



Testimony on Proposals to Tax Capital Gains and Other Wealth: H-7486

House Committee on Finance

May 14, 2024

Alan Krinsky, Director of Research and Fiscal Policy

In the United States, we generally tax wage and salary income at higher rates than we do income from investments, and over the last few decades we have witnessed the wealth gap grow, as the wealthiest people make sure that the tax code treats their income and wealth more favorably compared with how tax rules treat ordinary salary and wages, the major source of income for most Americans, including Rhode Islanders. Representative Ajello’s H-7486 seeks to take some important steps to rectify this imbalance. The Economic Progress Institute supports three proposals contained in this omnibus legislation:

- Adding a 2% state tax surcharge on higher amounts of capital gains.
- Adding a surcharge on fees paid to financial managers, to compensate for the (mis)classification of this income – basically payment for services rendered – as capital gains investment income instead of as normal wage or salary income.
- Adding a property tax on second homes, ones not occupied by the owners as a primary residence.

All of these measures would do something to decrease the wealth and income gaps while also increasing equity and raising revenue for the state, **an estimated \$79.4 million in annual revenue** for the first and third parts, according to a 2023 fiscal note on identical legislation.

Racial Equity and Tax Fairness

In a system of equitable income and wealth, we would expect Black, Latino, and White Rhode Islanders to be distributed proportionally among the lowest and highest income groups. Yet, Rhode Islanders with the highest incomes are disproportionately White, and those with the lowest incomes are disproportionately Black and Latino, as *Figure 1* shows.

Only 9% of Black and 6% of Latino Rhode Islanders are among the top 20% of income, whereas 26% of Black and 32% of Latino Rhode Islanders fall in the lowest 20%.

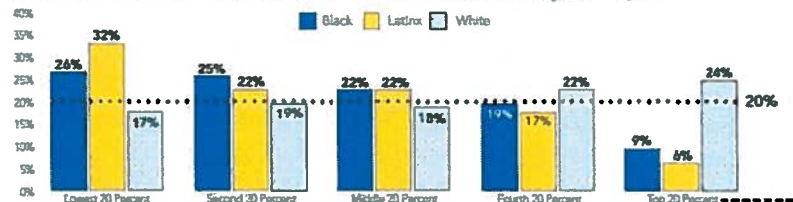
And while Latino Rhode Islanders make up 13% of the state’s population, they

Racial and Ethnic Inequities Span the Income Scale in Rhode Island

Black and Latino Rhode Islanders find themselves underrepresented in the higher income groups and overrepresented in the lower and middle groups. If income distribution were equal, all the bars would be at 20% each, reaching to the dotted line.

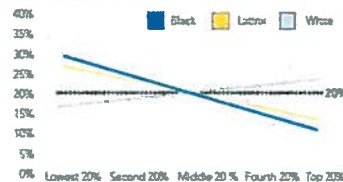
Income is Not Distributed Equally in the Ocean State

Black and Latino Rhode Islanders overrepresented in lower-income, and underrepresented in higher-income groups.



Income Distribution Trends Are Inequitable in Rhode Island

With racial and ethnic equity in income, all lines would match the dotted line.



Race/Ethnicity of the Top 20% Does Not Reflect Proportional Distribution of Total Population

Focusing on the top 20%, one can see the stark disproportionality, with White households making up 75% of Rhode Island’s overall population yet comprising 89% of the state’s top 20%.



Figure 1



account for only 2% of those in the top 20%. White Rhode Islanders account for 89% of the top 20% although they make up only 75% of the overall population.

Decades of racist tax and other public policy – such as redlining for providing and denying mortgages – have resulted in large racial and ethnic disparities in both income and wealth across the country. Tax policies on the state and local levels play a role in maintaining or even worsening the existing wealth and income gaps. **H-7486 would improve the situation by decreasing racial and ethnic disparities.**

Capital Gains

There is no good reason why capital gains should be taxed at a lower rate than wages and salary (and not only are they taxed at a lower rate, but the investor does not pay FICA or social security taxes on the earnings). And in many cases, capital gains can increase in value for years without being taxed and sometimes escape taxation altogether due to other features of the tax code. Although Rhode Island does presently tax capital gains and wage/salary income at the same rate, there is still a large federal tax advantage for capital gains. This provision of H-7486 would recoup for the state a small portion of the tax revenue forgone by the federal government.

The Carried Interest Loophole

Through the influence of the wealthy, we have something called the carried interest loophole, by which some high-end financial advisors can claim as *investment* income what the rest of us recognize as compensation for services rendered. This measure in the bill would only take effect if our neighboring states and New Jersey take the same action, and so long as the U. S. Congress fails to take action. It would assess an additional tax on this income to compensate for the unfairly favorable tax rate such income currently receives.

Second Homes

The pandemic era has seen an increase in wealthy individuals purchasing second or even third homes, raising the price of homes and making the housing market even more difficult to access on the part of ordinary Rhode Islanders. Those wealthy enough to afford second homes and not live in them can afford to pay a little extra in property taxes to help maintain the level of services and programs Rhode Islanders need for us all to share in prosperity.

Tax Fairness and Revenue

H-7486, once enacted, would make our tax code more fair and equitable and would also likely raise tens of millions of dollars in revenue, which would help the state maintain the sorts of programs and services which benefit Rhode Islanders and the local economy. We have considerable federal pandemic assistance funds now, but **if we wait for the one-time relief funds to disappear before we address Rhode Island's revenue challenges, it will already be too late. We need to plan now, and H-7486 helps accomplish this.** With such funds, we will be able to build upon the successes of our investments in the state's recovery.