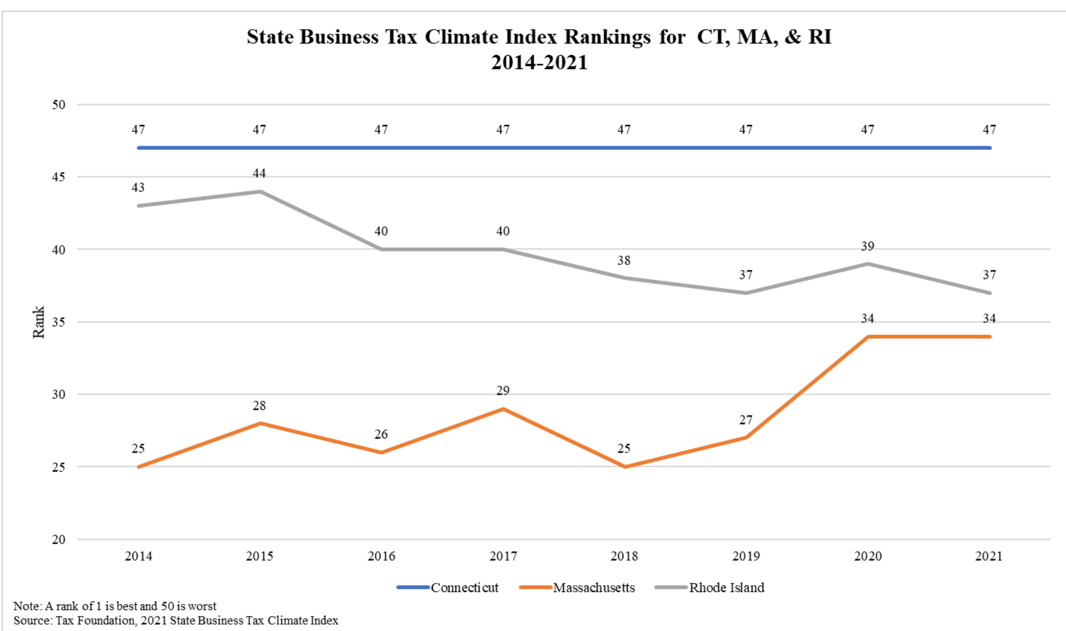
RIPEC Analyzes Rhode Island's Improved Business Tax Climate Index Ranking of 37th Among States

Executive Summary
December 2020

RIPEC's most recent Policy Brief analyzes Rhode Island's ranking on the Tax Foundation's 2021 Business Tax Climate Index, provides regional and historic context, and offers recommendations for how policymakers can improve the state's ranking.

The Tax Foundation, a think tank based in Washington D.C., has annually issued its *Business Tax Climate Index* (*Index*) since 2003. This fifty-state ranking provides a comparative analysis of each state's business tax climate. 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.

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 the figure below 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.



Looking deeper into Rhode Island's score in the five tax categories, the Ocean State ranks 29th on the individual income tax, the state's state single largest source of general revenues. The individual income tax is the most heavily weighted tax in the overall score produced by the *Index*. 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.

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; Rhode Island 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.

Rhode Island ranks 39th in the corporate income tax category. While every New England state has a corporate income tax score below the national average, Rhode Island scored higher than New Hampshire and Vermont but lower than Maine (37th), Massachusetts (38th), and Connecticut (27th).

Ranking 42nd, Rhode Island performs poorly in the category of property taxes. However, Rhode Island 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.

Rhode Island also ranks 42nd in unemployment insurance (UI) tax category. Every state in the New England region scores well below the national average on the 2021 *Index*. So, 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.

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. 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.

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. The great majority of businesses in Rhode Island are organized as S corporations, sole proprietorships, and partnerships, and report their profits through the individual income tax. 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 (TCJA) 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.

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.

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.