



State Fiscal Note for Bill Number: 2017-H-6031

Date of State Budget Office Approval:

Date Requested: Monday, April 03, 2017

Date Due: Thursday, April 13, 2017

Impact on Expenditures

| | |
|---------|-----|
| FY 2017 | n/a |
| FY 2018 | n/a |
| FY 2019 | n/a |

Impact on Revenues

| | |
|---------|-----------|
| FY 2017 | n/a |
| FY 2018 | see below |
| FY 2019 | see below |

**Explanation by State
Budget Office:**

This bill would amend Rhode Island General Law Chapter 44-62 entitled "Tax Credits for Contributions to Scholarship Organizations" by adding to Rhode Island General Law Section 44-62-3 titled "Application for the tax credit program" language that increases the total amount of credit that can be approved for FY 2018 to not more than \$5.0 million and to automatically increase the total amount of credit that can be approved by "fifteen percent (15%) following any fiscal year in which applications by eligible business entities exceed approved contributions by ten percent (10%)." The bill also amends Rhode Island General Law Section 44-62-6 titled "Definitions" by adding a definition for "eligible business entity" which is referenced in the amended language for Rhode Island General Law Section 44-62-3.

Under current law, Rhode Island General Law Section 44-62-3 limits the total amount of credit that can be approved to \$1.5 million in any given fiscal year. The credit for contributions to scholarship organizations can be taken against the taxes imposed by Rhode Island General Law Chapters 44-11 entitled "Business Corporation Tax", 44-13 entitled "Public Service Corporation Tax", 44-14 entitled "Taxation of Banks", 44-15 entitled "Tax on Bank deposits Generally", 44-17 entitled "Taxation of Insurance Companies", and 44-30 entitled "Personal Income Tax".

**Comments on
Sources of Funds:**

All business corporation, public utilities gross earnings, financial institutions, bank deposits, insurance companies gross premiums, and personal income taxes are considered to be general revenues.

**Summary of Facts
and Assumptions:**

The effective date of the act is upon passage but the implementation date is FY 2018 (i.e., July 1, 2017).

Based on information provided by the Department of Revenue Division of Taxation, the excess demand, meaning the amount by which the program was oversubscribed, for contributions to scholarship organizations tax credit from FY 2013 through FY 2017 is as follows:

| Fiscal Year | Applications for Tax Credits | Amount Available | Excess Demand |
|-------------|------------------------------|------------------|---------------|
| FY 2013 | \$1,891,796 | \$1,000,000 | \$891,796 |
| FY 2014 | \$2,206,650 | \$1,500,000 | \$706,650 |
| FY 2015 | \$2,933,450 | \$1,500,000 | \$1,433,450 |
| FY 2016 | \$3,206,489 | \$1,500,000 | \$1,706,489 |
| FY 2017 | \$6,410,799 | \$1,500,000 | \$4,910,799 |

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Wednesday, April 26, 2017

Page 1 of 3

It is important to note that FY 2013 is the last fiscal year that the amount of credit that could be awarded was capped at \$1.0 million and thus, FY 2014 is the first fiscal year that the amount of credit that could be awarded was capped at the \$1.5 million contained in current law. The FY 2017 figure includes more than 30 applications for credits submitted by business entities that had some level of common ownership. Each of these applications were for the maximum amount of \$100,000 as prescribed by Rhode Island General Law Section 44-62-3(a). Thus, of the \$6.4 million of credit applied for, more than \$3.0 million are for applications that are most likely to be later rescinded if these business entities have been awarded tax credits up to the amount desired by them. Thus, the excess demand figure for FY 2017 after accounting for the applications of business entities with common ownership is on the order of \$1.9 million rather than the \$4.9 million shown above.

Under current practice, the Division of Taxation awards contributions to scholarship organizations tax credit by a random draw from the pool of applicants. In order to maximize their odds of being awarded tax credits, some owners of business entities that pay tax under the personal income tax apply for credits in amounts of \$100,000 from different business entities that are all owned by the same owner. For example, Jane and John Doe are the owners of five limited liability companies (LLCs) and have a need for \$100,000 in tax credits to offset their expected personal income tax liability. In order to increase their chances of being awarded contributions to scholarship organizations tax credits, they submit five separate applications for tax credits at \$100,000 each. If Jane and John Doe are awarded \$100,000 of tax credits under one of the LLCs they own, they withdraw the applications of the other four LLCs if the four LLCs are also awarded tax credits of \$100,000 each. Otherwise, Jane and John Doe simply leave the applications that did not receive tax credits in place. Thus, what appeared to be applications for \$500,000 of contributions to scholarship organizations tax credits was in reality an application for \$100,000 of these tax credits. The initial applications are counted as being bona fide and inflate the demand for these tax credits beyond what the actual market is.

Under the assumption that this type of application behavior for contributions to scholarship organizations tax credits would continue, the Office of Revenue Analysis (ORA) determined that the full \$5.0 million of tax credits provided for in the bill for FY 2018 would not occur. ORA calculated the four year average annual growth rate from the data above of 27.7428 percent (i.e., $((\$706,650 - \$891,796)/\$891,796) - 1 + ((\$1,433,450 - \$706,650)/\$706,650) - 1 + ((\$1,706,489 - \$1,433,450)/\$1,433,450) - 1 + ((\$1,910,799 - \$1,706,489)/\$1,706,489) - 1 / 4$) to be 28.2777 percent. ORA applied this figure to the total adjusted demand for contributions to scholarship organizations tax credits to yield demand in FY 2018 of \$4,392,325 (i.e., $(\$6,410,799 - \$3,000,000) * (1 + 28.2777)$). Thus, the fiscal impact of the bill in FY 2018 is to reduce general revenues by \$2,892,325 (i.e., $\$4,392,325 - \$1,500,000$).

Given that the estimated demand for contributions to scholarship organization tax credits would be \$4,392,325 in FY 2018 no automatic increase in the capped amount of credits would occur in FY 2019. ORA assumed that the demand for tax credits would grow 28.2777 percent in FY 2019 to yield total demand for contributions to scholarship organizations tax credits of \$5,656,304 in FY 2019 (i.e., $\$4,392,325 * (1$

+ 0.282777)). Given that the total amount of credits allowed for in the bill for a given fiscal year is capped at \$5.0 million, the total demand that could be satisfied in FY 2019 is \$5.0 million. Thus, the revenue impact compared to the current law cap of \$1.5 million is a revenue loss of \$3,500,000 in FY 2019.

If the actual awards of tax credits for contributions to scholarship organizations reaches the cap of \$5.0 million contained in the bill for FY 2018, then the general revenue loss in FY 2018 would be \$3.5 million (i.e., \$1,500,000 - \$5,000,000). Assuming that at the \$5.0 million cap, the contributions to scholarship organizations tax credit program was oversubscribed by 10 percent, then the general revenue loss in FY 2019 would be \$4.25 million (i.e., (\$5,000,000 * (1 + 0.15)) - \$1,500,000).

The Governor's FY 2018 Recommended Budget projects a closing surplus of \$78.0 million in FY 2017 and \$654,736 in FY 2018. Passage of this bill would have no impact on the FY 2017 closing surplus, but it would put the Governor's FY 2018 Recommended Budget out of balance and increase the projected deficit for FY 2019.

*Summary of Fiscal
Impact:*

FY 2017: Not applicable due to the FY 2018 implementation date.

FY 2018: A general revenue loss of \$2,892,325 is forecast. A maximum general revenue loss of \$3,500,000 could be incurred.

FY 2019: A general revenue loss of \$3,500,000 is forecast. A maximum general revenue loss of \$4,250,000 could be incurred.

Budget Office Signature: _____

Fiscal Advisor Signature: _____

