



February 26, 2025

Subject: Request for Rhode Island to Maintain Conformity with Federal Tax Law After 2025 and Oppose “Millionaire’s Tax”

Dear RI Legislators and Other Interested Parties,

We are writing on behalf of the Tax Committee of the Rhode Island Society of CPA’s to respectfully urge that the Small Business Committee recommend that state policymakers maintain conformity with federal tax provisions enacted under H.R. 1 (P.L. 119-21) for years after December 31, 2025. Aligning Rhode Island’s tax code with the federal provisions—effective for tax years beginning in 2026 and beyond—would simplify compliance, enhance the state’s competitiveness in attracting and retaining high-value businesses.

Conformity between Rhode Island and federal tax rules ensures streamlined compliance for individuals, businesses, and practitioners. When Rhode Island decouples from multiple federal provisions—such as, research and development, business interest limitation adjustments, and qualified income exclusions, taxpayers must maintain two separate sets of records and calculations.

This dual accounting is particularly onerous for small businesses and individual filers who depend on commercial software or tax return preparers. Lack of conformity not only increases tax compliance costs but raises the likelihood of errors and audit disputes. Maintaining alignment with federal provisions would make tax compliance simpler, less expensive, more transparent and less burdensome on the Division of Taxation’s staff in auditing taxpayers for compliance and reduces computer programming required to implement the various changes.

Rhode Island does not have a revenue problem; it has a spending problem. By continuing to decouple, Rhode Island risks being viewed as a less predictable and a less business-friendly tax environment. Rhode Island has historically ranked in the bottom 5 of all states when it comes to being business friendly and this has had a significant impact on the state’s economy. According to the Tax Foundation’s Taxes and Interstate Migration: 2024 Update dated September 3, 2024, based in IRS data between 2021 and 2022, the state of Rhode Island lost \$130 million dollars in adjusted gross income because 3,027 residents left the state. Rhode Island not only lost the income tax revenue from those dollars it also lost the benefit of that income being spent or invested in the state’s economy. The Tax Foundation’s report states Rhode

Island lost 1,428 tax returns. The report also states “it is clear from the 2021-2022 IRS migration data that there is a strong positive relationship between state tax competitiveness and net migration. Overall, states with lower taxes and sound tax structures experienced stronger inbound migration than states with higher taxes and more burdensome tax structures.

The report also stated “among the 26 states that experienced net inbound migration of income tax filers, only 10 had a top marginal individual income tax rate above the national medication, which stood at 5.7% percent in 2021 (and by now has gone down to 5%). Meanwhile, among the 24 states (and the District of Columbia) that experienced net outbound migration of income tax filers, 15 states and DC had top marginal rates above the median.” The report indicates there is a strong negative relationship between net migration and the top state individual income tax.

The Tax Foundation’s report supports what our CPA practices see from our clients. The tax burden and the unfriendly business environment are at the top of the list of reasons why clients/taxpayers leave Rhode Island. Many businesses do not need to be in Rhode Island to operate their businesses. It is important for policymakers to recognize the results of the report and take actions consistent with encouraging the business community to stay in Rhode Island by prioritizing structurally sound tax policy improvements, which was also stated in the Tax Foundation report referred to above.

These businesses make significant contributions to the Rhode Island economy.

Businesses evaluating where to locate or expand operations often factor in compliance simplicity, tax provisions beneficial to their businesses, tax incentives and conformity to federal law. Maintaining alignment with the federal tax code will improve Rhode Island’s reputation as a competitive jurisdiction that fosters growth, innovation and investment, particularly for research and development businesses, service industries, hospitality, and small manufacturers.

The federal provisions impacting business are particularly important to support the Rhode Island economy as described in more detail below.

Section 174 Research and Experimental Expenditures

Encouraging Innovation and Economic Growth

The ability to deduct domestic research and experimental costs immediately (Section 174) rather than amortizing them over several years—directly incentivizes investment in innovation.

Small and mid-sized businesses rely on near-term cash-flow savings to reinvest in new products, technology, and workforce development.

Rhode Island Commerce, the state’s economic development agency, fosters business growth, attracts new businesses, creates jobs and strengthens the state’s economy. Several of its programs support emerging technologies, innovators, and the Ocean Tech Hub, which according to Rhode Island Commerce’s website, is turning Southeastern New England into a global powerhouse for undersea innovation, economic growth and national security.

Allowing the immediate tax deduction of research and development expenses supports the businesses that the Rhode Island economy is focusing on.

By decoupling, Rhode Island effectively increases the state-level tax burden on innovative firms, particularly startups, biotech companies, and advanced manufacturers. This could disincentivize research activities within the state and make neighboring jurisdictions such as Massachusetts or Connecticut comparatively more attractive for research investment.

The new Rhode Island schedules (RI Schedule 174A, HR1-Individual/Entity, and Schedule M modifications) will require additional recordkeeping and manual adjustments, adding to compliance burden and additional costs. Maintaining conformity would allow businesses to rely on consistent federal treatment, improving both compliance efficiency and audit transparency.

Supporting Small Business Viability

The federal amendment specifically allows “small businesses” (with gross receipts under \$31 million) to apply accelerated research and development expensing retroactively for 2022 through 2024. These same businesses are the backbone of Rhode Island’s economy.

If Rhode Island maintains its decoupled stance, the smallest entities, often those least equipped to manage complex state adjustments, will bear a disproportionate administrative and financial burden.

Re-conforming after 2025 would align Rhode Island’s policy with its stated goal of supporting small business growth and innovation.

Enhancing Competitiveness and Economic Development

Neighboring states that maintain conformity with the federal §174 treatment will offer a more favorable environment for innovation. Rhode Island’s decoupling would risk out-migration of R&D activities to those jurisdictions, reducing the state’s tax base and potential employment growth.

Given Rhode Island’s emphasis on technology, life sciences, and manufacturing clusters, aligning with federal rules would signal that the state is serious about being a partner in innovation.

Fiscal Neutrality and Long-Term Revenue Stability

Although accelerated expensing may modestly reduce short-term revenue collections, these effects are temporary. Over the long term, total deductions remain the same, the timing merely changes. Moreover, increased R&D investment leads to higher taxable income, employment, and economic activity, offsetting the short-term revenue effect. Maintaining conformity can thus be fiscally neutral or even positive over the full investment cycle.

Section 163(j) Business Interest Deduction Limitation

Avoiding Economic Disincentives and Protecting Access to Capital

Section 163(j) was expanded by HR 1 to increase the base on which interest expense deduction is calculated. The change results in a higher interest expense deduction for federal tax purposes. Rhode Island legislation does not follow this provision.

Interest deductibility plays a critical role in how businesses finance expansion, equipment purchases, and working capital. Rhode Island's decision to decouple from the federal Section 163(j) expansion would effectively tighten the cap on allowable business interest deductions, raising the after-tax cost of borrowing.

This could discourage investment, especially in capital-intensive industries such as manufacturing, energy, construction, and real estate, sectors vital to Rhode Island's economy. Aligning with federal Section 163(j) changes helps preserve affordable access to capital and ensures Rhode Island businesses remain competitive with peers in neighboring states that conform to the new federal limitation rules.

Supporting Consistency for Pass-Through Entities and Small Businesses

Under H.R. 1, many small businesses are exempt from the Section 163(j) limitation altogether based on their gross-receipts threshold. Federal conformity ensures that these same thresholds apply at the state level, simplifying the compliance process for partnerships, LLCs, and S-corporations.

If Rhode Island decouples, pass-through entities will need to compute a separate Rhode Island-specific interest limitation, allocate adjustments to partners and shareholders, and reconcile inconsistent results. This creates confusion, unnecessary accounting fees, and a higher risk of inadvertent noncompliance. Conforming to the federal rule allows small businesses to rely on consistent treatment and clear thresholds. If Rhode Island decouples, the Division of Taxation would also need to create a new form equivalent to the federal Form 8990 Limitation on Business Interest Expense Under Section 163(j).

Maintaining Competitive Neutrality and Policy Stability

Rhode Island competes with neighboring states for new investment and business retention. Many states already conform to the federal Section 163(j) framework, ensuring a uniform tax base and consistent treatment of business financing. Rhode Island's continued decoupling would make it an outlier, sending a signal of policy unpredictability to potential investors and corporate taxpayers.

Adopting the federal Section 163(j) provision promotes neutrality, aligns Rhode Island's tax base with modern federal standards, and reduces the compliance disparity that could otherwise drive businesses to locate new debt-financed projects outside the state.

Fiscal Impact and Long-Term Neutrality

The fiscal impact of conformity with federal Section 163(j) is primarily a timing issue, not a permanent revenue loss. Allowing greater deductibility of interest expense shifts the recognition of taxable income over time rather than eliminating it. In the long run, this effect is neutral, while the economic activity spurred by easier financing access can increase overall tax revenues from payroll, sales, and corporate income sources.

Harmful Impact of an Additional 3% Marginal Tax Rate for Individuals Taxpayers & Individual taxpayers' owners of Passthrough Entities (S-Corporations and Limited Liability Companies) Beginning January 1, 2027.

While separate from the analysis of the state maintaining conformity with federal tax provision enacted under H.R. 1, we wanted to take this opportunity to address the 8.99% additional marginal tax rate proposed in Article Five of the Governor's Budget Bill. This seems to replace the millionaire's tax that was proposed last year, which was not enacted. This will increase the top tax rate for all income above \$648,398 and \$36,427 for trusts & estates. Once these amounts are indexed for inflation, individuals with taxable income of approximately \$1 million will be subject to the higher 8.99% marginal tax rate.

In addition, the proposal increases the passthrough entity tax (PTE) rate from 5.99% to 8.99%, while continuing to limit the credit that can be claimed on their individual return to just 90% further increasing the taxpayer's financial burden. This would make the Rhode Island PTE tax election, less favorable amongst our neighboring states.

The 3% tax increase on income above \$648,398 would disproportionately harm pass-through entities such as S-corporations, partnerships, and LLCs—many of which are small and mid-sized businesses whose income is reported on their owners' individual returns. Similar to large corporations, these businesses often reinvest earnings into payroll, equipment, and expansion rather than distributing them as personal income. This tax would erode the working capital that many Rhode Island businesses rely on to hire workers, purchase materials, and weather economic fluctuations. For a state striving to attract and retain entrepreneurs, manufacturers, and professional firms, layering an additional 3% tax on productive enterprises sends the wrong signal—discouraging investment, job creation, and long-term economic stability.

We already have the most complicated Passthrough Entity Tax calculations in the country and we rank 18th highest in the country for highest marginal rates as ranked by the Tax Foundation. The policy over the last several years to increase the tax on upper earners is taking its toll on the RI Economy. Higher income earners are leaving the state. They are leaving the state because they don't need to live here full time to enjoy what RI has to offer. They can vacation here in the summer months and live in a lower cost state. This takes away the income taxing power of the state and continues to put pressure on the remaining residents to fill the spending philosophy of our State Government.

While we are not in favor of the additional 3% tax, if the legislation were to move forward, we would recommend leaving the 5.99% and adding an additional bracket of 8.99% on taxable income above \$1,000,000. This ensures that taxpayers who elect the passthrough entity tax and do not reach the 8.99% bracket can continue paying at the rate applicable to their income level.

Conclusion

For the reasons above, we respectfully urge the Small Business Committee and state policymakers to reconsider Rhode Island's new marginal tax rate and the current decoupling position and restore conformity with federal law for tax years after 2025. Doing so would simplify compliance, enhance

fairness, reduce administrative burden, and strengthen Rhode Island's competitiveness as a place to live, work, and do business.

Thank you for your consideration. We would welcome the opportunity to discuss these issues further or provide supporting data on the potential compliance cost savings and economic benefits of federal conformity.

Respectfully submitted,

Tax Committee of Rhode Island Society of CPA's