State of Rhode Island
Budget Office
Department of Administration

State Fiscal Note for Bill Number: 2013-H-5412

Date of State Budget Office Approval: **Thursday, April 04, 2013**

Date Requested: **Friday, March 29, 2013**

Date Due: **Monday, April 08, 2013**

Impact on Expenditures		*Impact on Revenues*	
FY 2013	n/a	FY 2013	n/a
FY 2014	n/a	FY 2014	$(7,091,012)
FY 2015	n/a	FY 2015	$(14,369,731)

Explanation by State Budget Office:

******************************** REVISED April 3, 2013 **

This act would amend Rhode Island General Law by adding Chapter 44-68 entitled "Job Creation Incentive Act". Under this chapter, any newly established business in the State that hires and retains a minimum of two employees shall be eligible to receive the tax incentives established in the chapter. The new employees cannot include the owner of the business or "a relative of any controlling shareholder, director, or officer of the claimant corporation, nor controlling shareholder, officer, or manager of the claimant limited liability company, nor partner or owner of any claimant partnership, joint venture, sole proprietorship or any other type of legal business entity claiming the incentive under this chapter."

A business is defined as "any corporation, limited liability company, partnership, individual, sole proprietorship, joint stock company, joint venture, or any other legal entity through which business is legally conducted or any successors or assigns of the legal entity". The tax incentives available are "a deduction or modification in computed taxes owed by a claimant's business". The tax incentive is equal to 50.0 percent "for the first three years of the claimant's allowable expenses for wages and benefits" and 25.0 percent "for the next three years of the claimant's allowable expenses for wages and benefits".

In order to receive the tax incentive, "the business must file for the incentive with the Tax Administrator within 30 days from the date the business hires its second employee." The deduction made available through the tax incentive can be used to (i) lower net income for the purposes of computing the tax owed under Rhode Island General Law Chapter 44-11 entitled "Business Corporation Tax"; (ii) reduce gross earnings for the purposes of computing the tax owed under Rhode Island General Law Chapter 44-13 entitled "Public Service Corporation Tax"; (iii) lower deposits for the purposes of computing the tax under Rhode Island General Law Chapter 44-15 entitled "Tax on Bank Deposits Generally";(iv) reduce gross premiums subject to tax under Rhode Island General Law Chapter 44-17 entitled "Taxation of Insurance Companies"; or (v) be taken as a modification reducing federal adjusted gross income under the tax imposed by Rhode Island General Law Chapter 44-30 entitled "Personal Income Tax".

The deduction or modification made available to the business is not refundable and

Prepared by: Paul Dion / 4015748943 / pdion@revenue.ri.gov

cannot reduce the tax due for a given tax year below the minimum tax imposed, if any. The act also disallows the incentive made available by the act to any business that uses the "hiring of employees…to obtain any other tax incentive or tax benefit"

Comments on Sources of Funds:

All business corporations, public utilities gross earnings, bank deposits, insurance companies gross premiums and personal income taxes are considered to be general revenues.

Summary of Facts and Assumptions:

******************************** REVISED April 3, 2013 **

The act takes effect upon passage but the tax incentive is assumed to be effective for tax years beginning after June 30, 2013.

The act does not define what constitutes a "newly established business". One interpretation of this term would be only a business that never existed before that is established in the State. A second interpretation would be any business that newly establishes operations in the State. The latter interpretation includes the first interpretation as well as an established multi-state business that opens a new location within the State. For example, if Costco were to open a warehouse store in the State that would be a new business in the State but Costco itself would not be a new business since it already exists and operates in other states. It is recommended that a definition of what constitutes a newly established business be included in the act.

The Office of Revenue Analysis (ORA) consulted the Rhode Island Secretary of State's (SOS) website under Business Services and collected data on the number of new entities that filed incorporation papers with the Secretary of State to establish a new business in the State. The SOS website listed the number of new entities that filed papers with the Secretary of State's office on a weekly basis for the period August 12, 2012 through March 31, 2013. A total of 4,600 new business entities were established during this 34 week period, an average of 135 per week. ORA annualized the weekly average to estimate the number of new business filings for FY 2013 at 7,020. Based on the data taken from the SOS' website, ORA determined that 93.4 percent of the newly formed businesses were for-profit entities, either limited liability companies, limited partnerships, limited liability partnerships, C corporations, subchapter S corporations, or professional services corporations. ORA multiplied the estimated number of new business incorporations by the percentage of new business incorporations that were for for-profit entities to arrive at an estimate of new for-profit entities that would be eligible for the tax incentive contained in the act of 6,557 (i.e., 7,020 * 0.934). Since some newly incorporated businesses are formed in order to provide legal protections to the business owners and not as entities that will produce goods and/or services and hire employees to do so, ORA assumed that one-half of the estimated number of new for-profit business filings would be by business entities that would qualify for the tax incentive contained in the act or a total of 3,279 entities.

ORA consulted the Rhode Island Department of Labor and Training's (DLT) website under Labor Market Information, Occupational Wage Rates and collected data on the entry wage in Rhode Island as of May 2011, the most recent data available. DLT reports the entry wage in Rhode Island to be $11.57 per hour. ORA assumed that business entities that qualified for the tax incentive would employ eligible employees

Prepared by: Paul Dion / 4015748943 / pdion@revenue.ri.gov

for 40 hours per week, 52 weeks per year. These assumptions yield an annual wage paid of $24,066 (i.e., $11.57 * 40 * 52). ORA assumed that wages paid by qualified businesses to eligible employees would grow by inflation as measured by the U.S. Consumer Price Index for All Urban Consumers (CPI-U) over the six year time period in which the qualified business can receive the tax incentive. ORA further assumed that each qualified business would hire on average three eligible employees and that the wages paid to these employees would constitute all "allowable expenses for wages and benefits" that would qualify for the tax incentive. Thus, ORA estimated that the total tax incentive earned under the first fiscal year of the act, which is assumed to be FY 2014, would be $118,380,840 (i.e., 3,279 * $24,066 * 3 * 0.50).

For reasons of simplicity, ORA assumed that all taxpayers that received the tax incentive contained in the act were owners of and/or shareholders or partners in limited liability companies, partnerships, or subchapter S corporations. Thus, the tax incentive received was a modification reducing federal adjusted gross income of $118,380,840 in the first fiscal year of the act. ORA assumed that the owners, shareholders and partners had total Rhode Island taxable incomes from all sources that would be taxed at the top marginal tax rate of 5.99 percent. ORA multiplied the estimated modification reducing federal adjusted gross income amount of $118,380,840 by this marginal tax rate to derive an estimated revenue loss in FY 2014 of $7,091,012 (i.e., $118,380,840 * 0.0599).

In the second fiscal year of the act, the total tax incentive earned would grow by 2.535 percent the value for CPI-U in FY 2015 for those employees that were hired in FY 2014. This yields a total tax incentive for those hired in FY 2014 of $121,514,502 (i.e., $118,380,840* 1.02535) and foregone personal income tax revenues of $7,278,719 (i.e., $121,514,502 * 0.0599). In addition, based on the assumptions above another $118,380,840 of tax incentive would be earned under the act for the employees hired by the new businesses established in FY 2015. Thus, personal income tax revenues foregone from the new firms established in FY 2015 would be $7,091,012 and total personal income tax revenues foregone in FY 2015 would be $14,369,731 (i.e., $7,091,012 + $7,278,719). It should be noted that this scenario would repeat itself in FY 2016, FY 2017, etc. with the revenue loss growing as each wave of newly established businesses hires employees that generate tax incentives under the act.

Rhode Island General Law Sections 44-30-11 and 44-30-31 should be amended to explicitly include the tax incentive contained in the act as a modification reducing federal adjusted gross income. Similar changes would also be needed for the definitions of net income in Rhode Island General Law Chapter 44-11, gross earnings in Rhode Island General Law Chapter 44-13, bank deposits in Rhode Island General Law Chapter 44-15, and gross premiums in Rhode Island General Law Chapter 44-17.

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

Prepared by: Paul Dion / 4015748943 / pdion@revenue.ri.gov

State Fiscal Note for Bill Number: 2013-H-5412

Summary of Fiscal Impact:

******************************** REVISED April 3, 2013
****

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

FY 2014: A revenue loss of $7,091,012 is forecast.

FY 2015: A revenue loss of $14,369,731 is forecast.

Budget Office Signature: Thomas A. Mullaney

Fiscal Advisor Signature:

Prepared by: Paul Dion / 4015748943 / pdion@revenue.ri.gov