
Rhode Island Governor Proposes Positive Corporate Tax Reform

By
Elizabeth Malm

Introduction

In his annual budget briefing, Rhode Island Governor Lincoln Chafee (I) proposed a reduction of the state's corporate income tax rate from 9 percent to 7 percent over the next three years.¹ If enacted, this would make the state's tax rate the lowest in the New England region. Rhode Island currently shares the spot for the highest regional corporate tax rate with Connecticut and New Jersey.²

To offset some of the projected revenue reduction from the tax rate cut (\$5.3 million in 2014, \$12.9 million in 2015, and upwards of \$20 million in years thereafter), the governor's plan would broaden the corporate income tax base by phasing back a few corporate income tax carve-outs.³ Governor Chafee's tax plan moves in the right direction by broadening the tax base to lower the overall rate for all firms.

If a state must offer lucrative incentives to entice business to the state, chances are this is because the tax climate is prohibitive in the first place. Not only do such carve-outs distort the market, they complicate the tax code unnecessarily and require firms ineligible for the carve-outs to pay a higher rate in order to generate adequate tax revenue. It is debatable whether such tax incentive programs are even effective at reaching their goals.⁴ Further, high corporate income taxes are negatively related to economic growth⁵ and are the most

¹ Rhode Island Office of Management & Budget, *FY 2014 Budget Plan Overview* (Jan. 1, 2013), <http://www.budget.ri.gov/Documents/CurrentFY/2014%20Briefing.pdf> [hereinafter *Governor Budget Overview*].

² Tax Foundation, *Weekly Map: Top State Corporate Income Tax Rates as of January 1, 2013*, <http://taxfoundation.org/blog/weekly-map-top-state-corporate-income-tax-rates>.

³ *Governor Budget Overview*, *supra* note 1.

⁴ Terry F. Buss, *The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature*, 1 *ECONOMIC DEVELOPMENT QUARTERLY* 90-105 (Feb. 2001).

⁵ William McBride, *What is the Evidence on Taxes and Growth?*, TAX FOUNDATION SPECIAL REPORT NO. 207 (Dec. 18, 2012), <http://taxfoundation.org/article/what-evidence-taxes-and-growth>.

volatile source of state tax revenue.⁶ Moving away from such a revenue source will make the state more conducive to growth and less likely to see revenue shortfalls in an economic downturn.

Plan Trades Targeted Tax Incentives for a Broader, Lower Tax Rate

Governor Chafee's proposal would narrow the Jobs Development Act⁷ (a rate reduction program tied to job creation and retention) and eliminate the Enterprise Zone Credit,⁸ which subsidizes development in areas deemed economically distressed.

The suggested reduction in Jobs Development Act tax is the portion of the plan that has garnered the most scrutiny. The program lowers the corporate income tax rate for businesses that meet specific employment and wage requirements. For every fifty jobs added by a large company (ten jobs for small firms)⁹ over an initial three year period, the firm receives a 0.25 percent rate reduction, subject to certain wage and benefit requirements.¹⁰ The rate reduction is only retained if the company maintains the employment level reported in the third year.¹¹ Though firms cannot entirely eliminate their corporate income tax liability, they can lower their rate to three percent.

In 2012, only eight companies took advantage of the program, for a total cost of \$16.4 million. One firm, CVS Caremark, received nearly 94 percent of the total amount of benefits granted from the Jobs Development Act in 2010 (over \$15 million).¹² CVS has corporate headquarters, 59 pharmacy stores, one operations center, one distribution center, and one set of regional offices within Rhode Island, making it one of the state's largest private employers.¹³ If Chafee's plan is enacted, CVS Caremark would lose roughly \$8 million annually in tax incentives.

⁶ Kail Padgitt, *State Revenue Changes from 2008 to 2009*, TAX FOUNDATION FISCAL FACT NO. 225 (May 13, 2010), <http://taxfoundation.org/article/state-revenue-changes-2008-2009>.

⁷ Rhode Island Economic Development Corporation, *Jobs Development Act: Corporate Income Tax Reduction for Job Creation*, <http://riedc.com/business-services/business-incentives/corporate-income-tax-reduction-for-job-creation>.

⁸ Rhode Island Economic Development Corporation, *Gross Premiums Tax Credits in Enterprise Zones*, <http://riedc.com/business-services/business-incentives/gross-premiums-tax-credits-enterprise-zones>.

⁹ The Jobs Development Act defines a small company as one with less than 100 employees, while a large company is one that has more than 100 employees. See *Rhode Island Jobs Development Act* definitions, which can be found at <http://www.tax.state.ri.us/regulations/other/ct04-11.php>.

¹⁰ As dictated by Chapter 42-64.5 of Rhode Island Statutes, found at <http://riedc.com/business-services/business-incentives/corporate-income-tax-reduction-for-job-creation>.

¹¹ The Jobs Development Act page on the Rhode Island Economic Development Corporation website states that the "rate reduction is permanent as long as the company maintains the same level of employment that it had at the end of the third year following the company's self-selected base period." See Rhode Island Economic Development Corporation, *Jobs Development Act: Corporate Income Tax Reduction for Job Creation*, <http://riedc.com/business-services/business-incentives/corporate-income-tax-reduction-for-job-creation>.

¹² Rhode Island Department of Revenue, *Tax Credit and Incentive Report—Fiscal Year 2012*, <http://www.tax.ri.gov/reports/Tax%20Credit%20and%20Incentive%20Reports/FYE2012%20Tax%20Credit%20&%20Incentive%20Report.pdf> [hereinafter *2012 Tax Credit and Incentive Report*].

¹³ CVS Caremark, *Rhode Island*, <http://info.cvscaremark.com/newsroom/facts-by-state/rhode-island>; <http://www.riedc.com/files/Top%20Employers%20ranking%202011.pdf>.

The *Providence Journal* recently estimated that the average corporation in Rhode Island pays an effective tax rate of 7.97 percent, while CVS paid roughly 4.25 percent:

In state fiscal year 2012, [CVS] would have owed Rhode Island about \$29 million in corporate taxes, had it paid the standard 9-percent rate. Instead, the drug store giant paid \$13.8 million in taxes at the discounted rate of 4.25 percent, saving about \$15.4 million that year, based on a taxable income of roughly \$325 million.¹⁴

Governor Chafee has said that he is concerned about CVS's position but said lowering taxes for thousands of companies could help the state's economy more than preserving a tax credit enjoyed by only a few businesses."¹⁵

There has not been significant pushback from the suggested repeal of the Enterprise Zone tax credit. Twenty companies took advantage of the program in 2012 for a total cost of just over \$700,000.¹⁶ The program is relatively small compared to other tax incentive programs within the state aimed at economic development. Further, academic research has suggested that the economic growth effects of Enterprise Zone programs is mixed at best.¹⁷

Lower Corporate Rate Would Improve Rhode Island's Regional Competitiveness

Rhode Island does not fare well in terms of business taxes when compared with the rest of the country. Not only does the state have one of the highest corporate income tax rates in the New England region and the greater U.S., but it also has a high sales tax rate,¹⁸ high property taxes,¹⁹ and high unemployment insurance taxes.²⁰

¹⁴ Philip Marcelo, *Jobs credit halves taxes paid by CVS*, PROVIDENCE JOURNAL, Mar. 20, 2013, <http://www.economicprogressri.org/Newsroom/ViewArticle/tabid/164/ArticleId/101/Jobs-credit-halves-taxes-paid-by-CVS-Providence-Journal.aspx>.

¹⁵ David Klepper, *CVS opposes gov's plan to pay for business tax cut*, ASSOCIATED PRESS, Mar. 6, 2013, <http://www.boston.com/news/local/rhode-island/2013/03/06/cvs-opposes-gov-plan-pay-for-business-tax-cut/vowa5d1ojlqLEva8OJN1IN/story.html>.

¹⁶ 2012 Tax Credit and Incentive Report, *supra* note 12.

¹⁷ See, e.g., Robert T. Greenbaum & Jim Landers, *Why Are State Policy Makers Still Proponents of Enterprise Zones? What Explains Their Action in the Face of a Preponderance of Research?*, 32 INTERNATIONAL REGIONAL SCIENCE REVIEW 466-479 (2009). See also Margaret G. Wilder & Barry M. Rubin, *Rhetoric vs. Reality: A Review of Studies on State Enterprise Zone Programs*, 62 JOURNAL OF THE AMERICAN PLANNING ASSOCIATION 472-492 (1996).

¹⁸ Scott Drenkard, *State and Local Sales Tax Rates in 2013*, TAX FOUNDATION FISCAL FACT NO. 357 (Feb. 11, 2013), <http://taxfoundation.org/article/state-and-local-sales-tax-rates-2013>.

¹⁹ Scott Drenkard & Joseph Henschman, *2013 State Business Tax Climate Index*, TAX FOUNDATION BACKGROUND PAPER NO. 64, at 24 (Oct. 9, 2012), <http://taxfoundation.org/article/2013-state-business-tax-climate-index> [hereinafter *2013 State Business Tax Climate Index*].

²⁰ 2013 State Business Tax Climate Index, *supra* note 19, at 28.

Rhode Island's overall score on our *State Business Tax Climate Index* is poor.²¹ The state is ranked 46th worst in the country for overall business climate. Though much of New England does not score favorably (Vermont, New Jersey, and New York are ranked 47th, 49th, and 50th worst, respectively), Rhode Island could improve its ranking if it were to reduce its high corporate rate and reduce targeted base carve-outs.

If the Chafee proposal, fully phased in, had been in effect on July 1, 2012, the snapshot date for our most recent *State Business Tax Climate Index*, Rhode Island would have ranked 30th best rather than 42nd best on the corporate tax component, and 44th best rather than 46th best overall (see Table). While not a dramatic improvement, Chafee's proposal would build upon other positive tax and fiscal moves taken by Rhode Island.

Table: Chafee Proposal in 2013 State Business Tax Climate Index

	Current Law	Chafee Plan
Overall Index rank	46th	44th
Index corporate tax component	42nd	30th
Index individual income tax component	37th	37th
Index sales tax component	25th	25th
Index unemployment tax component	50th	50th
Index property tax component	46th	46th

Conclusion

Tax reform that broadens the tax base in order to lower the overall rate ensures neutrality and simplicity in the tax code and removes the incentive for companies to lobby for special tax treatment. Trading targeted tax incentives for a better tax system for everyone is positive tax reform, as is moving away from revenue sources that can harm growth and generate instability in a state's overall revenue system.

©2013 Tax Foundation
National Press Building
529 14th Street, N.W., Suite 420
Washington, DC 20045

202.464.6200
www.TaxFoundation.org

About the Tax Foundation

The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

²¹ 2013 *State Business Climate Index*, *supra* note 19.