

## **TWO STEPS FORWARD, THREE STEPS BACK**

### *Tax Policy Proposals in the Proposed FY2011 Budget*

February 2010

Governor Carcieri's proposed FY 2011 budget totals \$7.5 billion and includes spending and revenue changes to close a \$427.4 million deficit. The tax policy proposals contained in the Budget include the repeal of two tax credits that will increase revenues by \$3 million. This increase is offset, however, by a corporate tax rate reduction and new small business jobs program tax credit that would cause an anticipated revenue loss of \$21.5 million. In addition, the budget proposes continuing the phase-in of the flat tax, which will cost the state more than \$56 million in Tax Year 2010 and \$79 million when it is fully phased in during Tax Year 2011.

### **TWO STEPS FORWARD: REVENUE PROPOSALS THAT MAKE SENSE**

The Governor proposes eliminating two tax credit programs: the Motion Picture Tax Credit and the Enterprise Zone Tax Credit.

**Eliminating the Motion Picture Tax Credit** -- The Motion Picture Tax Credit is equivalent to 25% of qualified production costs attributable to expenditures made within the state. The Governor estimates that the state will save \$2.0 million by eliminating this credit.

Since Rhode Island enacted its motion picture tax credit program in 2006, the state has foregone close to \$45 million in revenue. A 2008 report by the state's Office of Revenue Analysis found that for every dollar the state gives up to motion picture tax credits, it only recoups 28 to 32 cents in revenue, indicating that the state has not benefitted from this tax credit program.<sup>i</sup> In addition, more and more states have enacted motion picture tax credits. Today, 41 states offer some form of a motion picture tax incentive that resulted in combined revenue losses of \$1.3 billion in 2008.<sup>ii</sup> The widespread availability of the credit means that states need to enact steeper credits to remain competitive. Rhode Island can no longer afford to compete in this race to the bottom.

**Eliminating the Enterprise Zone Tax Credit** -- Businesses certified by the Enterprise Zone Council receive a credit equal to 50% of wages paid to newly-hired workers, capped at \$2,500 per worker or \$5,000 if the worker resides in a designated Enterprise Zone. Eliminating this credit results in a \$1.0 million revenue increase.

There are no job quality standards required for the positions that are funded through these credits. A company is not required, for example, to provide benefits to the newly-hired employee or pay a wage above the minimum wage.

## **THREE STEPS BACK: TWO NEW QUESTIONABLE TAX CUTS WILL COST AT LEAST \$21.5 MILLION A YEAR AS FLAT TAX CONTINUES TO DRAIN STATE COFFERS**

**Reducing the Minimum Corporate Tax Rate** -- The Governor proposes to reduce the minimum business corporation tax from \$500 to \$250 a year. This will result in an \$11.5 million revenue loss. In Tax Year 2007 there were 50,605 corporate taxpayers, of which 47,078, or 93.0%, paid the minimum tax of \$500 per year.

Rhode Island's minimum corporate tax is paid by some of the state's largest corporations. In Tax Year 2006, 3,600 corporations, each of which had with gross receipts of more than \$1,000,000, paid the minimum business tax of \$500. Twenty-two percent (784) of those corporations had gross receipts of more than \$5,000,000.

The Poverty Institute suggests that there is a more equitable and efficient way to provide tax relief to corporations without losing much needed state revenue. The corporate minimum tax could be eliminated for the close to 24,000 companies with gross receipts of less than \$25,000, and decreased for close to 10,000 companies, by imposing a graduate minimum tax on companies with gross receipts above \$25,000. This proposal would reduce the administrative burden of filing the tax, create efficiencies for the Division of Taxation which would no longer have to process 24,000 minimum corporate tax returns, and provide tax relief for these small businesses. Furthermore, it would create a much more equitable tax system that requires companies with significantly more resources to contribute a more reasonable amount towards funding public services that businesses rely on, such as consumer and environmental protection, a legal system that protects investments and production, and a safe, efficient transportation network.

**Creating a Small Business Jobs Program Tax Credit** -- The Governor proposes a new temporary Small Business Jobs Program Tax Credit of \$2,000 for each new full-time employee hired who collected unemployment, received cash assistance through Rhode Island Works, or graduated from a post-secondary program within the last 24 months. This will result in a \$10 million revenue loss.

The Poverty Institute is concerned this is not a cost-effective way to promote job growth. The cost of each new job created will be over \$10,000. The Budget Office estimates that 5,000 jobs will qualify for the tax credit, but acknowledges that 4,050 of these will be created as part of the recovery without the availability of the tax credit. Thus, a net of 950 new jobs will be created as a result of the credit at a cost of \$10,500 per job. Moreover, there is a strong possibility that a similar program will be created at the national level and offer a \$5,000 tax credit to small businesses who hire, making the Rhode Island credit program less significant in inducing new job creation. Furthermore, because state business income taxes are deductible against the federal

income tax, approximately one third of every dollar Rhode Island spends on tax credits is “wasted” because the recipient's federal tax liability goes up.

If the Small Business Jobs Program Tax Credit is going to be enacted, the following changes should be made to ensure the credit is better targeted and actually achieves its goals:

1. There is a significant loophole in the legislation that would allow a Rhode Island corporation that is a subsidiary of a Fortune-500 corporation to be an eligible “small business” as long as the subsidiary has fewer than 200 employees worldwide. The legislation should clearly state that the 200 worldwide employee limit applies to the entire corporate group of which the Rhode Island corporation is a member.
2. There should be a provision to prevent a company from laying off employees and hiring replacements in order to obtain the credit.
3. The program should be targeted to individuals who have received unemployment insurance in Rhode Island and/or who have graduated from a Rhode Island institution of higher education.
4. The legislation should require public disclosure of which companies received the credits and the number of jobs created.

These changes would strengthen the accountability provisions that are included in the bill. This includes the requirement that to qualify for the credit eligible employees work a minimum 30 hours per week and be paid 250% of the minimum wage. The law also includes an important “recapture” clause that would force employers to repay the state any credits used if the conditions of the program are not met.

**Continuing the Phase In of the Costly Flat** -- The Governor’s Budget calls for the continued phase in of the “Flat Tax” through 2011. The "Flat Tax" rate will be reduced from 6.5% to 6.0% in Tax Year 2010, resulting in an additional revenue loss of \$17.9 million and from 6.0% to 5.5% in Tax Year 2011 with an additional loss of \$22.9 million. By Tax Year 2011, the total annual revenue loss will be nearly \$80 million per year.

The “flat tax” should be repealed, or at the very least frozen. The state cannot afford to continue to lose tens of millions of dollars to this tax break that is used by a small number of high income households and has no documented benefit to the state’s economy.

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<sup>i</sup> RI Department of Revenue, Office of Revenue Analysis (July, 2008). A Macro Analysis of the Return on Investment of the Rhode Island Motion Picture Production Tax Credits.

<sup>ii</sup> Polansky, J. and Glanz, S., November 2009. Tax Subsidies for US Films with Tobacco Imagery. University of California, San Francisco. Center for Tobacco Control Research and Education.