State of Rhode Island
Budget Office
Department of Administration

State Fiscal Note for Bill Number: 2013-H-5740

Date of State Budget Office Approval: **Monday, April 15, 2013**

Date Requested: **Wednesday, April 03, 2013**

Date Due: **Saturday, April 13, 2013**

Impact on Expenditures		*Impact on Revenues*	
FY 2013	n/a	FY 2013	n/a
FY 2014	n/a	FY 2014	$3,115,640
FY 2015	n/a	FY 2015	$3,290,691

Explanation by State Budget Office:

This act would amend Rhode Island General Law Chapter 44-55 entitled "Tax Incentives for Employers" to require all Rhode Island corporations to add back any amount deducted under the federal domestic production activities deduction to their Rhode Island taxable income for purposes of computing Rhode Island tax liabilities due under Rhode Island General Law Chapter 44-11 entitled "Business Corporation Tax" and Rhode Island General Law Chapter 44-30 entitled "Personal Income Tax". The domestic production activities deduction generally allows businesses to deduct a percentage of their domestic activities production income from the business' total net income. For Tax Years 2010 and onward the percentage amount is 9.0 percent. Qualified domestic production activities include: the manufacture of tangible personal property, the production of computer software, sound recordings and certain films; the production of electricity, natural gas or water; and construction, engineering, and architectural services.

Comments on Sources of Funds:

All business corporations and personal income taxes are considered to be general revenues.

Summary of Facts and Assumptions:

The effective date of the act is upon passage. It is assumed to be applicable to tax years beginning on or after January 1, 2013. It is assumed that revenue changes that result from the passage of the act would not be realized until the fiscal year following the effective tax year of the act. That is, the tax year 2013 revenue impact would not be realized until FY 2014, the tax year 2014 revenue impact would not be realized until FY 2015, etc.

According to the United States Internal Revenue Service, TY 2010 Statistics of Income by State there were a total of 1,681 Rhode Island resident returns that took the domestic production activities deduction. Of these returns, the TY 2010 SOI reports a total domestic production activities deduction of $28.258 million.

The Office of Revenue Analysis estimated effective tax rates for Rhode Island residents that took the domestic production activities deduction ranging from 0.03 percent to 5.22 percent based on income brackets and the individual taxpayer's Federal Adjusted Gross Income. The effective rates were determined using the personal income tax simulation model developed by the Office of Revenue Analysis applied to TY 2010 Rhode Island tax return data. Application of the Rhode Island effective tax rates to the domestic production activities deduction noted above yields estimated total personal income tax revenues foregone of $1,351,902 from the inclusion of the federal domestic production activities deduction in Rhode Island

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taxable income.

Rhode Island personal income tax collections in FY 2011 were $1,021,338,869. Thus, income taxes from the domestic production activities deduction for Rhode Island residents are estimated to comprise 0.13 percent of total personal income tax revenues. This percentage was applied to the November 2012 Revenue Estimating Conference's personal income tax estimate for FY 2014 of $1,129,000,000 to yield $1,467,700 in Rhode Island personal income tax revenue foregone from the inclusion of the federal domestic production activities deduction in Rhode Island taxable income. This percentage was also applied to the Budget Office's projection for FY 2015 of $1,190,710,000 in personal income tax revenues to yield an estimated $1,547,923 in Rhode Island personal income tax revenue foregone from the inclusion of the federal domestic production activities deduction in Rhode Island taxable income. Thus, disallowing the domestic production activities deduction in Federal Adjusted Gross Income prior to the determination of Rhode Island personal income tax liability will result in estimated revenue gains of $1.47 million in FY 2014 and $1.55 million in FY 2015.

It is important to note that in the derivation of the estimates, ORA could not estimate the amount of personal income tax revenue foregone from the use of the domestic production activities deduction by non-residents subject to Rhode Island personal income taxes. As a result, the revenue impacts cited in the fiscal note should be considered the minimum amount of revenue gain from a modification increasing Federal Adjusted Gross Income by the amount of federal domestic production activities deduction.

The fiscal impact for business corporation taxes is based on an analysis done by the Division of Taxation using TY 2005 tax returns of manufacturers required to file a Rhode Island business corporation tax return. Based on this analysis, the Office of Revenue Analysis estimates that the elimination of the domestic production activities deduction would increase business corporation tax revenues by 1.4212 percent. The Office of Revenue Analysis applied this percentage to the November 2012 Revenue Estimating Conference's adopted estimate net of minimum tax payments of $115,954,104 for FY 2014 to derive an estimated revenue gain of $1,647,940 in business corporation taxes in FY 2014. For FY 2015, the Office of Revenue Analysis used the Budget Office's forecast of the business corporation tax net of minimum tax payments, and disregarding the proposed changes to the business corporation tax included in the Governor's FY 2014 recommended budget, of $122,626,537 and applied the 1.4212 percent estimated revenue increase to this projection to estimated increased business corporation tax revenues of $1,742,768 in FY 2015 from the elimination of the domestic production activities deduction.

In total then, passage of the act is forecast to increase revenues by $3,115,640 in FY 2014 and $3,290,691 in FY 2015. The Governor's FY 2014 Recommended Budget projects an ending balance of $1.4 million in FY 2014 and a deficit of $170.5 million in FY 2015. Passage of the act would increase the Governor's FY 2014 recommended closing balance and reduce the FY 2015 projected deficit.

Summary of Fiscal Impact:

FY 2013: Not applicable due to the assumed implementation date of the act.

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FY 2014: A revenue gain of $3,115,640 is forecast ($1,647,940 in business corporation taxes and $1,467,700 in personal income taxes).

FY 2015: A revenue gain of $3,290,691 is forecast. This revenue gain is comprised of $1,742,768 in business corporation taxes and $1,547,923 in personal income taxes.

Budget Office Signature: Thomas A. Mullaney

Fiscal Advisor Signature: