SENATE COMMITTEE ON FINANCE HEARING

GOVERNOR'S FY 2021 BUDGET
H7171 ARTICLE 8 (Submitted on 8.18.20)

OCTOBER 7, 2020

STATE OF RHODE ISLAND
DEPARTMENT OF REVENUE

House Bill 7171, Article 8, 8.18.20

- The CARES Act was the third federal act to address the COVID pandemic and enacted by the federal government on March 27, 2020.
- Some of the tax changes in the CARES Act affect state tax revenues, depending on the link to state tax structure and conformity to the Internal Revenue Code.
- In the May 2020 Revenue Estimating Conference, the Department of Revenue provided the estimated impact of the CARES Act tax changes, where available.
  - The federal government retroactively removed excess business loss limitations for Tax Years 2018, 2019, and 2020 (enacted in 2017 under the TCJA).
  - The change in the retroactive treatment of excess business losses was one provision for which DOR was unable to provide a fiscal impact for the REC.
  - Further review in the following months resulted in revised analysis suggesting a 2-year, $29.1 million impact from the change in the treatment of active business losses.
- The amended language in this proposed budget article-modifies R.I. Gen. Laws §44-30-12 to temporarily decouple Rhode Island income tax from federal "active" business loss rules.

CARES Act Background

STATE OF RHODE ISLAND DEPARTMENT OF REVENUE

- Business losses are “active” or “”passive” based on the taxpayer's involvement in the entity.
- Prior to 2017, <u>individual</u> taxpayer’s excess business losses could offset nonbusiness income without limitation.
- The Tax Cut and Jobs Act (TCJA) adopted in December 2017 contained dozens of changes to multiple tax types including limiting the amount of excess business losses a taxpayer can claim each year - which resulted in Rhode Island recognizing revenue from that TCJA limit because of Rhode Island’s rolling conformity with the Internal Revenue Code.
  - $250k for individual, and $500k for joint fliers.
  - Excess business losses, are deferred into future years.
- The CARES Act retroactively suspends the cap on excess business losses for pass-through entities imposed by the TCJA, effective for tax years 2018, 2019 and 2020 causing Rhode Island’s previously recognized TCJA revenue gain to be lost.

Requested Amendment

- The Governor's requested amendment language would:
  - Disallow the excess business loss deduction 26 U.S.C. 461(l)(1)(B) in tax years 2018-2020 by adding that amount to Rhode Island taxable income.
  - Allow for 20% of the deferred deduction to be taken each year, for tax years 2021 through 2025.
- With these modifications, Rhode Island would join Nebraska, Colorado, and North Carolina in decoupling from 26 U.S.C 461(l)(1)(B) in response to the CARES Act of 2020.
- New York also has the same tax treatment in limited excess business losses allowed through their fixed date conformity to the IRC.

Estimated Revenue Impact

The table below summarizes the estimated revenue impact of decoupling from the CARES Act Provision on the excess business loss limitations:

Provision	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
Decouple from CARES Act Provision on the Excess Business Loss Limitations (modify existing statute)	$0	$0	($5.8M)	($5.8M)	($5.8M)	($5.8M)	($5.8M)
Retain CARES Act Provision on the Excess Business Loss Limitations (do not modify existing statute)	($18.8M)	($10.3M)	$0	$0	$0	$0	$0

- This is a deferral/shift of the use of the losses to future years—that is, the taxpayer will be able to use it as appropriate not retroactively, but prospectively, and with % limits—they will still realize a benefit at the federal level.
- This change would affect about 692 taxpayers (64.2% of which are non-residents).
- 80% of the revenue impact would be borne by Rhode Island residents.
- The Controller included in the FY 2020 preliminary revenues a payable equal to the FY 2020 amount of the estimated impact of not decoupling from this provision of the CARES Act.

Examples of Taxpayers Impacted

- Sole proprietors, partnerships, S Corporations, limited liability companies for years beginning after December 31, 2017 and before January 1, 2026.
- Individual filers with active participation in multiple pass-through entities in which losses that are realized in one entity are used to offset income from another entity (i.e., real estate developers).
- Joint filers in which one taxpayer has an active participation in a business that incurs losses (i.e., restaurateur) and those losses are used to offset the income of the other taxpayer (i.e., a lawyer).