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GOVERNMENT

Businesses may be hit by R.I. budget

By David Ortiz,
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The fiscal 2008 budget that was scheduled to be voted on in the General Assembly last Friday is expected to significantly affect the business community in Rhode Island, in part by eliminating a few corporate tax shelters worth tens of millions of dollars a year.

The legislature's \$7 billion state budget proposal closes an estimated \$350 million deficit in part by eliminating or amending such perceived corporate "loopholes" as the preferential treatment of real estate investment trusts (REITs).

The House Finance Committee's proposed budget eliminates the REIT provision in the tax code, under which corporations like Wal-Mart have avoided paying almost all of the state's 9 percent corporate income tax by leasing properties from subsidiaries they've created specifically for that purpose, and then writing off the rent as a business expense.

The proposed budget also would make it more difficult to avoid taxes by using passive investment companies, which some businesses active in Rhode Island use to reduce their liabilities.

Toys 'R' Us and other corporations have been criticized for their use of such shelters since news broke that the national toy retailer was able to avoid paying state income tax throughout the nation by transferring its logo and trademark into a passive investment company in Delaware, which doesn't have a corporate tax, and then having all of its stores and operating units pay royalties to the passive investment company and deducting those royalty payments on their state income tax forms.

About 25 states have passed or are in the process of enacting bills restricting state income tax deductions based on payments made to passive investment companies in other states.

Some advocates had sought to fully abolish tax shelters for passive investment companies, but business groups managed to have the language softened so some entities will still be able to keep their tax-preferred treatment.

Still, even the modified language is viewed by some – including Gov. Donald L. Carcieri – as anti-business and bad for the state's economic climate.

"The governor does not believe we should be raising taxes on businesses," said spokesman Jeff Neal, who expressed even more concern about legislators' decision to halt the capital gains tax phaseout. "That is not the way to create a business-friendly environment."

David R. Carlin III, vice president of government affairs for the Northern Rhode Island Chamber of Commerce and lobbyist for the Rhode Island Chamber of Commerce Coalition, said the measures would hurt the state's economy.

"Whenever you add a tax burden, that prohibits a company from expanding or doing business in the most efficient manner possible," he said.

But Ellen Frank, an economist at the Poverty Institute at Rhode Island College who has pressed lawmakers to eliminate the corporate tax shelters, said the changes would mirror legislation that lawmakers and Republican governors in Massachusetts, Texas, Kentucky, Ohio and Georgia already

have enacted without hurting their state economies.

“Our position is that businesses should have been paying these taxes all along,” Frank said. “When the corporate franchise tax was enacted, nobody anticipated that businesses would use such creative accounting techniques as paying rent to themselves to an out-of-state subsidiary or paying royalties to themselves through Delaware holding companies.”

The Greater Providence Chamber of Commerce was able to save the use of passive investment companies in some cases, negotiating two amendments to a bill that would have abolished the practice.

The most significant amendment – which parallels what’s on the books in Massachusetts – is essentially a safe-harbor provision that enables companies to continue paying royalties to passive investment companies in states with corporate tax rates roughly comparable to Rhode Island’s, said Kelly Sheridan, legislative counsel for the Chamber and author of the amendments.

Another amendment enables companies to receive a tax credit for royalties paid to passive investment companies in states where the tax rate is much lower than Rhode Island’s, Sheridan said.

“We were just trying to make sure the bill was focused to address the tax abuse that lawmakers were concerned with,” he said.

The Chambers are critical of other aspects of the House budget proposal, including plans to eliminate a 3-percent across-the-board increase in state education aid, cash in the last of the state’s remaining bonds from its settlement with the tobacco industry and freeze the capital gains tax – which was set to be phased out by next year – at 1.67 percent.

In particular, Carlin said the Chamber of Commerce Coalition believes the state needs to stick with its plan to increase education aid by 3 percent to stave off municipal property tax hikes by cash-starved cities and towns across the state.

Laurie White, president of the Greater Providence Chamber, said she was also disappointed that lawmakers failed to enact a tax credit for small business owners, but said it was understandable given the state’s budget crisis.

White said she was pleased that lawmakers held on to major reforms advanced last year by the Providence Chamber, especially the phase-in of a flat income tax, and that the state’s historic tax credit program was maintained.

“It’s an extremely challenging year for lawmakers and a wide range of constituent organizations, including the business community,” she said.