The Providence Journal projo.com

Business

Study suggests eliminating R.I.'s capital gains tax break

01:00 AM EDT on Saturday, March 21, 2009

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Rhode Island could save more than $49 million a year by eliminating the favorable tax treatment that the state currently allows on capital gains, a new report says.

Rhode Island is one of only nine states that currently offer a significant tax break to taxpayers who profit from the sale of stock, bonds and other such investments, according to the report issued yesterday by the Institute on Taxation and Economic Policy (ITEP).

The other states are Arkansas, Hawaii, Montana, New Mexico, North Dakota, South Carolina, Vermont and Wisconsin, the report said.

Treating capital gains the same as ordinary income could help Rhode Island cut its budget deficit, according to ITEP, a nonprofit group in Washington, D.C., which obtains funding from the National Education Association, J.C. Penney Foundation and Ford Foundation, among others.

Rhode Island House Finance Committee Chairman Steven M. Costantino has estimated the deficit to be at least $357 million for the year ending June 30, and between $400 million and $500 million — "possibly more" — for the year beginning July 1.

Jeff McLynch, ITEP's northeast regional director and one of the authors of the report, said, "Right now, legislators across the country are searching for solutions to mounting budget deficits, solutions that will allow them to finance vital public services without placing additional responsibilities on those families struggling to make ends meet. Repealing costly, inequitable and ineffective tax breaks like Rhode Island's preferential tax rates are the first place they should look."

Kate Brewster, executive director of the Poverty Institute at the Rhode Island College School of Social Work, which analyzes tax and budget policies on behalf of low-income people, said, "Rhode Island's capital gains preferential tax rates deprive the state of millions of dollars in needed funds, benefit almost exclusively the very wealthiest members of our communities and fail to promote economic growth."

She added, "Investment income should be taxed at the same level as the wages of hard-working Rhode Islanders, not less."

Under current law, Rhode Island tax treatment of capital gains differs depending mainly on how long an asset was held before it was sold.

For example, profit from the sale of stock held for 12 months or less is generally treated as ordinary income, the same as wages or bank-account interest, and taxed at rates up to 9.9 percent.

Rhode Island's favorable tax treatment of capital gains typically kicks in only for assets held more than a year. In general, the longer the holding period, the more favorable the tax treatment.

For example, profit from the sale of an asset held more than five years may be taxed at 1.67 percent — or 0.83 percent in some circumstances.

Governor Carcieri's tax-reform panel on March 9 proposed a variety of changes to the state's personal-income tax system, including the elimination of favorable tax treatment of capital gains and a reduction in the state's top rate, to 5.5 percent from the current 9.9 percent.

Carcieri on March 10 proposed many of the same changes, which he recommended take effect in 2011. Any such changes would be subject to General Assembly approval.

Mark Higgins, dean of the University of Rhode Island's College of Business Administration, who was a member of the panel, said yesterday that, because of market conditions, "I don't think there's going to be any capital gains to be had in 2009." And if the General Assembly approves the panel's recommendations, there would be no preferential treatment of capital gains in future years, he said.

The panel's proposed 5.5-percent top marginal rate, if adopted, would still be higher than the 5.3-percent rate that prevails in Rhode Island's neighboring state of Massachusetts, Higgins said.

Amy Kempe, a spokeswoman for Carcieri, said yesterday that she had not had a chance to read the ITEP report, but added, "The Governor's [stance] has not changed in terms of his position on tax reform," which was driven by the findings of his study panel.

A statistical report compiled in 2008 by the Rhode Island Division of Taxation showed that, out of a total of 491,750 resident state income tax returns, about 70,096 — or 14 percent of the total — included capital gains in 2006.

Capital gains showed up on returns from taxpayers in lower-income brackets, middle-income brackets and higher-income brackets, according to the report, based on data for the 2006 tax year.

Nevertheless, the bulk of the income from capital gains — and most of the benefit from favorable capital gains tax treatment — goes to those with incomes of more than $200,000, Brewster said.

The ITEP report, citing federal income-tax data for 2006, said that taxpayers with adjusted gross incomes of less than $50,000 made up 66 percent of all federal returns filed by Rhode Islanders, but 11 percent of returns with income from capital gains.

The ITEP report is available on the group's Web site:

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