

**WRITTEN TESTIMONY SUBMITTED TO:**

THE RHODE ISLAND HOUSE COMMITTEE ON FINANCE

**Regarding Proposals to Increase Taxes on Upper-Income Rhode Islanders**

*April 24, 2012*

Thank you for the opportunity to submit this written testimony. My name is Meg Wiehe and I am the State Tax Policy Director for the Institute on Taxation and Economic Policy (ITEP), a Washington-DC-based nonprofit research group. ITEP's research focuses on federal and state tax policy issues with an emphasis on the goals of sustainability, transparency and fairness in the tax laws.

My testimony focuses in general on the slate of bills in front of the committee today that would raise taxes on wealthy Rhode Islanders. These bills present Rhode Island policymakers sensible revenue-raising options that could be used to either prevent deeper spending cuts or restore spending to vital public investments such as education, health care, and transportation to name a few. Adding additional income tax brackets and raising the top marginal tax rate is also the most significant opportunity Rhode Island policymakers have to improve tax fairness while at the same time raising revenue.

There is a strong fairness-based reason for considering tax increases on upper-income Rhode Island households. Few would agree that those most able to pay should contribute less of their income than those least able to pay, yet that's exactly how Rhode Island's tax system is structured. In recent years, Rhode Island lawmakers have made significant reforms to the state's personal income tax which led to modest improvements in tax fairness. Eliminating itemized deductions and repealing the preferential tax rate on long-term capital gains took away many of the advantages and tax breaks enjoyed primarily by the wealthiest Rhode Islanders.

Even after accounting for these reforms, Rhode Island's tax system remains highly imbalanced. **Figures 1 and 2** accompanying this testimony show the distribution of Rhode Island state and local taxes by income group both before and after the 2010 personal income tax reform. Low and middle-income Rhode Islanders still spend far more of their family budgets on state and local taxes than do the state's wealthiest taxpayers. Today, the best-off 1 percent of Rhode Islanders pay a little over **7.2%** of their income in Rhode Island taxes (even less after accounting for the lower federal taxes they owe due to writing off their state incomes taxes), while the poorest 20 percent of families pay an average of **11.8%**. This is illogical at best, considering that wealth in the United States has become concentrated among the nation's richest households to an extent not seen since the late 1920s. Soaking the poor simply will not yield as much revenue as even a modest tax increase on the wealthy.

One reason Rhode Island's recent tax reforms made only modest gains in closing the tax fairness gap is because the increased revenue and improved fairness from taking away tax breaks for the rich were wiped out almost entirely through collapsing the state's personal income tax brackets and reducing the top rate from 9.9

percent to 5.99 percent. The 2010 personal income tax reform thus generated virtually no new revenue to address the state's budget crisis at the time and wealthy taxpayers' effective tax rates barely budged.

Fast forward two years and Rhode Island revenues have yet to fully recover from the recession's toll. In 2010, many Rhode Island policymakers and the business community championed reform as a means to make the state more competitive, convinced that lowering the marginal top rate would make the state more attractive to businesses.

Recently, ITEP took a look at the economic performance of the eighteen states on the opposite ends of the spectrum in terms of top marginal tax rates: the nine with the highest top income tax rates, and the nine with no income tax at all. And what we found is that the nine states with the highest top tax rates (RI currently not included) are actually doing better than average in terms of growth in economic output per capita and growth in median income, and they're beating most of the states without income taxes as well. Of course, this does not mean that having a higher top income tax rate is a guarantee of faster economic growth, but it does show the assumption of policymakers in 2010 that *lower* income tax rates would spur economic growth does not have a lot of empirical backing.

Enacting any of the bills before you would narrow the state's tax fairness gap and raise some additional revenue, though under each bill Rhode Island's wealthiest taxpayers would still pay a much smaller share of their income than any other group. **Figure 3** shows the distributional impact of the five bills, in other words which income groups would be impacted and the increased average share of income the options would impose on the taxpayers among the affected.

Less than 2 percent of Rhode Island taxpayers would see a tax increase under the three proposals that would add a new top rate on taxable income above \$250,000. More than 90 percent of the tax change from those proposals would be paid for by the top 1 percent of taxpayers, those with average incomes of close to \$1 million. If the new top rate was applied to taxable income starting at \$500,000, less than 1 percent of taxpayers would be impacted and the change would fall entirely on the top 1 percent.

It is also important to keep in mind that the actual impact of these bills on wealthy Rhode Islanders is even smaller since any increase in state taxes they pay can be written-off as an itemized deduction on their federal tax returns. Because of this "federal offset", an ITEP analysis found that as much as 30 percent of the state tax increases being debated today will be completely offset by a drop in federal tax bills. For example, if a Rhode Island taxpayer owes an additional \$10,000 in state income taxes under one of the bills, she will pay \$3,000 less in federal income taxes and thus her total tax increase is only \$7,000.

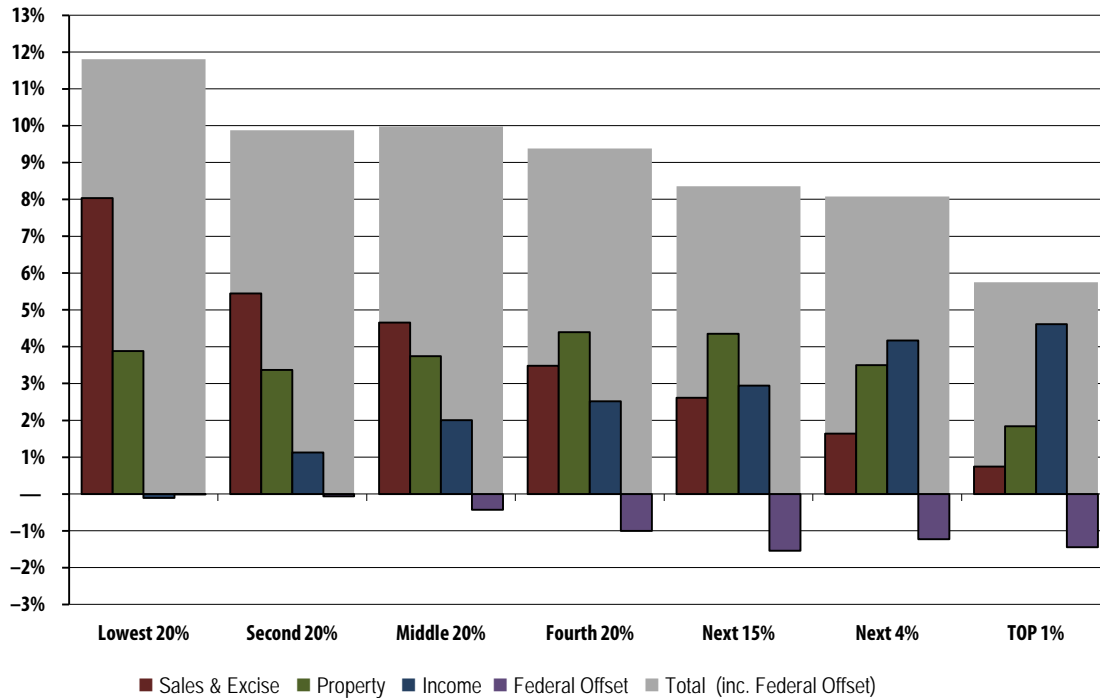
The bills before you offer reasonable options for balancing Rhode Island's budget while at the same time improving tax fairness. The choice between more cuts to vital public investments or asking wealthy Rhode Islanders to pay their fair share should be an easy one.

And with that, I thank you again for this opportunity.

# Fig. 1: Who Pays Taxes in Rhode Island?

## State & Local Taxes post-2010 Personal Income Tax Reform, 2007 Income Levels

Shares of family income for non-elderly taxpayers



Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
	Income Range	Income Range	Income Range	Income Range	Next 15%	Next 4%	TOP 1%
<b>Average Income in Group</b>	<b>\$9,500</b>	<b>\$23,500</b>	<b>\$41,700</b>	<b>\$66,600</b>	<b>\$113,000</b>	<b>\$248,100</b>	<b>\$1,211,300</b>
<b>Sales &amp; Excise Taxes</b>	<b>8.0%</b>	<b>5.4%</b>	<b>4.7%</b>	<b>3.5%</b>	<b>2.6%</b>	<b>1.6%</b>	<b>0.7%</b>
General Sales—Individuals	3.4%	2.5%	2.3%	1.8%	1.4%	0.9%	0.4%
Other Sales & Excise—Ind.	2.8%	1.6%	1.3%	0.8%	0.6%	0.3%	0.1%
Sales & Excise on Business	1.8%	1.3%	1.1%	0.8%	0.6%	0.4%	0.2%
<b>Property Taxes</b>	<b>3.9%</b>	<b>3.4%</b>	<b>3.7%</b>	<b>4.4%</b>	<b>4.3%</b>	<b>3.5%</b>	<b>1.8%</b>
Property Taxes on Families	3.8%	3.2%	3.6%	4.2%	4.1%	3.1%	1.0%
Other Property Taxes	0.1%	0.1%	0.1%	0.2%	0.3%	0.4%	0.8%
<b>Income Taxes</b>	<b>-0.1%</b>	<b>1.1%</b>	<b>2.0%</b>	<b>2.5%</b>	<b>2.9%</b>	<b>4.2%</b>	<b>4.6%</b>
Personal Income Tax	-0.1%	1.11%	2.00%	2.50%	2.90%	4.08%	4.44%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%
<b>TOTAL TAXES</b>	<b>11.8%</b>	<b>9.9%</b>	<b>10.4%</b>	<b>10.4%</b>	<b>9.9%</b>	<b>9.3%</b>	<b>7.2%</b>
<b>Federal Deduction Offset</b>	<b>-0.0%</b>	<b>-0.1%</b>	<b>-0.4%</b>	<b>-1.0%</b>	<b>-1.5%</b>	<b>-1.2%</b>	<b>-1.44%</b>
<b>TOTAL AFTER OFFSET</b>	<b>11.8%</b>	<b>9.9%</b>	<b>10.0%</b>	<b>9.4%</b>	<b>8.4%</b>	<b>8.1%</b>	<b>5.8%</b>

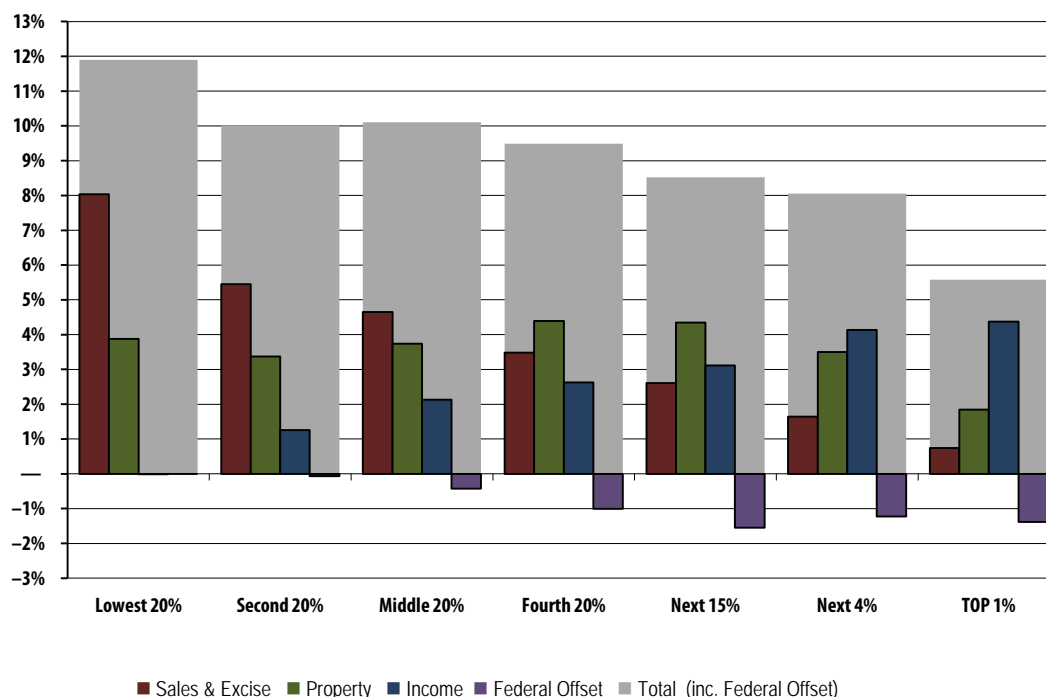
Source: Institute on Taxation and Economic Policy, 2012

**Notes:** Rhode Island Who Pays updated to include 2010 PIT reforms (eliminated itemized deductions, change rate structure, increase standard deduction, etc). Analysis uses 2007 income levels in order to compare to previous ITEP distributional analysis. Changes to the vehicle tax exemption and sales tax base in 2011 are not included at this time (preliminary analysis)-PIT reform only.

## Fig. 2: Who Pays Taxes in Rhode Island?

State & Local Taxes pre-2010 Personal Income Tax Reform, 2007 Income levels

Shares of family income for non-elderly taxpayers



Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
	Next 15%	Next 4%	TOP 1%				
<b>Income Range</b>	Less than \$17,000	\$17,000 – \$31,000	\$31,000 – \$51,000	\$51,000 – \$85,000	\$85,000 – \$167,000	\$167,000 – \$419,000	\$419,000 or more
<b>Average Income in Group</b>	\$9,500	\$23,500	\$41,700	\$66,600	\$113,000	\$248,100	\$1,211,300
<b>Sales &amp; Excise Taxes</b>	8.0%	5.4%	4.7%	3.5%	2.6%	1.6%	0.7%
General Sales—Individuals	3.4%	2.5%	2.3%	1.8%	1.4%	0.9%	0.4%
Other Sales & Excise—Ind.	2.8%	1.6%	1.3%	0.8%	0.6%	0.3%	0.1%
Sales & Excise on Business	1.8%	1.3%	1.1%	0.8%	0.6%	0.4%	0.2%
<b>Property Taxes</b>	3.9%	3.4%	3.7%	4.4%	4.3%	3.5%	1.8%
Property Taxes on Families	3.8%	3.2%	3.6%	4.2%	4.1%	3.1%	1.0%
Other Property Taxes	0.1%	0.1%	0.1%	0.2%	0.3%	0.4%	0.8%
<b>Income Taxes</b>	-0.0%	1.3%	2.1%	2.6%	3.1%	4.1%	4.4%
Personal Income Tax	-0.0%	1.2%	2.1%	2.6%	3.1%	4.1%	4.2%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%
<b>TOTAL TAXES</b>	11.9%	10.1%	10.5%	10.5%	10.1%	9.3%	7.0%
<b>Federal Deduction Offset</b>	-0.0%	-0.1%	-0.4%	-1.0%	-1.5%	-1.2%	-1.4%
<b>TOTAL AFTER OFFSET</b>	11.9%	10.0%	10.1%	9.5%	8.5%	8.1%	5.6%

Source: Institute on Taxation and Economic Policy, 2009

Notes: Rhode Island Who Pays published in ITEP's 2009 report: *Who Pays? A Distributional Analysis of the Tax Systems in all 50 States*.

Shows 2007 tax law updated to reflect permanent changes in law enacted through October 2009. Most significantly: capital gains are taxed at the same rate as earned income (ends preferential rate treatment) and the Alternative Flat Tax Rate used was 5.5% (fully phased-in).

### Fig 3: Impact of Rhode Island Upper Income Personal Income Tax Increase Options

All Rhode Islanders, 2011 Levels

2011 Income Groups	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$18,000	\$18,000 – \$32,000	\$32,000 – \$57,000	\$57,000 – \$90,000	\$90,000 – \$169,000	\$169,000 – \$390,000	\$390,000 – Or More
Average Income in Group	\$10,000	\$25,000	\$44,000	\$70,000	\$118,000	\$238,000	\$977,000

HB7379: Additional 1ppt on income above 250K							
Tax Change as % of Income	—	—	—	—	—	+0.0%	+0.5%
Average Tax Change	—	—	—	—	—	+119	+5,322
% of Income Group w/ Tax Increase	—	—	—	—	—	22%	95%
Avg. Tax Increase for those with Increase	—	—	—	—	—	+534	+5,619
Share of Increase/Tax Change	—	—	—	—	—	8%	92%

HB7381: Additional 2ppt on income above 250K							
Tax Change as % of Income	—	—	—	—	—	+0.1%	+1.1%
Average Tax Change	—	—	—	—	—	+237	+10,643
% of Income Group w/ Tax Increase	—	—	—	—	—	22%	95%
Avg. Tax Increase for those with Increase	—	—	—	—	—	+1,069	+11,239
Share of Increase/Tax Change	—	—	—	—	—	+8%	+92%

HB7729: Additional 4ppt on income above 250K							
Tax Change as % of Income	—	—	—	—	—	+0.2%	+2.2%
Average Tax Change	—	—	—	—	—	+474	+21,286
% of Income Group w/ Tax Increase	—	—	—	—	—	22%	95%
Avg. Tax Increase for those with Increase	—	—	—	—	—	+2,137	+22,477
Share of Increase/Tax Change	—	—	—	—	—	+8%	+92%

HB7305: Additional 1ppt on income above 500K							
Tax Change as % of Income	—	—	—	—	—	—	+0.4%
Average Tax Change	—	—	—	—	—	—	+3,602
% of Income Group w/ Tax Increase	—	—	—	—	—	—	45%
Avg. Tax Increase for those with Increase	—	—	—	—	—	—	+7,953
Share of Increase/Tax Change	0%	0%	0%	0%	0%	0%	100%

HB7382: Additional 2ppt on income above 500K							
Tax Change as % of Income	—	—	—	—	—	—	+0.7%
Average Tax Change	—	—	—	—	—	—	+7,204
% of Income Group w/ Tax Increase	—	—	—	—	—	—	45%
Avg. Tax Increase for those with Increase	—	—	—	—	—	—	+15,907
Share of Increase/Tax Change	—	—	—	—	—	—	100%

State Tax Change (\$1000)
<b>\$ +30,000</b>

Total Share w/Tax Increase	<b>1.8%</b>
Share of Tax Increase to Top 1%	<b>92%</b>

Bracket	
Income	Rate
0	3.75%
55,000	4.75%
125,000	5.99%
250,000	6.99%

State Tax Change (\$1000)
<b>\$ +59,000</b>

Total Share w/Tax Increase	<b>1.8%</b>
Share of Tax Increase to Top 1%	<b>92%</b>

Bracket	
Income	Rate
0	3.75%
55,000	4.75%
125,000	5.99%
250,000	7.99%

State Tax Change (\$1000)
<b>\$ +118,000</b>

Total Share w/Tax Increase	<b>1.8%</b>
Share of Tax Increase to Top 1%	<b>92%</b>

Bracket	
Income	Rate
0	3.75%
55,000	4.75%
125,000	5.99%
250,000	9.99%

State Tax Change (\$1000)
<b>\$ +18,000</b>

Total Share w/Tax Increase	<b>0.4%</b>
Share of Tax Increase to Top 1%	<b>100%</b>

Bracket	
Income	Rate
0	3.75%
55,000	4.75%
125,000	5.99%
500,000	6.99%

State Tax Change (\$1000)
<b>\$ +37,000</b>

Total Share w/Tax Increase	<b>0.4%</b>
Share of Tax Increase to Top 1%	<b>100%</b>

Bracket	
Income	Rate
0	3.75%
55,000	4.75%
125,000	5.99%
500,000	7.99%