

State Fiscal Note for Bill
Number: 2013-H-5302

Date of State Budget Office Approval:

Date Requested: Thursday, March 07, 2013

Date Due: Sunday, March 17, 2013

Impact on Expenditures

FY 2013 n/a
 FY 2014 n/a
 FY 2015 n/a

Impact on Revenues

FY 2013 n/a
 FY 2014 \$(9,872,394)
 FY 2015 \$(10,396,133)

Explanation by State Budget Office:

This act would amend Rhode Island General Law by adding Chapter 44-68 entitled "Rhode Island New Qualified Jobs Incentive Act of 2013". Under this chapter, any eligible company, defined as "any corporation (including a subchapter S corporation as defined in 26 U.S.C. section 1361), state bank, federal savings bank, trust company, national banking association, bank holding company, loan and investment company, mutual savings bank, credit union, building and loan association, insurance company, investment company, broker-dealer company or surety company, limited liability company partnership (including an eligible subsidiary of any of the foregoing), or sole proprietorship", that meets certain employment criteria would be entitled to a reduction in the tax rate imposed by Rhode Island General Law Sections 44-11-2(a) titled "Imposition of tax" (Business Corporation Tax), 44-14-3(a) titled "Tax on state banks", 44-14-4 titled "Tax on national banks", 44-17-1 titled "Companies required to file – Payment of tax – Retaliatory rates" (Taxation of Insurance Companies), 44-13-4(4) titled "Rate of taxation" (Public Service Corporation Tax), 44-30-2.6 titled "Rhode Island taxable income – Rate of tax" (Personal Income Tax) and 44-30-2.10 titled "Alternative flat tax rate" (Personal Income Tax) of 0.25 percentage points for each unit of new employment added between June 30, 2013 and December 31, 2015. The maximum rate reduction allowed in the act is 6.0 percentage points for taxes paid under Rhode Island General Law Chapters 44-11, 44-13, 44-14, and 44-17 and 3.0 percentage points for taxes paid under Rhode Island General Law Chapter 44-30. In addition, the rate reduction allowed against the personal income tax can be applied "only to the portion of net income of such taxpayer attributable to the eligible company". Furthermore, if any eligible company fails to maintain the number of units of new employment in any taxable year beginning on or after December 31, 2015, then the rate reduction earned under the act expires permanently.

The act defines a unit of new employment as follows: "(i) For eligible companies which are not small business concerns, the amount of new employment divided by fifty (50), rounded down to the nearest multiple of fifty (50); and (ii) For eligible companies which are small business concerns the amount of new employment divided by ten (10), rounded down to the nearest multiple of ten (10)." A small business concern is an eligible company that has a base employment level of less than 100 employees where the base employment level is defined as "the aggregate number of qualified full-time active equivalent employees employed within Rhode Island by an eligible company on July 1, 2013". New employment is the level of adjusted current employment determined as of December 31 of each year less the

Prepared by:

Paul Dion / (401) 574-8943 / pdion@revenue.ri.gov

amount of the eligible company's base employment. Adjusted current employment is, for taxable years ending on or after June 30, 2013, "the aggregate of the average daily number of qualified full-time equivalent active employees employed within the state by an eligible company during such taxable year". A qualified full-time equivalent active employee is defined as "any employee of an eligible company who: (i) Works a minimum of thirty (30) hours per week within the state, or two (2) or more part-time employees whose combined weekly hours equal or exceed thirty (30) hours per week within the state; (ii) Earns health care benefits; and (iii) Earns no less than two hundred fifty percent (250%) of the hourly minimum wage prescribed by Rhode Island law."

Finally, the act requires the Division of Taxation to report by August 15th of each year, the name, address and the amount of "credit" received by each eligible company during the prior fiscal year. The act also requires the eligible companies that receive a tax benefit under the act to file with the Division of Taxation by September 1st of each year, a report that contains "each full-time equivalent active employee's name, date of hire, and hourly wage as of the immediately preceding July 1 and such other information deemed necessary" by the Tax Administrator.

*Comments on
Sources of Funds:*

All business corporation, financial institution, public utilities gross earnings, insurance companies gross premiums and personal income taxes are considered to be general revenues.

*Summary of Facts
and Assumptions:*

The act takes effect upon passage but the rate reduction provided for in the act would apply to each taxable year ending on or after June 30, 2013.

The act essentially extends the tax rate reduction contained in Rhode Island General Law Chapter 42-64.5 entitled "Jobs Development Act" to subchapter S corporations, limited liability companies, partnerships and sole proprietorships. All other business entities included in the act are already eligible for an identical rate reduction under Rhode Island General Law Section 42-64.5-3 titled "Tax rate reduction". The remaining criteria in the act, including the "reduction rate schedule" are the same as those found in Rhode Island General Law Chapter 42-64.5 except for the definition of a full-time active equivalent employee. In Rhode Island General Law Chapter 42-64.5, an eligible full-time equivalent active employee hired after July 1, 2009 must work a minimum of 30 hours per week within the state, earn at least 250.0 percent of the Rhode Island minimum wage in effect at the time the employee is declared a full-time equivalent active employee, and earn healthcare insurance and retirement benefits. The act would retain the wage and benefit requirements but allow for "two (2) or more part-time employees whose combined weekly hours equal or exceed thirty (30) hours per week within the state" to also count toward the determination of a full-time equivalent active employee. For purposes of consistency, this language should be amended to match that of Rhode Island General Law subsection 42-64.5-2(7).

The Office of Revenue Analysis (ORA) used the Internal Revenue Service Statistics of Income (SOI) for TY 2010 to determine the fiscal impact of the act. In particular, ORA looked at the TY 2010 SOI data for Rhode Island residents. ORA used the line in the TY 2010 SOI table for Rhode Island residents titled "Partnership/S-corp net income (less loss)" as the act would apply to these taxpayers. The "Partnership/S-corp net income (less loss)" line in the TY 2010 SOI data for Rhode Island residents

indicates that 27,259 Rhode Island resident taxpayers reported partnership/S corporation net income (less loss) of \$1,367,466,000 in TY 2010. This partnership/S corporation net income (less loss) was spread across all nine tax brackets included in the TY 2010 SOI report. ORA used the TY 2010 personal income tax returns database to calculate effective tax rates for each of these nine tax brackets. The effective tax rates ranged from minus 0.03 percent to 5.22 percent. Each effective tax rate was applied to the amount of partnership/S corporation net income (less loss) reported for each tax bracket in the TY 2010 SOI table in order to estimate the amount of tax that was paid on said income. ORA then summed the estimated tax paid across all nine income tax brackets to arrive at an estimated total tax paid of \$67,974,380.

To determine the impact of the act on state revenues, ORA used the Division of Taxation's Tax Credit and Incentive Report – Fiscal Year 2011. FY 2011 was chosen as it is the fiscal year most closely aligned with TY 2010. In FY 2011, \$14,077,580 in tax benefits were earned under the rate reduction available in Rhode Island General Law Chapter 42-64.5. ORA estimated adjusted business corporation tax revenues for FY 2011 of \$106,223,969. (The adjusted FY 2011 business corporation tax revenues are equal to the audited FY 2011 business corporation tax revenues excluding \$21.7 million in non-recurring tax payments that were accrued back to FY 2010.) Under Rhode Island General Law Chapter 42-64.5, the rate reductions earned by eligible companies range from 0.5 percentage points to 4.75 percentage points. The act limits the rate reduction allowed against the personal income tax (i.e., Rhode Island General Law Section 44-30-2.6) for shareholders of eligible companies to a maximum of 3.0 percentage points. ORA recalculated the tax benefit associated with the rate reduction under Rhode Island General Law Chapter 42-64.5 under the assumption that no recipient could earn a rate reduction of greater than 3.0 percentage points. This recalculation resulted in a tax benefit of \$9,720,749 in FY 2011 versus the actual tax savings of \$14.1 million. Taking the ratio of the recalculated tax savings to the adjusted FY 2011 business corporation tax revenues yields a percentage of revenue foregone of 9.151 percent. ORA multiplied this percentage by the estimated total tax paid of Rhode Island residents with partnership/S corporation net income (less loss) of \$67,974,380 to arrive at a projected revenue loss of \$6,220,460 in TY 2010 had the act been in place.

ORA used the Rhode Island Division of Taxation's Statistics of Personal Income for TY 2010 to calculate the net tax paid by Rhode Island residents. ORA took the \$865,341,038 of "Grand Total Income + Alt Min Amt" and subtracted the value of all the credits used (except for "Historic Structure Amt" which is reimbursed to the General Fund from the Historic Preservation Tax Credit Trust Fund) to arrive at a net tax paid in TY 2010 by Rhode Island residents of \$711,367,435. ORA then took the ratio of the estimated tax revenue foregone under the act of \$(6,220,460) to the net tax paid in TY 2010 by Rhode Island residents of \$711,367,435 to yield the estimated percentage of revenue foregone in TY 2010 had the act been in place. This figure is 0.8744 percent.

At the November 2012 Revenue Estimating Conference (REC), the principals' adopted estimate for personal income taxes for FY 2014 is \$1,129,000,000. The act's effective date is for tax years ending on or after June 30, 2013 which

corresponds with FY 2014. ORA multiplied the estimated percentage of revenue foregone in TY 2010 by the November 2012 REC estimate for FY 2014 personal income tax to arrive at estimated revenue foregone from the act in FY 2014 of \$9,872,394 (i.e., \$1,129,000,000 * 0.008744). Similarly, ORA used the Budget Office's projection of FY 2015 personal income tax revenues, disregarding the proposed personal income tax collection enhancements contained in the Governor's FY 2014 recommended budget, of \$1,188,894,510 and multiplied it by the estimated percentage of revenue foregone in TY 2010 to arrive at a revenue loss of \$10,396,133 in FY 2015 (i.e., \$1,188,894,510 * 0.008744).

Other aspects of the act would pose problems for the Division of Taxation in the administration of the act. For example, the act allows eligible companies that meet the units of new employment requirements to receive a rate reduction under the personal income tax (Rhode Island General Law Chapter 44-30). The personal income tax, unlike the business corporation tax, has three tax rates, 3.75 percent, 4.75 percent and 5.99 percent. Under the act, if an eligible company received a rate reduction of 0.25 percentage points would this rate reduction apply to all three tax rates or just the highest tax rate that the taxpayer faced based upon the reported modified adjusted gross income? In addition, the act only allows the reduced tax rate under the personal income tax to apply "to the portion of net income of such taxpayer attributable to the eligible company". Differentiating between sources of income for a given taxpayer would likely require the Division of Taxation to develop a new form on which to determine the portion of income that is taxed under the act versus all other sources of income. This would be further complicated by nonresident filers and how such income would be apportioned to Rhode Island.

The Governor's recommended FY 2014 Budget projects a closing balance of \$1.4 million in FY 2014 and a deficit of \$170.5 million in FY 2015. Passage of the act would put the Governor's FY 2014 budget out of balance and increase the FY 2015 projected deficit

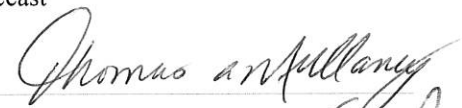
*Summary of Fiscal
Impact:*

FY 2013: Not applicable given the effective date in the act.

FY 2014: A revenue loss of \$9,872,394 is forecast.

FY 2015: A revenue loss of \$10,396,133 is forecast

Budget Office Signature:



Fiscal Advisor Signature:

