



State Fiscal Note for Bill Number: 2015-H-5116

Date of State Budget Office Approval:

Date Requested: Wednesday, February 04, 2015

Date Due: Saturday, February 14, 2015

Impact on Expenditures

FY 2015 n/a
FY 2016 n/a
FY 2017 n/a

Impact on Revenues

FY 2015 n/a
FY 2016 See below
FY 2017 See below

**Explanation by State
Budget Office:**

This act would amend Rhode Island General Law by adding Chapter 44-70 entitled "Rhode Island New Qualified Jobs Incentive Act of 2015". Under this chapter, any eligible company, defined as "any corporation (including a subchapter S corporation as defined in 26 U.S.C. section 1361), state bank, federal savings bank, trust company, national banking association, bank holding company, loan and investment company, mutual savings bank, credit union, building and loan association, insurance company, investment company, broker-dealer company or surety company, limited liability company, partnership (including an eligible subsidiary of any of the foregoing), or sole proprietorship", that meets certain employment criteria would be entitled to a reduction in the tax rate imposed by Rhode Island General Law Chapters 44-11 entitled "Business Corporation Tax" (Section 44-11-2(a) titled "Imposition of tax"), 44-14 entitled "Taxation of Banks" (Sections 44-14-3(a) titled "Tax on state banks" and 44-14-4 titled "Tax on national banks"), 44-17 entitled "Taxation of Insurance Companies" (Section 44-17-1 titled "Companies required to file – Payment of tax – Retaliatory rates"), 44-13 entitled "Public Service Corporation Tax" (Section 44-13-4(4) titled "Rate of taxation"), 44-30 entitled "Personal Income Tax" (Sections 44-30-2.6 titled "Rhode Island taxable income – Rate of tax" and 44-30-2.10 titled "Alternative flat tax rate") of 0.25 percentage points for each unit of new employment added between June 30, 2015 and December 31, 2017. The maximum rate reduction allowed in the act is 6.0 percentage points for taxes paid under Rhode Island General Law Chapters 44-11, 44-13, 44-14, and 44-17 and 3.0 percentage points for taxes paid under Rhode Island General Law Chapter 44-30. In addition, the rate reduction allowed against the personal income tax can be applied "only to the portion of net income of such taxpayer attributable to the eligible company". Furthermore, if any eligible company fails to maintain the number of units of new employment at the level reported in tax year 2015 in any taxable year beginning on or after December 31, 2017, then the rate reduction earned under the act expires permanently.

The act defines a unit of new employment as follows: "(i) For eligible companies which are not small business concerns, the amount of new employment divided by fifty (50), rounded down to the nearest multiple of fifty (50); and (ii) For eligible companies which are small business concerns the amount of new employment divided by ten (10), rounded down to the nearest multiple of ten (10)." A small business concern is an eligible company that has a base employment level of less than 100 employees where the base employment level is defined as "the aggregate number of qualified full-time active equivalent employees employed within Rhode

Island by an eligible company on July 1, 2015". New employment is the level of adjusted current employment determined as of December 31 of each year less the amount of the eligible company's base employment. Adjusted current employment is, for taxable years ending on or after June 30, 2015, "the aggregate of the average daily number of qualified full-time equivalent active employees employed within the state by an eligible company during such taxable year". A qualified full-time equivalent active employee is defined as "any employee of an eligible company who: (i) works a minimum of thirty (30) hours per week within the state, or two (2) or more part-time employees whose combined weekly hours equal or exceed thirty (30) hours per week within the state; (ii) Earns health care benefits; and (iii) Earns no less than two hundred fifty percent (250%) of the hourly minimum wage prescribed by Rhode Island law."

Finally, the act requires the Division of Taxation to report by August 15th of each year, the name, address and the amount of "credit" received by each eligible company during the prior fiscal year. The act also requires the eligible companies that receive a tax benefit under the act to file with the Division of Taxation by September 1st of each year, a report that contains "each full-time equivalent active employee's name, date of hire, and hourly wage as of the immediately preceding July 1 and such other information deemed necessary" by the Tax Administrator.

*Comments on
Sources of Funds:*

All business corporations, financial institution, public utilities gross earnings, insurance companies gross premiums and personal income taxes are considered to be general revenues.

*Summary of Facts
and Assumptions:*

The bill takes effect upon passage but the rate reduction provided for in the bill would apply to each taxable year ending on or after June 30, 2015.

The bill essentially extends the tax rate reduction contained in Rhode Island General Law Chapter 42-64.5 entitled "Jobs Development Act" to subchapter S corporations, limited liability companies, partnerships and sole proprietorships. All other business entities included in the act are already eligible for an identical rate reduction under Rhode Island General Law Section 42-64.5-3 titled "Tax rate reduction". The remaining criteria in the bill, including the "reduction rate schedule" are the same as those found in Rhode Island General Law Chapter 42-64.5 except for the definition of a full-time active equivalent employee. In Rhode Island General Law Chapter 42-64.5, an eligible full-time equivalent active employee hired after July 1, 2009 must work a minimum of 30 hours per week within the state, earn at least 250.0 percent of the Rhode Island minimum wage in effect at the time the employee is declared a full-time equivalent active employee, and earn healthcare insurance and retirement benefits. The bill would retain the wage and benefit requirements but allow for "two (2) or more part-time employees whose combined weekly hours equal or exceed thirty (30) hours per week within the state" to also count toward the determination of a full-time equivalent active employee. In addition, the bill only requires that health care benefits be made available to a full-time active equivalent employee while Rhode Island General Law Chapter 42-64.5 requires both health care benefits and retirement benefits be made available for an employee to be eligible for consideration as a full-time active equivalent employee. For purposes of consistency, this language should be amended to match that of Rhode Island General Law subsection 42-64.5-2(7).

The Office of Revenue Analysis (ORA) used the Internal Revenue Service Statistics of Income (SOI) for TY 2012 to determine the fiscal impact of the act. In particular, ORA looked at the TY 2012 SOI data for Rhode Island residents. ORA used the line in the TY 2012 SOI table for Rhode Island residents titled "Partnership/S-corp net income (less loss)" as the act would apply to these taxpayers. The "Partnership/S-corp net income (less loss)" line in the TY 2012 SOI data for Rhode Island residents indicates that 27,530 Rhode Island resident taxpayers reported partnership/S corporation net income (less loss) of \$1,604,571,000 in TY 2012. This partnership/S corporation net income (less loss) was spread across all nine tax brackets included in the IRS' TY 2012 SOI report. ORA used the TY 2012 personal income tax returns database to calculate effective tax rates for each of these nine tax brackets. The effective tax rates ranged from 0.03 percent to 4.89 percent. Each effective tax rate was applied to the amount of partnership/S corporation net income (less loss) reported for each tax bracket in the TY 2012 SOI table in order to estimate the amount of tax that was paid on said income. ORA then summed the estimated tax paid across all nine income tax brackets to arrive at an estimated total tax paid of \$75,095,814 for TY 2012.

To determine the impact of the act on state revenues, ORA used the Division of Taxation's Tax Credit and Incentive Report – Fiscal Year 2013. FY 2013 was chosen as it is the fiscal year most closely aligned with TY 2012. In FY 2013, \$15,283,897 in tax benefits were earned under the rate reduction available in Rhode Island General Law Chapter 42-64.5. ORA used the audited business corporation tax revenues for FY 2013 less the amount of business corporation tax revenues attributable to minimum tax payments of \$104,843,907 (i.e., \$131,827,907 \$26,984,000). Under Rhode Island General Law Chapter 42-64.5, the rate reductions earned by eligible companies range from 0.5 percentage points to 4.75 percentage points. The act limits the rate reduction allowed against the personal income tax (i.e., Rhode Island General Law Section 44-30-2.6) for shareholders of eligible companies to a maximum of 3.0 percentage points. ORA recalculated the tax benefit associated with the rate reduction under Rhode Island General Law Chapter 42-64.5 under the assumption that no recipient could earn a rate reduction of greater than 3.0 percentage points. This recalculation resulted in a tax benefit of \$10,455,885 in FY 2013 versus the actual tax savings of \$15.3 million. Taking the ratio of the recalculated tax savings to the audited FY 2013 business corporation tax revenues less the minimum payments yields a percentage of revenue foregone of 9.973 percent. ORA multiplied this percentage by the estimated total tax paid of Rhode Island residents with partnership/S corporation net income (less loss) of \$75,095,814 to arrive at a projected revenue loss of \$7,489,164 in TY 2012 had the bill been in place.

ORA used the Rhode Island Division of Taxation's Statistics of Personal Income for TY 2012 to calculate the net tax paid by Rhode Island residents. ORA took the \$1,008,471,103 of "Tax Table Amount" and subtracted the value of all the credits used (except for "Historic Tax Credit Amount" which was reimbursed to the General Fund from the Historic Preservation Tax Credit Trust Fund) to arrive at a net tax paid in TY 2012 by Rhode Island residents of \$836,312,382. ORA then took the ratio of the estimated tax revenue foregone under the act of \$(7,489,164) to the net

tax paid in TY 2012 by Rhode Island residents of \$836,312,382 to yield the estimated percentage of revenue foregone in TY 2012 had the bill been in place. This figure is 0.8955 percent.

At the May 2015 Revenue Estimating Conference (REC), the principals' adopted estimate for personal income taxes for FY 2016 is \$1,228,200,000. The bill's effective date is for tax years ending on or after June 30, 2015 which corresponds with FY 2016. ORA multiplied the estimated percentage of revenue foregone in TY 2012 by the May 2015 REC estimate for FY 2016 personal income tax to arrive at estimated revenue foregone from the bill in FY 2016 of \$10,998,531 (i.e., $\$1,228,200,000 * 0.008955$). Similarly, ORA used the Office of Management and Budget's projection of FY 2017 personal income tax revenues and multiplied it by the estimated percentage of revenue foregone in TY 2012 to arrive at a revenue loss of \$11,356,333 in FY 2017 (i.e., $\$1,268,155,543 * 0.008955$). The bill would allow for a company that is eligible for the rate reduction under Rhode Island General Law Chapter 42-64.5 to also be eligible for the rate reduction proposed under the bill (see section 44-70-5 of the bill). As a result, additional foregone revenue would be realized by the State as current taxpayers eligible only for the rate reduction under Rhode Island General Law Chapter 42-64.5 would now also be eligible for additional rate reductions under the bill. As a result, the forecasted revenue losses from passage of the bill should be considered minimum revenue losses.

Other aspects of the bill would pose problems for the Division of Taxation in the administration of the bill. For example, the bill allows eligible companies that meet the units of new employment requirements to receive a rate reduction under the personal income tax (Rhode Island General Law Chapter 44-30). The personal income tax, unlike the business corporation tax, has three tax rates, 3.75 percent, 4.75 percent and 5.99 percent. Under the act, if an eligible company received a rate reduction of 0.25 percentage points would this rate reduction apply to all three tax rates or just the highest tax rate that the taxpayer faced based upon the reported modified adjusted gross income? In addition, the bill only allows the reduced tax rate under the personal income tax to apply "to the portion of net income of such taxpayer attributable to the eligible company". Differentiating between sources of income for a given taxpayer would likely require the Division of Taxation to develop a new form on which to determine the portion of income that is taxed under the bill versus all other sources of income. This would be further complicated by nonresident filers and how such income would be apportioned to Rhode Island.

According to the Office of Management and Budget, the Governor's FY 2016 Recommended Budget projects an ending balance of \$3.1 million in FY 2015, a surplus of \$600,000 in FY 2016 and a deficit of \$75.2 million in FY 2017. Passage of the bill would put the recommended FY 2016 budget into deficit and increase the FY 2017 projected deficit.

*Summary of Fiscal
Impact:*

FY 2015: Not applicable given the effective date in the act.

FY 2016: A minimum revenue loss of \$10,998,531 is forecast.

FY 2017: A minimum revenue loss of \$11,356,333 is forecast.



State of Rhode Island
**Budget
Office**
Department of Administration

**State Fiscal Note for Bill
Number: 2015-H-5116**

Budget Office Signature:

Thomas C. McLaughlin

Fiscal Advisor Signature:

[Handwritten Signature]