

Benefit, cost of tax cut plan debated

An economist says a flat income tax would only reward the richest state residents, but the economic development chief says Rhode Island has a "perception problem" when it comes to taxes.

01:00 AM EDT on Thursday, April 6, 2006

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PROVIDENCE -- Economist Ellen Frank came armed yesterday with charts and graphs and studies that argued her point: that cutting the personal income taxes paid by the wealthiest Rhode Islanders will do little to nothing to produce new jobs.

She told a House-Senate committee that Rhode Island is already "business-friendly," that the state ranked "dead last" in a 2003 study of corporate tax burdens and that the median corporate tax by the state's largest employers was less -- at \$1,825 in the year 2000 -- than the median a joint-filing couple paid in personal income taxes.

She also posed this overarching question about the estimated first-year revenue loss from the high-end tax cut that House Democratic leaders are promoting: "There are many ways to spend \$10 million; is this the best way?"

Her answer, as the senior economist at Rhode Island College's Poverty Institute: an emphatic "no."

In his turn at the podium, state Economic Development Director Michael McMahon told the lawmakers he, too, could have brought "lots of studies," but didn't because "we also have common sense."

And, "what does our common sense tell us?" he asked rhetorically. "Being on the front-page of the Wall Street Journal as having one of the highest marginal tax rates creates a negative impression for Rhode Island. Perception influences reality."

McMahon said Rhode Island is mired where Massachusetts was more than a decade ago when it was widely known as "Taxachusetts." It has a "perception problem" that will continue to scare away the multimillionaires who make job-creation decisions until it takes steps to earn this front-page headline in the Wall Street Journal: "Rhode Island Taxes: Reasonable and Fair."

In their own version of TV's point-counterpoint, the two adversaries in the tax war -- McMahon and Frank -- were given an hour to argue the pros and cons of the centerpiece of House Speaker William J. Murphy's tax-cutting package to a Joint Committee on Economic Development.

The bill, as written, would give taxpayers the option of paying a new flat income-tax rate that would start at 7.5 percent and drop to 5.5 percent over 5 years.

Estimates are this rate reduction would cost the state anywhere from \$8 million to \$14 million in lost revenue the first year alone, and the lawmakers have not yet said how they hope to make up the loss while wrestling with multimillion-dollar projected deficits this year and next.

In 2010, the estimated revenue loss is \$75 million.

And the rate reduction would not affect the vast majority of Rhode Island taxpayers, who currently pay graduated rates that range from 3.75 percent on their first \$49,650 in adjusted gross earnings up to 9.9 percent on every dollar over \$326,450.

Study after study has indicated that the tax burden on Rhode Islanders with incomes below \$250,000 is less under the current system than it would be in Massachusetts or Connecticut.

But Rhode Island's 9.9 percent top marginal rate is the eye-catcher that always looks and sounds worse, at first blush, than Massachusetts' 5.3 percent flat-rate.

The Democratic leaders' bill would give each taxpayer the choice to pay this graduated tax or the new flat tax.

One of Frank's missions yesterday was to try to debunk the myth.

She showed, side by side, how much two couples with \$500,000 in adjusted gross income might pay in personal income taxes in Rhode Island, which allows itemized deductions for such things as mortgage interest, and Massachusetts, which doesn't. (The Bay State also taxes capital gains at a higher rate.)

Her conclusion: the couple with that half-million-dollar income in Rhode Island, \$66,567 in itemized deductions and \$84,726 in reduced-rate capital gains would pay \$29,509 in state taxes in Rhode Island, compared with \$28,578 in Massachusetts.

She questioned whether this difference was worth the lost millions in "needed" state revenue? She cited the findings of a recent state Division of Taxation study: \$111 million in lost revenue in 2004, to a plethora of existing tax incentives for economic development.

And she argued that there is no evidence that the vast majority of these "incentives" have any impact.

McMahon did not argue with her numbers. Of her concern for the loss of revenue, he said: "Phase it in over several years and also phase out some of the tax breaks we cannot be sure are having a positive impact." Asked for an example, he said: "sales tax." He did not elaborate.

But they sharply differed on whether the tax cuts should be available to one and all -- or targeted.

Her argument: "If tax breaks are used as an economic development strategy, they should be explicitly tied to wage-and-job quality standards" and include "clawback provisions" that enable the state to recoup the lost revenue if a company does not keep its promises.

At least," she said, "that gives you a piece of paper that says what you are getting" in return.

But McMahon said that would keep Rhode Island in the let's-make-a-deal business without changing the "perception" that stops most decision-makers from even considering the state as a place to expand or set up shop.

As McMahon wound down, Sen. Walter Felag, D-Warren, asked: "You are talking about perception; what does your data show in terms of reality?"

McMahon said state-by-state comparisons, such as the one Frank showed them, aren't relevant because "the people who make the decisions make a lot more than \$500,000," and they are not "coupon-clippers" living off dividend checks.

"Are these big jobs?" asked Rep. Joseph Almeida, a Providence Democrat who represents one of his city's poorer neighborhoods. McMahon's response: "One size doesn't fit all. One action doesn't solve [all] problems."

He said the first step is fixing what "isn't working" in the urban schools.

Frank gave the lawmakers this projection to chew on: the state would need to increase its job production by 50 percent next year -- and add 2,300 more new jobs that pay \$35,360 on average -- to recoup the \$9 million in lost tax revenue. Frank was skeptical.

But McMahon's response as the debate continued during and after the hearing: "All I know is our budget deficit has been swelling per capita more than any other. Our new company formation has been anemic. . . . We are fighting over smaller slices of a smaller pie, instead of growing the pie. If people think there's a budget deficit to contend with today, wait three years."