BUDGET MATTERS
December 2016
The Economic Progress Institute

Most Rhode Islanders share a vision of what the Ocean State should strive for: great schools for our children, safe roads and bridges, vibrant communities, prosperous families, and access to quality and affordable health care, housing and child care. The primary way we pay for these things is through our taxes.

Overview of Rhode Island's Tax Expenditures, Including Tax Incentives for Economic Development

Introduction: What are tax expenditures, and why do we care about them

- Tax expenditures are subsidies that occur through the tax code, as tax credits, exemptions, deductions, or preferential tax rates.
- Tax expenditures reduce the amount of taxes owed by individuals or corporations (and in turn reduce the total amount of revenue collected by the state).
- Tax expenditures are very similar to expenditures occurring through the appropriations process – essentially "spending by another name", but differ in one very important respect: unlike appropriated expenditures, they are not affirmatively approved on an annual basis by elected officials.

There are three primary reasons that we look closely at tax expenditures in Rhode Island:

1. Foregone revenues – Tax expenditures – including those used to catalyze economic development – cost the state a considerable amount of tax revenue, which could otherwise be used to meet the needs of Rhode Islanders. In 2013, tax expenditures totaled $1.9 billion, compared to $5.4 billion in direct expenditures in the FY2013 budget.
2. Transparency – Collectively, tax expenditures are not given anywhere near the same level of scrutiny as are expenditures occurring through the regular annual appropriations process.
3. Accountability for tax incentives for economic development – We need to know whether these expenditures are providing the promised jobs and economic activity and at what cost. Research indicates that economic development tax incentives may not be the most effective way to spur economic development at the state level. Retaining a larger share of tax revenues to invest in a healthy and well-educated workforce, transportation, and other critical infrastructure such as high-speed internet have a greater impact on states' future economic prosperity.

Tax Expenditures and Tax Fairness

Many tax expenditures are commonsense, such as the credit for taxes paid to other states, while others (such as the sales tax exemption for food, and the earned income tax credit) make our tax structure more fair. Currently, when looking at the the combined impact of state and local taxes in Rhode Island, lower income earners (those in the bottom twenty percent of families) pay 12.5 percent of their household income in state and local taxes, while those at the top pay only half as much, just 6.3 percent. Because the sales tax is regressive – falling more heavily on lower-income earners – exempting items such as food and clothing makes the overall system more fair.

The Biennial Tax Expenditure Report, 2016

The biennial Tax Expenditures Report (TER) details the total amount of money that is being foregone via tax expenditures, broken down by category of tax expenditure (e.g. credits, deductions, exemptions) and by tax type (e.g. business corporation tax, personal income tax, sales and use tax). For example, we learn that exempting charitable, educational, and religious organizations from the sales and use tax "cost" $104 million, and exempting electricity and gas sales for corporations cost approximately $27.0 million.

What? Biennial Tax Expenditure Report (TER)

How much? 223 separate tax credits - $1.9 Billion in FY2013

Tax Credit and Incentive Report, 2016

Currently, the main source of information we have on the use of tax credits and tax incentives as a tool for economic development is the Tax Credit and Incentive Report, published annually by the Department of Revenue's Division of Taxation. The 2016 report provides information on the following tax credits:

- Rhode Island Economic Development Corporation Project Status
- Jobs Development Act
- Distressed Areas Economic Revitalization Act—Enterprise Zones
- Motion Picture Production Tax Credit
- Historic Preservation Tax Credits

The report tells which companies received credits and incentives and the amount they received.

The Jobs Development Act, which reduces the business corporations tax rate in proportion to new jobs created by firms, accounted for the greatest value of tax credits allocated in FY2016 ($23.5 million out of $29.4 million total). Figure 1 shows the breakdown of credits received by firms from all five programs. (Another $69.5 million in foregone revenues were allocated through tax credits not covered by the Tax Credit and Incentive Report).

What? Tax Credit and Incentive Report

How much? $29.4 million to 23 businesses in FY2016

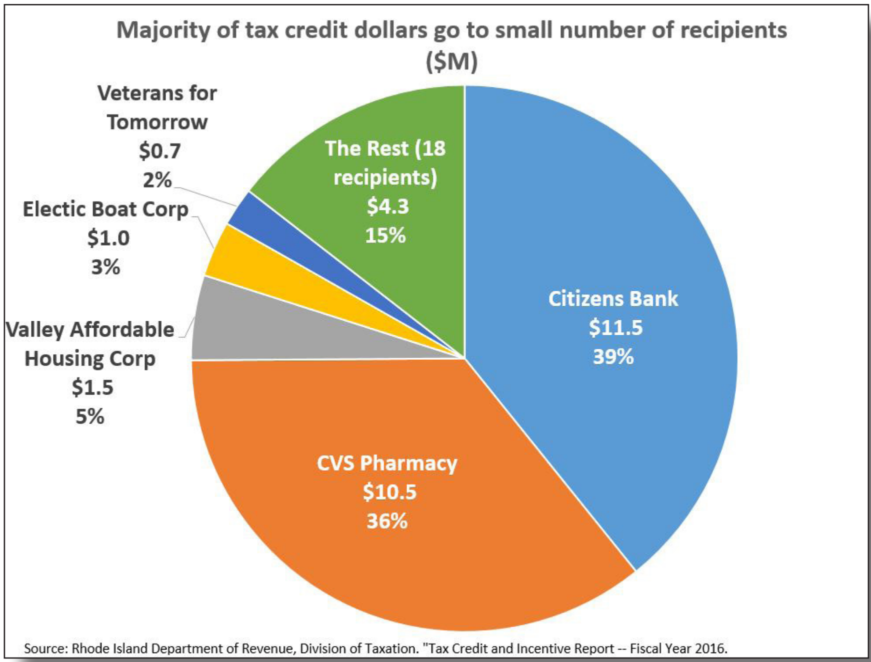

Figure 1

Tax credits over time: 2008-2016

During the nine year period spanning 2008-2016, credits allocated follow a few distinct patterns. A small number of firms received multiple credits over several years, led by CVS with 16 credits, United Natural Foods with 12 credits, and Electric Boat with 10 credits. The aggregate amount of those credits varied considerably. Another handful of recipients received credits periodically, including some recipients who received credits of considerable value. The majority of firms received only one or two relatively small credits over this period. During this period, for instance, 33 firms received average credit amounts of $2,500 or less (and a total of 117 firms received average credits of $10,000 or less), and 176 firms (out of a total of 264 firms) combined for just one percent of the total.

Annual Report of Tax Credit and Incentives Administered in Conjunction with the Rhode Island Commerce Corporation

What? Annual Report of Tax Credit and Incentives Administered in Conjunction with the Rhode Island Commerce Corporation

How much? $44.1 million approved (but no credits issued) in FY2016

This report provides the same basic information on firms receiving tax credits under Governor Raimondo's new suite of economic development tax incentives as the Tax Credit Incentive Report discussed above. These new credits are: the Rebuild RI Tax Credit, RI Tax Increment Financing, the Anchor Institution Tax Credit, the Stay Invested in Rhode Island Wavemaker Fellowship, and the Qualified Jobs Incentive.

The Economic Development Tax Incentives Evaluation Act of 2013

The Economic Development Tax Incentives Evaluation Act of 2013 [the Evaluation Act], was passed in the wake of the 38 Studios debacle, by a General Assembly that realized it needed more information to be able to properly assess whether tax incentives being used for economic development were having the intended positive impact on Rhode Island's economy. The Evaluation Act requires a much more rigorous examination of tax incentives for economic development purposes than required by either the biennial tax expenditure report or the Division of Taxation's Tax Credit and Incentive Report. This legislation requires a much deeper analysis of the effectiveness of 21 specific economic development tax incentives in place in 2013. When Governor Raimondo's new suite of economic development incentives were created during the 2015 session, the provisions of the Evaluation Act were extended to the new credits. This report requires the following for each use of tax incentives for economic development purposes:

- an assessment of the number of jobs created
- an assessment of the revenues generated for the state that resulted from the impact of the tax credit
- a cost-benefit analysis comparing the economic impact of the tax credit in comparison to the impact the foregone revenue would have had if collected and used for other budget purposes.

The Office of Revenue Analysis, which had originally intended to compete the analysis of a cohort of the incentives over a three year period, has now committed to completing the required reporting by June 30, 2017.

Conclusion

Tax expenditures merit close examination because they dramatically erode state revenues available for prudent investments, they require significant oversight to ensure appropriate accountability, and their effectiveness as tools for state economic development must be closely monitored.

Rhode Island has put in place several requirements to greatly improve the ability of the General Assembly and the people of Rhode Island to effectively assess the effectiveness of tax incentives for economic development. Until the reports required by the Economic Development Tax Incentives Evaluation Act of 2013 are available, we continue to fly blind. That's no way to steer a state economy to prosperity.

Accountability: Tax Incentives for Economic Development

Name of Report:		Tax Credit and Incentive Report	Tax Incentive Evaluation Act requirements Incorporated into [biennial] Tax Expenditure Report	Report on Commerce Corporation Incentive Programs	Annual Report of Tax Credit and Incentives
Report Prepared by:		Rhode Island Department of Revenue, Division of Taxation	Rhode Island Department of Revenue, Office of Revenue Analysis	Rhode Island Commerce Corporation	Department of Revenue, Office of Taxation, in Conjunction with the Rhode Island Commerce Corporation
Report Contents/Requirements:		name, address, and amount of tax credit received	Extensive analysis of the effectiveness of tax credit, including jobs created, cost-benefit analysis of credit vs retaining revenue foregone by credit.	name & address of credit recipient, project cost, incentive amount, incentive disbursed, planned job creation, actual job creation, use of funds.	name, address, and amount of tax credit received
Report Required/Authorized by:		Enabling legislation for each credit (RIGL 42-64-10, 44-63-3, 42-64.5, 42-64.3, 42-64.9, 44-31.2, 44-33.6-9)	RIGL 44-48.2 Tax Incentive Evaluation Act of 2013	Enabling legislation for each credit (RIGL 42-64.20, 42-64.21, 42-64.30, 44-48.3)	Enabling legislation for each credit (RIGL 42-64.30, 42-64.20, 44-48.3, 42-64.21, and 42-64.26)
Statute	Tax Credit Name				
42-64.3-6	Enterprise Zone (Business Tax Credits)	*	*		
42-64.3-7	Enterprise Zone (Resident business owner tax modification)	*	*		
42-64.5-3	Jobs Development Act (Tax rate reduction)	*	*		
42-64.6-4	Job Training Tax Credit		*		
42-64-10	RI Economic Development Corporation Project Status	*			
42-64.11-4	Jobs Growth Act		*		
44-30-1.1	PIT – Writers, Composers and Artists		*		
44-31-1	Investment Tax Credit		*		
44-31-1.1	Biotech Investment Tax Credit		*		
44-31-2	Specialized Investment Tax Credit		*		
44-31.2-5	Motion Picture Production Company Tax Credit	*	*		
44-32-1	R&D: Net Income		*		
44-32-2	R&D: Property		*		
44-32-3	R&D: Research Expenses		*		
44-33.6	Historic Preservation Tax Credits	*			
44-39.1-1	Renewable energy – energy tax credit		*		
44-43-2	Capital Investment in Small Business		*		
44-43-3	Wage Credit – capital investment		*		
44-63-2	Innovation tax Credit (Expires 12/31/16)		*		
44-63-3	Incentive for Innovation and Growth	*			
2015 Tax Incentives					
42-64.20	Rebuild RI Tax Credit		*	*	*
42-64.21	RI Tax Increment Financing		*	*	*
42-64.26	Stay Invested in RI Wavemaker Fellowship		*		*
42-64.30	Anchor Institution Tax Credit		*	*	*
44-48.3	Qualified Jobs Incentive Act (2015)		*	*	*