



Putting the Pieces Together

*Understanding Governor Carcieri's Tax Proposals
& Developing Alternatives to Them*

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Putting the Pieces Together - Overview

- **Introduction**

- **Assessing Rhode Island's Tax System**

Rhode Island's tax system is inadequate, inequitable, and inefficient.

- **Describing Governor Carcieri's Tax Proposals**

Governor Carcieri's FY 2010 budget would raise taxes on cigarettes, reduce the estate tax, flatten out the income tax, and ultimately eliminate the business corporation tax.

- **Evaluating Governor Carcieri's Tax Proposals**

Governor Carcieri's FY 2010 budget would fail to address the three main problems facing Rhode Island's tax system.

- **Improving Rhode Island's Tax System**

Eliminating preferential tax rates for capital gains, repealing the alternative flat tax, and adopting combined reporting would generate needed revenue, enhance fairness, and improve economic efficiency. Such changes would help RI address its current budget deficit and lay the foundation for long-term economic growth.



Introduction

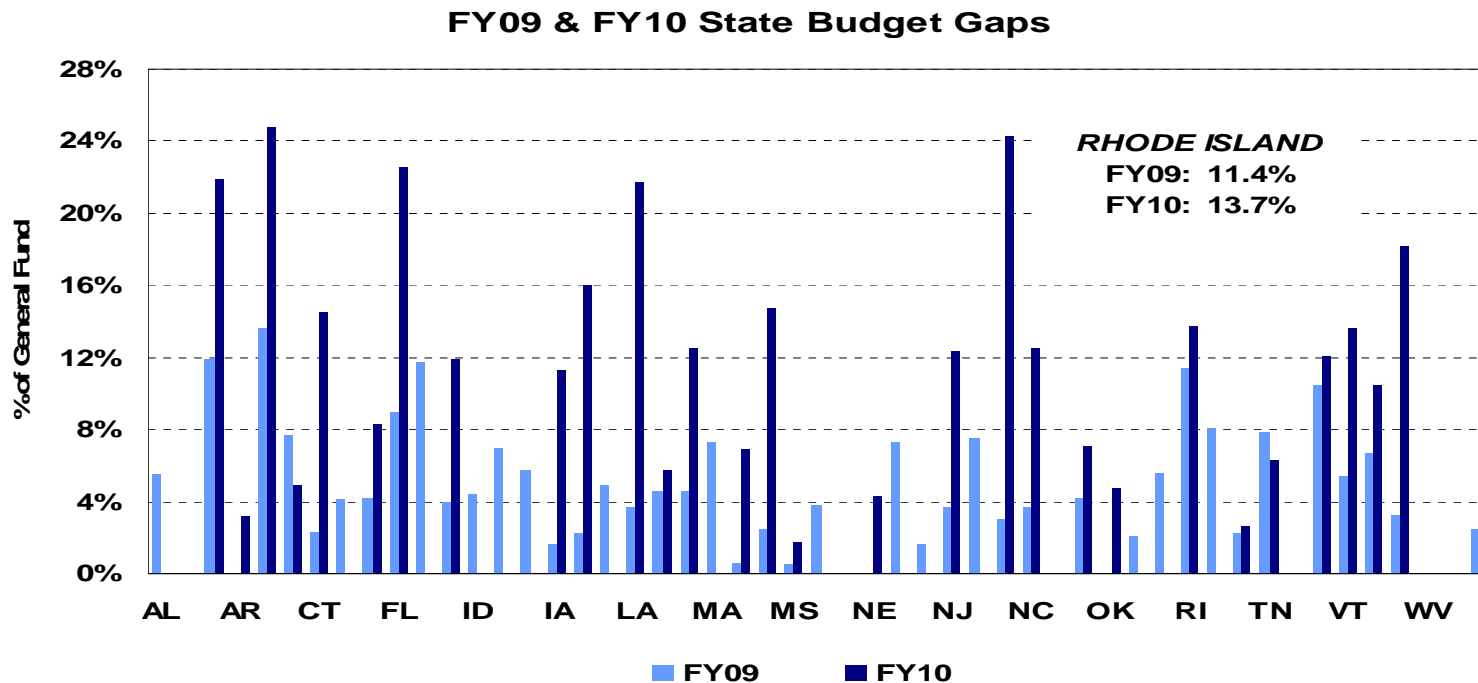
Hello, My Name is ITEP

- ❖ Founded in 1980
- ❖ Based in Washington, DC
- ❖ Research focuses primarily on state tax issues, with an emphasis on tax fairness and adequacy
- ❖ In the past five years, conducted studies of state tax systems in LA, MD, MS, IN, AR, IL, IA, MN, and NY
- ❖ Conducted hundreds of smaller-scale tax analyses in over 40 states
- ❖ In conjunction with Citizens for Tax Justice, publishes weekly newsletter, the *Tax Justice Digest*, that reviews the latest developments in federal and state tax policy

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Assessing Rhode Island's Tax System

Rhode Island's tax system is *inadequate*.



Source: Center on Budget and Policy Priorities

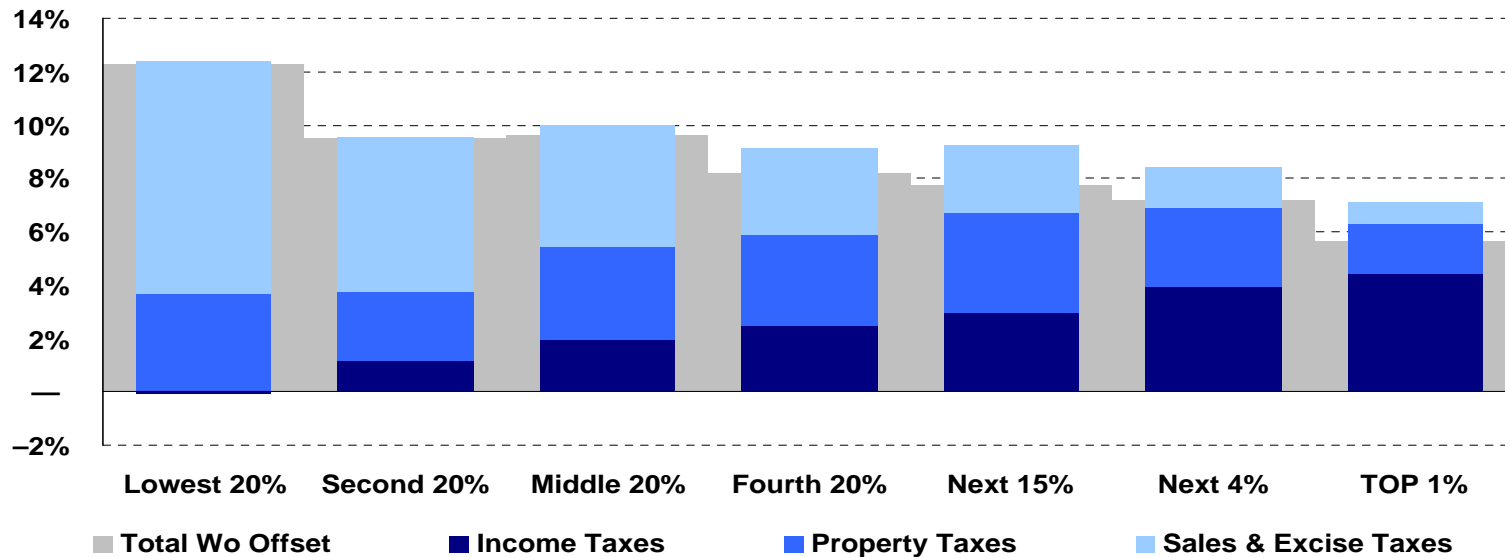
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Assessing Rhode Island's Tax System

Rhode Island's tax system is *inequitable*, as it requires low- and moderate-income families to pay larger shares of their incomes in taxes than upper-income families

State & Local Taxes in Rhode Island, 2007

Shares of income, non-elderly taxpayers



Source: ITEP Microsimulation Model



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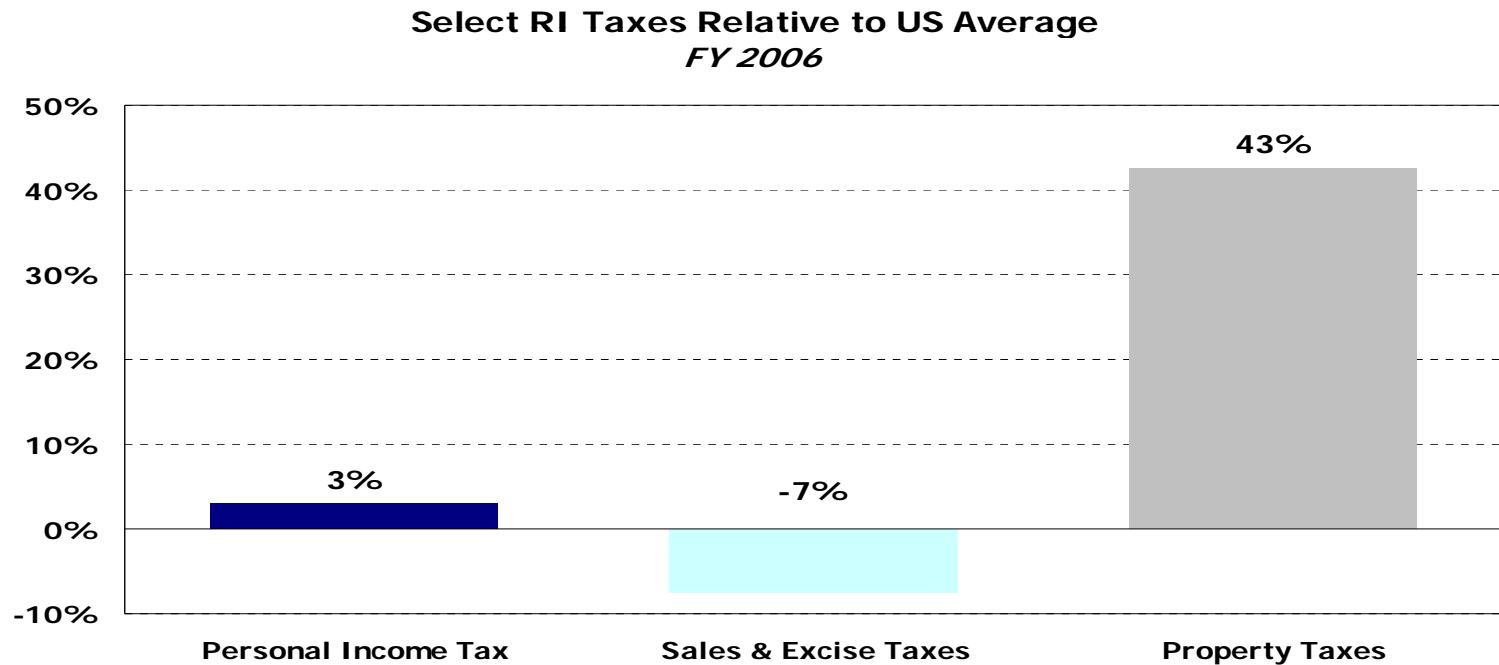
Assessing Rhode Island's Tax System

- ❖ The poorest fifth of Rhode Islanders – individuals and families with incomes of less than \$17,000 in 2007 – pay **12.3** percent of their incomes in taxes on average.
- ❖ Middle-income residents – whose incomes range from \$31,000 to \$51,000 – pay **9.6** percent on average (after accounting for the impact of the federal offset).
- ❖ The wealthiest 1 percent of Rhode Islanders – taxpayers whose average income amounted to **\$1.2 million** in 2007 – pay **5.7** percent (again, post-offset).
- ❖ In short, relative to their incomes, the most affluent Rhode Island residents pay **less than half as much in taxes** as poor and middle-income residents.

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Assessing Rhode Island's Tax System

Rhode Island's tax system is *inequitable*, due in part to the mix of state and local taxes levied



Source: U.S. Census Bureau; Bureau of Economic Analysis

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Assessing Rhode Island's Tax System

Rhode Island's tax system is *inequitable*, due in part to the mix of state and local taxes levied

Rhode Island State & Local Taxes as a Share of Personal Income, 2006

	Personal Income Tax	Rank	Sales & Gross Receipts Taxes	Rank	Property Taxes	Rank	Corporate Income Tax	Rank
Maine	3.3%	12	4.0%	21	5.3%	3	0.5%	24
New Hampshire	0.2%	42	1.4%	48	5.5%	1	1.1%	4
Vermont	2.6%	29	3.9%	23	5.5%	2	0.4%	31
Massachusetts	3.6%	6	2.1%	45	3.7%	17	0.6%	9
Rhode Island	2.6%	24	3.6%	32	4.8%	6	0.4%	26
Connecticut	3.4%	10	2.9%	41	4.4%	8	0.4%	35
New York	4.8%	1	3.9%	22	4.5%	7	1.1%	2
All States	2.5%		3.9%		3.4%		0.5%	
Addendum: Rhode Island Compared to National Average								
	+3%		-7%		+43%		-13%	

Source: Bureau of Economic Analysis; Bureau of the Census

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Assessing Rhode Island's Tax System

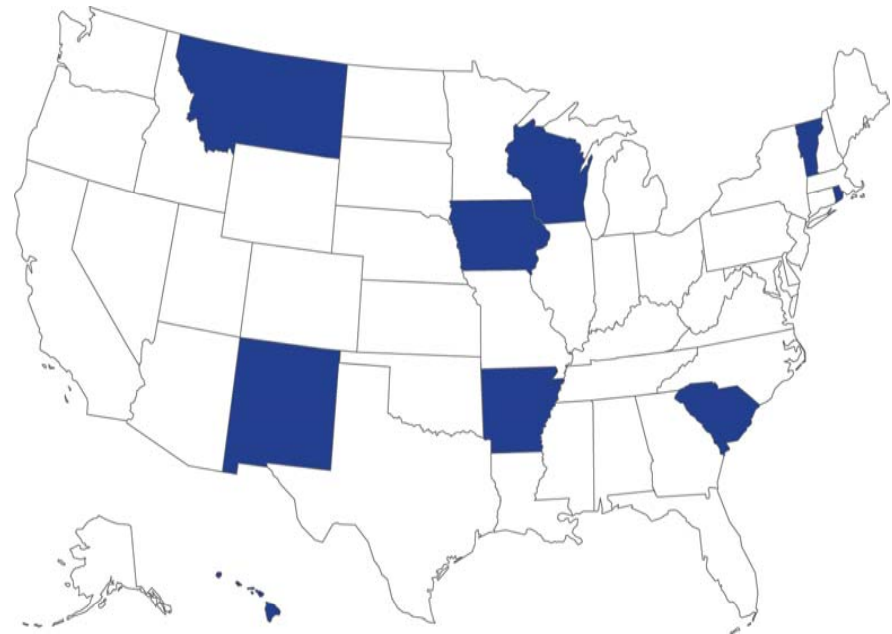
Rhode Island's personal income tax is *inefficient*, as it favors certain forms of income over others

Capital Gains Tax Preferences

"...a cut in the tax rate on capital gains is unlikely to have much effect on saving and investment..."

"...tax preferences are more likely to depress economic productivity than to improve it..."

-- Leonard Berman, *The Labyrinth of Capital Gains Tax Policy*

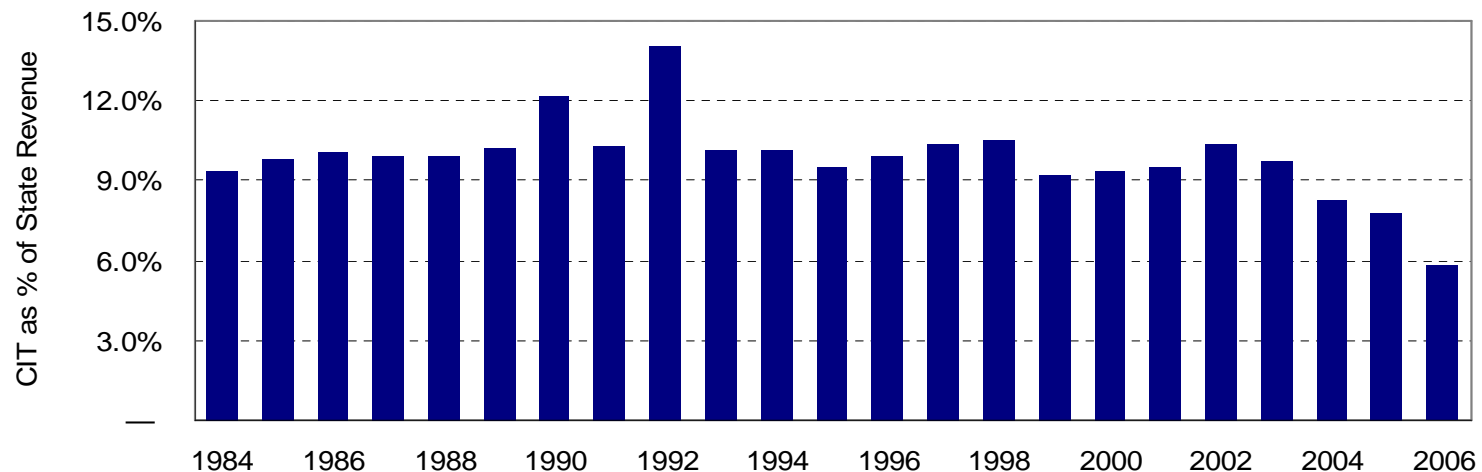


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Assessing Rhode Island's Tax System

Rhode Island's corporate income tax is *inefficient*, as it is vulnerable to a wide variety of schemes designed to shift income out of state and to reduce taxes paid

RI Corporate Income Tax Plays a Much Smaller Role in State Finances



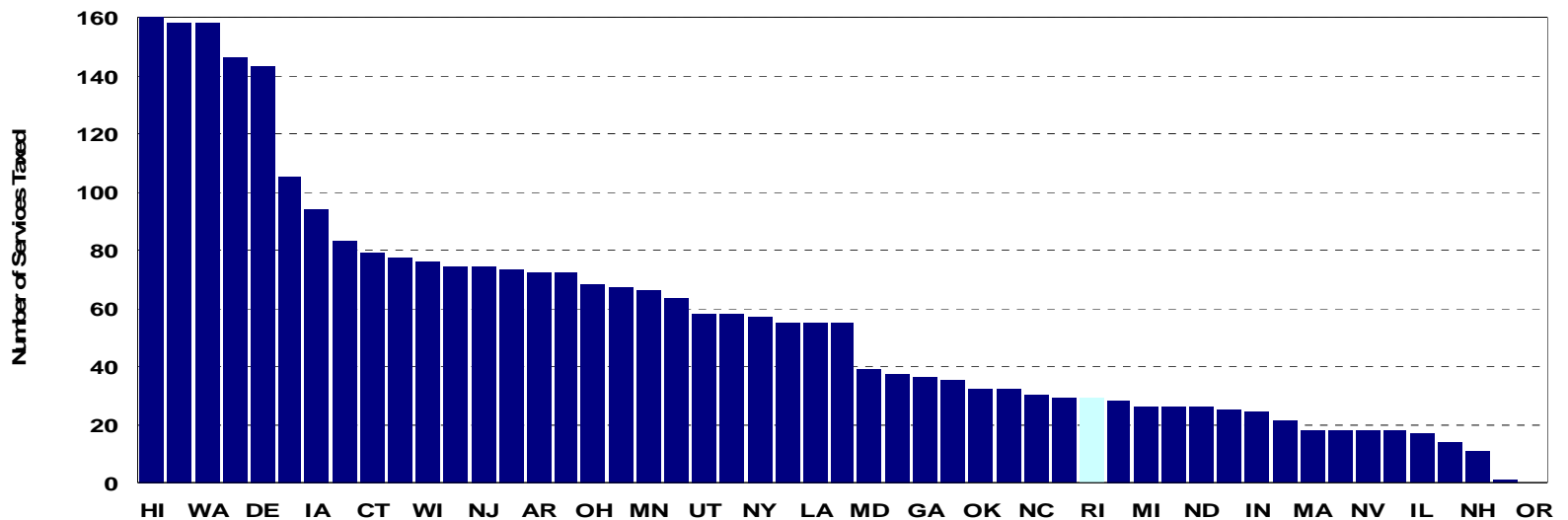
Source: U.S. Census Bureau

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Assessing Rhode Island's Tax System

Rhode Island's sales tax is *inefficient*, as it fails to include as much of the state's economic activity in its base as possible

Sales Taxation of Services, 2007



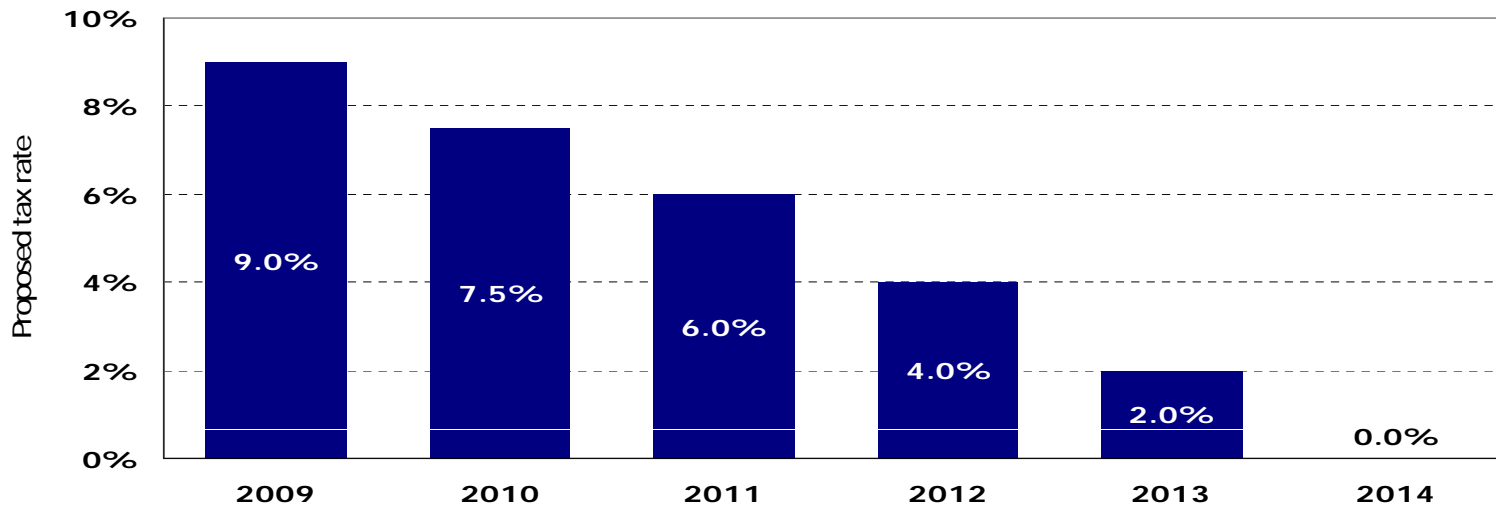
As of 2007, services constituted 60 percent of consumption nationwide; yet, according to the FTA, Rhode Island taxed just 29 out of a possible 168 services

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Governor Carcieri's Tax Proposals - Description

The Governor's top tax policy priority is the gradual elimination of RI's business corporation tax. As recently as FY 2008, this tax produced over \$150 million in revenue. The revenue lost to repeal would only partially be replaced – by a new tiered minimum tax – but not until 2014.

Phase-out of Business Corporations Tax under FY10 Budget

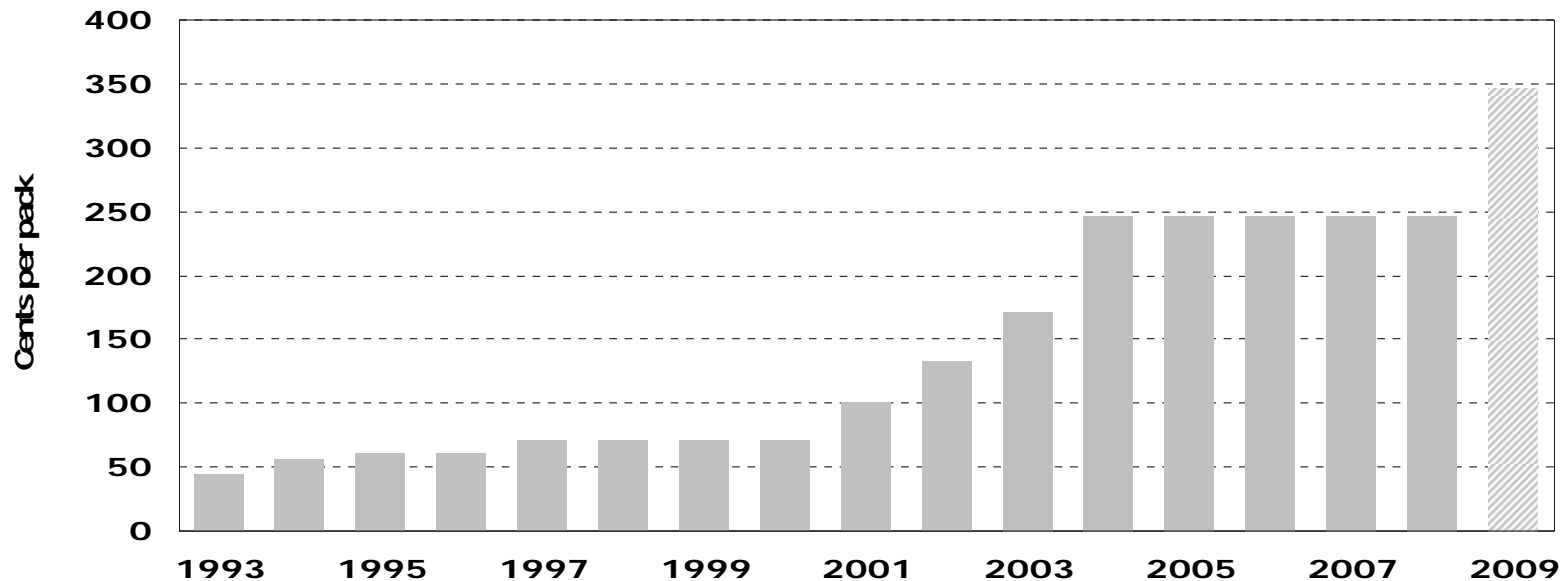


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Governor Carcieri's Tax Proposals - Description

Though not considered by the Tax Policy Workgroup, an increase in RI's cigarette tax – from \$2.46 per pack to \$3.46 per pack – is a major element of the Governor's budget.

Rhode Island's Rapidly Rising Cigarette Tax

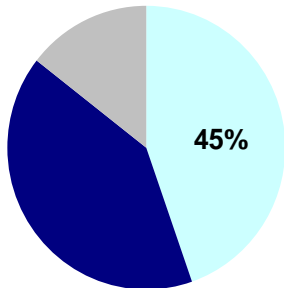


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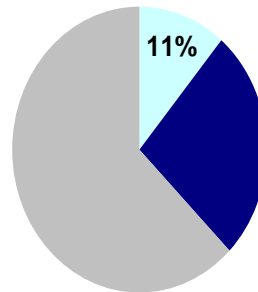
Governor Carcieri's Tax Proposals - Description

Another element of the Governor's tax proposals that would have an effect in FY 2010 is his call to increase the exemption for the Rhode Island estate tax from \$675,000 to \$1 million.

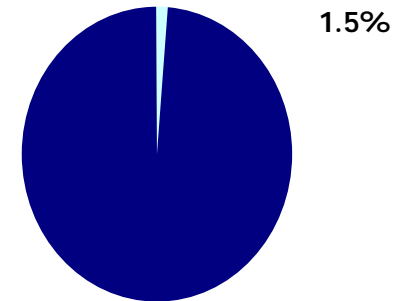
Share of Resident Returns



Share of Resident Liability



Share of All Resident Deaths



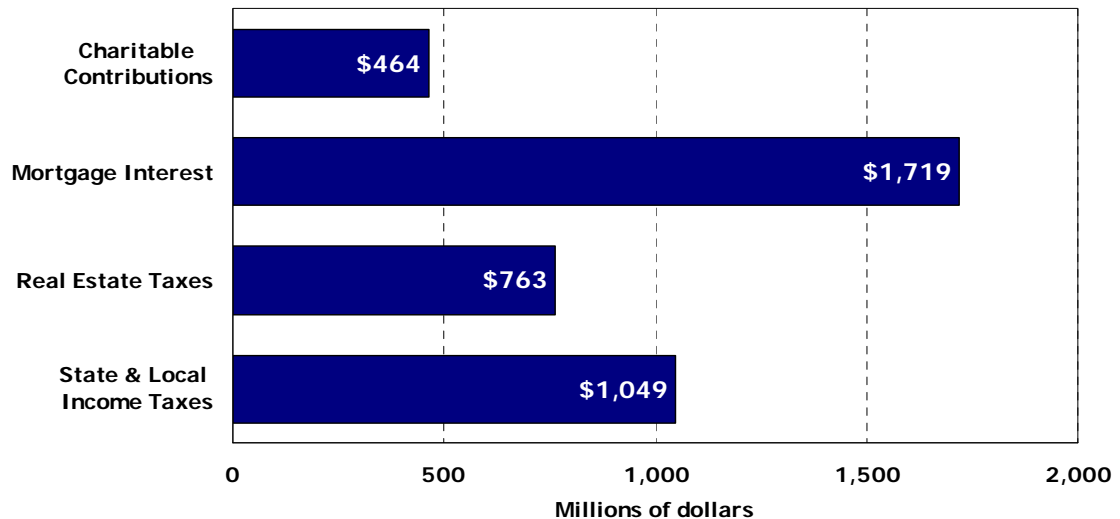
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Governor Carcieri's Tax Proposals - Description

While they would not take effect until 2011, the Governor's FY10 budget would also make a number of dramatic changes to the personal income tax, including:

*...repealing
all itemized
deductions...*

Major Itemized Deductions
Federal itemized deductions claimed by Rhode Island residents, 2006

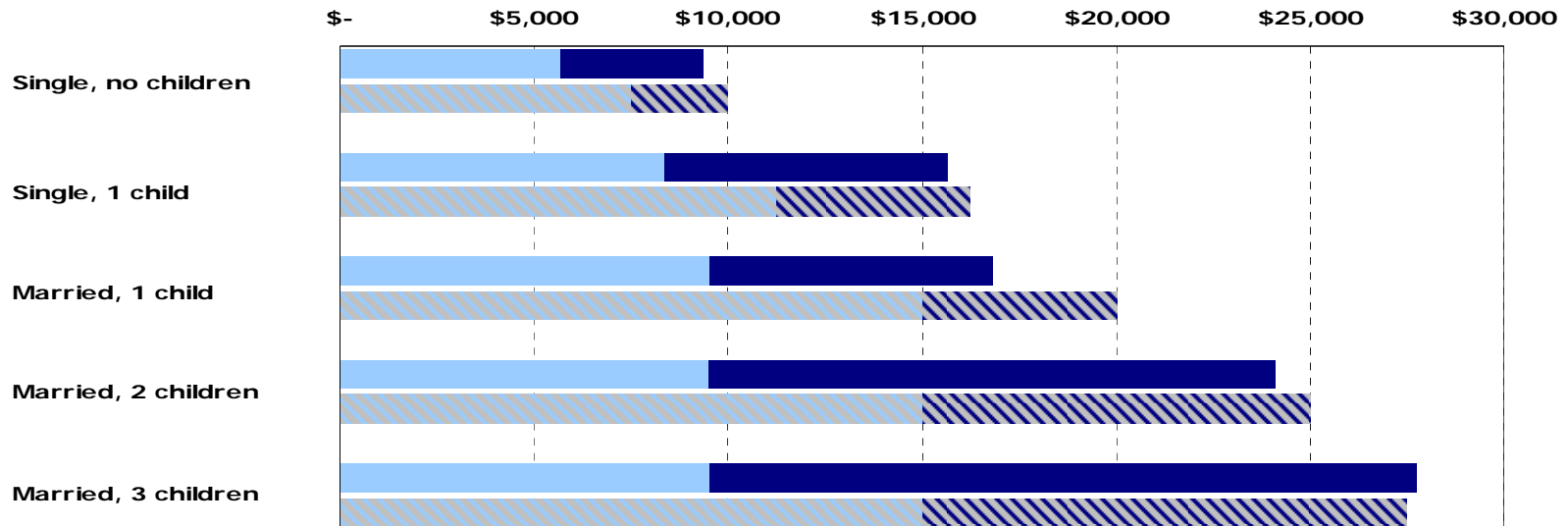


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Governor Carcieri's Tax Proposals - Description

...increasing the standard deduction and reducing the personal/dependent exemption...

Total Standard Deduction & Exemptions
Current Law (2009) vs. Carcieri Proposal



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Governor Carcieri's Tax Proposals - Description

...flattening out income tax brackets...

Current Law - Projected 2009 Brackets
Ordinary Income

Proposed Brackets
All Income

<i>Filing Type</i>				<i>Rate</i>	<i>All Filing Types</i>	<i>Rate</i>
<i>Single</i>	<i>Married Couple</i>	<i>Head of Household</i>	<i>Rate</i>			
—	—	—	3.75%	—	3.00%	
33,950	56,700	45,500	7.00%	55,000	4.00%	
82,250	137,050	117,450	7.75%	110,000	5.00%	
171,550	208,850	190,200	9.00%	175,000	5.50%	
372,950	372,950	372,950	9.90%			

Alternative flat rate of 6.5 percent, ultimately falling to 5.5 percent

No alternative rate

Putting the Pieces Together

Governor Carcieri's Tax Proposals - Description

... eliminating both the alternative flat tax and preferential rates for capital gains ...

Current Law - Projected 2009 Brackets
Capital Gains Income

Proposed Brackets
All Income

<i>Filing Type</i>			Short-Term Rate	Long-Term Rate	<i>All Filing Types</i>	Rate
Single	Married Couple	Head of Household				
—	—	—	2.50%	0.83%	—	3.00%
33,950	56,700	45,500	5.00%	1.67%	55,000	4.00%
82,250	137,050	117,450	5.00%	1.67%	110,000	5.00%
171,550	208,850	190,200	5.00%	1.67%	175,000	5.50%
372,950	372,950	372,950	5.00%	1.67%		

Alternative flat rate of 6.5 percent, ultimately falling to 5.5 percent

No alternative rate

Putting the Pieces Together

Governor Carcieri's Tax Proposals - Description

... repealing most income tax credits and changing RI's two-tiered EITC to be a fully refundable credit equal to 15 percent of the federal amount.

Importantly, modifying the EITC in this fashion could leave some families worse off.

Two married couples, both with two children...

	Family A	Family B
AGI	25,000	32,000
Standard deduction	9,200	9,200
Personal exemptions	14,000	14,000
Taxable income	1,800	8,800
Tax before credits	68	330
<hr/>		
Federal EITC	3,859	2,385
25% of federal EITC	965	596
Non-refundable EITC	68	330
"Remaining" EITC	897	266
15% of "remaining" EITC	135	40
Tax after EITC	-135	-40
<hr/>		
Federal EITC	3,859	2,385
15% of federal EITC	579	358
Tax after EITC	-511	-28

Figures reflect 2008 law.



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Governor Carcieri's Tax Proposals - Evaluation

Governor Carcieri's tax proposals will make RI's budget problems worse – not better – over the long run. In the absence of the cigarette tax increase, they would add to the existing budget deficit.

Tax Policy Workgroup recommendations

Projected FY 2009 impact	-	\$116.2m
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Governor Carcieri proposed FY 2010 Budget

Projected FY 2010 impact	+	\$18.4m
ARRA	-	\$5.1m
Business tax changes	-	\$13.6m
Estate tax exemption increase	-	\$1.5m
Cigarettes & motor vehicles changes	+	\$38.6m

Projected FY 2011-2014 impact

	-	\$???
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ARRA funds exhausted by 2011? By 2012?

Tiered minimum tax does not take effect until 2014

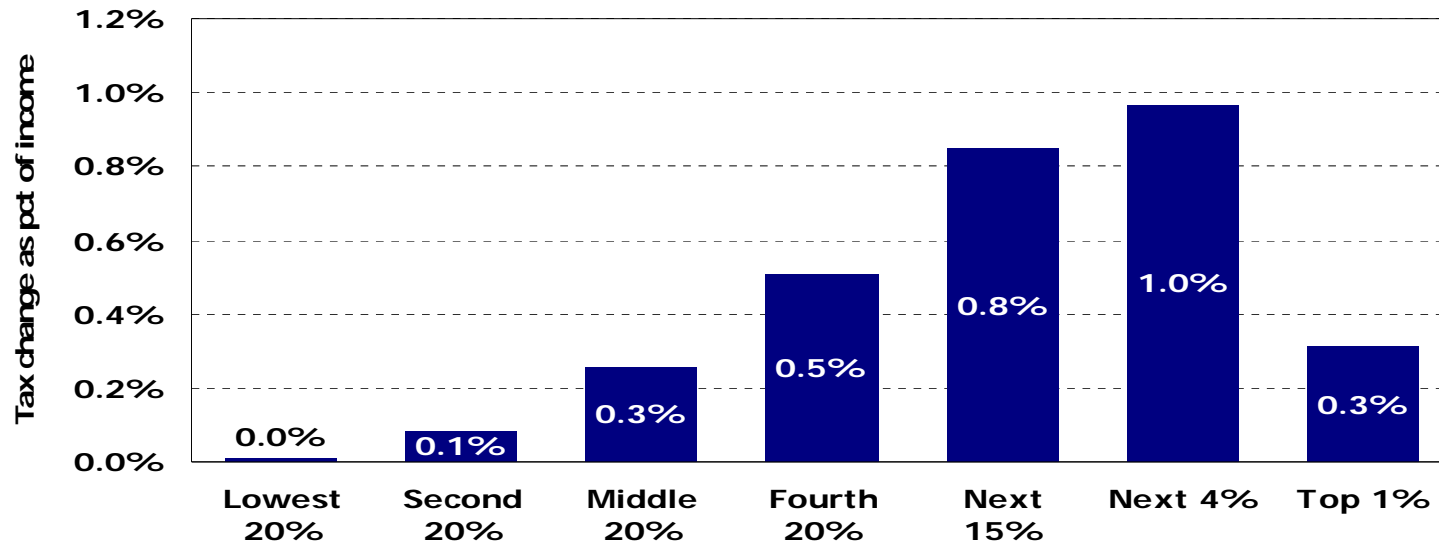
Excise tax yields may decline over time

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Governor Carcieri's Tax Proposals - Evaluation

Some of the Governor's proposals would improve tax fairness ...

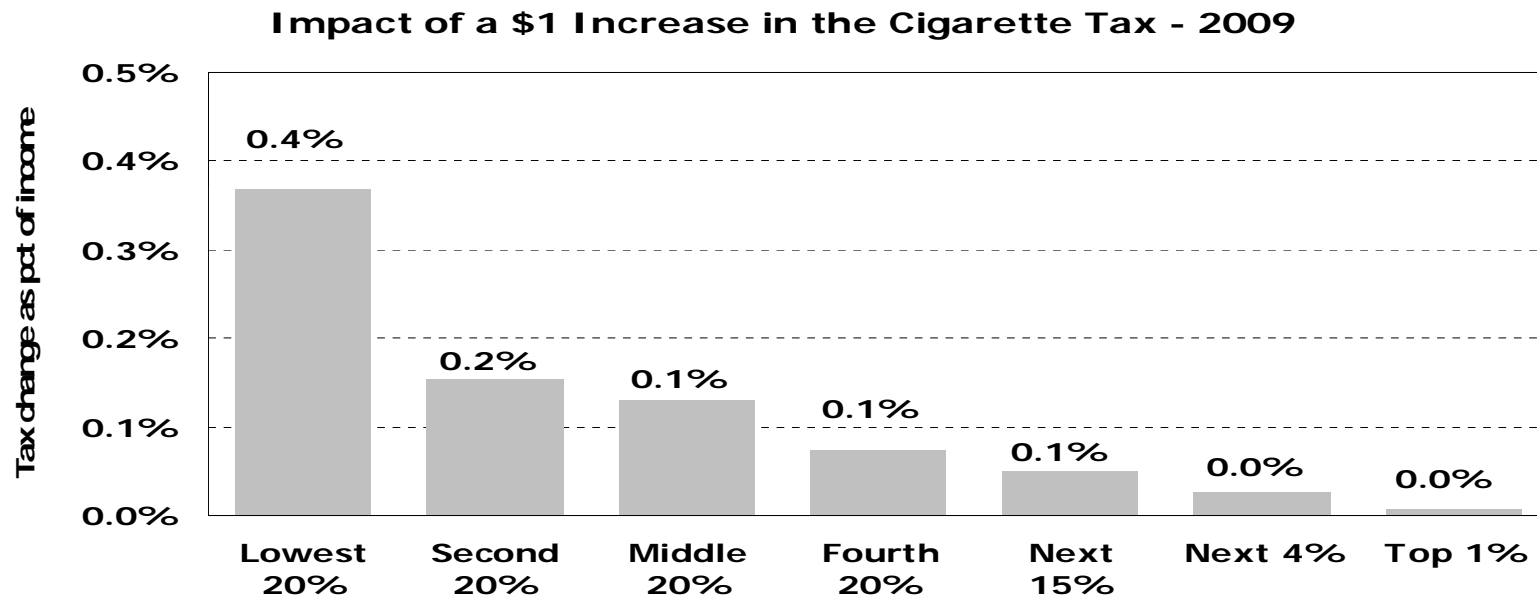
Impact of Repealing Itemized Deductions - 2009



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Governor Carcieri's Tax Proposals - Evaluation

...while others would add to existing inequities.

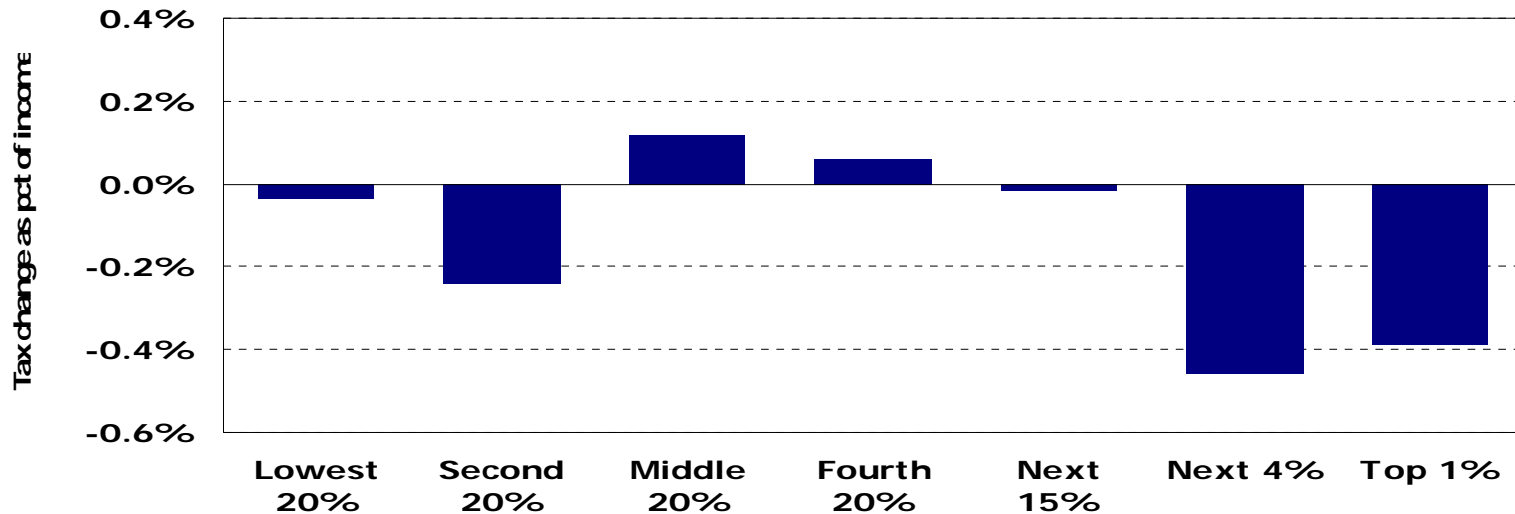


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Governor Carcieri's Tax Proposals - Evaluation

On balance, though, the Governor's tax proposals would likely leave Rhode Island's tax system even less fair than it is already.

Overall Impact of Proposed Carcieri Tax Changes - 2009
excludes repeal of historic restoration & film production credits





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Governor Carcieri's Tax Proposals - Evaluation

Governor Carcieri's tax proposals would address at least one existing inefficiency, leave some in place, and exacerbate another.

*Preferential tax rates
for capital gains*

**All income taxed at
the same rates**

*Most services exempt
from taxation*

**Most services exempt
from taxation**

*Separate entity reporting
favors large, multi-state
enterprises at expense of
small, locally-owned
businesses*

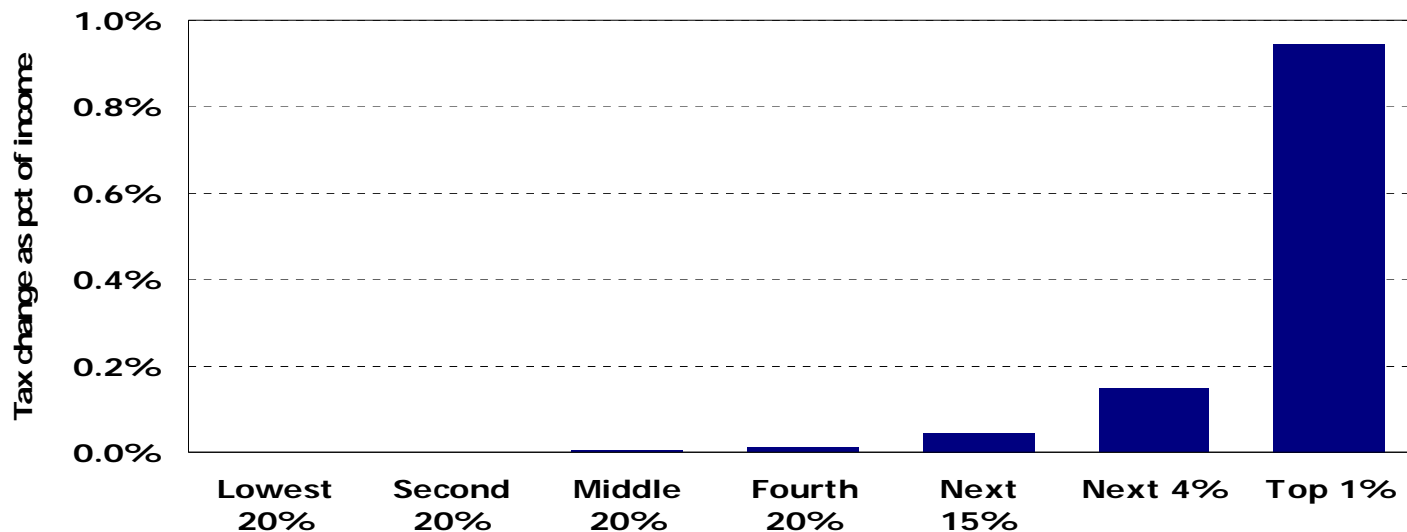
**Tiered minimum tax
provides major tax
reduction for large, multi-
state enterprises at expense
of small, locally-owned
businesses**

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Improving Rhode Island's Tax System

Repealing both the alternative flat tax and preferential tax rates for capital gains – as the Governor and his Tax Policy Workgroup advocate – would generate in excess of \$60 million in 2009, but would affect fewer than 1 in 10 Rhode Island residents.

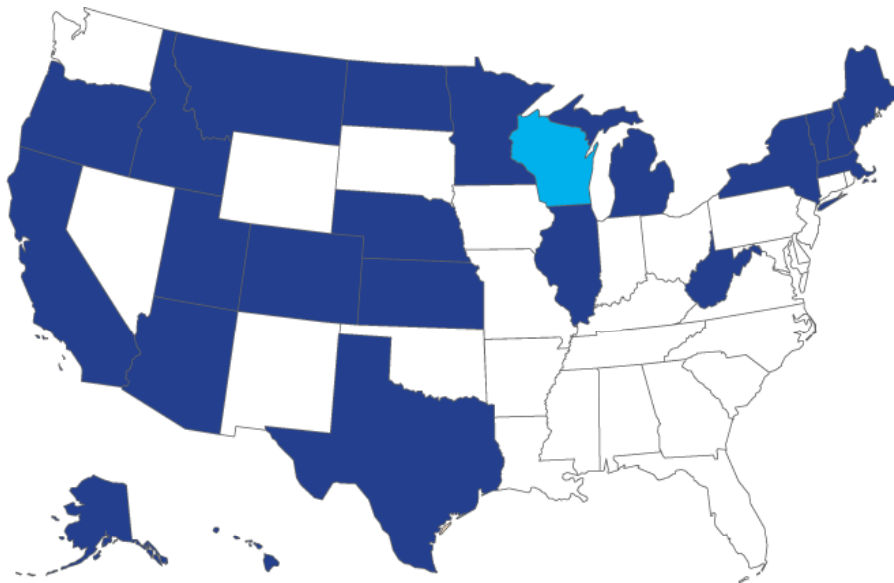
Impact of Repealing Flat Tax & Capital Gains Tax Rates - 2009



Putting the Pieces Together

Improving Rhode Island's Tax System

Adopting combined reporting would nullify a host of tax planning techniques, ensuring that large & profitable businesses pay their fair share and leveling the playing field between multistate and locally-owned and -operated businesses.



Twenty-three of the forty-five states that levy a corporate income tax either use combined reporting now or will use it soon

Three northeastern states – VT, MA, NY – have adopted combined reporting in the last five years