

CLIENT ALERT

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Rhode Island Reduces Capital Gains Tax Rate for Individuals

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Beginning January 1, 2007, individuals who incur capital gains for capital assets held more than five years will be taxed at a new rate in Rhode Island. Legislation enacted in 2001 by the Rhode Island General Assembly changed the tax rate assessed on individual taxpayers for certain capital gains transactions (RIGL 44-30-2.7). The legislation deferred the effective date of the change until January 1, 2007.

The new rate will be 8.33% of the federal capital gains rate (20%) that was in effect prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (also known as "EGTRRA"). This results in a favorable tax rate of 1.67% (8.33% times 20%).

When to Cash In:

As an example, if you sell stock in 2006 that qualifies as a capital asset and that has been held for the requisite five-year period and your gain is \$5000, the Rhode Island personal income tax due would be \$250. If you wait until 2007,

the tax due would be \$83.50. A careful assessment of the stock market, real estate values and the values of other capital assets is needed to determine whether any potential reduction in value due to market fluctuation would more than offset the tax savings that can be achieved by waiting until 2007 and beyond to cash in.

In addition, beginning in 2008, the capital gains rate for capital assets held more than five years will be 0%. For capital assets held less than five years, but more than one year, the previous Rhode Island capital gains rate of 5% will remain in effect and continue to apply.

One final note, Rhode Island's new elective "flat tax" system is available for tax year 2006 and thereafter. If the flat tax system is used, capital gains will be taxed at 7.5% in 2007 versus the 1.67% rate. Taxpayers should keep this in mind when considering a flat tax election.

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Mr. Morganelli advises clients concerning federal and state tax issues and in the development of state and local tax strategies to enhance tax filing positions and satisfy compliance obligations. He has experience negotiating with multiple state agencies and state revenue departments.

If you have questions about this Client Alert or other tax issues, please feel free to contact David C. Morganelli, Kathleen A. Ryan or Lawrence D. Hunt.

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