



# The Poverty Institute

at Rhode Island College School of Social Work

## Rhode Island's Tax Ranking in Perspective

Every two years, the Department of Census compiles estimates of state and local taxes throughout the nation. Census figures serve as the basis for the widely cited "tax rankings" that compare tax burdens among all 50 states. In FY 2002, Rhode Islanders paid an average 11.1 percent of their personal income in state and local taxes. This was the 7th highest percentage of the 50 states. This represents a jump from FY 2000, when Rhode Island taxes came in at 12th highest. This issue brief provides information about tax rankings and explains why this change alone should not be cause for concern.

### **I. Rhode Island's FY 2002 rank is probably a statistical anomaly.**

**Rhode Island's tax burden has declined.** In FY 2000, Rhode Islanders devoted 11.5% of personal income to state and local taxes. In FY 2002, taxes claimed only 11.1% of personal income.

**Rhode Island escaped the worst fallout of the 2001 recession.** The recession of 2001 precipitated the worst fiscal crisis for state and local governments since the Great Depression. Thanks to sharp declines in incomes and sales, seven states collected less revenue in 2002 than they had in 2000. In another 18 states, tax collections fell short of inflation. By contrast, during the same period, tax collections in Rhode Island rose 6.2%, nearly twice the national average. This occurred not because Rhode Island lawmakers raised taxes, nor because other states cut taxes. Rather Rhode Island's economy was less dependent on the high-tech and finance industries and thus less hard hit by the recession.

**Rankings of taxes as a percent of personal income can change dramatically when the national economy is unstable.** Over the past five years, Rhode Island

consistently ranked either 11th or 12th in taxes as a percent of personal income. The jump from 12th to 7th in FY 2002 reflects the unsettled fiscal environment of the past few years. Both tax collections and personal income fluctuate sharply during recessions with uneven impact on different states and this causes tax rankings to fluctuate as well. In the wake of the fiscal crisis, twenty states saw their ranking change by at least 5 places; 8 states changed rank by 10 places or more.

**Data for FY 2004 will likely find Rhode Island's rank back near number 12.** Following the fiscal crisis, many states raised personal income taxes, sales taxes and taxes on corporations. Rhode Island increased only cigarette taxes and the business franchise tax, so it is likely that Rhode Island's rank will fall when FY 2004 data is released.

### **II. Public policy should not be based on just one tax ranking using one methodology.**

Tax rankings can provide useful information for state officials interested in comparing their policies with other states. But there are many ways to compare state revenues and each yields different results.

**Taxes are often ranked by population rather than personal income.** Per capita rankings (taxes divided by the state's population) are a more reliable comparative tool, since they are less sensitive to economic fluctuations. Using this method, Rhode Island ranked 12th in FY 2002 and 13th in FY 2000. Over the past decade, Rhode Island's average rank in taxes per capita was 12.

**States are also compared by "own-source revenues" rather than taxes.** Own-source revenues include public college tuition, water, sewage and other user fees, lottery

revenues, and revenue from the sale of public buildings and other assets. The National Conference of State Legislatures points out that many states are relying heavily on such fees and one-time revenue boosters in order to avoid raising broad-based taxes. Rhode Island depends less on such revenues than other states and ranks 33rd in own-source revenues as a percent of personal income.

### **III. All taxes are not created equal.**

Lawmakers need to consider not only how much revenue the government raises, but must also look at the types of taxes collected and whether taxes are levied equitably. Comparing Rhode Island to other states by type of tax suggests that the state relies too heavily on property taxes and too little on business taxes.

Depending on whether taxes are compared by income or population, Rhode Island has the 6th or 7th highest property tax burden in the nation. Property taxes account for 40 percent of all taxes raised by state and local governments in the state.

Rhode Island ranks 46th in corporate income tax collections. The Poverty Institute found that, in 2000, the median tax payment among the state's 64 largest private employers was only \$1825 - half of Rhode Island families paid more than this in state income tax.

Rhode Island ranks 29th or 35th in sales tax collections, again depending on whether one compares by income or population. Though the state's sales tax rate is 7 percent, Rhode Island exempts food, clothing and other necessities from the sales tax, making its sales tax less regressive than in many other states. But Rhode Island also fails to tax most services consumed by upper-income residents, making the sales tax less broad-based than in other states.

On the other hand, Rhode Island ranks 16th or 18th on "selective sales taxes" -- a category which includes gasoline and cigarette taxes. State officials have twice increased the cigarette tax since FY 2002 and FY 2004 data will likely show a jump in this ranking - a matter of concern, as these taxes are particularly burdensome on low and moderate income residents.

## **Conclusion**

As an urbanized, densely-populated state with relatively high costs and a strong tradition of investment in its citizens and families, Rhode Island will probably never rank among the lowest-taxed states in the country. Over the past decade, Rhode Island's state and local taxes have consistently ranked around the 12th highest in the nation. The jump to 7th highest in FY 2002 occurred in the midst of a national fiscal crisis among the states and is probably not significant.

In comparing Rhode Island's taxes to other states, policy makers need to consider a broad range of measures and consider not only how much Rhode Islanders pay on average, but also on how equitably the tax burden is distributed.

**The Poverty Institute** works to promote economic security for low- and moderate-income Rhode Islanders and equitable tax and budget policies through policy analysis, education and advocacy.

The Poverty Institute is housed at the Rhode Island College School of Social Work. The Rhode Island College Foundation, a non-profit organization, is the Poverty Institute's fiscal agent. The Poverty Institute is separately funded by grants and private donations.

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