

Is Rhode Island a High Tax State?

In this year's Budget Address, Governor Carcieri rejected the idea of raising taxes to balance the budget, arguing that Rhode Islanders "are already too heavily taxed (with) the 4th highest state and local tax burden in the nation." The figure on which the Governor is basing his FY2005 budget policy comes from the Tax Foundation. Yet the Tax Foundation's numbers do not agree with other widely used rankings of state and local taxes and its methodology fundamentally misrepresents state tax policy -- so much so that Tax Foundation economist Scott Moody acknowledged the rankings "are not useful for policy makers who want to control the tax climate within their state."^{*}

Data compiled by the Federation of Tax Administrators, the Tax Policy Center and the Rockefeller Institute of Government rank Rhode Island's state and local tax burden at either 14, 20 or 32 depending on the specific method used.

Issues with Tax Rankings

To compare tax burdens among the 50 states plus the District of Columbia, most analysts employ a straightforward method: add up all the taxes levied by state and local governments, then divide the results either by each state's population or by each state's total personal income. This method results in the following ranks for RI:

<i>Method:</i>	<i>RI Rank</i>
Total state and local taxes as a percent of personal income	14
Total state and local taxes per capita	14

However, many states wishing to avoid tax increases will raise fees and other costs instead. Public college tuitions and many other user fees function as hidden taxes. A more complete picture of the burden of state and local government combines taxes with these other "own-source" revenues, then divides the result by population or personal income. This method yields the following ranks for Rhode Island:

<i>Method:</i>	<i>RI Rank</i>
Total state and local own-source revenue as a percent of personal income	32
Total state and local own-source revenue per capita	20

Most tax ranking sources, employing widely accepted methodologies, rate Rhode Island's state and local tax burden at either 14, 20 or 32.

Even so, these comparative rankings may paint a misleading picture of the Rhode Island's relative tax burden for the following reasons.

* Phone conversation, 4/15/2004.

First, owners of vacation homes pay local property taxes and tourists pay local sales, hotel and entertainment taxes. When total state and local revenue collections are compared to state income or population, the residents of a state with a significant vacation industry like Rhode Island will appear to have a higher tax burden than residents of a non-tourist state with similar tax levels.

Also, tax rankings are not adjusted for differences in the costs of providing government services. Urban states in the Northeast tend to have relatively high living costs, so that public-sector workers need higher dollar salaries to achieve a living standard comparable to workers in lower-cost states. Relatively expensive states like Rhode Island would therefore be expected to rank higher than low-cost states.

The Tax Foundation Rankings

While all other tax-ranking sources place Rhode Island near the middle of the 50 states, the Tax Foundation ranks Rhode Island near the top. Since 2000, the Tax Foundation has placed Rhode Island at number 4 or 5 each year. But the Tax Foundation's methodology is highly misleading and greatly exaggerates the burden that *Rhode Island* state and local taxes impose on Rhode Island residents.

The Tax Foundation's rankings diverge sharply from other sources because, using a complex economic model, it allocates taxes paid by corporations operating in multiple states to the state where the tax is presumably paid, rather than to the state where the tax is imposed and collected.

For example, Alaska levies taxes on oil producers, generating nearly \$2b in revenue each year. For 2000 (the most recent year for which complete data is available), the Federation of Tax Administrators charged this \$2b to Alaska and ranked Alaska #1. The Tax Foundation attributed it to oil consumers throughout the nation, ranking Alaska #50 and frigid Maine at #1. (Cold Rhode Island came in at #5, by the Tax Foundation's method.)

Delaware has lenient corporate tax laws which allow companies to set up "passive investment" subsidiaries and evade taxes levied by other states. Several thousand such firms are registered in Delaware where they pay only a flat licensing fee, earning the state about \$500m annually. The Federation of Tax Administrators credits this \$500m to Delaware and ranks Delaware #4. But because these firms are mostly mail-drops without employees or sales, the Tax Foundation charges it to the employees, shareholders and customers of firms using Delaware tax havens – including Rhode Islanders – and ranks Delaware #48.

These adjustments for corporate taxes account for the jump in Rhode Island's rank on "state and local taxes as a percent of personal income" from #14 to #5. Each time Rhode Islanders buy heating oil, fill up their gas tank, shop at Toys'R'Us, or eat at Burger King, part of the price they pay covers business taxes in states like Alaska and Delaware. The Tax Foundation adds this to Rhode Island's total "state and local taxes," though Rhode

Island policy makers have no control over Alaska's, Delaware's or any other state's tax policies.

Conclusion

When one looks at the taxes local governments levy on local residents – the only taxes for which local officials can or should be held accountable, Rhode Island ranks #14. When analysts add in other charges that local residents pay, which can be as onerous as taxes and for which local officials are also responsible, Rhode Island ranks #20 on a per-capita basis and #32 as a percentage of personal income. All these measures place Rhode Island near the middle of the 50 states. When one considers that some of these taxes are paid by out-of-state residents with vacation homes in Rhode Island and that Rhode Island is a densely-populated state in the expensive Northeast metropolitan corridor, Rhode Island's tax burden does not seem out of line.

State and local officials should certainly be attentive to Rhode Island's comparative standing with other states. But critical policy decisions should not rest on one number, especially when that number derives, like the Tax Foundation's ranking, from very questionable methodology.

Data Sources

The Federation of Tax Administrators, Washington D.C.

<http://www.taxadmin.org>

The Rockefeller Institute of Government, Albany, NY.

<http://stateandlocalgateway.rockinst.org>

The Tax Foundation, Washington, DC.

<http://www.taxfoundation.org>

The Tax Policy Center, Washington D.C.

<http://www.taxpolicycenter.org/taxfacts>

All these organizations compile their data from the US Census and from state and local government agencies. Population data comes from the US Census and data on state personal income from the US Dept. of Commerce, Bureau of Economic Analysis

Tax Ranking Tables

Table 1. State and Local Taxes as a percent of Personal Income

Source	Description	Rhode Island's rank
Federation of Tax Administrators	State and local taxes as percent of personal income – 2000	14

Rockefeller Institute of Government	Same as above	14
Tax Policy Center	Same as above	14
Tax Foundation	Same as above, with adjustments made for taxes paid by multi-state businesses	5

Table 2. State and Local Taxes Per Capita

Source	Description	Rhode Island's rank
Federation of Tax Administrators	State and local taxes per capita – 2000	14
Rockefeller Institute of Government	Same as above	14
Tax Policy Center	Same as above	14
Tax Foundation	No comparable data	n.a

Table 3. State and Local Own Source Revenue as a Percent of Personal Income

Source	Description	Rhode Island's rank
Federation of Tax Administrators	State and local own source revenues as a percent of personal income – 2000	32
Tax Policy Center Government	Same as above	32
Rockefeller Institute of Government [†]	State and local general revenues as a percent of personal income - 2000	29
Tax Foundation	No comparable data	n.a.

Table 4. State and Local Own Source Revenue per capita.

Source	Description	Rhode Island's rank
Federation of Tax Administrators	State and local own source revenue per capita – 2000	20
Tax Policy Center Government	Same as above	20
Rockefeller Institute of Government	State and local general revenues per capita – 2000	22
Tax Foundation	No comparable data	n.a.