RIPEC

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Representative Marvin Abney
Chairperson, House Committee on Finance
Room 35
Rhode Island State House
Providence, RI 02903

May 2, 2024

RE: House Bill 7338 —An Act Relating to Taxation—Personal Income Tax

Dear Chairperson Abney,

I am writing on behalf of the Rhode Island Public Expenditure Council (RIPEC) in strong opposition to House Bill 7338, which would apply a surtax of three percent over the current top rate of 5.99 percent on taxable income over $1,000,000. Under the proposed legislation, revenue from this three percent tax would be deposited into a restricted receipt account for use on childcare and early learning programs, public education, public colleges and universities, road and bridge maintenance and repair, and public transportation.

The income tax increase proposed by this bill would impose a higher tax burden on business, and particularly on small business. The great majority of businesses, and nearly all small businesses, in Rhode Island are organized as pass-through entities and report their profits through the personal income tax rather than the corporate tax.[1] Business profits are often reinvested in the local economy through new ventures or expansion of existing businesses.

The proposed legislation also would undermine and reverse important work done to improve Rhode Island's income tax structure and business climate. In 2011, the General Assembly undertook a major reform of the personal income tax, reducing Rhode Island's top rate of 9.9 percent—then among the highest in the country—to 5.99 percent. The tax rate reduction was revenue neutral since the reform also eliminated nearly all deductions and credits then available.

[1] Of the Rhode Island resident tax filers with income over $1,000,000, 73 percent reported income (or loss) attributed to a pass-through entity, such as a partnership or S corporation. Internal Revenue Service, "Statistics of Income, Tax Year 2021: Historic Table 2, Rhode Island."

At the time, Rhode Island's overall business tax climate was ranked 47th in the nation, according to the Tax Foundation, a national tax policy research organization. As a result of the 2011 income tax reform, and other tax reforms affecting businesses and individuals, Rhode Island's business tax climate ranking climbed steadily to 38th in 2019. However, the Ocean State never cracked the top two-thirds of states and has since fallen to the bottom ten, currently ranking 41st. Notably, by enacting a four percent surtax on incomes over $1,000,000, Massachusetts saw its business tax climate ranking plummet from 34th to 46th (fifth worst).[2]

Businesses, and those who invest in business, have choices. Higher tax rates will discourage investments in Rhode Island and cause businesses to invest in states with more favorable tax climates. At 5.99 percent, Rhode Island's top rate is already 15th highest among states. The bill would increase this rate for income above $1,000,000 by 50 percent to 8.99 percent, which would make Rhode Island's top rate the 7th highest among states.[3] Moreover, if Rhode Island were to raise income taxes, the state would be moving in the opposite direction of most states, which have been cutting income taxes over the past few years.[4]

There is compelling evidence of migration from higher tax states to lower tax states. In a recent study, the Tax Foundation found that the states with the greatest out-migration in FY 2023 were high-cost and high-tax, while the states with the greatest in-migration were relatively low-cost and low-tax. Of the 32 states with per capita state and local tax burdens below the national average in 2022, 24 experienced net inbound migration in FY 2023. During the same period, 14 of the 18 states and D.C. with per capita tax burdens above the national average experienced net outbound migration. The same study found that the average combined top marginal state and local income tax rate for the top one-third of states for population growth was 3.8 percent—3.5 percentage points lower than for the bottom third of states for population growth (7.3 percent).[5]

Compared to other states, Rhode Island's personal income tax is already among the more progressive. Rhode Island has three brackets—3.75 percent, 4.75 percent, and 5.99 percent—and while the majority of states still have graduated income tax rates, several states have moved to a single-rate structure over the last few years.[6] According to the Rhode Island Department of Revenue income tax return summaries for tax year 2020, taxpayers making $200,000 or more represent the top 5 percent of resident taxpayers by income and pay nearly half (48.7 percent) of all state income taxes collected from Rhode Island residents.[7]

[2] Rhode Island Public Expenditure Council, "Policy Brief: RIPEC Analyzes Rhode Island's Business Tax Climate Index Ranking of 41st," February 2024.
[3] Tax Foundation, "Facts & Figures 2024: How Does Your State Compare?," April 3, 2024.
[4] Fourteen states have individual income tax reductions taking effect in 2024. Tax Foundation, "State Tax Changes Taking Effect January 1, 2024," December 21, 2023.
[5] The population growth measured was attributable solely to domestic migration. Tax Foundation, "Americans Moved to Low-Tax States in 2023," January 9, 2024.
[6] Tax Foundation, "The State Flat Tax Revolution: Where Things Stand Today," February 15, 2024.
[7] Rhode Island Division of Taxation, Statistics of Income: 2020 Resident Report; RIPEC calculations.

Regarding the creation of a restricted receipt account contained in the legislation, there is no requirement or guarantee that the proposed account would raise current funding levels beyond that which would otherwise be appropriated, and without this guarantee it is likely that additional funds from the tax increase eventually would be offset by a reduction in state or municipal spending.

For these reasons, RIPEC urges that the Finance Committee reject House Bill 7338.

Sincerely,

Michael DiBiase
President & CEO

Michael DiBiase

Rhode Island Public Expenditure Council

RIPEC is a nonpartisan and nonprofit public policy research organization dedicated to providing objective research and analysis that addresses the critical challenges surrounding public finance and economic opportunity in Rhode Island.