Testimony Relating to H-7127 Budget Article 5, Sections 2 and 6

Decoupling from Federal Tax Provisions in H.R.1

House Committee on Finance

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The Economic Progress Institute **supports the Governor's budget proposal in Article 5, Sections 2 and 6, to decouple Rhode Island from the federal H.R.1 tax provision concerning the expensing of Research and Development expenditures**.

This proposal could save the state over $20 million next year, building upon the wise decoupling for Tax Year 2025 from this and a number of other H.R.1 provisions, saving close to $80 million this year. The federal R&D provision basically speeded up the usual and sensible process of expensing deductions over 5 years – and also allowed applying this retroactively. This is a really poor approach, because retroactive tax incentives do not work. It is impossible to motivate desired behavior by providing a credit for purchases that have already been made! To be clear, even with Rhode Island's decoupling, tax filers still keep the more generous federal benefit.

Although we strongly support this proposal, we think <u>the proposed budget does not go nearly far enough</u>. There are a number of other provisions in H.R.1 – some of which we decoupled from for Tax Year 2025 and some of which pre-date it – that will do nothing to benefit Rhode Island's economy while causing an annual revenue loss of tens of millions of dollars.

<u>Here's **why** additional decoupling should be added to the FY2027 budget and/or enacted with stand-alone legislation:</u>

- These provisions **frequently subsidize out-of-state economic activity**.
- Many **benefits flow to investors and companies outside Rhode Island**.
- These incentives, if they work at all, work at the federal level – not as state policy.
- Companies and investors can still claim the more generous federal benefits, even when RI decouples.
- These tax provisions **primarily benefit wealthy households, large corporations, and investors** and not Rhode Island's small business owners.
- Some provisions are retroactive, and retroactive tax breaks cannot incentivize future growth.
- **State revenue will be reduced without strengthening Rhode Island's economy**.
- Decoupling protects revenue without harming Rhode Island's small businesses.
- At a time of budget pressure and unmet needs, these provisions would drain funding for public priorities such as education, healthcare, housing, and infrastructure.

We recommend that Rhode Island decouple from the following provisions:

H.R.1 Federal Tax Provision	Why It's a Problem	Estimated Annual Revenue Cost
Research & Development Expensing (Section 70302) (included in Governor's proposed budget)	Retroactive deductions reward past behavior without incentivizing future investment, while front-loading state revenue losses.	**$20.0M–$25.0M**
Qualified Small Business Stock (QSBS) (Section 70431)	Only C-Corps qualify; 94% of benefits go to households earning over $1M; often benefits out-of-state investments.	**$3.7M** (existing credit) **$2.3M–$3.0M** (H.R.1 expansion)
Foreign-Derived Deduction Eligible Income (FDDEI) (Sections 70321, 70322, 70323)	Rhode Islanders could claim benefit for investment in out-of-state companies, with RI losing revenue without economic gain.	**$13.5M**
Business Interest Deductibility Changes (Section 70303)	Businesses use what was already a generous provision to leverage debt to reduce tax obligations, including for private equity transactions.	**$4.4M–$5.9M**
Expanded Small Business Expensing (Section 70306)	Accelerates deductions and frontloads state revenue losses without evidence of increased in-state investment.	**$1.8M–$3.6M**
Opportunity Zones Expansion (Section 70421)	Benefits wealthy investors and corporations, mostly for real estate investments rather than job creation for local communities.	**$5.0M–$6.0M** (existing program + expansion)
Total	Some annual revenue losses decrease over time and others increase.	**$35.0M-$50.0M**

In some cases, **we recommend decoupling not only from the expanded provisions in H.R.1, but also from the original provisions**, notably for QSBS and Opportunity Zones.

I would be happy to discuss any of these matters in more detail with members of the Finance Committee or with someone from the House Fiscal Office.

I urge you to make sure these measures are included in the enacted FY2027 budget, saving the state $35 million to $50 million dollars annually.