

**Date of State Budget Office Approval:**

**Date Requested:** Friday, January 29, 2016

**Date Due:** Monday, February 08, 2016

**Impact on Expenditures**

FY 2016 n/a  
 FY 2017 n/a  
 FY 2018 n/a

**Impact on Revenues**

FY 2016 \$(24,643,577)  
 FY 2017 \$(50,232,093)  
 FY 2018 \$(52,471,120)

*Explanation by State Budget Office:*

This bill would amend Rhode Island General Law Chapter 44-30 entitled "Personal Income Tax" by adding to Rhode Island General Law Section 44-30-12(c) titled "Rhode Island income of a resident individual – Modifications reducing federal adjusted gross income" a deduction for the first \$15,000 of income received when an individual withdraws from any retirement or savings plan.

Under current law, Rhode Island's personal income tax system's starting point is federal Adjusted Gross Income (AGI) and thus Rhode Island taxes all income withdrawn by an individual from any retirement or savings plan to the extent that such income is included in federal AGI.

*Comments on Sources of Funds:*

All personal income taxes are considered to be general revenues.

*Summary of Facts and Assumptions:*

The bill takes effect upon passage. For simplicity, the Office of Revenue Analysis (ORA) assumed the bill would be applicable to tax years beginning on or after January 1, 2016. Based upon the accrual methodology employed by the Office of Accounts and Controls, 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 has used this accrual based methodology to provide the budgetary revenue impacts contained in this fiscal note.

The bill as drafted allows resident taxpayers to exempt the first \$15,000 of income withdrawn from a retirement or savings plan from the personal income tax. ORA developed the revenue impacts of the bill to include use of the proposed exemption by both resident and nonresident taxpayers due to the assumption that nonresident taxpayers would be allowed the exemption as well under Rhode Island General Law Section 44-30-32(c) titled "Rhode Island income of a nonresident individual – Income and deductions partly from Rhode Island sources."

The bill allows a modification reducing federal AGI for any withdrawal, up to \$15,000, by individual from any retirement or savings plan. The term "retirement or savings plan" is not defined in the bill. ORA assumed that a "retirement or savings plan" meant a public or private pension plan, interest income, a 401K plan, or an individual retirement account as determined by the United States Internal Revenue Service. It should be noted that a savings plan could have a very broad interpretation to include non-retirement based savings accounts such as Christmas Clubs. The bill should be modified to specifically define what savings plans the withdrawals from

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which would be eligible for the modification reducing federal AGI.

ORA estimated that in tax year 2013 (TY 2013) 88,591 Rhode Island resident taxpayers would have received a tax benefit under the bill. These 88,591 Rhode Island resident taxpayers received \$2.5 billion in taxable retirement benefits that are included in federal AGI. In order to estimate the fiscal impact of the bill, ORA reduced each eligible individual's Rhode Island adjusted gross income (RI AGI) by the modification under the proposed legislation up to a maximum of \$15,000. After reducing RI AGI for the proposed income received from public and private pensions, interest income, 401K plans and individual retirement accounts modification, ORA ran each tax filer through ORA's personal income tax simulation model adjusted to incorporate TY 2016 current tax law. Allowing the deduction of the first \$15,000 of taxable retirement benefits per filer in federal AGI generated \$34,616,429 less in Rhode Island personal income tax revenue in TY 2013 adjusted to reflect TY 2016 law than under current law where no such deduction is allowed.

According to the United States Internal Revenue Service's, TY 2013 Statistics of Income (SOI) by State there were a total of 517,840 Rhode Island resident returns. The SOI data typically encompasses all tax returns that were processed for a given tax year, including returns that were placed on extension at the April 15 due date. ORA analyzed 505,659 returns provided by the Department of Revenue's Division of Taxation. The difference between the SOI number of Rhode Island resident tax returns and the number of returns provided by the Division of Taxation, a total of 12,181 returns, are assumed to be returns that were on extension at the federal level at the time the Division of Taxation provided ORA with the TY 2013 tax returns. As a result, the revenue impact provided in this fiscal note should be considered a minimum impact.

Rhode Island resident personal income tax collections from the TY 2013 file adjusted to reflect TY 2016 law were \$805,193,626. Thus, income taxes generated from the first \$15,000 of taxable retirement benefits of Rhode Island residents are estimated to comprise 4.30 percent of resident personal income tax revenues (i.e. \$34,616,429 / \$805,193,626). ORA could not directly estimate non-resident taxable retirement benefits which would also be exempt from Rhode Island personal income taxes. As a result, it applied the same percentage calculated for resident TY 2013 returns to the non-resident personal income tax collections from the TY 2013 file adjusted to match TY 2016 law of \$176,106,895 to arrive at a TY 2013 estimate of \$7,579,494 in personal income tax payments from the inclusion of the first \$15,000 of taxable retirement benefits in Rhode Island taxable income for non-resident filers. The total amount of personal income tax revenue the state receives from the first \$15,000 of taxable retirement benefits is therefore estimated to be \$42,195,922 in TY 2013 (i.e., \$34,616,429 + \$7,579,494).

The TY 2013 resident and non-resident actual personal income tax receipts of \$1,006,843,088 represent payments made by taxpayers for that particular tax year estimated by ORA. It is important to distinguish between a particular tax year's receipts 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 TY 2013 actual personal income tax receipts to total personal income taxes received in calendar year 2013 of \$1,111,538,070 to arrive at a ratio of TY 2013 personal income tax payments received to total calendar year 2013 personal income tax receipts of 90.5811 percent (i.e., \$1,006,843,088 / \$1,111,538,070).

The ratio of TY 2013 actual personal income tax payments to CY 2013 personal income tax receipts was applied to the November 2015 Revenue Estimating Conference's personal income tax revenues estimate for FY 2017 of \$1,265,400,000 to arrive at TY 2016 estimated personal income tax revenues of \$1,146,212,872 (i.e.,  $0.905811 * \$1,265,400,000$ ). The percentage of personal income tax revenues foregone from exempting the first \$15,000 of taxable withdrawals from retirement or savings plans included in federal AGI for Rhode Island resident and non-resident taxpayers was applied to the FY 2017 estimate of TY 2016 personal income tax revenues to arrive at an estimate of \$49,287,153 in TY 2016 personal income tax revenues foregone (i.e.,  $\$1,146,212,872 * 0.043$ ) from passage of the bill. This same process was repeated for the Budget Office's projection of personal income tax revenues for FY 2018 of \$1,313,920,805 to yield an estimated \$51,177,032 in Rhode Island personal income tax revenue foregone from exempting the first \$15,000 of taxable withdrawals from retirement or savings plans included in federal AGI from the Rhode Island income tax for TY 2017 (i.e.,  $(0.905811 * \$1,313,920,805) * 0.043$ ). Similarly for FY 2019, the Budget Office projects personal income tax revenues of \$1,380,369,710 which results in estimated foregone personal income tax revenues from the first \$15,000 of taxable withdrawals from retirement or savings plans included in federal AGI from the Rhode Island income tax for TY 2018 of \$53,765,208 (i.e.,  $(0.905811 * \$1,380,369,710) * 0.043$ ).

Employing the Office of Accounts and Controls accrual methodology yields budgetary revenue losses for FY 2016 of \$24,643,577 (i.e.,  $0.5 * \$49,287,153$ ), for FY 2017 of \$50,232,093 (i.e.,  $0.5 * \$49,287,153 + 0.5 * \$51,177,032$ ) and for FY 2018 of \$52,471,120 (i.e.,  $0.5 * \$51,177,032 + 0.5 * \$53,765,208$ ).

The Governor's FY 2017 Recommended Budget projects a closing surplus of \$81.7 million in FY 2016 and \$519,565 in FY 2017. Passage of this bill will decrease the projected surplus in FY 2016 and put the Governor's FY 2017 Recommended Budget out of balance.

*Summary of Fiscal Impact:*

FY 2016: A minimum revenue loss of \$24,643,577 is forecast.

FY 2017: A minimum revenue loss of \$50,232,093 is forecast.

FY 2018: A minimum revenue loss of \$52,471,120 is forecast.

Budget Office Signature: 

Fiscal Advisor Signature: 

*See attached comments*

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**House Fiscal Advisor Comments H 7272:**

As presented, the Fiscal Note does not identify potential issues with a change in tax rate after the tax year has begun. In the past, such changes have applied to the upcoming tax year, in this case the year beginning January 1, 2017. The impacts would be similar to those reported, but shift one year.