RIPEC

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February 15, 2024

Representative Marvin Abney
Chairperson, House Committee on Finance
Room 35
Rhode Island State House
Providence, RI 02903

Re. Testimony on House Bill 7225, Article 6, Section 2, Net Operating Loss Carryforward

Dear Chairperson Abney,

House Bill 7225, Article 6, Section 2 includes a proposed change to state corporate income tax law that would extend the period for which businesses are allowed to carry forward net operating losses from five years to 20 years, starting with losses on or after January 1, 2025. I am writing on behalf of the Rhode Island Public Expenditure Council (RIPEC) in strong support of this proposal.

Rhode Island's current loss carryforward provision is the most limited in the nation, marking the Ocean State as a regional and national outlier. As depicted in the figure below, every state that levies corporate income tax except California has a carryforward provision, and of those, none is more limited than Rhode Island's five-year provision. In comparison, one state has an eight-year carryforward period, ten states have either carryforward periods of ten or 15 years, 15 states have a 20-year period, and 17 states conform to federal treatment by allowing net operating losses to be carried forward indefinitely.[1] If enacted, the proposal in Article 6, Section 2 would therefore place Rhode Island more in line with the nation. It would also place Rhode Island on par with neighboring Connecticut and Massachusetts, which each have a 20-year carryforward provision.[2]

[1] The federal government has allowed up to 80 percent of taxable income to be carried forward indefinitely since the 2017 passage of the Tax Cuts and Jobs Act (TCJA). Prior to 2017, the federal government had a more time limited 20-year provision but did not have a deductibility cap. Tax Foundation, Net Operating Loss Carryforward. In one form of another, net operating loss carryforwards have been part of federal tax code since 1918. Congressional Research Service, "The Tax Treatment and Economics of Net Operating Losses," Updated October 19, 2020.

[2] Regarding other New England states: New Hampshire and Vermont have ten-year provisions and Maine allows losses to be carried forward indefinitely.

States by Length of Net Operating Loss Carryforward Provision

No Carryforward	5 Years	8 Years	10 Years	15 Years	20 Years	Indefinate
California	**Rhode Island**	Arkansas	Michigan	Alabama	Arizona	Alaska
			Montana	Minnesota	Connecticut	Colorado
			New Hampshire	North Carolina	Idaho	Delaware
			South Dakota	Oregon	Illinois	Florida
			Vermont	Tennessee	Indiana	Georgia
					Iowa	Hawaii
					Louisiana	Kansas
					Massachusetts	Kentucky
					Mississippi	Maine
					Missouri	Maryland
					Nebraska	New Mexico
					New Jersey	North Dakota
					New York	Oklahoma
					Pennsylvania	South Carolina
					Wisconsin	Utah
						Virginia
						West Virginia

Source: Tax Foundation, 2024 Business Tax Climate

Given its extremely limited nature, Rhode Island's current carryforward provision reduces the state's competitiveness from the vantage point of prospective companies determining whether to begin operations, and existing companies choosing where to relocate or expand. Business taxes are hardly the lone factor in determining a state's overall business climate, but tax reforms can have immediate effect by reducing a business's operating cost, and research affirms the relationship between a favorable tax climate and economic growth.[3] Expanding Rhode Island's carryforward provision from five to twenty years would be a boon to businesses because it would allow them to better weather periods of market fluctuation and economic recession by enabling them to deduct losses from future years' profits over more extended business cycles, thereby smoothing out those losses.[4]

Rhode Island has particular incentive to improve its business competitiveness; the state's gross domestic product has been expanding at a slower rate than the U.S. and the New England region for about two decades, and its tax climate ranks among the least business friendly among states.[5]

[3] For example: Timothy J. Bartik, "Business Location Decisions in the United States: Estimates of the Effects of Unionization, Taxes, and Other Characteristics of States," *Journal of Business and Economics Statistics* vol. 3, iss. 1 (January 1985): 14-22; Stephen T. Mark, Therese J. Mc Quire, and Leslie E. Papke, "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area," *National Tax Journal* vol. 53 (March 2000): 105-123; J. William Harden and William H. Hoyt, "Do States Choose their Mix of Taxes to Minimize Employment Losses?" *National Tax Journal* vol. 56 (March 2003): 7–26.
[4] Congressional Research Service, "The Tax Treatment and Economics of Net Operating Losses," Updated October 19, 2020.
[5] In partnership with Bryant University's Center for Global and Regional Economic Studies, RIPEC has tracked Rhode Island's comparatively sluggish GDP growth on a quality basis in a series of quarterly Current Economic Indicator and Key Economic Indicator briefings since 2011. Find those briefings here.

The Ocean State has consistently ranked in the bottom third of states for its business tax competitiveness by the Tax Foundation, a Washington D.C.-based think tank, on its annual Business Tax Competitiveness Climate Index, and it currently ranks 41st best (or 10th worst) among states. In the corporate income tax category of these rankings, Rhode Island ranks 40th (11th worst)—second worst in the New England region and below neighboring Massachusetts and Connecticut (ranked 36th and 30th, respectively).[6]

Finally, establishing a carryforward provision that is more in line with the region and nation is of particular importance in encouraging the growth of new businesses and industries in Rhode Island. Start-ups creating novel products or technologies often have years of investment and operations before their company turns a profit, with modern examples of companies that took years to achieve profitability including Uber, Amazon, and Tesla. More generous carryforward provisions encourage this type of economic activity by providing a more realistic timeline for new businesses to smooth out early losses.[7] A twenty-year carryforward provision would serve, therefore, as a vital tool for encouraging the entrepreneurship and innovation Rhode Island needs to grow its economy and provide greater economic opportunity to all Rhode Islanders.

I appreciate your consideration of these comments and RIPEC's support for Article 6, Section 2 of House Bill 7225.

Sincerely,

Michael DiBiase
President & CEO
Rhode Island Public Expenditure Council

[6] New Hampshire ranks 44th. Tax Foundation, *2024 State Business Tax Climate Index*, October 2023.
[7] Bloomberg Tax, "Net Operating Losses—Policies, Effectiveness, and Alternatives," May 31, 2022;Tax Foundation, "Net Operating Loss Provisions, State Treatment and the Economic Benefit," January 13, 2022.