



State Fiscal Note for Bill Number: 2020-H-7664

Date of State Budget Office Approval:

Date Requested:

Date Due:

Impact on Expenditures

FY 2020	n/a
FY 2021	\$0
FY 2022	see below

Impact on Revenues

FY 2020	n/a
FY 2021	see below
FY 2022	see below

Explanation by State Budget Office:

This bill would amend Rhode Island General Laws Chapter 44-30 entitled “Personal Income Tax” by adding a fourth Rhode Island taxable income bracket to Rhode Island General Laws Section 44-30-2.6(c)(3)(A)(I) titled “Rhode Island taxable income – Rate of tax – Tax imposed.” The fourth Rhode Island taxable income bracket contained in the bill would apply a marginal tax rate of 6.99% to the amount of Rhode Island taxable income that exceeds \$500,000 in 2011 dollars. In addition, the personal income tax that will be collected under the bill, will be deposited into a restricted receipt account and spent only on education for grades kindergarten through and including twelfth grade.

Under current law, for tax year 2019, a marginal tax rate of 3.75% is applied to the first \$64,050 of taxable income, taxable income above \$64,050 but less than or equal to \$145,600 is taxed at a rate of 4.75%, and taxable income amounts that exceed \$145,600 are taxed at a rate of 5.99%. All revenues generated from the personal income tax are deposited as general revenues.

Comments on Sources of Funds:

Personal income tax revenues generated from Rhode Island taxable income of less than \$500,000 (in 2011 dollars) and taxed at rates of 5.99% or less are general revenues.

The personal income tax revenues generated from the taxation of Rhode Island taxable income in excess of \$500,000 (in 2011 dollars) at a rate of 6.99% are restricted receipts.

Summary of Facts and Assumptions:

The effective date of the bill is upon passage. The bill as written makes the fourth taxable income bracket of 6.99% for Rhode Island taxable income in excess of \$500,000 effective for tax years beginning on or after January 1, 2011, thereby making the change in law retroactive to prior tax years. The Department of Revenue, Office of Revenue Analysis (ORA) believes that such a retroactive increase in the personal income tax liability of taxpayers with Rhode Island taxable income in excess of \$500,000 is invalid and the bill should be redrafted to make the effective date of the tax years beginning on or after January 1, 2021. ORA assumed that the provisions of the bill are applicable to the “tax years beginning on or after January 1, 2021.”

Based upon the accrual methodology employed by the Department of Administration’s Office of Accounts and Controls (OAC), tax law changes that take effect in the middle of a fiscal year have a current fiscal year revenue impact equal to

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one-half of the succeeding fiscal year's revenue impact. ORA has used this accrual-based methodology to provide the budgetary revenue impacts contained in this fiscal note.

It should be noted that the bill will have no impact on FY 2020 personal income tax revenues as the bill will be effective for tax years beginning on or after January 1, 2021. The impact of the bill on FY 2021 personal income tax revenues will be realized through the personal income tax net accrual rather than actual revenue flows during the fiscal year as the returns filed for TY 2021 would not be received until FY 2022. The impact of the bill on FY 2022 personal income tax revenues will be realized through actual revenue flows during that fiscal year but primarily concentrated in the month of April.

The revenue generated from the bill is to be deposited into a restricted receipt account and spent on K-12 education. Although the revenue generated from the bill will be recognized on an accrual basis, the expenditure of these revenues would be on a cash basis. Thus, there would be no additional expenditures on K-12 education in either FY 2020 or FY 2021, given an assumed effective date of tax years beginning on or after January 1, 2021. Increased personal income tax cash receipts will be realized in FY 2022 when personal income tax returns for tax year 2021 are filed.

The bill as written sets the new taxable income bracket at "over \$500,000" in 2011 dollars. Rhode Island General Laws Section 44-30-2.6(c)(3)(E) titled "Adjustment for inflation" requires that the amounts in Rhode Island General Laws Section 44-30-2.6(c)(3)(A)(I) be annually indexed to inflation for all tax years beginning on or after January 1, 2012. Applying this inflation adjustment to the proposed new taxable income bracket results in the cutoff between the 5.99% taxable income bracket and the 6.99% taxable income bracket to be \$557,600 in 2017 dollars. TY 2017 is the base year that is used in ORA's personal income tax simulation model.

The revenue figures reported in this fiscal note are based on ORA's TY 2017 personal income tax return simulation model adjusted to reflect current tax law as of TY 2019. Under current law, the taxable income brackets that were in place in tax year 2011 were indexed for inflation for future tax years. In TY 2017, a marginal tax rate of 3.75% was applied to the first \$61,300 of taxable income, taxable income over \$61,300 but less than or equal to \$139,400 was taxed at a rate of 4.75% and taxable income amounts that exceeded \$139,400 were taxed at a rate of 5.99%. As noted above, ORA applied the same adjustment for inflation that was used to determine the TY 2017 values of the taxable income brackets to the fourth additional bracket proposed in the bill. Thus, in personal income tax simulation, ORA applied the 5.99% tax rate to taxable income amounts over \$139,400 but less than or equal to \$557,600 and the 6.99% tax rate to all taxable income in excess of \$557,600 for resident and nonresident tax returns that were filed for TY 2017. The results of this simulation were then compared to actual TY 2017 personal income tax revenues generated by the state's TY 2017 personal income tax adjusted to reflect TY 2019 law. The results of the simulation indicate that implementation of the bill would increase personal income tax revenues by 3.1677 percent.

Using the personal income tax simulation model, ORA determined that resident and nonresident TY 2017 personal income tax collections under TY 2017 law were \$1,197,895,105. This amount solely represents payments made by taxpayers for that tax year. It is important to distinguish between a tax year's revenues 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 resident and nonresident TY 2017 personal income tax revenues to total personal income tax revenues received in calendar year 2017 of \$1,279,668,989 to arrive at an estimate of the ratio of total calendar year personal income tax revenues that TY 2017 payments comprise of 93.6098 percent (i.e., \$1,197,895,105 / \$1,279,668,989).

The ratio of TY 2017 personal income tax revenues to CY 2017 personal income tax revenues was applied to the Department of Administration, Office of Management and Budget's (OMB) FY 2022 projection of personal income tax revenues based on estimates adopted at the November 2019 Revenue Estimating Conference (REC) of \$1,552,264,766. This calculation yields estimated TY 2021 personal income tax payments of \$1,453,071,365 realized in FY 2022 (i.e., \$1,552,264,766 * 0.936098). Applying the 3.1677 percent estimated personal income tax revenue gain from passage of the bill to the FY 2022 estimate of TY 2021 personal income tax revenues yields estimated personal income tax revenue gains of \$46,029,052 in TY 2021 attributable to adding a fourth additional tax bracket at a rate of 6.99% for taxable income above \$500,000 in 2011 dollars (i.e., \$1,453,071,365 * 0.031677). The two percentages described above were also applied to OMB's projection of personal income tax revenues based on estimates adopted at the November 2019 REC for FY 2023 of \$1,615,768,282 to yield an estimated \$47,912,111 in additional TY 2022 personal income tax revenue from the addition of fourth personal income tax bracket as proposed in the bill (i.e., 0.936098 * \$1,615,768,282 * 0.031677).

Employing the Office of Accounts and Controls accrual methodology yields budgetary revenue gains from the passage of this bill for FY 2021 of \$23,014,526 (i.e., 0.5 * \$46,029,052) and for FY 2022 of \$46,970,581 (i.e., 0.5 * \$46,029,052 + 0.5 * \$47,912,111). Based on the estimates above, the amount deposited into the restricted receipt account for K-12 expenditures in FY 2022 is \$46,029,052.

It should be noted that the estimated revenue impacts do not incorporate any changes in taxpayer behavior in response to the new higher marginal tax rates for the relevant taxable income brackets. As a result, these revenue estimates should be interpreted as the maximum revenue that could be generated by the bill. For example, if taxpayers reduce the realization of income by 10 percent in response to these proposed changes, then realized revenues in FY 2021 would be reduced to \$20,713,073 and revenues in FY 2022 would be reduced to \$42,273,523. Any decline in the revenue that results from a change in taxpayer behavior will also decrease the monies available for K-12 expenditures in FY 2022 and beyond on a dollar-for-dollar basis.



*Summary of Fiscal
Impact:*

The Governor's FY 2021 Recommended Budget projects a closing surplus of \$24,842,778 in FY 2020 and \$892,259 in FY 2021. Passage of this bill would have no impact on the FY 2020 closing surplus, the Governor's FY 2021 Recommended Budget surplus or projected deficit for FY 2022 as all revenues generated by the bill will be deposited into a restricted receipt account.

FY 2020: Not applicable due to the implementation date of January 1, 2021.

FY 2021: A maximum revenue gain of \$23,014,526 is forecast under the assumption that taxpayer behavior is unaffected by the proposed increase in marginal personal income tax rates. This revenue gain will be deposited into a restricted receipt account for spending on education for grades kindergarten through and including twelfth grade.

No increase in K-12 expenditures will be possible until FY 2022 as tax year 2021 personal income tax returns, which would be subject to the higher tax bracket and higher marginal tax rate, are not filed until after January 15, 2022 (at the earliest).

FY 2022: A maximum revenue gain of \$46,970,581 is forecast under the assumption that taxpayer behavior is unaffected by the proposed increase in marginal personal income tax rates. This revenue gain will be deposited into a restricted receipt account for spending on education for grades kindergarten through and including twelfth grade.

An increase in K-12 expenditures of \$46,029,052 in FY 2022 is projected.

Budget Office Signature:

Fiscal Advisor Signature: