

Rhode Island should not cut personal income taxes of top earners in the state as it is unnecessary and unaffordable.

High-earning Rhode Island families pay only slightly more than they would pay in Massachusetts once differences in the two state's tax systems are taken into account. In a 2006 *Boston Herald* article on the Rhode Island economy, Rhode Island's Economic Development Corporation executive director Michael McMahon pointed out that "various deductions knock (the top personal income tax rate) down to about 5 to 5.5 percent in reality."¹

Further, given the current deficit of \$220 million, the state cannot afford to lose any more revenue. Because Rhode Island's personal income tax is progressive, cutting rates at the top could cause severe revenue losses which the state can ill afford. Cutting the top rate from 9.9 to 7.5 percent could cost the state as much as \$10 million in revenue next year. This would result in an average tax break of \$1077 for the 9282 taxpayers who earn more than \$200,000.

Advocates of cutting Rhode Island's top tax rate argue that high top tax rates drive high earners out of the state and inhibit economic development. Research has found, however, that progressive personal income taxes do not stifle job growth. Furthermore, there is no evidence that top tax rates are causing people to move from Rhode Island to Massachusetts. From 2000 – 2004, more taxpayers moved from Massachusetts to Rhode Island than vice versa and those entering the state had a higher median income than those leaving.

High income families in Rhode Island are already doing well. In the past two-decades, their incomes have risen 4 times as fast as middle-class families in the state and they have received generous tax cuts from the federal government.

High income Rhode Islanders pay only slightly more income tax in Rhode Island than they would pay in Massachusetts.

Massachusetts has a top marginal tax rate on wage and salary income of 5.3 percent, compared to Rhode Island's top marginal rate of 9.9 percent. However, looking only at the top rate on wage and salary income vastly overstates the difference in taxes that high-earners actually pay.

Massachusetts taxes interest, dividends and short-term capital gains at 12 percent and long-term capital gains at 5.3 percent. In contrast, Rhode Island taxes interest and dividends at the same rate as wage and salary income – at a maximum rate of 9.9 percent. Capital gains in Rhode Island are taxed at rates ranging from 2.5 to 5 percent. According to the IRS Statistics of Income, 1.9 percent of Rhode Island taxpayers reported Adjusted Gross Incomes (AGI) of over \$200,000. These taxpayers derived an average of 49 percent of their income from wages and salaries and 23 percent of their income from dividends, interest and capital gains.

Also of importance to high income taxpayers is that unlike Massachusetts, Rhode Island allows deductions for property taxes, mortgage interest and charitable contributions. IRS data shows that 97 percent of Rhode Islanders with AGI of \$200,000 and above itemized deductions, 94 percent deducted property taxes and 95 percent deducted charitable contributions.

In addition, Rhode Island allows numerous federal credits against taxes that Massachusetts does not allow and permits many state tax credits that primarily benefit upper-income taxpayers, such as the historic residence tax credit.²

As a result, actual tax rates paid by upper income RI taxpayers are only slightly above rates paid to Massachusetts. In a 2006 *Boston Herald* article on the Rhode Island economy, Rhode Island's Economic Development Corporation executive director Michael McMahon pointed out that "various deductions knock (the top personal income tax rate) down to about 5 to 5.5 percent in reality."³

A Poverty Institute analysis of data from the Rhode Island Division of Taxation confirms this. Rhode Island taxpayers earning more than \$1 million in 2002 paid an average income tax rate of 5.8 percent. The Institute for Taxation and Economic Policy estimates that, in 2002, the top one percent of Massachusetts taxpayers (with an average income of \$1.3 million) paid 5.1 percent in income taxes.

Table 1 – Average Tax Rates Paid by Upper-Income Taxpayers in Rhode Island for Tax Year 2002

AGI Range	RI Income Tax Liability as a Percentage of AGI	RI Tax Net of Credits as a Percentage of AGI
\$100,001 – \$200,000	4.1%	3.5%
\$200,001 – \$500,000	5.8%	5.1%
\$500,001 – \$1,000,000	6.9%	6.0%
\$1,000,001 – \$5,000,000	7.3%	6.3%
\$5,000,000 and Greater	5.7%	5.2%

Source: Rhode Island Division of Taxation cited in RIPEC and RISCPA, *Rhode Island's Personal Income Tax: A Call for Reform*, May 2005.



Table 2 – Comparison of Rhode Island and Massachusetts Personal Income Taxes for Representative Joint Filers Earning \$500,000

Rhode Island		Massachusetts	
AGI	\$500,000	AGI	\$500,000
Itemized Deductions	(\$66,567)	Itemized Deductions	Not allowed
Capital Gains	(\$84,726)	Capital Gains	Taxed as ordinary income
Interest	Taxed as ordinary income	Interest	(\$14,765)
Dividends	Taxed as ordinary income	Dividends	(\$23,506)
Taxable Ordinary Income After Exemptions & Deductions	\$348,707	Taxable 5.3 Percent Income After Exemptions & Deductions	\$452,579
Tax on Ordinary Income	\$25,245	Tax on 5.3 Percent Income	\$23,986
+5% Tax on Capital Gains	\$4,263	+12% Tax on Interest & Dividends	\$4,592
= Total State Income Tax	\$29,509	= Total State Income Tax	\$28,578
Effective Tax Rate	5.90%	Effective Tax Rate	5.72%

Source: Poverty Institute calculations

The Poverty Institute also estimated the state income taxes paid by a representative high-income couple with two children in Rhode Island and Massachusetts.

Values for itemized deductions, capital gains, interest and dividend income were estimated by using data reported for high-income taxpayers in Rhode Island and Massachusetts in the Internal Revenue Service 2003 Statistics of Income. Taxes and personal exemptions were calculated from the tax tables in 2005 Rhode Island Form 1040 and 2005 Massachusetts Form 1.

To simplify the estimate, the Poverty Institute assumed no interest income was from in-state banks, since Massachusetts taxes in-state bank interest at 5.3 percent and all other interest at 12 percent. We also assumed that all capital gain income was from assets held for more than a year; since Massachusetts taxes short term capital gains at 12 percent and all other capital gains at 5.3 percent.

After deductions and exemptions and differential treatment of interest, dividend and capital gain income was taken into account, the effective tax rate for a couple earning \$500,000 in 2005 was 5.9 percent in Rhode Island and 5.7 percent in Massachusetts.

Table 3 – Turbo-Tax Simulations for 2-parent, 2-child Family with Wage and Salary Income

Family Income	Income Tax Owed in RI	RI Effective Tax Rate	Income Tax Owed in MA	MA Effective Tax Rate
\$50,000	\$860	1.8%	\$1,610	3.2%
\$100,000	\$2,964	2.9%	\$4,378	4.4%
\$150,000	\$5,729	3.8%	\$7,027	4.7%
\$200,000	\$9,083	4.5%	\$9,678	4.5%

Source: Poverty Institute tax simulations

Most Rhode Island residents pay less personal income tax to Rhode Island than they would pay in Massachusetts.

In contrast to high income taxpayers, most taxpayers earn only wage and salary income and do not itemize deductions. Ninety-eight percent of Rhode Island taxpayers earned less than \$200,000. This group derived only 4.2 percent of income from dividends, interest and capital gains and less than one-third of these taxpayers itemized deductions.

These taxpayers pay less income tax under Rhode Island's system of graduated rates than they would in Massachusetts which taxes virtually all wage and salary income at a flat rate of 5.3 percent. The Poverty Institute estimated the taxes owed to Rhode Island and Massachusetts for two-parent, two-child families with wage and salary income only in 2003. Such families will generally owe less to Rhode Island than to Massachusetts at salary levels up to \$200,000.

RIPEC and the RISCPA simulated taxes paid for 2-parent, 2-child families earning only wage and salary income in all fifty states. For middle-income taxpayers earning \$35,000 - \$100,000, Rhode Island ranked in the bottom quarter of states and ranked significantly lower than Massachusetts.⁴

Cutting income taxes does not promote economic development.

Advocates of reforming Rhode Island's personal income tax claim that high marginal tax rates on upper-income taxpayers deter businesses from moving to Rhode Island and harm the state's economic development and job growth. But research shows that personal income tax cuts don't promote job growth.

From 1994-1996, New Jersey cut personal income tax rates by 30 percent as an economic development strategy, providing researchers with a clear case study to evaluate the effects of personal income taxes on regional job growth. A 2004 study found that New Jersey experienced no additional job growth compared to neighboring New York and Pennsylvania.⁵

A 1999 study by the Institute for Taxation and Economic Policy found that high income tax states experienced more rapid economic growth than states with low income taxes during the 1980s and 1990s.⁶ A 1997 review of the literature on state income taxes and economic growth found that "tax progressivity has a very tenuous relationship with a state's economic performance."⁷

Studies that have found a connection between personal income taxes and regional competition conclude that any beneficial effect of tax cuts disappears when subsequent cuts in state expenditures are taken into account.⁸

The RIPEC and RISCPA report claimed that Rhode Island's top marginal tax rate might cause businesses to locate across the Massachusetts border in order to serve the Rhode Island market. However, in testimony before Rhode Island's Joint Committee on Economic Development, Federal Reserve regional economist Robert Tannenwald found "no noticeable trend of businesses from Rhode Island locating across the border" and "no density of jobs with salaries over \$250,000" along the Massachusetts-Rhode Island border.⁹

High-Income Rhode Islanders are not fleeing the state for Massachusetts.

Advocates of personal income tax reform also contend that Rhode Island's top marginal tax rate induces Rhode Islanders to move to Massachusetts, especially top-earners seeking to reduce their tax payments. To evaluate this claim, the Poverty Institute analyzed data provided by the US Internal Revenue Service on state-to-state migration flows from 2000 – 2004. For each of the five years, net

migration between Rhode Island and Massachusetts was positive, with significantly more Massachusetts taxpayers moving to Rhode Island than vice versa. Moreover, the median income of taxpayers moving to Rhode Island from Massachusetts was consistently higher than the median income of people moving from Rhode Island to Massachusetts – as much as 17.4 percent higher in 2003.

Other regional and national studies also fail to find a relationship between personal tax rates and migration. In 2005, the Iowa Legislative Services Agency analyzed migration from Iowa and other Midwestern states from 1996-2002. They compared personal income taxes and especially tax treatment of retirement income in the Midwest and the most common destination states for out-migrants. The study found that South Dakota, which does not have a state income tax, fared worst for out-migration while Arizona, which does tax income, was the most popular destination for Midwest migrants. The authors concluded that "differences in state tax policy do not explain Iowa's out-migration."¹⁰

*Table 4 –
Migration Between Massachusetts
and Rhode Island, 2000 - 2004*

Year	Percent Difference in Median Income of Taxpayers Moving In & Taxpayers Moving Out.
2004	+4.9%
2003	+17.4%
2002	+10.6%
2001	+2.4%
2000	+4.3%

Source: Poverty Institute analysis of IRS state-to-state migration data.

A 2005 study by Dr. Andrew Leigh analyzed data from all 50 US states from 1977-2002 to assess the impact of progressive personal income taxes on migration and income distribution. The author concluded that "redistributive state taxes do not have a significant impact on interstate population flows."¹¹

High-income taxpayers are already doing well in Rhode Island.

Since the early 1980s, the highest-earning fifth of Rhode Island households—with an average income of \$128,021—have realized significant gains in income. A 2006 report of the Center for Budget and Policy Priorities and the Economic Policy Institute found that the average income of the top fifth of Rhode Island households rose by \$60,133—13 times as much as the bottom fifth of households and 4 times as much as the gain for middle-income households.¹²

Moreover, high-income Rhode Islanders are already receiving generous tax breaks from the federal government. Citizens for Tax Justice performed a detailed state-by-state analysis of federal tax cuts using the widely respected tax model of the Institute for

Table 5 – Change in Income by Income Group in Rhode Island, 1980/82 – 2001/03

	Income Change, 1980/82 – 2001/03	Percent Change
Bottom 20%	\$4,563	31.8%
Second 20%	\$9,133	34.8%
Middle 20%	\$16,607	46.2%
Fourth 20%	\$26,782	59.1%
Top 20%	\$60,133	88.5%

Source: Center for Budget and Policy Priorities and Economic Policy Institute.

Taxation and Economic Policy. They found that the top one-percent of taxpayers in Rhode Island, with an average income of \$923,000 received an average tax cut of \$49,770 in 2004 and are slated to receive average annual tax cuts of \$35,132 for 2005 – 2010 if the federal capital gains and dividend tax breaks are extended.¹³

Rhode Island can't afford to cut personal income taxes.

Advocates of cutting the Rhode Island's top personal income tax rate claim that the state will not lose much revenue as a result of the cut. The personal income tax is Rhode Island's primary source of revenue. In FY 2005, Rhode Island took in \$980 million in revenue from the personal income tax. Data from the Division of Taxation indicate that the 1.9 percent of taxpayers earning more than \$200,000 paid 34.8 percent of all personal income taxes. Any serious cut in the rates paid by these taxpayers will thus have a significant impact on a major revenue source.

Cutting the top marginal rate to 7.5 percent on Adjusted Gross Income, without deductions or credits, as has been proposed by the leadership in the House of Representatives, could cost the

Table 6 – Personal Income Taxes of High Earners in Rhode Island, 2003

AGI Range	Percentage of RI Income Tax Revenues	Cumulative Percentage
\$200,001 – \$500,000	14.6%	14.6%
\$500,001 – \$1,000,000	6.4%	21.0%
\$1,000,001 – \$5,000,000	8.2%	29.2%
\$5,000,000 and greater	5.6%	34.8%

Source: Rhode Island Division of Taxation, printed in RIPEC and RISCPA, *The Rhode Island Personal Income Tax: A Call for Reform*

state as much as \$10 million in revenue in 2007. Since this cut would only benefit the 9282 households in the state with AGI over \$200,000, this amounts to an average tax cut of \$1077 for the top-earning 1.9 percent of taxpayers.

Cutting the top personal income tax rate will make Rhode Island taxes more regressive.

Lower income Rhode Island households already face disproportionately high taxes. Because of the state's heavy reliance on property taxes and sales and use taxes, the lowest earning 20 percent of Rhode Islanders devote more than twice the share of their income to state and local taxes as the highest-earning one percent.¹⁴ Rhode Island ranks 6th nationally in property taxes as a share of personal income, but only 19th in personal income taxes as a share of personal income. A progressive personal income tax makes the tax system fairer and more balanced. Cutting the personal income tax would not only make the overall system more regressive but would sacrifice revenues that could be better used addressing the state's over-reliance on local property taxes.

Table 7 – Rhode Island Tax Rates by Income Group, 2002

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$15,000	\$15,000 to \$29,000	\$29,001 to \$47,000	\$47,001 to \$71,000	\$71,001 to \$144,000	\$144,001 to \$272,000	\$272,001 or greater
Avg. Income in Group	\$8,400	\$21,500	\$36,000	\$57,900	\$96,000	\$189,000	\$757,000
Sales and Use Taxes	8.1	5.8	4.5	3.4	2.6	1.7	0.8
Property Taxes	4.4	3.5	4.1	4.4	4.3	3.2	2.0
Income Taxes	0.5	1.5	2.2	2.6	3.4	4.2	5.8
Total Taxes	13.0	10.8	10.8	10.4	10.3	9.1	8.6
Federal Offset	—	-0.1	-0.4	-1.0	-1.6	-1.8	-2.6
Total After Offset	13.0	10.7	10.4	9.4	8.7	7.3	6.0

Source: Institute for Taxation and Economic Policy

-
- ¹ Jay Fitzgerald, *Can Providence be heavenly? Fidelity nearing judgment day*, *Boston Herald*, January 9, 2006.
 - ² A list of state tax credits can be found in RIPEC and RISCPA, *The Rhode Island Personal Income Tax: A Call for Reform*, May 2005.
 - ³ Jay Fitzgerald, *Can Providence be heavenly? Fidelity nearing judgment day*, *Boston Herald*, January 9, 2006.
 - ⁴ RIPEC and RISCPA
 - ⁵ WR Reed and CL Rogers, *Tax Cuts and Employment in New Jersey: Lessons from a Regional Analysis*, *Public Finance Review*, May 2004.
 - ⁶ Institute for Taxation and Economic Policy, *High Income Tax States Have Strong Economies*, December, 1999.
 - ⁷ Howard Chernick, *Tax Progressivity and Economic Performance*, *Economic Development Quarterly*, August 1997.
 - ⁸ Sally Wallace, *The Effect of State Personal Income Tax Differentials on Interstate Competition*, *State Tax Notes*, December 1991.
Robert Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Effect Economic Development*, *Economic Policy Institute*, March 2004.
 - ⁹ Robert Tannenwald, *The Competitiveness of Rhode Island's Personal Income Tax*, presented to the Rhode Island Joint Committee on Economic Development, December 7, 2005.
 - ¹⁰ Iowa Legislative Services Agency, *Taxpayer Migration – Iowa to Texas and Arizona*, Issue Review, February 10, 2005.
 - ¹¹ Andrew Leigh, *Can Redistributive Taxes Reduce Inequality?*, Center for Economic Policy Research, Australian National University, Discussion Paper 490, April 2005.
 - ¹² Center for Budget and Policy Priorities and Economic Policy Institute, *Pulling Apart: A State-by-State Analysis of State Income Trends*, January 2006.
 - ¹³ Citizens for Tax Justice and the Institute for Taxation and Economic Policy, *How do the Bush Tax Cuts Affect Rhode Island*, 2006. <http://www.ctj.org/pdf/gwbri.pdf>
 - ¹⁴ Institute for Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in all 50 States*, 2nd edition, 2002. <http://www.itepnet.org/wp2000/ri%20pr.pdf>