The Poverty Institute
at the Rhode Island College School of Social Work

Phasing out Rhode Island's Corporate Income Tax (Article 37) is Unaffordable, Unsound and Unfair Public Policy

Rhode Islanders have already suffered from a decade of failed tax policies enacted in the name of economic development. These policies have cost hundreds of millions of dollars in lost revenue, crippling the Ocean State's ability to fund the public services that employers and workers rely on. Phasing out the state's corporate income tax would represent a continuation and expansion of these failed policies.

UNAFFORDABLE

The Governor's proposal to phase-out the corporate income tax will cost the state more than $14 million in FY 2010 and over $80 million when fully implemented in FY 2014. These estimates are likely to be understated due to significant declines in corporate revenue streams in FY 2009, the year the estimate is based on. This year, corporate income tax receipts are expected to be $108 million. As recently as FY 2007, the corporate income tax was generating close to $150 million for Rhode Island.

UNSOUND POLICY

Tax cuts are an *ineffective* economic development strategy. Michael Mazerov, Senior Fellow at the Center on Budget and Policy Priorities, participated on the Governor's Tax Advisory Workgroup and wrote a detailed minority report. In it he cites numerous economic studies that show tax cuts are not a cost-effective strategy for growing jobs or state economies.[1] Many other studies come to similar conclusions, including one that shows states that enacted significant tax cuts in the late 1990s and the early part of this decade fared worse than other states, on average, in terms of job growth, personal income and employment.

CEOs cite numerous other factors such as quality infrastructure, a skilled workforce and labor and energy costs as being more important than tax policy when deciding where to grow and locate jobs. Well respected business executives - such as Bill Gates of Microsoft[2] and Paul O'Neill,[3] former CEO of Alcoa and Secretary of the Treasury under George W. Bush - have validated through public testimony research findings that an educated workforce, infrastructure and other public services outweigh the importance of taxes in location decisions.

State and local taxes paid by businesses represent, on average, less than 2.5 percent of their total expenses, and the state corporate income tax less than 10 percent of that 2.5 percent.[4] In fact, according to a 2008 report by the Rhode Island Public Expenditure Council, property taxes comprised over 50 percent of the taxes paid by business, with sales and use taxes making up 17 percent, while the corporate income tax accounted for less than 8 percent.[5]

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One-third of the "savings" to businesses will simply be transferred to the federal government. Because state corporate income taxes are deductible on a business's federal corporate income tax return, over $4 million saved by corporations in FY 2010 from having their Rhode Island taxes reduced will instead be sent to Washington in the form of higher federal taxes, undermining the intent of the Governor's proposal to improve the state's business climate.

In the short-term, federal stimulus funds "paper over" the hole created by the gradual elimination of the corporate income tax but, over the long-run that change is not paid for. The American Recovery and Reinvestment Act (ARRA) funds are intended to help states avoid making significant budget cuts as a result of the recession and plummeting revenues. Such cuts further exacerbate the economic downturn. While the Governor's FY 2010 Budget uses ARRA funds to plug some budget holes, the budget also in effect uses some of Rhode Island's stimulus money to pay for the corporate tax cut in the hope that this might eventually lead to higher economic growth in the state. Regardless of whether that comes to pass, there is little question that this choice is contrary to the goal of ARRA's intent, which is to minimize the need for cuts in the state spending on vital services in order to maximize economic growth during the immediate crisis.

UNFAIR TO SMALL AND MID-SIZE BUSINESSES

In 2014 when the corporate income tax is eliminated the minimum franchise tax of $500 would be replaced with a tiered tax that would levy between $450 and $10,000 on corporations, depending on the amount of the company's profits.

Big business gets a 99 percent tax cut. When the corporate income tax is fully phased out in 2014, the 50 companies with the largest tax bills will go from having an average tax liability of $787,172 in 2008 to $10,000, a 99 percent decline. The majority of small businesses (48,282 out of 50,605) with taxable income of less than $10,000 would see their minimum franchise tax reduced from $500 to $450 a year, or 10 percent.

Fifty corporations get 50 percent of the savings. The top 50 corporations will reap roughly 50 percent of the total savings from the phase out of the corporate income tax, or $39 million of the $82 million in foregone tax revenues. The 135 largest corporations will reap almost 60 percent of the total tax savings.

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[1] Report of the Governor's Tax Policy Strategy Workgroup, March 2009. Dissenting Report of Workgroup Member Michael Mazerov, Senior Fellow, Center on Budget and Policy Priorities, Washington, D.C.
[2] Bill Gates, interview before the 2005 annual meeting of the National Conference of State Legislatures, August 17, 2005.
[3] Testimony before the United States Senate Finance Committee, January 18, 2001.
[4] See: Michael Mazerov, "Most Large North Carolina Manufacturers Are Already Subject to 'Combined Reporting' in Other States," Center on Budget and Policy Priorities, January 15, 2009, endnote 9.
[5] "A System at Capacity: Rhode Island's State and Local Tax System," June 2008.

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