RIPEC

RIPEC Policy Brief

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RIPEC Analyzes Rhode Island's Improved Business Tax Climate Index Ranking of 37th Among States

This RIPEC Policy Brief analyzes Rhode Island's ranking on the Tax Foundation's 2021 Business Tax Climate Index in regional and historic context and offers recommendations for how policymakers could improve the state's ranking.

Introduction

The Tax Foundation, a think tank based in Washington D.C., has annually issued its *Business Tax Climate Index* since 2003. Hereafter referred to as the *Index*, this fifty-state ranking provides a comparative analysis of each state's business tax climate. The *Index* is based on the principle that tax systems which are favorable to business give states advantage in attracting new businesses and generating economic and employment growth.[1] A multitude of studies show that economic development correlates to business tax climate, as decisions by companies about where to locate or whether to begin operation in the first place is in good part determined by anticipated operating costs.[2] Of course, factors such as access to raw materials or infrastructure, or the availability of a skilled labor pool, also play a large role in determining a state's overall business climate, but as the Tax Foundation points out, improving the business tax climate provides policymakers with an opportunity to spur economic development immediately, whereas many other improvements may take decades to realize.[3]

A corollary premise of the Tax Foundation's *Index* is that, even in our global economy, states are in greater competition with each other than with foreign countries.[4] Moreover, while it is true that the Ocean State faces more competition with Texas than Tehran, it faces the greatest competition with its neighboring New England states, particularly Massachusetts and Connecticut. These states, after all, share similar demographic and economic features with the Ocean State, with

[1] Tax Foundation, 2021 Business Tax Climate Index, 6.

[2] These studies include: Timothy J. Bartik, "Business Location Decisions in the United States: Estimates of the Effects of Unionization, Taxes, and Other Characteristics of States," *Journal of Business and Economics Statistics* vol. 3, iss. 1 (January 1985): 14-22; James A. Papke and Leslie E. Papke, "Measuring Differential State-Local Tax Liabilities and Their Implications for Business Investment Location," *National Tax Journal* vol. 39, iss. 3 (September 1986): 357–366; Stephen T. Mark, Therese J. Mc Quire, and Leslie E. Papke, "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area," *National Tax Journal* vol. 53 (March 2000): 105-123; J. William Harden and William H. Hoyt, "Do States Choose their Mix of Taxes to Minimize Employment Losses?" *National Tax Journal* vol. 56 (March 2003): 7–26.

[3] Tax Foundation, 2021 Business Tax Climate Index, 6.

[4] Ibid.

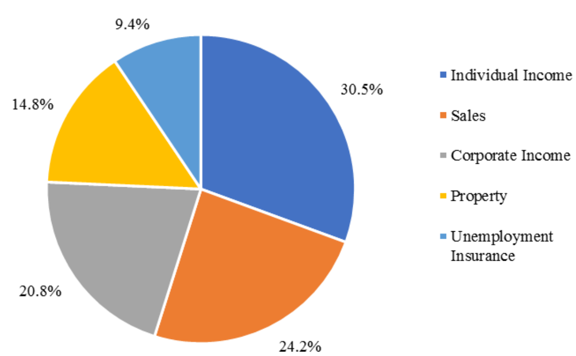
comparable characteristics important to business. Due to its small size, Rhode Island's competition with its neighboring states is particularly acute since businesses often can move across borders without necessarily relocating their existing workforce.

This policy brief is organized by first breaking down the methodology of the *Index*. It then delves into Rhode Island's overall ranking, including a comparison to Rhode Island's ranking over time and within the region. The brief next analyzes Rhode Island's ranking in each of the five tax categories that comprise the *Index*. Finally, it recommends tax policies that would enable the Ocean State to continue its currently positive trajectory and improve its ranking in the future.

Methodology

The *Index* produces an overall score for states, and ranks them accordingly, on a scale of zero to ten, with a higher score indicating a better business tax climate. A state's overall score is determined by comparing 124 variables across five major tax categories: individual income, sales, corporate income, property, and unemployment insurance. Each state receives a score for each tax category, but, as Figure 1 shows, each category is weighted differently when determining the composite score, with the most weight attributed to those taxes with the heaviest variability between states. The Tax Foundation employs this weighting "because components with higher standard deviations are those areas of tax law where some states have significant competitive advantages."[5] In other words, there is less difference between the burden of unemployment insurance tax in one state to the next because this tax is administered by every state, but the six states that do not impose an individual income tax have significant advantage over the 44 states that do. The scores each state receives in each category are normalized so that scores may be compared across categories.

Figure 1
***Index* Weights on Five Major Tax Categories**



Source: Tax Foundation, 2021 State Business Tax Climate Index

Like every edition of the *Index*, some methodological changes are introduced in the 2021 edition. In this case, new variables were added to the property tax index to account for the use of split roll property taxation (for which states are penalized), as well as property tax limitations (for which states may be rewarded or penalized, depending on the type of limitation).[6] Each edition of the *Index* recalibrates scores and rankings for the previous seven editions to backcast methodological changes, and also to incorporate retroactively applied statutes and

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[5] Tax Foundation, 2021 Business Tax Climate Index, 15.

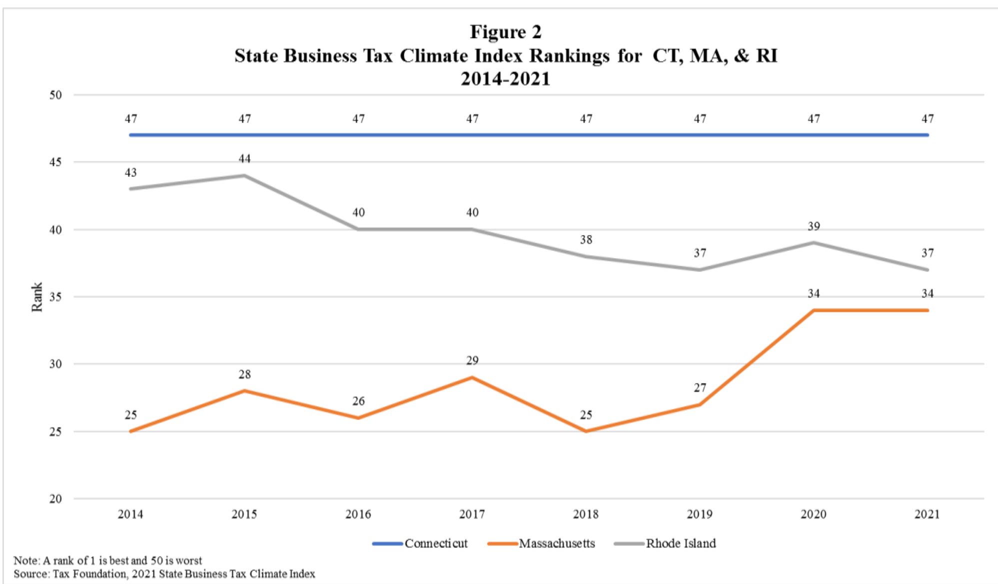
[6] A state is rewarded for a limit on rate or levy, but not assessment, as limiting assessment value distorts market value and creates a system in which similarly valued properties may receive very different tax bills. Rhode Island mandates that municipalities apply a 4.0 percent cap on year-over-year levy increases, which improves its property tax score, but its score is hindered by the fact that the state permits municipalities to use a split roll property tax system, in which commercial and tangible property are typically taxed at higher rates than residential property. Tax Foundation, 2021 Business Tax Climate Index, 45; R.I. Gen. Laws § 44-5-2; R.I. Gen. Laws § 44-5-20.20.

corrections. Thus, the scores and rankings reported in previous iterations of the *Index* are revised by each new edition.

The 2021 *Index* covers tax policy from July 1, 2020 to June 30, 2021, consistent with fiscal year (FY) 2021 for all but four states.[7]

Overall Ranking

Rhode Island's ranking on the 2021 *Index* is 37, improving by two spots over its 2020 ranking and returning the Ocean State to the same standing it held on the 2019 *Index*. As Figure 2 shows, Rhode Island has been on a positive trajectory over the last six years; in 2015, the Ocean State's business tax climate was ranked 44th best (or seventh worst) in the country. Rhode Island's improved score has positioned it well ahead of Connecticut, which has stagnated at 47th since 2014, and closer in line with Massachusetts. Though the Bay State has become less competitive in terms of business tax policy in the last four years, its ranking at 34 still bests Rhode Island.

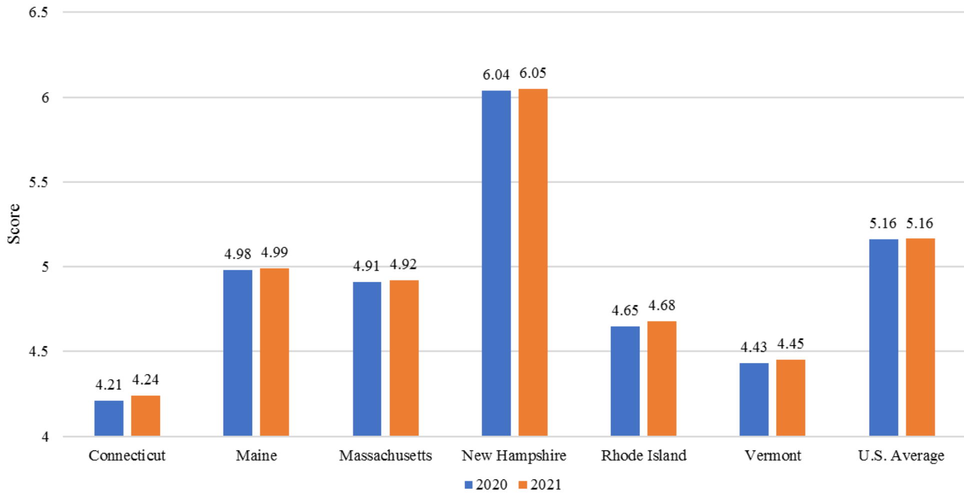


A state's ranking is based on a state's relative composite score, and Figure 3 details the 2020 and 2021 scores of every state in the New England Region as well as the U.S. average. As states are ranked and scored in relation to one another, an improved score does not necessarily improve a state's ranking, so while Rhode Island's score improved by 0.03 points between 2020 and 2021 and it moved up two ranks in the same time frame, Connecticut's score also improved by 0.03 points but its ranking did not budge. Rhode Island has a more competitive business tax climate than Vermont and Connecticut, but is less competitive than Maine, Massachusetts, and New

[7] New York's fiscal year begins April 1, Texas' fiscal year begins September 1, and Alabama and Michigan's fiscal year begin October 1. Washington D.C. is given a score and ranking in the *Index*, but both are neutral; they do not affect any state's score or ranking.

Hampshire. Every New England state is less competitive than the average U.S. state except New Hampshire, which ranked 6th best on the *Index* in both 2020 and 2021.

Figure 3
Business Tax Climate Index Score for New England States & U.S. Average 2020-2021



Note: U.S. Average excludes Washington D.C.; a higher score indicates a better business tax climate
Source: Tax Foundation, 2021 State Business Tax Climate Index

Importantly, Rhode Island's improved score and rank between 2020 and 2021 are not the product of proactive policy choice. Rather, the Ocean State moved up two spots because its policymakers took no major action to harm the business tax climate, while other states worsened their position relative to Rhode Island. Specifically, an increase of property tax rates in Hawaii caused the state to move from a rank of 37 to 38, while Ohio moved from a rank of 38 to 39 because of changes in its excise tax. With that stated, Rhode Island *has* made important changes to tax policy in recent years, and the following five sections of this brief—which break down Rhode Island's standing in each of the five major tax categories—detail what actions led to the state's improved ranking.

The overall ranking of every state and Washington D.C. is included in the appendix to this policy brief.

Individual Income Tax

The individual income tax is Rhode Island state government's single largest source of general revenues and is the most heavily weighted tax in the overall score produced by the *Index*.[8] Studies have shown that a high or poorly structured individual income tax can adversely impact a businesses' bottom line in two ways. First, for the many businesses that operate as sole proprietorships, partnerships, or S corporations, profits are reported through individual income tax. Second, individual income tax impacts the cost of labor, a significant—and often the single greatest—expense in most businesses. The *Index* measures the impact of individual income tax by taking into account whether a state levies this tax (six do not), the rates applied, the graduated rate

[8] In Rhode Island's FY 2020 Budget as Enacted, the individual income tax comprised 34.1 percent of anticipated general revenue collections. R.I. Office of Management and Budget, FY 2020 Budget as Enacted Executive Summary.

structure, and the standard deductions and exemptions applied.[9] The *Index* also accounts for measures taken to improve fairness. For instance, states are rewarded if they protect married couples from a higher rate than if they had filed as individuals, or if they index the tax code for inflation (Rhode Island tax code results in a 'marriage penalty' but also indexes for inflation).

As Figure 4 shows, Rhode Island is less competitive than the average state in terms of its individual income tax. Regionally, Rhode Island is more competitive in this category than Connecticut and Vermont, but less competitive than Maine, Massachusetts, and New Hampshire. In fact, the competitive difference is considerable between Rhode Island and Massachusetts and New Hampshire, which respectively rank 11th and 9th. New Hampshire scores well in this category because, while it taxes interest and dividends, it does not tax wages and salaries. Massachusetts scores well because it applies a relatively low flat rate of 5.05 percent to all individual income. Comparatively, Rhode Island has three income tax brackets, with a 3.75 percent rate applied to income less than $65,250, 4.75 percent applied to income over $65,250 and less than $148,350, and 5.99 percent applied to income greater than $148,350. Connecticut, which ranks 44th, has seven brackets and a top rate of 6.99 percent for income over $500,000.

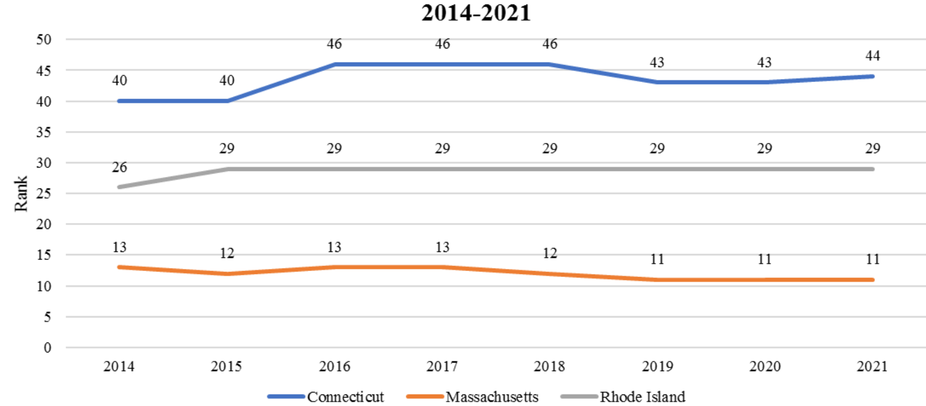
Figure 4
Individual Income Tax Score for New England States & U.S. Average, 2020-2021

	2020	2021
Connecticut	3.88	3.87
Maine	5.14	5.13
Massachusetts	5.96	5.94
New Hampshire	6.39	6.37
Rhode Island	**4.88**	**4.86**
Vermont	4.37	4.36
U.S Average	5.40	5.40

Note: U.S. Average excludes Washington D.C.; a higher score indicates a better business tax climate
Source: Tax Foundation, 2021 State Business Tax Climate Index

Figure 5 shows that Rhode Island has maintained the same rank in this category since 2015—29th—signifying that its individual income tax structure has not undergone significant change to alter its competitiveness in this period.

Figure 5
Individual Income Tax Component Ranking for CT, MA, & RI 2014-2021



Note: A rank of 1 is best and 50 is worst
Source: Tax Foundation, 2021 State Business Tax Climate Index

[9] Alaska, Florida, South Dakota, Texas, Washington, and Wyoming do not have an individual income tax, but Texas and Washington do tax limited liability corporations and S corporations through gross tax receipts.

Sales Tax

Sales tax comprises the second-largest source of the Ocean State's general revenues and is the second most heavily weighted component of the *Index*.[10] Sales tax is an important consideration for businesses both because business inputs are subject to sales tax and because it can dissuade customers from purchasing goods and, increasingly, services. The *Index* scores states based on if they levy a sales tax (five states do not), if they levy excise taxes, what their sales tax rate is, and the nature of their sales tax base.[11]

Ranked 25th, Rhode Island is squarely in the middle of all states in the nation on the sales tax component of the *Index*. Compared to its New England neighbors, however, Rhode Island's sales tax is less competitive; Figure 6 shows that it just ekes out an advantage over Connecticut, but scores significantly lower than Maine, Massachusetts, and Vermont, and far lower than New Hampshire, which levies excise taxes but not a sales tax. Rhode Island's closest neighbor, Massachusetts, ranks 12th.

Figure 6
Sales Tax Score for New England States & U.S. Average, 2020-2021

	2020	2021
Connecticut	4.76	4.78
Maine	5.67	5.63
Massachusetts	5.21	5.23
New Hampshire	9.08	9.08
Rhode Island	**4.77**	**4.78**
Vermont	5.12	5.14
U.S. Average	5.00	4.96

Note: U.S. Average excludes Washington D.C.; a higher score indicates a better business tax climate
Source: Tax Foundation, 2021 State Business Tax Climate Index

As depicted in Figure 7, Rhode Island's sales tax ranking has been relatively stable over the last several years, ranging between 23 and 27 in the 2014-2021 editions of the *Index*. Rhode Island's system of sales taxation has not undergone large structural change in this period, but it has experienced some shifts relevant to its overall score. For one, it twice raised its tobacco excise tax, to $3.75 per pack of twenty cigarettes in FY 2016, and to $4.25 per pack in FY 2018. Only two states place a greater excise tax on cigarettes: Connecticut and New York ($4.35 a pack in both states).[12] While Rhode Island hindered its competitiveness by making permanent its excise tax on beer, wine, and liquor in this period, it improved its score by removing wine and liquor from its sales tax base. Similarly, while the Ocean State removed commercial energy from its sales tax base in this period, its sales tax is less competitive for having added vacation home rentals and room resellers, security services, and software as a service to that base.[13]

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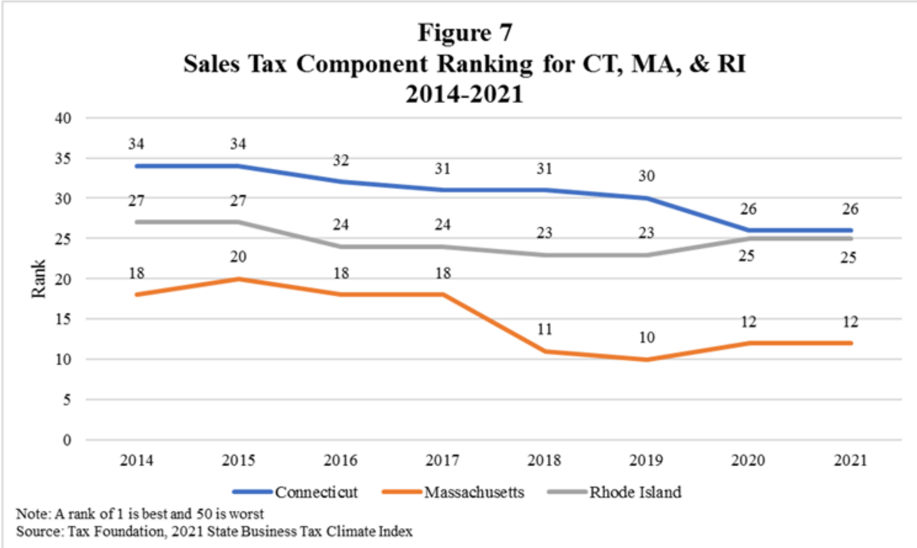
[10] In Rhode Island's FY 2020 enacted budget, sales tax comprised 32.1 percent of general revenues. R.I. Office of Management and Budget, FY 2020 Budget as Enacted Executive Summary.
[11] Alaska, Delaware, Montana, New Hampshire, and Oregon do not levy a state sales tax, but Alaska permits municipal governments to levy a sales tax. All of these states levy excise taxes on goods like gasoline, tobacco, and beer.
[12] Federation of Tax Administrators, Cigarette Tax Increases: 2000-2020; Tax Foundation, 2021 Business Tax Climate Index, 67.
[13] National Conference of State Legislatures, State Tax Actions Database. Rhode Island also took advantage of the 2018 U.S. Supreme Court decision in *South Dakota v. Wayfair, Inc*. and began requiring remote sellers to collect and remit state sales tax. While nearly all states did the same, a few—not including Rhode Island—are penalized by the *Index* for not providing safe harbor to small sellers through a single point of administration.



Corporate Income Tax

Corporate income tax is the third most heavily weighted tax component of the *Index* and is the primary means through which business activities are taxed by most states. The two states that score highest in this category—South Dakota and Wyoming—do not have a corporate income tax. The scores of the remaining 48 states are determined by several factors, including top tax rate and graduated rate structure. Rhode Island, like 21 other states, is rewarded for having a single-rate system.[14] Other variables that positively affect a state's score include carryback or carryforward provisions on net operating losses (Rhode Island has a carryforward provision) and conforming to federal depreciation schedules (as Rhode Island does). Conversely, states are penalized for offering investment, job, and/or research and development tax credits (Rhode Island offers all three). According to the Tax Foundation, such credits "complicate the tax system, narrow the tax base, drive up rates for companies that do not qualify, distort the free market, and often fail to achieve economic growth."[15]

In the 2021 *Index*, Rhode Island ranks 39th in the corporate income tax category. Figure 8 shows that, while every New England State's corporate income tax score is below the national average, Rhode Island scored higher than New Hampshire and Vermont but lower than Maine, Massachusetts, and Connecticut. Regarding its closest neighbors, Rhode

Figure 8
Corporate Income Tax Score for New England States & U.S. Average, 2020-2021

	2020	**2021**
Connecticut	5.12	5.10
Maine	4.60	4.58
Massachusetts	4.58	4.56
New Hampshire	4.39	4.41
Rhode Island	**4.57**	**4.55**
Vermont	4.20	4.18
U.S.Average	5.20	5.22

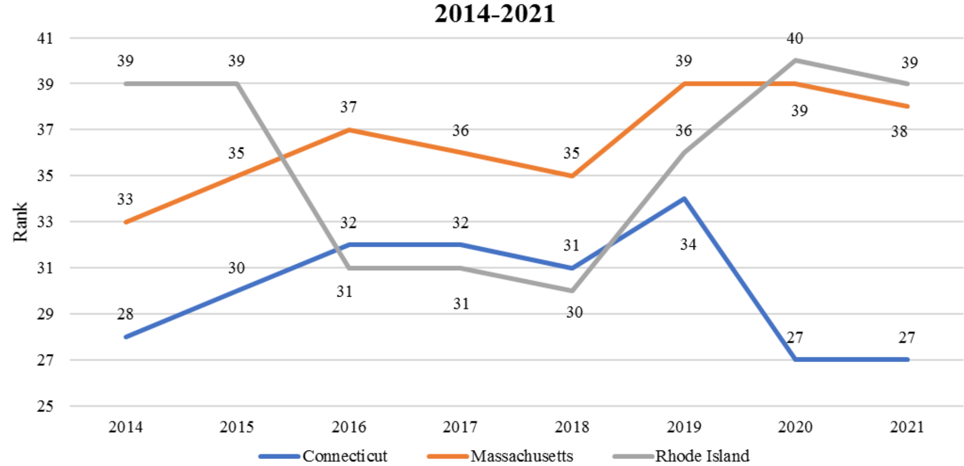
Note: U.S. Average excludes Washington D.C.; a higher score indicates a better business tax climate
Source: Tax Foundation, 2021 State Business Tax Climate Index

[14] Tax Foundation, 2021 Business Tax Climate Index, 18, 56.
[15] Ibid, 25.

Island is marginally less competitive in this category than Massachusetts (ranked 38th) and substantially less competitive than Connecticut (ranked 27th).

Figure 9 indicates that Rhode Island's corporate income tax ranking fluctuated widely in the last six years. Ranked 39th in the 2015 edition of the *Index*, compared to Massachusetts' ranking of 33rd and Connecticut's 28th place spot, Rhode Island bested both states in 2016, improving by eight spots and ranking 31st. The Ocean State's improved score between 2015 and 2016 is primarily due to the reduction of its corporate income tax rate from 9.0 percent to 7.0 percent, bringing the state closer in line with national averages.[16] Conversely, the decline in Rhode Island's corporate income tax score in the last few years is primarily because it did not adopt state tax changes consistent with the federal Tax Cuts and Jobs Act (TCJA) of 2017. For instance, in many states, but not Rhode Island, the TCJA's passage was impetus to improve taxpayers' ability to deduct net operating losses.[17]

Figure 9
Corporate Income Tax Component Ranking for CT, MA, & RI
2014-2021



Note: A rank of 1 is best and 50 is worst
Source: Tax Foundation, 2021 State Business Tax Climate Index

Property Tax

Unlike personal income tax, corporate income tax, and sales and use tax, property tax is levied across the United States. It consequently has a lower weight in the *Index* than the preceding three categories. While property tax is often considered by experts to be one of the fairest and most transparent forms of taxation, studies have shown that raising property tax rates can reduce

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[16] At 9.0 percent, Rhode Island's rate was tied with Connecticut and New Jersey for the sixth highest top marginal corporate tax rate in the country in FY 2015, whereas Rhode Island's 7.0 rate tied with Kansas and Indiana for 21st highest nationally in FY 2016, and tied with Kansas for 19th highest in FY 2020. Tax Foundation, Top State Corporate Income Tax Rates in 2014, April 30, 2014; Tax Foundation, State Corporate Income Tax Rates and Brackets for 2015, April 21, 2015; Tax Foundation, State Corporate Income Tax Rate and Brackets for 2020, January 28, 2020.

[17] In Rhode Island tax law, net operating losses may be carried forward for 5 years, the shortest span of time of any state that has a carryforward provision. 16 states enable businesses to carryforward net operating losses for 20 years. Tax Foundation, 2021 Business Tax Climate Index, 58.

employment. Moreover, property taxes are levied on businesses regardless of whether they turn a profit, and consequently can be particularly impactful to new businesses. The property tax component of the *Index* considers several variables, including property tax collections per capita, property tax base, effective property tax rate, and whether a state enables split roll property taxation[18] (as Rhode Island does). Importantly, Rhode Island has the fourth highest effective property tax rate in the nation: 4.6 percent.[19] The property tax component of the *Index* additionally considers the taxation of capital stock, intangible property, inventory, real estate transfers, estates, inheritance, and gifts.

Ranking 42nd, Rhode Island performs poorly in this category. However, as Figure 10 indicates, it scored better than every state in the region but Maine because property tax collections have an outsized role in New England revenue streams. Compared to its closest neighbors, Rhode Island scored slightly better than Massachusetts, which ranked 44th, and significantly better than Connecticut, which, at 50th, has the country's least competitive system of property taxation.

Figure 10
Property Tax Score for New England States & U.S. Average, 2020-2021

	2020	**2021**
Connecticut	2.26	2.34
Maine	4.20	4.34
Massachusetts	3.78	3.84
New Hampshire	3.74	3.70
Rhode Island	**4.03**	**4.19**
Vermont	3.23	3.30
U.S. Average	5.00	5.00

Note: U.S. Average excludes Washington D.C.; a higher score indicates a better business tax climate

Source: Tax Foundation, 2021 State Business Tax Climate Index

As shown in Figure 11, Rhode Island's ranking has improved since the 2015 edition of the *Index*, shifting from 47th to 46th in 2016, and further improving to 43rd in 2017. Rhode Island has ranked 42nd in property tax since the 2019 edition of the *Index*. As with every other tax category under consideration, Rhode Island's property tax score is in part predicated on the actions of other states, but the primary reason for Rhode Island's improved ranking over this period is the full phase out of its capital stock tax on January 1, 2015.[20] Conversely, Connecticut and Massachusetts respectively have the nation's first and fourth highest capital stock tax rates.[21] It is also noteworthy that the Ocean State began phasing out its excise tax on motor vehicles in FY 2018, though this change had a far smaller impact on the state's ranking than the elimination of the capital stock tax.[22] The *Index* does not have a specific variable for motor vehicle taxes, but as reductions in car taxes have modestly and positively impacted two important variables in the property tax category—effective property tax rate and

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[18] Split roll property taxation refers to the practice of applying a different (typically higher) tax rate to commercial properties than the rate applied to residential properties.

[19] Regionally, Rhode Island's high effective property tax rate is not unique; New Hampshire has the highest effective property tax rate in the country (5.66 percent), Vermont has the second highest (5.14 percent), and Maine the fifth highest (4.59 percent). Tax Foundation, 2021 Business Tax Climate Index, 43.

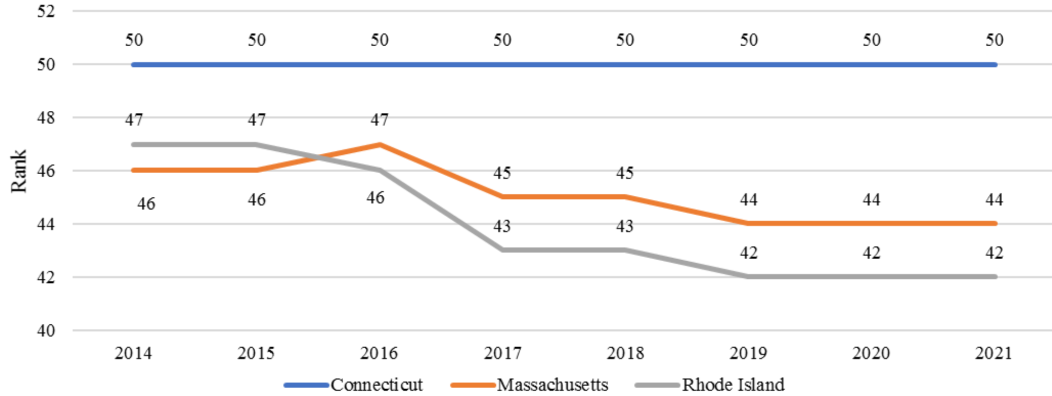
[20] Also known as franchise taxes, capital stock taxes are levied on a percentage of a firm's assets and typically as a percentage of a firm's net assets. Sixteen states levied a capital stock tax as of January 1, 2020 but four states have plans to, or else are in the process of, phasing it out. Tax Foundation, "Does Your State Levy a Capital Stock Tax?," April 29, 2020.

[21] Massachusetts and Connecticut are the only states in New England to levy a franchise tax, but Connecticut has plans to phaseout its franchise tax. Ibid.

[22] R.I. Gen. Laws § 44-34.1-1.

property taxes per capita—it has likewise modestly and positively impacted Rhode Island's ranking.

Figure 11
Property Tax Component Ranking for CT, MA, & RI
2014-2021



Note: A rank of 1 is best and 50 is worst
Source: Tax Foundation, 2021 State Business Tax Climate Index

Unemployment Insurance Tax

The smallest component of a state's overall score on the *Index* is determined by its unemployment insurance (UI) tax, which is levied on employers across the country to fund each state's UI program. UI taxes are levied by both federal and state governments, and the amount levied on individual employers is in part determined by the number of employees they lay off; the tax thereby frequently leads to greater mandatory payments from businesses that are already struggling, and have downsized their workforce out of necessity. A state's UI score on the *Index* is determined by rate structure and tax base, with states receiving credit if they exclude from benefit charges situations for employee separation that is beyond an employers control (such as discharge due to misconduct or an employee leaving on a voluntary basis).[23] The UI component of the *Index* additionally factors in several taxes related to UI, such as surtaxes for UI administration, solvency taxes, and taxes related to temporary disability insurance programs that augment UI programs.[24]

As Figure 12 indicates, every state in the New England region scores well below the national average on the 2021 *Index*. With a rank of 42nd, Rhode Island's UI system is still second most competitive in the region, after Maine, which is ranked 40th. Rhode Island's closest neighbors—Massachusetts and Connecticut— respectively rank 44th and 50th.

[23] Rhode Island is ranked among the best states for exclusions from benefit charges. The other states that score highly in this area are Alaska, Connecticut, Delaware, Louisiana, Missouri, Ohio, and Vermont. Tax Foundation, 2021 Business Tax Climate Index, 52, 75.
[24] Because TDI in Rhode Island is a separate program with a distinct funding stream, the state is not penalized for its TDI program.

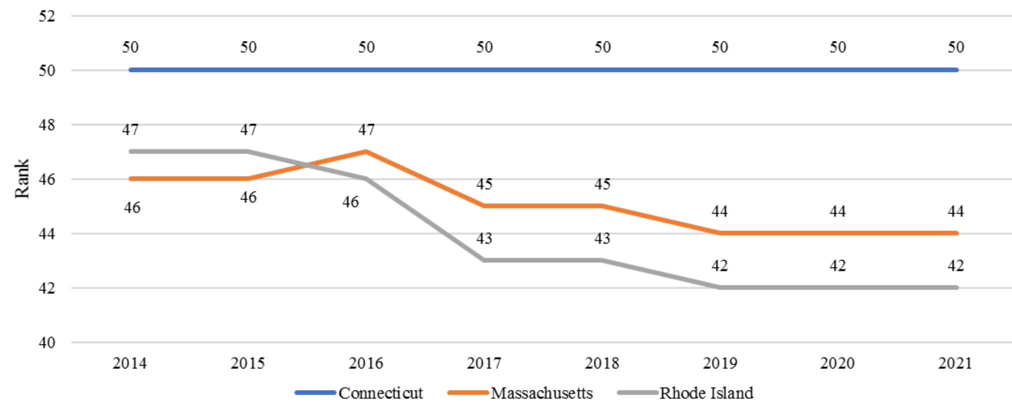
Figure 13 shows that Rhode Island experienced significant improvement in this category since FY 2015, when it ranked 47th. Rhode Island's improvement is due primarily to a law passed as part of the state's FY 2017 budget, which reduced the level of reserve that the state's UI trust fund must have before the state could move to a lower tax schedule.[25] In result, the amount of UI taxes paid by the average employer fell substantially, from $839 per employee in 2016 to $598 in 2019.[26] However, by reducing UI taxes, and consequently foregoing greater investment into its UI trust fund, Rhode Island employers may very well pay higher UI taxes in the near future, as the scope of the unemployment crisis brought on by the COVID-19 pandemic has significantly drained Rhode Island's reserves.[27]

Figure 12
Unemployment Insurance Tax Score for New England States & U.S. Average 2020-2021

	2020	2021
Connecticut	2.26	2.34
Maine	4.20	4.34
Massachusetts	3.78	3.84
New Hampshire	3.74	3.70
Rhode Island	**4.03**	**4.19**
Vermont	3.23	3.30
U.S. Average	5.00	5.00

Note: U.S. Average excludes Washington D.C.; a higher score indicates a better business tax climate
Source: Tax Foundation, 2021 State Business Tax Climate Index

Figure 13
Unemployment Insurance Component Ranking for CT, MA, & RI 2014-2021



Note: A rank of 1 is best and 50 is worst
Source: Tax Foundation, 2021 State Business Tax Climate Index

RIPEC Comments

Rhode Island's ranking on the Tax Foundation's *Index* matters. Numerous studies have demonstrated that economic development correlates with a state's business tax climate. While there are several important factors in a company's determination to locate its business in a

[25] Rhode Island was on Schedule I, the highest possible rate schedule, but moved to Schedule H. This altered the rate range from 1.69-9.79 percent to 0.99-9.59 percent. Rhode Island Department of Revenue Division of Taxation, Summary of Legislative Changes, July 11, 2016.
[26] All sums are in 2019 dollars. RIPEC, "The Impacts of the COVID-19 Crisis on Rhode Island's Unemployment and Temporary Disability Insurance Programs," June 2020.
[27] Ibid.

particular state, the decision about where to locate and whether to begin operations in the first place typically begins with an assessment of operating costs, of which taxes can be a significant component. The Tax Foundation's *Index* in particular was found by a 2013 study to have produced "statistically significant estimates for every specification" it measured and had "particularly strong and robust evidence of predictive power."[28] Even if there was only a weak correlation between economic development and business tax climate as scored by the Tax Foundation's *Index*, a state's ranking by the *Index* is important because the rankings are utilized by many business leaders in their decisions on where to locate and grow. The *Index* rankings also inform the general reputation of a state as friendly or antagonistic to business.

Policymakers should be recognized for efforts to substantially improve Rhode Island's ranking in the *Index* from seventh worst at 44th in 2015 to a ranking of 37th today. Faced with competing demands for resources, policymakers have enacted tax changes favorable to business, and perhaps more importantly, have foregone unfavorable tax changes. As a result, the Ocean State is no longer among the bottom quintile of states in terms of business tax climate. Moreover, except for a small setback last year, the state's ranking has been on a consistently positive trajectory since FY 2016. Also significant is that Rhode Island has markedly improved its competitive position relative to its neighboring states, nearly closing the gap in rankings with Massachusetts, and widening its advantage over Connecticut.

That being said, Rhode Island's rank of 37th on the *Index* is hardly cause for celebration. The Ocean State's competitive position in terms of business tax climate places it solidly in the bottom half of states. While the ranking advantage over Connecticut is heartening, the economic center of the Nutmeg State is closer to New York City than to Rhode Island. Of the two neighboring states, Massachusetts is the more important competitor, and still has a business tax climate ranked more favorable than Rhode Island. Also, despite its improved *Index* ranking, Rhode Island stubbornly lags the region and the nation in economic growth.[29]

Accordingly, policymakers should consider how Rhode Island can continue its current trajectory and improve on its *Index* ranking in future years. Based on this analysis, RIPEC recommends several areas of priority for policymakers to consider.

First, current proposals to increase individual income tax rates for high wage earners should be resisted.[30] The individual income tax is the most heavily weighted tax in the *Index*. The great majority of businesses in Rhode Island are organized as S corporations, limited liability companies, partnerships, and sole proprietorships, and report their profits through the individual income tax.[31]

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[28] Jed Kolko, David Neumark, and Marisol Cuellar Meija, "What Do Business Climate Indexes Teach Us About State Policy and Economic Growth?," *Journal of Regional Science*, vol. 53, iss. 2 (Apr. 28, 2013): 220-255.

[29] RIPEC and the Center for Global and Regional Economic Studies at Bryant University, Rhode Island Economic Indicator Briefing for Q3 2020, November 2020.

[30] 2020 Senate Bill 2059; 2020 House Bill 7436; 2020 Senate Bill 2516; 2020 House Bill 7921; 2020 Senate Bill 2801; 2020 Senate Bill 2494; 2020 House Bill 7664.

[31] In Rhode Island, pass-through entities such as S corporations, LLCs, and partnerships report income taxes through an owner's personal income tax. R.I. Gen. Laws § 44-11-2.3. In 2017, 65,697 institutions paid business corporations tax to the State of Rhode Island. Of these, 24,582 were S corporations, 24,183 were LLCs, and 4,093 were partnerships; 12,839 were C corporations, a number of which operate out of state. R.I. Division of Taxation, Reports, Statistics of Income.

Rhode Island's ranking of 29th for this *Index* category is already in the bottom half of states, and is considerably less competitive than Massachusetts (ranked 11th).

Second, Rhode Island should explore changes to make its corporate income tax more favorable to business. Despite improving its ranking for this category from 39th in 2015 to 30th in 2018, Rhode Island's rating has slipped back to 39th in the most recent *Index*, largely because of decisions to forego state tax law changes consistent with the federal Tax Cuts and Jobs Act of 2017.

Third, Rhode Island needs to continue to improve its ranking in the category of property taxes. While the Ocean State has moved from a ranking of 47th in 2016 to 42nd in the most current *Index* and is ranked more favorably than both Massachusetts and Connecticut, this tax category continues to deserve greater focus from policymakers. Since Rhode Island permits split roll property taxation, businesses often pay a disproportionate share of the Ocean State's relatively high property taxes.

Fourth, while weighted less heavily than other taxes in the *Index*, unemployment insurance taxes in Rhode Island remain an area for potential improvement, with a category ranking of 42 in the current *Index*. UI taxes have taken on greater importance given the COVID-19 pandemic and the unemployment crisis, which has significantly drained Rhode Island's UI trust fund reserves and will necessitate future UI tax increases for employers. The state should resist increasing UI benefit levels, which were reformed in 2011 to be more in line with neighboring states but remain relatively generous compared to other states.[32]

Finally, in making these recommendations, RIPEC is mindful that Rhode Island is facing a very challenging economic environment as a result of the COVID-19 pandemic, and that there will be pressure to increase revenues and to consider tax increases affecting business. It is in these times that policymakers need to be even more vigilant to protect and advance the progress that has made in improving Rhode Island's business tax climate so that the state's economy can better grow and thrive in the long term.

[32] RIPEC Policy Brief, "How Rhode Island Unemployment Benefits Compare," February 2019.

Appendix

Figure 14
2021 State Business Tax Climate Ranking

Alabama	41	Nebraska	28
Alaska	3	Nevada	7
Arizona	24	New Hampshire	6
Arkansas	45	New Jersey	50
California	49	New Mexico	23
Colorado	21	New York	48
Connecticut	47	North Carolina	10
Delaware	13	North Dakota	17
Florida	4	Ohio	39
Georgia	31	Oklahoma	30
Hawaii	38	Oregon	15
Idaho	20	Pennsylvania	27
Illinois	36	**Rhode Island**	**37**
Indiana	9	South Carolina	33
Iowa	40	South Dakota	2
Kansas	35	Tennessee	18
Kentucky	19	Texas	11
Louisiana	42	Utah	8
Maine	29	Vermont	43
Maryland	44	Virginia	26
Massachusetts	34	Washington	16
Michigan	14	West Virginia	22
Minnesota	46	Wisconsin	25
Mississippi	32	Wyoming	1
Missouri	12	Washington D.C.	46
Montana	5		

Note: A rank of 1 is the best and 50 is the worst
Source: Tax Foundation 2021 State Business Tax Climate Ranking