TAXFACTS: CAPITAL GAINS

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Rhode Island cannot afford to eliminate taxes on capital gains.

In 2002, Rhode Island enacted legislation that will phase-out then eliminate taxes on capital gains from the sale of assets held for more than five years (RIGL 44-30-2.7). Capital gains are gains from selling an asset such as a stock, bond or business. Currently, the top tax rate on capital gains in Rhode Island is 5 percent. For the 2007 tax year, the top rate on assets held for more than five years will fall to 1.7 percent then it will fall to zero for tax year 2008.

If allowed to go into effect, RIGL 44-30-2.7 could cost the state tens of millions of dollars in tax revenues beginning in FY 2008. The General Assembly should rescind RIGL 44-30-2.7 this year, so that taxpayers considering selling assets over the next year have adequate notice.

Rhode Island's current capital gains taxes are competitive with Massachusetts taxes.

When the General Assembly agreed to phase-out the income tax on long-term capital gains in 2003, they were reacting in part to similar legislation in Massachusetts. However, Massachusetts has since repealed its elimination of taxes on long-term gains. Currently, Massachusetts taxes short-term capital gains at 12 percent and long-term capital gains at 5.3 percent. In contrast, all capital gains in Rhode Island are taxed at a maximum rate of 5 percent – lower than the lowest Massachusetts rate.

Eliminating taxes on capital gains will benefit only a few taxpayers in Rhode Island.

According to the IRS Statistics of Income, 73.9 percent of all net income from capital gains in Rhode Island was reported by taxpayers with an adjusted gross income (AGI) of more than $200,000 for 2003. This group represented only 1.9 percent of Rhode Island tax returns. The average AGI reported by these taxpayers was $462,755 – nearly 10 times the average AGI on all Rhode Island returns of $47,874. The average capital gain reported by these taxpayers was $78,454. By contrast, the average capital gain reported by all other Rhode Island taxpayers was only $524.

High-income Rhode Islanders already receive generous tax breaks from the federal government.

Since 2001, the federal government passed three rounds of tax cuts benefiting high-income taxpayers – including cuts in the top marginal tax rate, a reduction in the top rate on capital gains and dividend income to 15 percent and a phase-out of the federal estate tax. Currently Congress is considering legislation to extend the reductions in rates on capital gains and dividends, which are now scheduled to end in 2008.

Citizens for Tax Justice performed detailed state-by-state analysis of the Bush administration tax cuts using the widely respected tax model of the Institute for Taxation and Economic Policy. They found that the top one-percent of taxpayers in Rhode Island, with an average income of $923,000 received an average federal tax cut of $49,770 in 2004 and are slated to receive an average annual tax cut of $35,132 for 2005-2010 if the federal capital gains and dividend tax breaks are extended.

Table 1 – Rhode Island Capital Gains By Income Category for Tax Year 2003[i]

INCOME CATEGORY	$0-$50,000	$50,001-$75,000	$75,001-$100,000	$100,001-$200,000	OVER $200,000
Number Of Tax Returns	342,035	70,862	39,262	36,652	9,252
% of Tax Returns Filed	68.7%	14.2%	7.9%	7.4%	1.9%
% Net Capital Gains Reported	1.5%	2.7%	4.3%	17.5%	73.9%
Average AGI	$20,180	$61,393	$86,058	$130,622	$462,755
Average Net Capital Gain Reported	$43	$380	$1,087	$4,691	$78,454
Maximum Tax Owed Rhode Island (5% tax)	$2	$19	$54	$234	$3,922

[i] *Internal Revenue Service, Statistics of Income for Tax Year 2003 and Poverty Institute calculations.*

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