# State Fiscal Note For Bill Number: S 2801

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| **Date of State Budget Office Approval:** | **Friday, November 13, 2020** |
| **Date Requested:** | **Monday, January 01, 0001** |
| **Date Due:** | **Thursday, January 11, 0001** |

| Impact on Expenditures | | Impact on Revenue | |
|---|---|---|---|
| FY 2020 | n/a | FY 2020 | n/a |
| FY 2021 | n/a | FY 2021 | $49,277,617 |
| FY 2022 | n/a | FY 2022 | $102,230,225 |

*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 8.99% to the amount of Rhode Island taxable income that exceeds $400,500 in 2011 dollars.

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%.

*Comments on Source of Funds:*

Personal income tax revenues are general revenues.

*Summary of Facts and Assumptions:*

The effective date of the bill is 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 one-half of the succeeding fiscal year's revenue impact. The Office of Revenue Analysis (ORA) has used this accrual-based methodology to provide the budgetary revenue impacts contained in this fiscal note.

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 bill as written sets the new taxable income bracket at "over $400,500" 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 $455,400 in 2018 dollars. TY 2018 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 2018 personal income tax returns simulation model adjusted to reflect current tax law as of TY 2020. 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 2018, a marginal tax rate of 3.75% was applied to the first $62,550 of taxable income, taxable income over $62,550 but less than or equal to $142,150 was taxed at a rate of 4.75%, and taxable income amounts that exceeded $142,150 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 2018 values of the taxable income brackets to the fourth additional bracket proposed in the bill. Thus, in the personal income tax simulation, ORA applied the 5.99% tax rate to taxable income amounts over $142,150 but less than or equal to $455,400 and the 8.99% tax rate to all taxable income in excess of $455,400 for resident and nonresident tax returns that were filed for TY 2018. The results of this simulation were then compared to actual TY 2018 personal income tax revenues generated by the state's TY 2018 personal income tax adjusted to reflect TY 2020 law.

ORA excluded from the personal income tax simulation results, those tax returns for which the new taxable income bracket of 8.99% at taxable income above $455,400 would generate an increase in personal income tax liability of $200,000 or more. This was done to account for reductions in the realization of taxable income by upper income taxpayers in response to the new higher tax rates. It should be noted that 84 tax returns were found to have a tax increase greater than $200,000 under the bill and that these taxpayers would face an estimated tax increase of $40.350 million with a range from $200,000 to over $3.0 million. The results of the personal income tax simulation excluding these 84 tax returns indicate that enactment of the bill would increase personal income tax revenues by 7.2677%.

Using the TY 2018 personal income tax simulation model, ORA determined that resident and nonresident TY 2018 personal income tax liability under TY 2018 law was $1,242,307,344. This amount solely represents payments made by taxpayers for TY 2018. 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

*Summary of Facts and Assumptions:*

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 2018 personal income tax revenues to total personal income tax revenues received in calendar year 2018 of $1,318,375,783 to arrive at an estimate of the ratio of total calendar year personal income tax revenues that TY 2018 payments comprise of 94.2301% (i.e., $1,242,307,344 / $1,318,375,783).

The ratio of TY 2018 personal income tax revenues to CY 2018 personal income tax revenues was applied to the FY 2022 estimate of personal income tax revenues as adopted at the November 2020 Revenue Estimating Conference (REC) of $1,439,100,000. This calculation yields estimated TY 2021 personal income tax payments of $1,356,065,943 realized in FY 2022 (i.e., $1,439,100,000 * 0.942301). Applying the 7.2677% 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 $98,555,234 in TY 2021 attributable to adding a fourth additional tax bracket at a rate of 8.99% for taxable income above $400,500 in 2011 dollars (i.e., $1,356,065,943 * 0.072677). The two percentages described above were also applied to $1,546,424,184, where ORA's projection of FY 2023 personal income tax revenues is based on the ratio of the average of the FY 2021 and FY 2022 personal income tax revenue estimates adopted at the November 2020 REC to the average of the FY 2021 and FY 2022 personal income tax revenue estimates projected by ORA for the November 2020 REC multiplied by the FY 2023 personal income tax revenue estimate projected by ORA for the November 2020 REC. This calculation yielded an estimated $105,905,217 in additional TY 2022 personal income tax revenue from the addition of a fourth personal income tax bracket as proposed in the bill (i.e., 0.942301 * $1,546,424,184 * 0.072677).

Employing the Office of Accounts and Controls accrual methodology yields budgetary revenue gains from the passage of this bill for FY 2021 of $49,277,617 (i.e., 0.5 * $98,555,234) and for FY 2022 of $102,230,225 (i.e., 0.5 * $98,555,234 + 0.5 * $105,905,217).

*Summary of Fiscal Impact:*

FY 2020: Not applicable given the effective date of the bill's provision of tax years beginning on or after January 1, 2021.

FY 2021: A revenue gain of $49,277,617 is forecast.

FY 2022: A revenue gain of $102,230,225 is forecast.

*Fiscal Advisor's Approval:*

*Signature:* Thomas A. Mullaney