

Tax expenditures are tax credits, deductions, exemptions, exclusions and preferential rates that reduce the tax liability for selected firms or individuals. They are similar to direct spending programs in that they expend public funds to accomplish policy goals. Unlike direct spending programs, however, tax expenditures become permanent provisions of the tax code and are not part of the annual budget appropriations process.

Many tax expenditures have been enacted in Rhode Island over the last two decades to encourage the growth of certain firms or industries. By reducing the tax liability of a firm or industry, Rhode Island lowers the cost of doing business. The state, for example, subsidizes the costs of motion picture production companies, boat makers, artists and international investment firms. Other tax expenditures are intended to serve a public purpose, like the tax credit for adoption expenses or exemption of food from the sales tax. Still other tax expenditures were enacted to coordinate Rhode Island's tax code with those of other states or with federal rules. The credit for income taxes paid to other states and the allowance for federal itemized deductions are two examples.

In 2003, the General Assembly required the Division of Taxation to publish a complete bi-annual Tax Expenditures Report which estimates the cost of all "tax preference items" (RIGL 44-48.1-1). The Report does not, however, provide information on whether the state's tax expenditures are achieving intended policy goals. A more thorough evaluation would offer lawmakers and the general public a better understanding of how these expenditures benefit the residents of this state, and which expenditures promote economic growth and foster thriving communities.

This report analyzes the 2008 Tax Expenditures Report which documents cost estimates for 211 tax expenditures based on 2007 data.¹

Findings

The Poverty Institute analysis of the 2008 Tax Expenditures Report finds that:

1. The state lost potential revenue of at least \$1.3 billion in 2007 as a result of tax expenditures. The majority (48%) of estimated revenue forgone is for tax expenditures adopted through the sales and use tax, followed by the personal income tax (41%).
2. 118 of the 211 tax expenditures (56%) could not be reliably estimated by the Division of Taxation. Thus the true cost of Rhode Island's tax expenditures may be considerably higher than \$1.3 billion.
3. Eighty-eight of Rhode Island's 211 tax expenditures (42%) are not found in any other New England state.
4. No reliable estimates were provided for 24 of the 25 preference items (96%) adopted through the business corporation tax.

The 2008 Tax Expenditures Report documents \$1.3 billion in tax expenditures for 2007. The true cost of tax expenditures on state revenues, however, is probably much higher than \$1.3 billion since the Division of Taxation was unable to estimate the costs of 118 items (56% of all items). While this represents a small improvement over the 2006 report, when 127 items were not estimated (new estimates include the lead abatement credit, adoption credit and credit for artwork exhibition), little headway has been made towards developing reliable estimates since the first complete report was released in 2004, which contained 128 non-estimated items.

Summary of 2008 Tax Expenditures Report

Rhode Island state government lost at least \$1.291 billion in revenue in 2007 as taxpayers took advantage of any of 211 "tax preference items": credits, exemptions, and deductions that reduce state tax liability. (See *Table 1*)

¹The 2008 Tax Expenditures Report can be found online at www.tax.state.ri.us/reports.

Table 1. 2008 Tax Expenditure Report Results Summary

CATEGORY	Number of tax preference items	Number of items not estimated	No similar provision in other NE states	Estimated revenue forgone
PERSONAL INCOME TAX	38	11	12	\$529,821,335
SALES AND USE TAX	72	43	20	\$625,575,000
BUSINESS CORPORATION TAX	25	24	9	\$36,700,000
MISCELLANEOUS TAXES	47	31	31	\$27,446,000
PREFERENCE ITEMS FOR MORE THAN ONE TAX	29	9	16	\$71,923,475
TOTAL	211	118	88	\$1,291,465,810

Personal Income Tax: Estimated Cost = \$530 million

Just over 40% of the estimated revenue forgone in 2007 is due to preference items for the personal income tax. Because Rhode Island has historically “piggybacked” on the federal income tax, all deductions, exemptions and credits allowed on federal tax forms are also allowed in Rhode Island, at a cost of \$381 million in 2007. These include personal exemptions, itemized and standard deductions, deductions for IRA and Keogh contributions, and credits for child care. Another \$128 million is credit for taxes paid to other states. The state expended \$14 million on the property tax circuit breaker and \$4.6 million to the alternative flat tax that was passed in 2005 to reduce taxes on high-income Rhode Islanders. (See Table 2)

No estimates were provided for 11 of the 38 preference items for the personal income tax (29%). Items not estimated include exemptions for artists (RIGL 44-30-1.1 and 44-30-24), exclusion of stock options in computer companies (RIGL 44-39.3-1) and reduction in taxes under the Jobs Growth Act (RIGL 44-64.11). In 12 cases, no similar expenditures were found in other New England states.

Sales and Use Taxes: Estimated Cost = \$626 million

Seventy-two items are exempt from Rhode Island’s sales tax. The Division of Taxation estimates that at least \$626 million in revenue was forgone in 2007 due to sales tax exemptions. Most (78%) of this was attributable to the nine items listed in Table 3.

No estimates were provided for 43 of the 72 items (61%), including exemptions for boats and for investment companies’ toll free calls. Twenty preference items were

not found in any other New England state, including the exemptions for boats, sales by artists, property for jewelry display, florist supplies and horse food.

Table 2. Major Estimated Personal Income Tax Items in 2007

Personal income tax preference items	Estimated revenue forgone
CREDIT FOR OTHER STATES’ TAXES	\$128,133,000
CREDIT/REFUND PROPERTY TAX RELIEF	\$14,000,000
FEDERAL ADJUSTMENTS AND CREDITS	\$381,000,000
ALTERNATIVE FLAT TAX	\$4,600,000

Table 3. Major Estimated Sales Tax Exemptions in 2007

Sales tax preference items	Estimated revenue forgone
NEWSPAPERS	\$5,500,000
FOOD PRODUCTS	\$125,200,000
MEDICINES AND DRUGS	\$23,300,000
NURSING HOME/HOSPITAL RENTAL CHARGES	\$137,000,000
EDUCATIONAL INSTITUTIONS RENTAL CHARGES	\$21,300,000
HEATING FUEL FOR RESIDENCES	\$39,000,000
ELECTRICITY AND GAS FOR RESIDENCES	\$42,400,000
MANUFACTURER’S MACHINERY AND EQUIPMENT	\$8,900,000
CLOTHING AND FOOTWEAR	\$86,000,000

Business Corporation Tax:

Estimated Cost = \$36.7 million

The Division of Taxation provided reliable estimates for only one of the 25 preference items for the Business Corporation Tax – allowing a deduction for net operating losses, in accordance with federal tax rules, reduced state revenue by \$36.7 million.

No reliable estimates were provided for 24 of the 25 preference items (96%). For nine items, no other New England state had similar provisions, including special provisions for investment and security companies, exclusion for Foreign Sales Corporations, international investment services and exemption of dividend and interest from net income.

Miscellaneous Preference Items:

Estimated Cost = \$27.4 million

This category includes 47 preference items for 19 different state taxes and fees. Among the most significant items are licensee commissions for Jai Alai, Pari-Mutuel and Simulcast betting. These three items resulted in \$24 million in lost revenue to the state.

Of 47 preference items, 31 had no reliable estimate (66%). Among the items not estimated were four exemptions from the bank excise tax found in no other New England state.

Other Preference Items for More than One Tax:

Estimated Cost = \$71.9 million

This category consists of 29 tax expenditures that can be claimed against more than one tax (for example against the personal income and other business taxes). Most of these items provide tax incentives for economic development purposes. (See Table 4)

The Division of Taxation was unable to reliably estimate the revenue foregone for nine of 29 preference items in this category (31%). Items not estimated include the biotechnology investment tax credit, the innovation and growth tax credit and credits for investment in mill buildings. Most of the tax expenditures in this category — 23 of 29 (79%) — are not found in other New England states.

Table 4. Major Estimated Economic Development Incentives in 2007

Other preference items for more than one tax	Estimated revenue forgone
ENTERPRISE ZONE WAGE CREDIT	\$2,325,000
INVESTMENT TAX CREDIT	\$11,728,000
EDUCATIONAL ASSISTANCE EXPENSE CREDIT	\$1,583,300
JOB DEVELOPMENT RATE REDUCTION	\$4,608,000
CREDIT FOR HISTORIC STRUCTURES	\$34,308,000
MOTION PICTURE TAX CREDIT	\$12,307,000

Policy Implications

The Tax Expenditures Report is an extremely important public policy document. Reporting the amount of revenues forgone to tax expenditures is a first step to ensuring that the state is making the best use of its limited resources. To fully understand which tax incentive and credit programs are cost effective, however, the state must conduct a comprehensive analysis of such policies.

Economic development incentives in particular need to be estimated and evaluated so that state officials and the public can determine whether the incentives offer a return on the investment. If the state is not benefiting economically, these incentives should be eliminated. Many development expenditures are enacted in the belief that they will pay or themselves in new tax revenue generated from economic growth. Yet, the projected job growth required to recoup forgone revenue can be significant and particularly challenging as the state struggles to grow jobs.

An important step in evaluating tax incentives was made at the beginning of 2008: hiring directors for both the Department of Revenue and the Office of Revenue Analysis. Enacting legislation mandating disclosure and accountability from tax incentive recipients (similar to New Jersey's) is a second essential step.

Improving the process of reporting and evaluating our state's tax expenditures will ensure that the investments we make in our state are profitable, equitable and beneficial to Rhode Island's economy.