

Date of State Budget Office Approval: Thursday, March 05, 2015

Date Requested: Wednesday, February 11, 2015

Date Due: Saturday, February 21, 2015

Impact on Expenditures

FY 2015 n.a.
 FY 2016 n.a.
 FY 2017 n.a.

Impact on Revenues

FY 2015 n.a.
 FY 2016 \$(52,286,303),
 FY 2017 \$(106,449,337)

Explanation by State Budget Office:

This bill would amend Rhode Island General Law Chapter 44-30 entitled "Personal Income Tax" to allow a modification reducing federal Adjusted Gross Income (AGI) for the purpose of determining income subject to the tax imposed under Rhode Island General Law Section 44-30-2.6 titled "Rhode Island taxable income – Rate of tax". The bill would allow a taxpayer to subtract the amount of federal and state and local governments' retirement plans, Social Security retirement and disability benefits, military pensions, railroad retirement benefits, private pension plans, and deferred-compensation plans in the public and private sector deemed taxable income under the Internal Revenue Code and included in Federal Adjusted Gross Income on a taxpayer's federal income tax return from federal AGI as reported on a taxpayer's Rhode Island personal income tax return prior to determining the tax owed under the Rhode Island personal income tax. The proposed exemption also requires that the individual or beneficiary seeking the exemption be at least sixty-five (65) years of age before the close of the taxable year for which the exemption is being claimed.

Under current law, Rhode Island's personal income tax system's starting point is federal AGI and thus Rhode Island taxes all income, including federal and state and local governments' retirement plans, Social Security retirement and disability benefits, military pensions, railroad retirement benefits, private pension plans, and deferred-compensation plans in the public and private sector, to the extent that the federal government does.

Comments on Sources of Funds:

All personal income taxes are considered to be general revenues.

Summary of Facts and Assumptions:

***** REVISED March 4, 2015

The bill takes effect upon passage. For simplicity, the Office of Revenue Analysis (ORA) assumed the bill would be applicable to tax years beginning on or after January 1, 2016. Based upon the accrual methodology employed by the Office of Accounts and Controls, tax law changes that take effect in the middle of a fiscal year have a current fiscal year revenue impact equal to one-half of the succeeding fiscal year's revenue impact. The Office of Revenue Analysis has used this accrual based methodology to provide the budgetary revenue impacts contained in this fiscal note.

Section one of the bill provides an exemption for all taxpayers who are at least sixty five years of age or older on all retirement income regardless of whether the taxpayer

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in question is a Rhode Island resident or not. Section two of the bill only allows a subtraction from federal AGI for taxable federal and state and local governments' retirement plans, Social Security retirement and disability benefits, military pensions, railroad retirement benefits, private pension plans, and deferred-compensation plans in the public and private sector by a Rhode Island resident 65 years of age or older. According to the Tax Administrator's interpretation of the bill, section one, which grants the exemption on retirement income to both residents and non residents aged 65 or over, takes precedence over section two which limits said exemption to Rhode Island residents only and thus, the Office of Revenue Analysis developed the revenue impacts of the bill under the assumption that both Rhode Island resident and non-resident personal income tax filers aged 65 and over are eligible for the exemption provided.

ORA estimated that in tax year 2011 (TY 2011) 64,639 resident taxpayers aged 65 years and older received \$2,175,086,000 in taxable retirement benefits that were included in federal AGI. The inclusion of these taxable retirement benefits in federal AGI generated \$71,817,617 in Rhode Island personal income tax revenue. ORA used TY 2011 because of the unusual capital gains and interest income received in TY 2012 as the result of federal tax law changes that affected the realization of capital gains by upper income taxpayers in particular. It is ORA's assumption that TY 2011 is more representative of underlying income flows for state income tax purposes than TY 2012.

According to the United States Internal Revenue Service's, TY 2011 Statistics of Income (SOI) by State there were a total of 513,134 Rhode Island resident returns with taxable income. The SOI data typically encompasses all tax returns that were processed for a given tax year, including returns that were placed on extension at the April 15 due date. ORA analyzed 492,351 returns provided by the Department of Revenue's Division of Taxation. The difference between the SOI number of Rhode Island resident tax returns and the number of returns provided by the Division of Taxation, a total of 20,783 returns, are assumed to be returns that were on extension at the federal level at the time the Division of Taxation provided ORA with the TY 2011 tax returns. As a result, the revenue impact provided in this fiscal note should be considered a minimum impact.

Rhode Island resident personal income tax collections for TY 2011 were \$809,079,063. Thus, income taxes from taxable retirement benefits for Rhode Island resident individuals 65 years of age and older are estimated to comprise 8.88 percent of all Rhode Island resident personal income tax revenues (i.e. $\$71,817,617 / \$809,065,538$). ORA could not directly estimate non-resident taxable retirement benefits which would likely also be exempt from Rhode Island personal income taxes. As a result, ORA applied the same percentage calculated for resident TY 2011 returns to all TY 2011 personal income tax collections of \$975,278,121 to estimate the total personal income tax revenues received from the taxation of taxable retirement benefits for taxpayers aged 65 and older of \$86,604,697 (i.e., $\$975,278,121 * 0.0888$). The amount of personal income tax revenues attributable to Rhode Island resident taxpayers from the taxation of taxable retirement benefits for taxpayers aged 65 and over was subtracted from this total to yield estimated TY 2011 personal income tax collections from the taxation of taxable retirement benefits

of non-resident taxpayers aged 65 and over of \$14,787,080.

The TY 2011 resident and non-resident personal income tax receipts of \$975,278,121 represent payments made by taxpayers for that particular tax year. It is important to distinguish between a particular tax year's receipts and total personal income taxes received in a given calendar year. Total personal income tax payments received in a given calendar year may include tax payments that are associated with prior tax year liabilities or estimated payments for future tax year liabilities as well as tax payments that are related to current tax year liabilities. To account for the receipt of tax payments not associated with the current tax year, ORA compared the TY 2011 personal income tax receipts to total personal income taxes received in calendar year 2011 of \$1,053,411,625 to arrive at a ratio of TY 2011 personal income tax payments received to total calendar year 2011 personal income tax receipts of 92.58 percent (i.e., \$975,278,121 / \$1,053,411,625).

The ratio of TY 2011 personal income tax payments to CY 2011 personal income tax receipts was applied to the Budget Office's projection of personal income tax revenues for FY 2017 of \$1,271,963,320 to arrive at TY 2016 estimated personal income tax revenues of \$1,177,619,429 (i.e., $0.9258 * \$1,271,963,320$). The percentage of personal income tax revenues foregone from exempting Rhode Island resident and non-resident taxable retirement benefits for individuals 65 years of age and older that are included in federal AGI was applied to the FY 2017 estimate of TY 2016 personal income tax revenues to arrive at an estimate of \$104,572,605 in TY 2016 personal income tax revenues foregone (i.e., $\$1,177,619,429 * 0.0888$) from passage of the bill. This same process was repeated for the Budget Office's projection of personal income tax revenues for FY 2018 of \$1,317,618,366 to yield an estimated \$108,326,068 in Rhode Island personal income tax revenue foregone from exempting taxable retirement benefits of resident and non-resident individuals 65 years of age and older included in federal AGI from the Rhode Island income tax for TY 2017 (i.e., $(0.9258 * \$1,317,618,366) * 0.0888$).

Employing the Office of Accounts and Controls accrual methodology yields budgetary revenue losses for FY 2016 of \$52,286,303 (i.e., $0.5 * \$104,572,605$) and for FY 2017 of \$106,449,337 (i.e., $0.5 * \$104,572,605 + 0.5 * \$108,326,068$).

According to the Office of Management and Budget, the FY 2015 Enacted Budget projects deficits of \$172.9 million in FY 2016 and \$296.3 million in FY 2017. Passage of the bill would increase the FY 2016 and FY 2017 projected deficits.

Summary of Fiscal Impact:

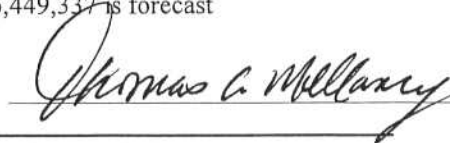
***** Revised March 4, 2015

FY 2015: No fiscal impact given the assumed implementation date of the act.

FY 2016: A minimum revenue loss of \$52,286,303 is forecast.

FY 2017: A minimum revenue loss of \$106,449,337 is forecast

Budget Office Signature:



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