



## Testimony Relating to H-7127 Budget Article 5, Section 6

Proposed 4<sup>th</sup> Personal Income Tax Bracket

House Committee on Finance

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The Economic Progress Institute **supports as a good first step the Governor’s proposal in Article 5, Section 6 of his recommended FY2027 Budget to add a 4<sup>th</sup> Personal Income Tax bracket to tax income above \$1 million at 8.99%**, 3% above the current top rate. However, we think the proposal would be made stronger by including all taxable income above a Top 1% cutoff of \$640,000.

My purpose in this written testimony is to dispel some common myths and to reassure members of the House Finance Committee that **this proposal will not impact any of Rhode Island’s struggling small business owners. It will affect few small business owners, and those it affects cannot, by definition, be struggling – because they will have taxable income above \$1 million, after all exemptions and deductions.**

*Here are the facts:*

- Approximately **90% of all filers claiming PTE income are NOT in the Top 1%** and *will not pay a penny more*. For a millionaires tax, even fewer filers would be affected.
- Most of the approximately 10% in the Top 1% are not “small ‘mom and pop’ businesses.” Millionaire and Top 1% PTE filers include:
  - **Passive investors not involved in running a business**
  - Filers with **vacation rentals or other properties producing revenue**
  - Self-employed professionals, including consultants
  - People with **income from trusts**
- For the millionaire and Top 1% filers, PTE income accounts for only about **20% of their total income**, which contains even more in **capital gains, which are taxed at a lower rate than wage income at the federal level**.
- There is **no good evidence that business owners use money saved through PTE filing to pay more to non-owner employees, hire more employees, or expand their businesses**.
- **Business expenses are generally deductible and therefore exempt from taxation**. This applies to profits that business owners reinvest in their businesses in the same tax year.

Please see the attached example for a small business illustration of this.

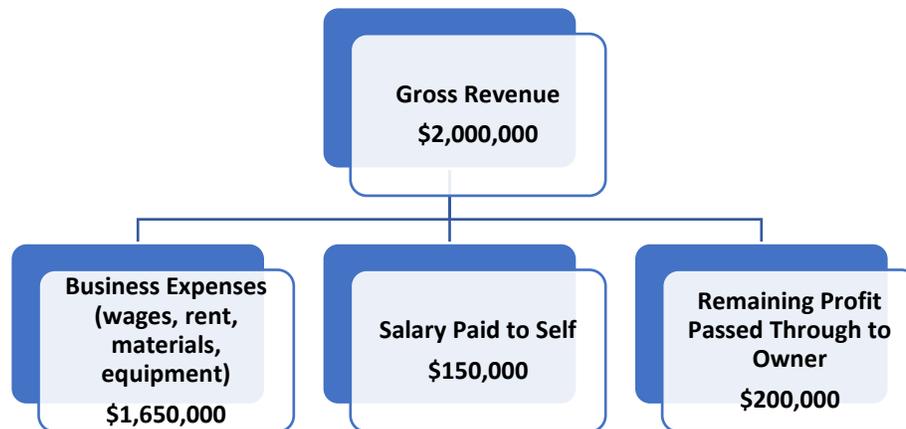


## QUESTION: Would a Top 1% or Millionaires Tax Impact Sally and Sam, Owners of Mom & Pop Shop on State House Lane in Providence?

Sally is a Rhode Island small business owner with \$2 million in Gross Revenue, the amount she takes in before spending anything on running her business. Her husband, Sam, helps with the business but also has a full-time job as a lawyer earning \$300,000 a year, and they have two school-age children. Sally's Mom & Pop Shop is registered as an S-Corp and is a Pass-Through Entity (PTE).

Most of the \$2 million in Gross Revenue is Operating Income, meaning that she spends it to pay her employees, to cover her rent, and purchase various supplies and equipment. Operating Income does not include taxes she owes, and even though it's called "income", it's not taxable. None of these expenses are taxed at all if she pays for them in the same year she takes in the Gross Revenue.

Let's take a look at the numbers and figure out if a new tax on high-income tax filers could possibly affect Sally and her family!



Neither the business nor Sally pay any taxes on the \$1,650,000 in business expenses.

Sally could pass through the entire \$200,000 in profits to her personal income taxes, but she will save \$3,000 in federal taxes by electing to take the PTE option. This means her business will pay the taxes on the \$200,000 and then pass through to her a credit for those paid taxes for her personal income tax return.



She also gets to take advantage of the 20% Qualified Business Income (QBI) deduction, a benefit unavailable for regular salary or wages.

Profit	\$200,000
5.99% PTE Tax paid by the business entity	-\$11,980
Federal Pass-Through Income	\$188,020
Federal W-2 Income for Sally	\$150,000
Federal W-2 Income for Sam	\$300,000
<b>Total Federal Income</b>	<b>\$638,020</b>
Standard Deduction	-\$29,000
20% QBI Deduction	-\$37,604
<b>Federal Taxable Income</b>	<b>\$571,400</b>
<b>Total Federal Personal Income Taxes</b>	<b>\$158,000</b>
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State Income (Salary + Business Profit)	\$650,000
Standard Deduction & Exemptions	-\$35,000
<b>RI Taxable Income</b>	<b>\$615,000</b>
Total RI Personal Income Tax Owed	\$33,200
PTE Credit from taxes paid by business entity	-\$11,980
<b>RI Personal Income Tax Paid after PTE Credit</b>	<b>\$21,220</b>
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<b>Total Federal and State Taxes Paid</b>	<b>\$179,220</b>
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<b>Additional owed w/millionaires tax</b>	<b>\$0</b>
<b>Additional owed w/Top 1% tax with \$640,000 taxable income cutoff</b>	<b>\$0</b>

Sally and Sam would not come close to having to pay any additional taxes if Rhode Island institutes either a millionaires tax or a Top 1% tax. Neither would the vast majority of Rhode Island's 100,000 or so small business owners. Approximately 90% of Rhode Islanders claiming any pass-through income **are not in the Top 1%**. And the 10% who do are mostly not your typical mom & pop business owners. Revenue from a Top 1% surtax would help Rhode Island's small business owners because of the additional investments in public transit, education, child care, and job training such revenue will make possible.

**ANSWER: Sally and Sam, Owners of Mom & Pop Shop on State House Lane in Providence would pay NOTHING ADDITIONAL under either a Top 1% or Millionaires Tax.**

