

The Flat Tax Causing Steep Decline in Revenue

Over the past decade, Rhode Island has given up hundreds of millions of dollars in revenue through a variety of tax breaks of questionable value to the economy. Even before the economic downturn, the state was struggling to maintain adequate funding for vital public services like education, infrastructure, and health care.

To grow our state's economy and help families weather the economic storm, Rhode Island must keep investing in the services that people and businesses rely on. This will require state leaders to take a balanced approach to solving our financial problems. That means making sure each dollar we spend is a wise, efficient investment and that we carefully review our state revenue policies. As Rhode Island faces one of the worst fiscal crises in history, we must consider not only what we spend but also what we give away.

The "flat tax" is one example of a tax break enacted in recent years that is costing the state tens of millions of dollars in forgone revenue. It has no documented benefit to the state's economy and benefits a small number of high income households.

What is the "flat tax"?

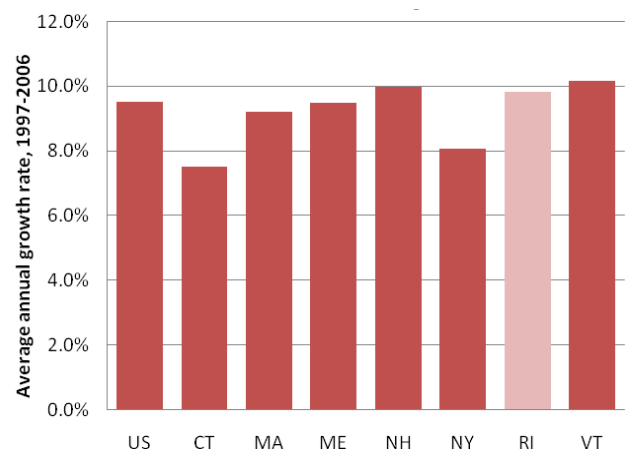
The Rhode Island General Assembly enacted the alternative "flat tax" in 2006. This allows taxpayers to choose either the current tax rate of 9.9 percent with all deductions and credits, or a "flat tax" rate without deductions or credits. Beginning in 2007, the flat tax rate is being gradually phased in. By Tax Year 2011 when the phase in is complete, the rate will be 5.5%. In Tax Year 2010, the flat tax rate is 6.0%.

Flat tax enacted to fix a problem that did not exist

The "flat tax" was enacted based on the premise that offering an alternative tax rate to upper income households would stop these taxpayers from leaving the state.

The notion that wealthy Rhode Islanders were fleeing the state is unfounded. Prior to the enactment of the flat tax, the number of high income taxpayers in the Ocean State and the amount they earn was growing in

NUMBER OF HIGH INCOME RHODE ISLAND TAXPAYERS WAS GROWING BEFORE THE FLAT TAX



line with the regionⁱ. In fact, Rhode Island was outpacing neighbors Massachusetts and Connecticut during this time period.

Furthermore, according to a memo issued by the state's Office of Revenue Analysis, upper income taxpayers do not pay the 9.9% tax rate. Based on actual taxes paid, millionaire taxpayers had an effective Rhode Island tax rate of between 3.1% and 3.6% in 2007.ⁱⁱ

Big cost to state, very few Rhode Islanders benefit

The cost of the flat tax is significant. Since it was implemented in 2007, Rhode Island has given up \$84.6 million. In Tax Year 2010 alone, the flat tax is expected to cost the state \$56.2 million. When fully phased-in this tax break will cost the state close to \$80 million on an annual basis.

Only 2% of taxpayers benefit from the flat tax. More than 90% of those filers earn more than \$200,000 a year and almost half of these taxpayers do not reside in Rhode Island.

FLAT TAX COST CLIMBING

2007 Tax File; As of November 2007

Source: RI Division of Taxation

TAX YEAR	RATE	# OF RESIDENT TAXPAYERS	RESIDENT TAX LOSS (MILLIONS)	# OF NON-RESIDENT TAXPAYERS	NON-RESIDENT LOSS (MILLIONS)	# OF TAXPAYERS	TOTAL LOSS (MILLIONS)
2006*	8.00%	492	\$5.7	1,075	\$1.4	1,567	\$7.1
2007**	7.50%	1,013	\$11.6	1,643	\$2.6	2,656	\$14.1
2008	7.00%	1,616	\$19.3	2,315	\$5.8	3,931	\$25.1
2009	6.50%	2,782	\$30.0	3,245	\$8.3	6,027	\$38.3
Cumulative Revenue Loss Thus Far			\$66.6		\$18.0		\$84.6
2010	6.00%	4,608	\$44.9	4,440	\$11.3	9,048	\$56.2
2011	5.50%	7,509	\$64.1	5,983	\$15.0	13,492	\$79.1
Cumulative Revenue Loss at Full Phase In			\$175.7		\$44.3		\$220.0

*As of 11 Feb 2008

** As of 17 Oct 2008

ⁱ IRS 2006 Statistics of Income.

ⁱⁱ Memo from Paul Dion, PhD, Chief of the Office of Revenue Analysis, RI Department of Revenue to Gary Sasse, Director of the RI Department of Administration and Revenue, April 17, 2009, Updated Personal Income Tax Reform Analysis.