Publication: The Providence Journal; Date: May 17, 2012; Section: Commentary; Page: B6

Wait before judging R.I. tax reform

R. KELLY SHERIDAN

Even under the best of circumstances, it can be challenging to fully understand all the implications of proposed changes to Rhode Island's tax code. Seemingly innocuous or straightforward changes in our tax policy can have unforeseen implications for private-sector investment, economic development, consumer spending and cross-border sales.

With these inherent challenges, it is essential that the state's elected leaders and policy makers be provided with honest and accurate data regarding all aspects of the existing tax code as well as reliable projections of the anticipated revenue if legislative changes are enacted.

Unfortunately, that has not been the case throughout the current debate over various legislative proposals that would increase the state's marginal income-tax rate, currently at 5.9 percent. Sadly, the proponents have repeatedly sought to justify these tax increases by mis-characterizing the General Assembly's 2010 reform of the personal-income tax as a "tax cut for the rich." In recent months, this claim has been repeated countless times in State House testimony, letters to the editor, blogs and direct mail. During the course of a recent hearing before the House Finance Committee, dozens of tax-increase proponents repeated the falsehood for almost five hours.

Here are the facts. The 2010 reform of the state's personal-income-tax code was carefully and intentionally structured so that it would not result in a tax cut for higher earners. In fact, it was not a tax cut at all. Rather, it was designed to be revenue-neutral, that is, generate revenue which was within 2 percent of the revenue generated under the prior code.

The principal objective of the 2010 reform was to reduce the state's top income tax rate from 9.9 percent to a level that was more competitive with neighboring states and national averages. The punitive 9.9 percent rate, one of the highest in the country, was repeatedly cited by national and regional organizations and journals as a symbol of Rhode Island's poor business climate. State policymakers succeeded in lowering the marginal income-tax rate to 5.9 percent without reducing overall state revenue by eliminating itemized deductions and most tax credits which were on the books at that time. The state further enhanced tax revenue and the progressivity of the state income-tax code by eliminating favorable treatment for capital gains in 2009.

The data that supports these facts was prepared by the state Department of Revenue. To assist the House and Senate Finance Committees, the department prepared a personal-income-tax-reform simulation run that compared the personal-income-tax system that was in place in 2010 with the 2010 reform which would take effect on Jan. 1, 2011. The report can be found at: http://www.dor.ri.gov/ Reports/. Using the most current tax returns on file, the simulation compared the aggregate tax liability of various income categories under the prior system and under the 2010 reform.

The simulation demonstrated that the aggregate tax liability of every income bracket up to $175,000 decreased, and the aggregate tax liability for every income bracket over $175,000 increased. The simulation also demonstrated that those with federal adjusted gross income over $175,000 constituted just 5.1 percent of all those who filed tax returns, yet they would pay a whopping 46 percent of the total income-tax burden. Those with income over $250,000 constituted just 2.7 percent of the total tax filers yet they would pay 36 percent of the burden. So much for a tax break for the rich.

Those advocating an immediate tax increase have attempted to evade these data by selectively focusing on narrow subsets of the population rather than all tax filers. For example, some proponents have focused on a small group of 30 Rhode Island families that reported adjusted gross income in excess of $10 million. The

simulation projected that this subset of the population would pay $43.2 million in taxes under the 2010 reform, rather than the projected $43.7 million under the then-existing tax code.

Yet the department's simulation also demonstrated that there were a total of 340 taxpayers, including both residents and out-of-state taxpayers, who reported adjusted gross income in excess of $10 million in 2008 and those filers would collectively pay an additional $3.2 million in state income taxes under the 2010 reform.

Most of us have recently filed our first tax returns under the new system. As anticipated, some have seen their state tax liability decrease. Others, particularly those who previously filed with relatively high itemized deductions (for charitable gifts, mortgage interest, etc.) or tax credits, saw their taxes increase. Those under extension will file their returns in October. At that time the Department of Revenue will be in a position to review all the returns and present hard data to the governor and the General Assembly on the impact of 2010 reform, including an assessment of the distribution of the state's income-tax burden by gross income.

Until that analysis is completed, there simply is no better, more reliable data regarding the 2010 income tax reform than the Revenue Department's simulation run. It would be extremely unwise to dismantle the 2010 reform before the first returns are evaluated. To do so in response to baseless rhetoric would be irresponsible.

R. Kelly Sheridan is legislative counsel for the Greater Providence Chamber of Commerce.