Some Options for Increasing Revenue

The May revenue estimating conference has determined that there will be a significant shortfall in the FY03 revenues, and an even more precipitous decline in the FY04 collections. The Poverty Institute provides the following options for some revenue enhancements and savings for consideration.

The Governor's budget already acknowledges that we can't get through the next fiscal year without some new taxes. Table 1 contains a summary of the significant sources of tax revenue the state receives. (Note that only $6.6 million of the gas tax goes into the General Fund. Three quarters of the remainder goes directly to the Department of Transportation (DOT), and what's left is split between RIPTA and the Department of Elderly Affairs [ES102][1].) The substantial changes in law are with respect to gambling, where the Governor proposes renegotiating the state's take of the video poker games at Newport Jai Alai and Lincoln Park (the number of terminals will increase, too), and dramatically increasing taxes on cigarettes, a regressive tax.

Part of the change in the Business Corporations Tax comes from a change in the way manufacturing firms are to estimate how much business they do in Rhode Island. This will result in a $2 million loss to the state [B28], though the promise is that the decrease will make enough other firms settle here to make up the loss, eventually. There is no promise of a single job, nor any accountability built into this tax break in the Governor's budget.

The change in the "department receipts" category comes from such changes as an increase in the filing fee for mutual funds and real estate licenses ($3.7 million [ES50]), increases to the fees for hunting and fishing licenses ($451,000 [ES98]), as well as shellfishing and marine licenses ($292,000 [ES98]), and adjustments to Medicaid uncompensated care calculations.

[1]These are page numbers referring to one of the volumes of the budget. "ES" is the Executive Summary volume. "B" is the Budget, "CB" the Capital Budget, and so on.

	FY01	FY02	FY03	FY04
Income Tax	913.8	808.2	808.9	853.0
Sales Tax	712.6	745.7	778.2	810.6
Lottery	180.7	214.1	238.5	342.3
Dept. Receipts	261.7	244.3	284.0	290.0
Gas Tax	130.8	140.0	125.2	142.0
Cigarettes	60.1	85.5	96.5	104.8
Public Utilities	82.1	80.8	74.0	77.8
Motor Vehicles.	44.4	45.8	46.8	48.2
Ins. Corp. Tax	37.5	32.4	49.5	50.6
Bus. Corp. Tax	68.8	32.7	64.0	64.8

Table 1: State taxes. Bold face indicate the taxes whose change stems from a change in the law. Updated figures for FY04 were not available.

The budget projections presented for FY05 and beyond apparently depend on income tax collections predicted to rise at 150% the rate of increase of personal income. That is, income taxes are predicted to rise faster than the income taxed. [ES118 and ES121] Presumably this is part of the reason the FY05 deficit is now predicted to be only $24 million [ES116] as opposed to the $215 million predicted just last year [ES116/FY03]. Even with this source of money, the years FY05 and FY06 are both scheduled to end in deficit.

Revenue Proposals

Rhode Island's problem is not a lack of discipline in spending. From 1990 to 2000 (the most recent year for which nationwide comparisons can be made), per capita state government spending (inflation-adjusted) rose by 29.2% across the United States, while in Rhode Island it rose by only 11.0%, the sixth-lowest rate of increase among all the states, and well lower than any other New England state. The problem is that we've starved ourselves of the revenue we need through the tax cuts of the 1990's.[2]

Following is a list of tax proposals for raising the revenue needed to begin to get our state's government back to fiscal responsibility.

Tax Amnesty Program In 1996, Rhode Island had a tax amnesty, to allow businesses and individuals delinquent in their taxes to pay up with no or reduced penalties. The effect of the tax amnesty was to raise $7.9 million. It has been long enough since 1996 that it is worth considering having another.

Decrease Tax Breaks for Gambling There is a tax preference in place that favors business income from Simulcast and pari-mutuel betting over other gambling income. This tax preference costs $14.8 million each year.[3]

Kennel-Owner Subsidy According to statements from the Governor, this subsidy will be ended this year. But the existence of this subsidy is essentially a matter of negotiations between the Lottery Commission and Lincoln Park, and it is specifically referenced in the Lottery Commission presentation [B456]. The Lottery terminals are there at the permission of the state. If Lincoln Park wants to spend its share on subsidizing kennel owners, that is their prerogative. But a subsidy like that has no place in public policy.

Rental Vehicle Surcharge When you rent a car at T.F. Green airport, the 6% rental vehicle "surcharge" is split between the state and the rental car companies. The rental car companies' share of this money is earmarked for Warwick property taxes and licensing fees, and the companies must refund any portion that isn't used for that purpose. That is, it's meant as an incentive for rental companies to register their cars in Warwick. The tax raises $3.3 million (it's lumped with the Motor Vehicles tax in budget tables [B24] and in table 1). This is only a little more than 50% of the tax collected, so the state could raise up to $3.3 million by appropriating some or all of the rental companies' share, but the bulk of this money will have come from Warwick.

Fix Withholding from S Corps and Partnerships S Corporation and Partnership owners who do not live in Rhode Island are still supposed to pay income tax on the partnership's earnings in RI. Currently there is no requirement that the S corporation or partnership withhold RI taxes from payments it makes to its owners. RI should establish such a requirement to ensure that partnership and S corporation owners pay the RI tax that they owe.

Stem the Erosion of State Corporate Taxes

Amend business corporation tax to fix out-of-state loopholes.

Close the PIC Loophole Right now, a "passive investment company" can be used to avoid substantial RI Business Income Taxes. A business here might claim that some PIC incorporated in Delaware owns the intellectual property rights to its product, and that it must pay a licensing fee to the PIC. This can soak up all the income from the local business, and move it to Delaware, which has no corporate income tax. Thirty-one states have acted to close this kind of loophole, and RI should do so as well. (Senate bill S794 does this.)

[2] Another report from the Poverty Institute documents this. See "Where Did The Money Go? Rhode Island Revenues and Spending 1993 to 2003" at www.povertyinstitute.org.

[3] Tax Division Tax Expenditure Report 1998, p.25. Updated in 2002 report, see table, p.5

Establish a "Throwback" Rule The federal rules (established by regulation and court decisions) that define what part of a corporation's income comes from which states is imperfect, and often leaves income allocated to a state in which a corporation has no "nexus"—some kind of presence, such as an office or factory. A corporation without a nexus in a state cannot be taxed in that state. This often leaves income untaxable by any state. Rhode Island should establish a "throwback" rule to apply to corporations based here that would require that income not taxed by other states should be taxed here. Twenty-five states with corporate income taxes have this rule. (House bill H5612 does this.)

Fine-tune Business Income Definitions Rhode Island's definition of what constitutes "business income" for purposes of taxation seeks to maximize the definition for out-of-state companies by defining all corporate income as subject to taxation. This includes irregular income, such as from the sale of a subsidiary or of real estate, that may not be part of a company's regular business. In so doing, however, Rhode Island creates a situation where companies based here can easily create irregular income apportionable to no state, and thus taxable by no state. Rhode Island's definition of business income should be changed to reflect the decision in the 1992 Supreme Court case, *Allied Signal v. New Jersey*.

Estimates from the Center on Budget and Policy Priorities are that Rhode Island could realize as much as $8 million in revenue by closing the previous three corporate tax loopholes.

Income Tax Bringing back the income tax to the levels of 1996 (a 10% increase) would produce nearly $85 million in additional revenue. Applying this increase only to the upper half of all taxpayers would raise about $76 million. Table 2 shows the amount of money that would be raised by different increases in the personal income tax, when applied to taxpayers earning more than the given amount for all categories.[4]

	Increase (millions)				
Income	**10%**	**8%**	**6%**	**4%**	**2%**
all	85	68	52	34	18
$30,000	84	67	51	33	17
$50,000	77	61	46	33	16
$75,000	62	50	37	25	13
$100,000	54	44	33	21	11
$150,000	44	35	26	18	9
$200,000	37	29	22	15	8
$500,000	24	20	15	10	5

Table 2: Income tax projections for tax increases applied to all taxpayers above a given level of AGI. A 10% tax increase would restore the tax to the levels of 1996, or a rate of 27.5%. Increases of 8%, 6%, 4%, and 2% would correspond to rates of 27%, 26.5%, 26%, and 25.5%, respectively.

Realty Capital Gains Rhode Island's housing market is once again in sad shape as it heats up. There is a dire shortage of affordable housing in Rhode Island, and overheated markets are a big part of the problem. There is a need for public policy to throw some water on this fire. A land speculation tax, of 70% on the capital gains of any residential property held less than one year, 50% on property held between one and three years and 25% on property held between three and six years, could raise as much as $15 million.[5]

Realty Transfer Tax In 2002, there were over $2.8 billion in residential real estate sales in Rhode Island. Each additional dollar on the realty transfer tax will raise $2.8 million. Exempting homes below the median (about $188,000 for a single-family home) will raise approximately $2.2 million.

[4] The AGI amount given is for joint filers. The thresholds for single filers would be slightly lower, as in the current tax code. Data for this and the following from IRS statistics (00in40ri.xls. See www.irs.gov/taxstate/article/0,,id=103106,00.html).

[5] Data from www.riliving.com and the US Housing Census (RI data from 1997). Vermont has a law like this one.

Broadening the Sales Tax The sales tax avoids some categories that could raise significant income.

- Broaden the sales tax to take in recreational activities. This includes country and dinner club memberships, gyms, marinas. This would raise $5.6 million.[6]
- Repeal various exemptions in the sales tax that do not have an apparent economic benefit to the state, do not promote a "public good" or where the exemption is a unique exception in a category of similar items that are not exempt. Such items include horse food, florist supplies, tangible property for jewelry displays, coins, precious metal bullion, private camps, some types of non-returnable containers, installation labor, pool water, gasoline used for aircraft. (Estimated revenue: $3-4 million.)
- In an attempt to make the regressive sales tax slightly more progressive, sales of clothing and shoes are currently exempt. Applying the tax to clothing and shoes priced at over $200 would be a progressive change to the tax, and could raise a significant amount. (Reported statistics do not allow reliable estimates of the revenue to be earned by this change.)

[6]The estimate leaves aside municipal courses, and non-profit gyms like the YMCA. The data used for these projections are from the 1997 economic census, at http://www.census.gov/epcd/ec97/ri/RI000.HTM.

Other Options

Duplication of State Services

The Governor's Fiscal Fitness commission is examining ways to make state government more efficient. The following are some spending suggestions that deserve consideration:

- The state supports two television stations: Channel 36 [B304, P304] and Capitol TV [P85]. Channel 36 has a more substantial capital investment, but the general revenue contribution to the two is comparable. It is not possible from the published budget documents to find the capital budget of Capitol TV, which is just a part of the Joint Committee on Legislative Affairs [B136]. Capitol TV is essentially dormant for several months of the year, when the legislature is not in session. Allowing Channel 36 to take over the Capitol TV functions could provide capital equipment and management savings, and provide Channel 36 with extra resources it could use for the time that the Legislature is not in session.
- State government contains two elections agencies: the Secretary of State's office, elections division [B154,P99] and the state Board of Elections [B176,P118]. Roughly, the division of labor is that the Secretary of State's office prepares elections—printing ballots and voter guides—and the Board of Elections manages them—training poll workers, and collecting the results. But the situation also provides confusion and diffusion of the ultimate responsibility for our elections. The two should be combined.
- There are three distinct environmental agencies in the state: DEM [B372] and the Coastal Resources Management Commission [B380,P384], and the State Water Resources board [B382,P386]. CRMC, whose mandate

includes inland waters as well as the coastal ones, is supposed to provide a forum to allow expert opinion to help make policy. But that's also a function of the State Planning Council. The same argument is made in support of an independent Water Resources Board, and the same argument can be made to oppose it. In addition to the possible duplication of effort, making plans for state function in a context isolated from other state departments is an ideal way to foster confusion and conflict. These agencies should be combined into one organization with no overlapping mandates. The planning function should be restored to the State Planning Council, where interdepartmental policy conflicts can be hammered out.

Capital Projects

The "Rainy Day" fund (also called the "Budget Stabilization Fund") is made up of unbudgeted general revenue funds. That is, 2% of the revenue budget is withdrawn from the budgeting process and put in a separate account, called the Rainy Day Fund. When the account balance reaches 3% of general revenue, the remainder is available to be spent on either debt service or capital projects. The Fund balance is close to full (3%), so most of the money is available to be spent on debt service or on capital projects. This money is called the "Capital Plan" fund, and represents The Governor's budget envisions the bulk of the Capital Plan money being spent on capital projects [ES116] rather than debt service.

A capital project is an investment now where the payoff will be realized over several years. For example, a building may cost $2 million in one year, but its benefit will last over many years. Other common capital expenses are HVAC systems for buildings or restoration of older buildings. This is in contrast to expenses like salaries, or income supports, where the expense and the benefit are realized in the same year. Because of this difference in the nature of capital projects, capital expenses are presented in a different budget. The norm for the state is to borrow for capital expenses, but the state has already done much borrowing, and is currently trying to shift many capital expenses onto a "pay-as-you-go" basis.

Capital projects are presented as something quite separate from ordinary budget line items, but the difference is not really so distinct. There are many eligible capital expenses lurking in the rest of the budget. Low-income housing, school building aid, and public transit improvements are all capital projects rarely considered to be acceptable candidates for inclusion in the state's capital budget. Even economic development investments, environmental cleanups, and some kinds of education spending can justifiably be considered investment.

- In the Capital Plan budget, there are a host of air-conditioning projects, along with parking-lot repaving at the state house, and $4 million for the the Legislative office building [CB162ff]. Because of the Rainy Day constitutional amendment, this money must go to capital projects. But housing is a capital project: trim the air-conditioning projects, and put the investment parts of the $5 million of Housing Resource Commission money [CB36 and B450] into the Capital Plan Fund. This will free up $4-5 million in general revenue for other things.
- Furthermore, while it is true that the Capital Plan money is only to be used for capital projects, these can be defined more usefully. For example, we spend $750,000 each year on "environmental compliance" from that fund [CB162 and CB35]. This is money (well-spent money) that goes into looking after underground storage tanks and similar environmental threats. That is, this is money spent that produces lasting benefits, worth considering as capital investment. In a similar vein, the Slater Center investment [B444] could be moved to the Capital Plan fund,

which would free up $5 million of general revenue for other things.

Transportation

The state continues to waste huge sums at the Department of Transportation. DOT is planning to borrow at least $30 million every year for the foreseeable future. If we could avoid borrowing this money, it would save us almost $3 million in FY04 in debt service on this money. For example, moving I-195 is projected to cost the state $30 million every year through 2013. (Around $3-4 million per year is borrowed for this project alone.) In addition, we are spending $11-12 million in FY04 alone to build a highway to Quonset without a clear plan why.

DOT debt is getting paid down to some extent. There are bond issues being retired, most notably by the huge defeasement of bonds from the tobacco-securitization business in FY03. But the fact that a budget line is currently declining doesn't mean that it's on its way to zero, and this one is not. At the rate we're going, in 15 years we'll pull down the annual debt service costs from about $120 million/year to around $95 million/year. This means we'll be paying $95 million each year in order to spend $30 million.

In light of these facts, the idea of accelerating the pace of borrowing, against future federal largesse, seems ill-advised [CB99]. Current practice at DOT is that almost all federal funds are matched with borrowed money. The "GARVEE" program, proposed to help address capital needs right now (replacing the Sakonnet River bridge, the Freight Rail Improvement Project, the road to Quonset, I-195, and repairs to the Washington Bridge) would have us borrow against future federal highway money that we generally borrow in order to receive [ES102]. This does not seem the best way to preserve scarce resources.

Compiled with data from Tom Sgouros and Gerry Billings