.4%</b>	<b>18.3%</b>	<b>17.2%</b>	<b>19.6%</b>	<b>19.0%</b>
Vermont	41.7%	44.8%	19.7%	18.5%	12.0%	12.0%	26.6%	24.6%

\* US average includes District of Columbia

Source: US Bureau of the Census, the Bureau of Economic Analysis, RIPEC calculations