

The Status of Rhode Island's Business Climate: A National Review

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Principles of Sound Tax Policy

Simplicity

Administrative costs are a loss to society, and complicated taxation undermines voluntary compliance by creating incentives to shelter and disguise income.

Transparency

A good tax system requires informed taxpayers who understand how tax assessment, collection, and compliance work, with open hearings and fully explainable and replicable estimates.

Neutrality

The fewer economic decisions that are made for tax reasons, the better. The primary purpose of taxes is to raise needed revenue, not to micromanage the economy. The tax system should not favor certain industries, activities, or products.

Stability

When tax laws are in constant flux, long-range financial planning is difficult. Lawmakers should avoid enacting temporary tax laws.

Tax Foundation Annual Studies

- **Facts & Figures**

- Rates, collections data, and rankings

- **Tax Freedom Day**

- Calendar representation of combined federal, state, and local tax burden

- **State-Local Tax Burdens**

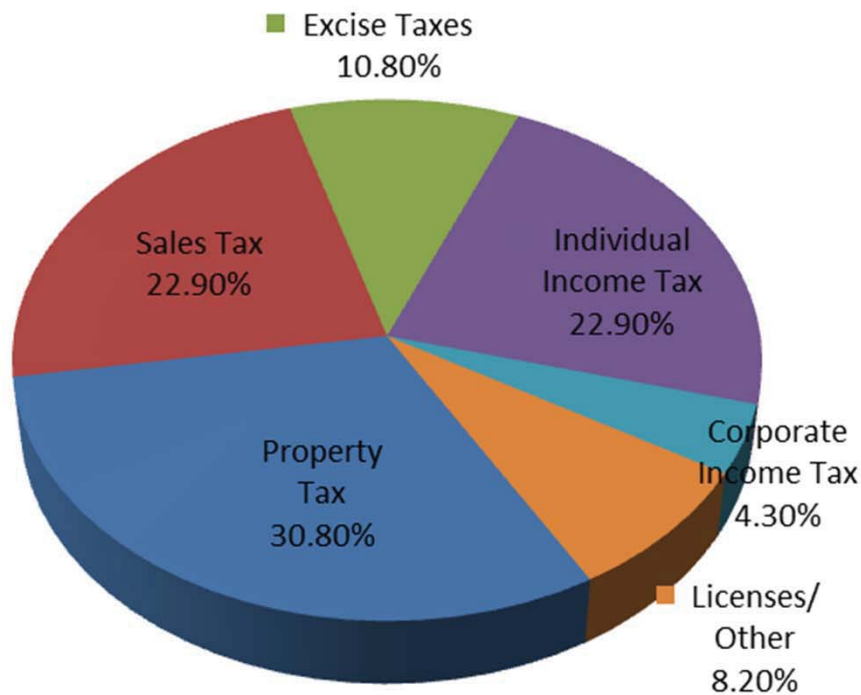
- Average effective tax rate paid by residents of a state as a whole

- **State Business Tax Climate Index**

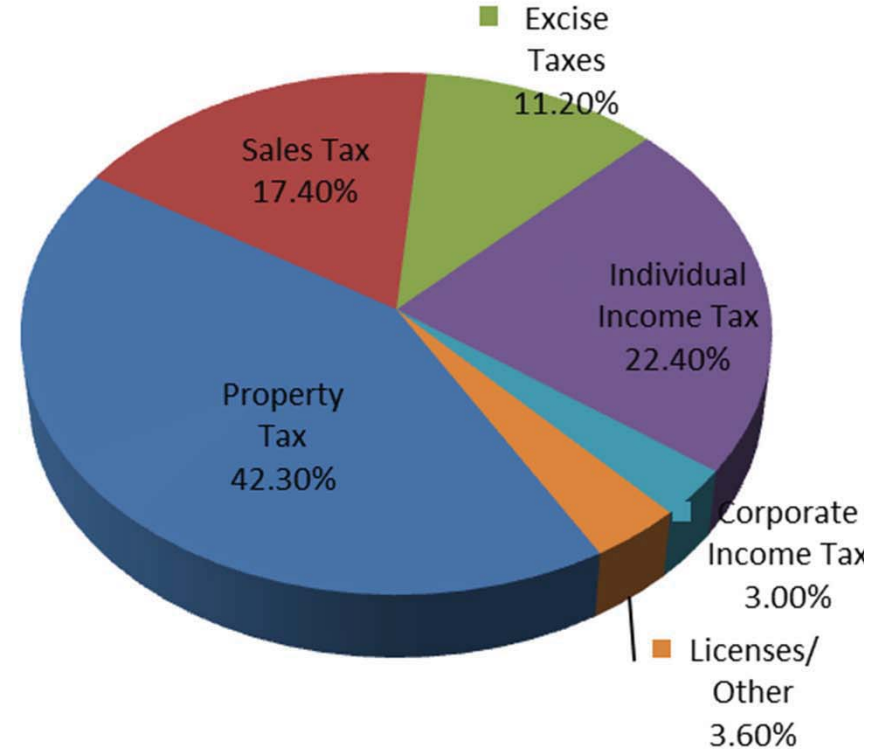
- How states raise their taxes

Sources of Revenue

All States



Rhode Island



Source: Tax Foundation calculations based on data from Census Bureau state and local government finance data for fiscal year 2008.

State Individual Income Tax Collections

| State | Collections per capita (2008) | Rank (2008) | Top State Rate (2010) |
|---------------------|-------------------------------------|----------------|--------------------------|
| U.S. | \$918 | -- | |
| Connecticut | \$2,002 | 1 | 6.5% |
| Massachusetts | \$1,916 | 2 | 5.3% (one-rate) |
| New York | \$1,880 | 3 | 8.97% |
| California | \$1,531 | 4 | 10.55% |
| Minnesota | \$1,493 | 5 | 7.85% |
| ... | ... | ... | ... |
| Rhode Island | \$1,026 | 17 | 9.90%/6.50% |

Source: U.S. Census Bureau; Tax Foundation

State Corporate Income Tax Collections

| State | Collections per capita (2008) | Rank (2008) | Top State Rate (2010) |
|---------------------|-------------------------------------|----------------|--------------------------|
| U.S. | \$167 | -- | |
| Alaska | \$1,433 | 1 | 9.4% |
| New Hampshire | \$466 | 2 | 8.5% |
| Delaware | \$355 | 3 | 8.7% |
| Massachusetts | \$334 | 4 | 8.8% |
| ... | ... | ... | ... |
| Connecticut | \$153 | 20 | 7.5% |
| ... | ... | ... | ... |
| Rhode Island | \$138 | 24 | 9.0% |

Source: U.S. Census Bureau; Tax Foundation. Rhode Island's top rate is exceeded only by Alaska, Minnesota, Pennsylvania, and the District of Columbia.

Combined State & Avg. Local Sales Tax Rate

| State | Rate | Rank |
|------------|-------|------|
| Tennessee | 9.44% | 1 |
| California | 9.08% | 2 |
| Arizona | 9.01% | 3 |
| Louisiana | 8.69% | 4 |
| Washington | 8.61% | 5 |
| New York | 8.52% | 6 |
| Oklahoma | 8.33% | 7 |
| Illinois | 8.22% | 8 |

| State | Rate | Rank |
|---------------------|--------------|-----------|
| ... | ... | ... |
| Rhode Island | 7.00% | 19 |
| ... | ... | ... |
| Massachusetts | 6.25% | 31 |
| ... | ... | ... |
| Connecticut | 6.00% | 33 |

Select Cities:

| | |
|---------------|--------|
| New York City | 8.875% |
| Los Angeles | 9.75% |
| Chicago | 9.75% |

Source: U.S. Census Bureau; Tax Foundation;
Sales Tax Clearinghouse

Breadth of Sales Tax Base

| State | Breadth of Base (2009) | Rank |
|--|------------------------|-----------|
| National Median | 39.27% | -- |
| Average of five states with greatest breadth (HI, WY, SD, NM, ND) | 77.49% | -- |
| Connecticut | 28.65% | 37 |
| Rhode Island | 26.94% | 41 |
| Massachusetts | 24.58% | 45 |
| Average of five states with narrowest breadth (IL, MA, VT, MD, NJ) | 25.12% | -- |

Source: Mikesell, "State Sales Tax in the Great Recession," 57 State Tax Notes 145 (Jul. 19, 2010)

Property Taxes on Owner-Occupied Housing

| State | Median Real Estate Taxes Paid (2009) | Rank |
|---------------------|--------------------------------------|----------|
| New Jersey | \$6,579 | 1 |
| Connecticut | \$4,738 | 2 |
| New Hampshire | \$4,636 | 3 |
| New York | \$3,755 | 4 |
| Rhode Island | \$3,618 | 5 |
| Massachusetts | \$3,511 | 6 |
| <i>U.S. Average</i> | \$1,917 | -- |

Source: U.S. Census Bureau; Tax Foundation. Property taxes paid by renters, businesses, and others are excluded.

Cigarette Tax Rates

| State | Rate | Rank |
|---------------------|---------------|----------|
| New York | \$4.35 | 1 |
| Rhode Island | \$3.46 | 2 |
| Connecticut | \$3.00 | 3 |
| Hawaii | \$3.00 | 3 |
| New Jersey | \$2.70 | 5 |
| Wisconsin | \$2.52 | 6 |
| Massachusetts | \$2.51 | 7 |
| Vermont | \$2.24 | 8 |

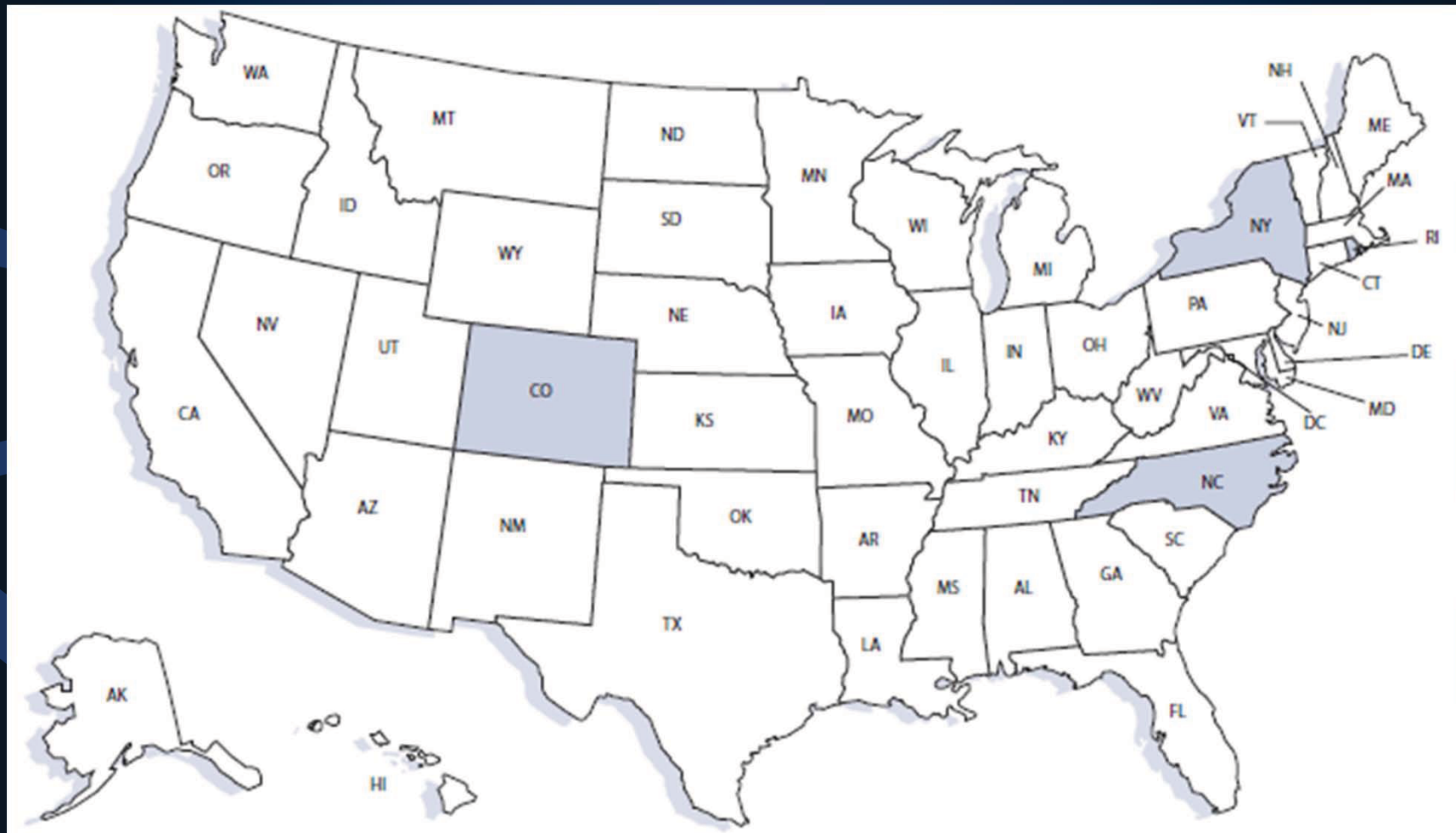
Source: Tax Foundation. As of August 23, 2010

Lottery Sales Per Capita

| State | Sales Per Capita | Rank |
|---------------------|------------------|----------|
| Rhode Island | \$2,275 | 1 |
| South Dakota | \$879 | 2 |
| Delaware | \$846 | 3 |
| West Virginia | \$840 | 4 |
| Massachusetts | \$722 | 5 |
| New York | \$388 | 6 |
| Georgia | \$366 | 7 |
| Oregon | \$331 | 8 |

Source: North American Association of State and Provincial Lotteries; U.S. Census Bureau; Tax Foundation. Fiscal Year 2008.

States with Aggressive Online Retailer Nexus Statutes



Source: <http://www.taxfoundation.org/files/sr176.pdf>

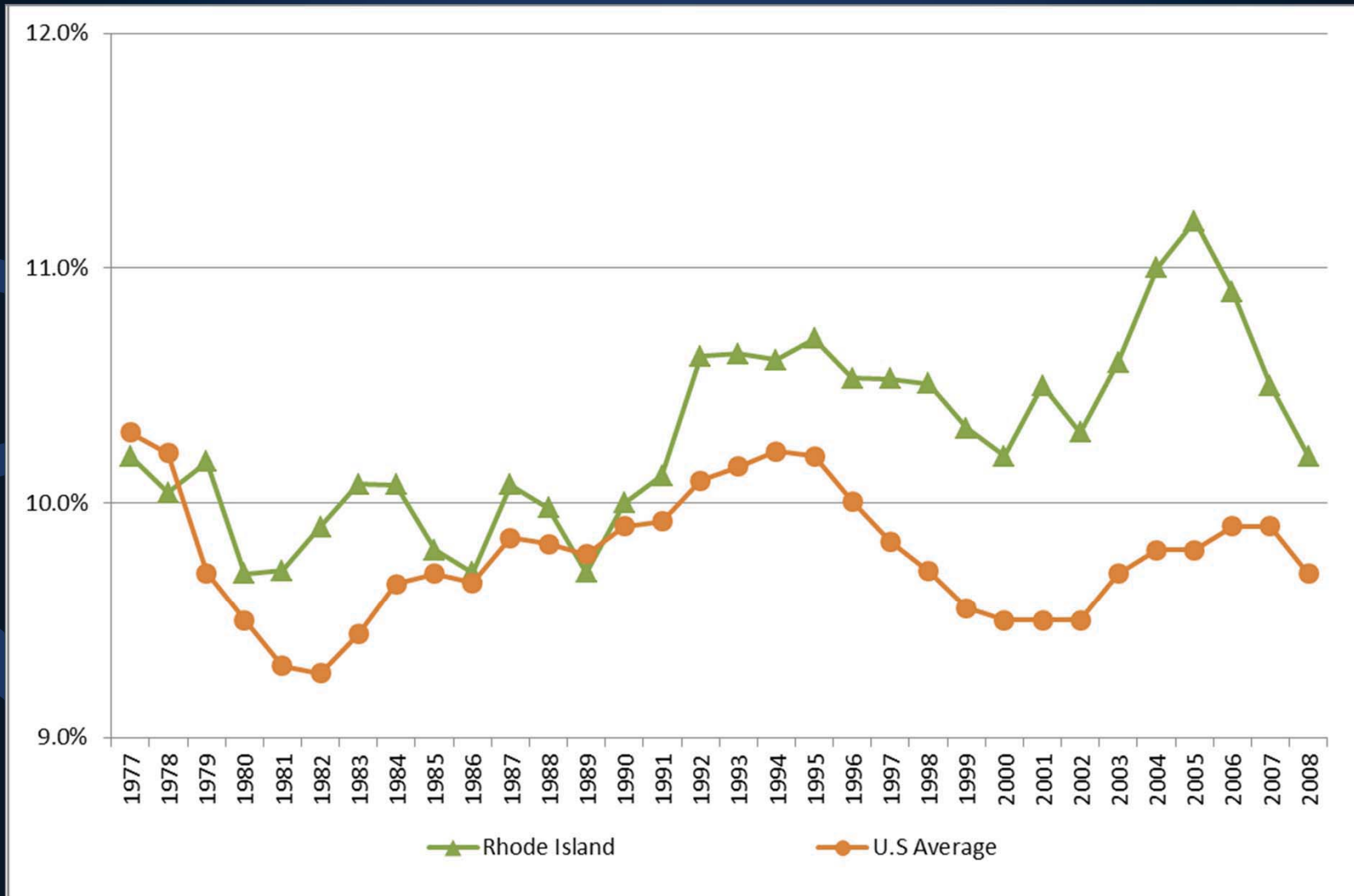
State-Local Tax Burdens

- Percent of residents' income paid in taxes
- Adjusts for tax burden exporting by states
- More relevant than *collections divided by income*
- Does not account for value of government services
- Does not account for regulatory policy benefits/costs or tax collection efficiency
- *How much*

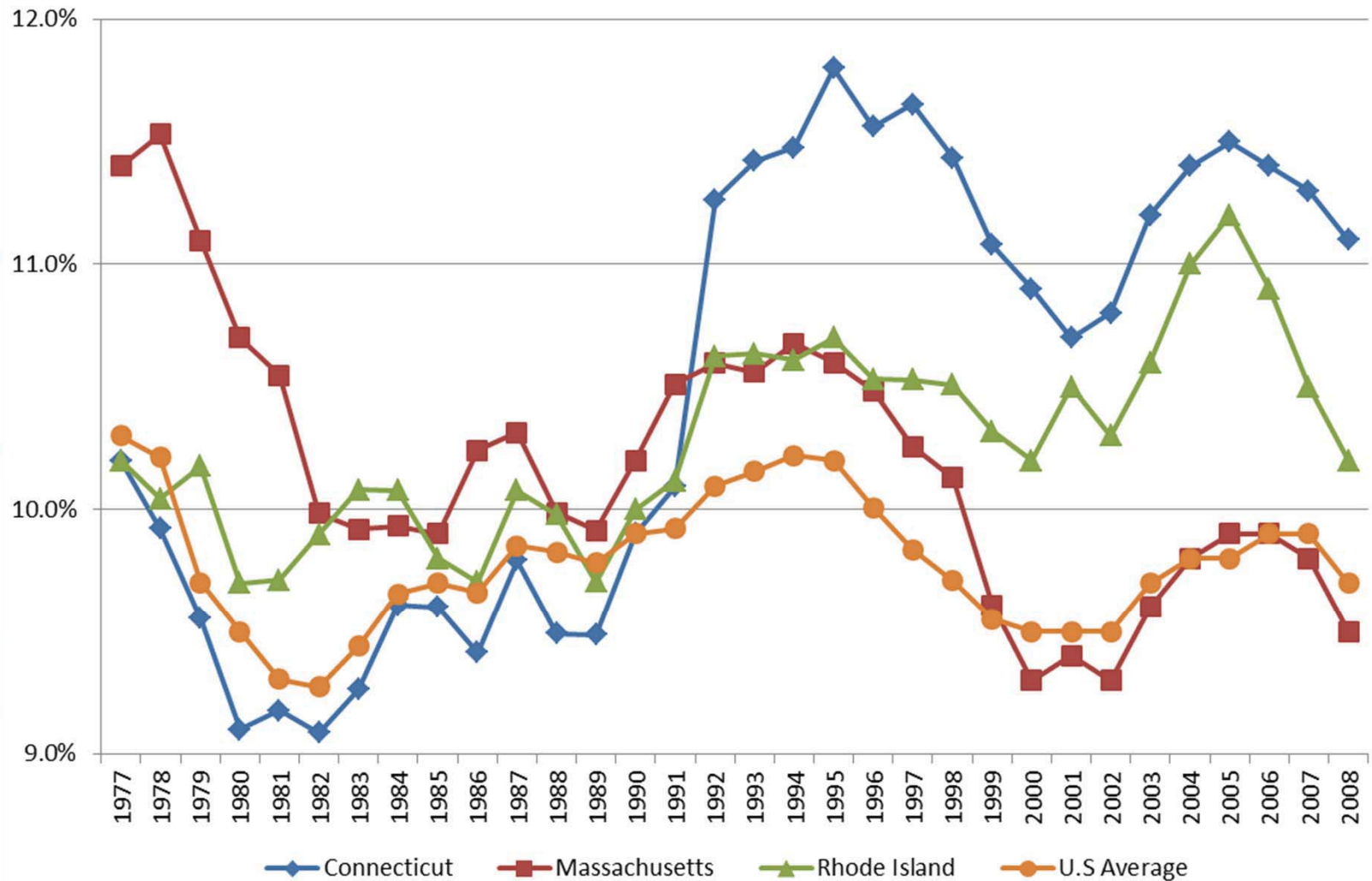
State-Local Tax Burdens

- 2008: Rhode Island residents paid **10.2%** of their income in state and local taxes
 - Massachusetts: 9.5%
 - Connecticut: 11.1%
 - U.S. Average: 9.7%
- 2008: Rhode Island's state-local tax burden ranked **10th highest** in the U.S.
 - Massachusetts: 23rd highest
 - Connecticut: 3rd highest

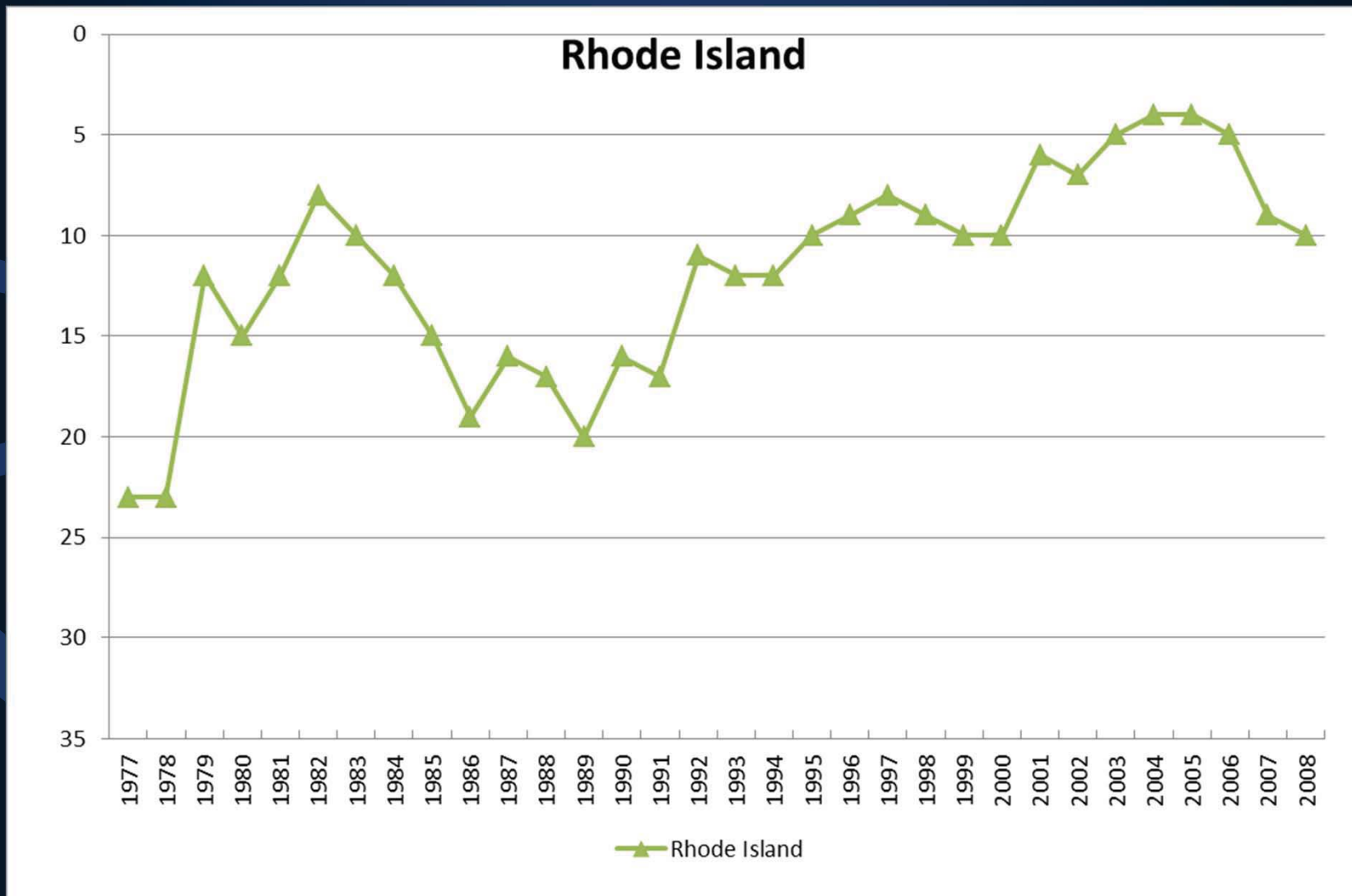
Effective State-Local Tax Burden



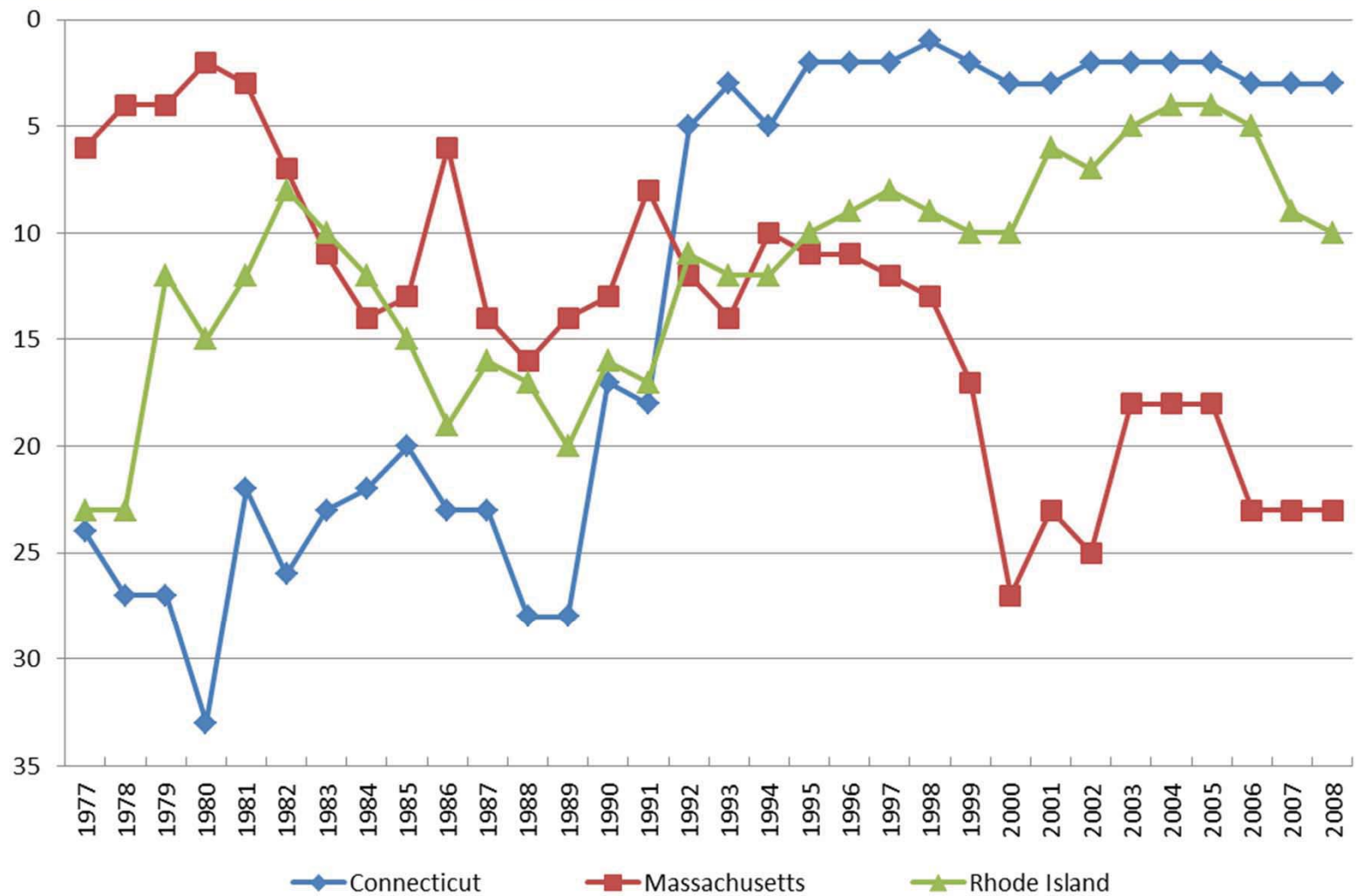
Effective State-Local Tax Burden



State-Local Tax Burden Ranks



State-Local Tax Burden Ranks



State Business Tax Climate Index

- Compares **how** states tax and provide a roadmap for improving state tax structure
- 112 variables measuring how simple, neutral, and transparent a state's tax code is
- Five major categories
 - Corporate Income
 - Individual Income
 - Sales and Use
 - Property
 - Unemployment Insurance

Rhode Island Tax Reform

- Bipartisan effort to lower high top income tax rate
- Reduces top rate from 9.9% to 5.99%
- Cuts number of brackets from five to three
- Increases standard deduction and eliminates itemized deductions
- Phase-outs of standard deduction and personal exemption for high-earners
- Pares income tax credits to 9
- Eliminates alternative flat tax (7% in 2006; 6% now; 5.5% in 2011)
- Effective January 1, 2011

State Business Tax Climate Index

| Rhode Island | Total | Corporate Income | Individual Income | Sales and Use | Property | Unemployment Insurance |
|--------------|-------|------------------|-------------------|---------------|----------|------------------------|
| 2009 | 46 | 40 | 42 | 14 | 43 | 50 |
| 2010 | 44 | 36 | 38 | 13 | 47 | 50 |
| 2011 | | | | | | |

Source: 2011 State Business Tax Climate Index (forthcoming October 2010).

State Business Tax Climate Index

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| 2009 | 46 | 40 | 42 | 14 | 43 | 50 |
| 2010 | 44 | 36 | 38 | 13 | 47 | 50 |
| 2011 | 42 | 37 | 35 | 14 | 47 | 50 |

Source: 2011 State Business Tax Climate Index (forthcoming October 2010).

State Business Tax Climate Index

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|--------------|-------|------------------|-------------------|---------------|----------|------------------------|
| 2009 | 46 | 40 | 42 | 14 | 43 | 50 |
| 2010 | 44 | 36 | 38 | 13 | 47 | 50 |
| 2011 | 42 | 37 | 35 | 14 | 47 | 50 |
| 2011* | 40 | 37 | 32 | 14 | 47 | 50 |

Source: 2011 State Business Tax Climate Index (forthcoming October 2010).

* - Counting income tax reforms that take effect in 2011 as if they were in effect on July 1, 2010.

State Business Tax Climate Index

| | Total | Corporate Income | Individual Income | Sales and Use | Property | Unemplo yment Insuranc e |
|-----------|-----------|---------------------|----------------------|---------------------|-----------|-----------------------------------|
| MA | 33 | 36 | 15 | 24 | 43 | 49 |
| RI | 42 | 37 | 35 | 14 | 47 | 50 |
| CT | 47 | 18 | 47 | 26 | 49 | 30 |
| RI * | 40 | 37 | 32 | 14 | 47 | 50 |

Source: 2011 State Business Tax Climate Index (forthcoming October 2010).

* - Counting income tax reforms that take effect in 2011 as if they were in effect on July 1, 2010.

Taxes Matter

- Rhode Island is competing to be a destination for entrepreneurial activity, capital formation, and productive job creation
- Competitors are not just MA and CT, but all 49 other states and many countries around the world

Taxes Matter

- Two options for income, corporate, and sales tax
 - **High rates and a narrow base**, with lots of gimmicky credits and exemptions for politically connected industries and groups or one-time/short-term activity
 - **Low rates on a broad base**, without officials picking “winners” to get lower tax burdens and “losers” to get higher tax burdens

Tax Foundation on Rhode Island

Rhode Island has shown its willingness to tackle its problematic tax system. Tax pundits were surprised when the state became a flat-tax pioneer, and the broad consensus for improvement means that **this may be the Ocean State's moment**. Rhode Island can compete with its border states and beyond, and it has recently shown the political will to do so. As the economy improves, capital and investment will flow to those states best positioned for it. Rhode Island has a chance to welcome that opportunity, and frankly, the state has nowhere to go but up.

Consensus for Change

- “We are living in a mobile global economy. There are those people who will embark upon entrepreneurship...and they will shop around.”

Sen. Daniel DaPonte (D)

- “A clear message to our citizens, businesses, and neighbors that we are serious about improving our tax competitiveness.”

Gov. Donald Carcieri (R)

- “Let’s tell our neighbors: ‘We are ready to do business.’”

Rep. Steven Costantino (D)

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