RIPEC

RIPEC Policy Brief

A SPECIAL PUBLICATION OF THE RHODE ISLAND PUBLIC EXPENDITURE COUNCIL

January 2022

RIPEC Analyzes Rhode Island's Drop from 38th to 40th in Business Tax Climate Index State Rankings

This RIPEC Policy Brief analyzes Rhode Island's ranking on the Tax Foundation's 2022 Business Tax Climate Index in regional and historical 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 U.S. state's business tax climate.

The *Index* is based on the principle that tax systems which are favorable to business give states advantages in attracting new businesses and generating economic and employment growth. Research shows that a tax climate favorable to businesses promotes economic development, 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.[1] Of course, factors such as the quality of 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 authors of the *Index* note, tax system reform may happen immediately, whereas many other business climate improvements can take decades to realize.[2]

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. The Ocean State, moreover, faces the greatest competition with its neighboring New England states, particularly its bordering states—Massachusetts and Connecticut. These states, after all, share with Rhode Island similar demographic and economic features important to business, such as access to markets and the cost of raw materials. Due to its small size, Rhode Island's competition with its neighboring states is

[1] 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.

[2] Janelle Cammenga and Jared Walczak, *2022 State Business Tax Climate Index*, Tax Foundation, December 2021.

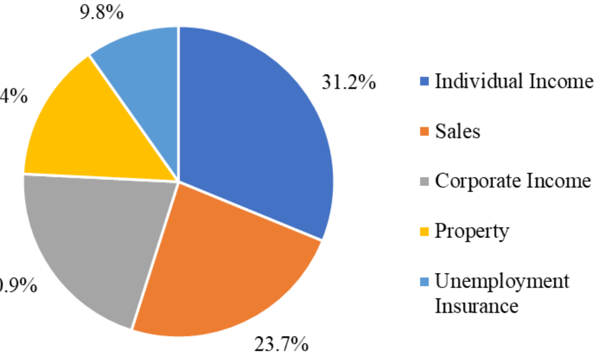
particularly acute, since businesses can potentially move across borders without relocating their existing workforce.

This policy brief first breaks down the methodology of the *Index* and then analyzes Rhode Island's overall ranking—and its ranking in each of the five tax categories that comprise the *Index*—in historical and regional context. Finally, it recommends tax policies that would enable the Ocean State to reverse its current trajectory and improve its ranking in the future.

Methodology

The *Index* produces a ranking based on an overall score for states on a scale of zero to ten, with a higher score indicating a better business tax climate.[3] A state's overall score is determined by comparing 125 variables across five major tax categories: individual income, sales, corporate income, property, and unemployment insurance tax. Each state receives a score for each tax category, but, as Figure 1 shows, each category is weighted differently, with the most weight attributed to those taxes with the heaviest variability between states, because those are the components of tax law where states may gain the greatest competitive advantage over each other. 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, 2022 State Business Tax Climate Index

New editions of the *Index* typically introduce new variables, and the 2022 edition adds a variable to the individual income tax subindex: convenience rules. Under this methodological change, several states—Rhode Island not included—are now penalized because they levy income tax on workers that have an in-state office, even if they work from another state, exposing those workers to double taxation, "ostensibly for the convenience of the employer."[4] Each edition of the *Index* recalibrates scores and rankings for the previous years, backcasting methodological changes and incorporating retroactively-applied statutes and corrections.

The 2022 *Index* covers tax policy from July 1, 2021, to June 30, 2022, consistent with fiscal year (FY) 2022 for all but four states.[5]

---

[3] No state received a perfect ten. The top-ranked state for 2022, Wyoming, had a score of 7.78. In comparison, the lowest-ranked state, New Jersey, had a score of 3.34. Washington D.C. is given a score and ranking in the *Index*, but both are neutral in that they do not affect any state's score or ranking.

[4] Janelle Cammenga and Jared Walczak, *2022 State Business Tax Climate Index*, Tax Foundation, December 2021.

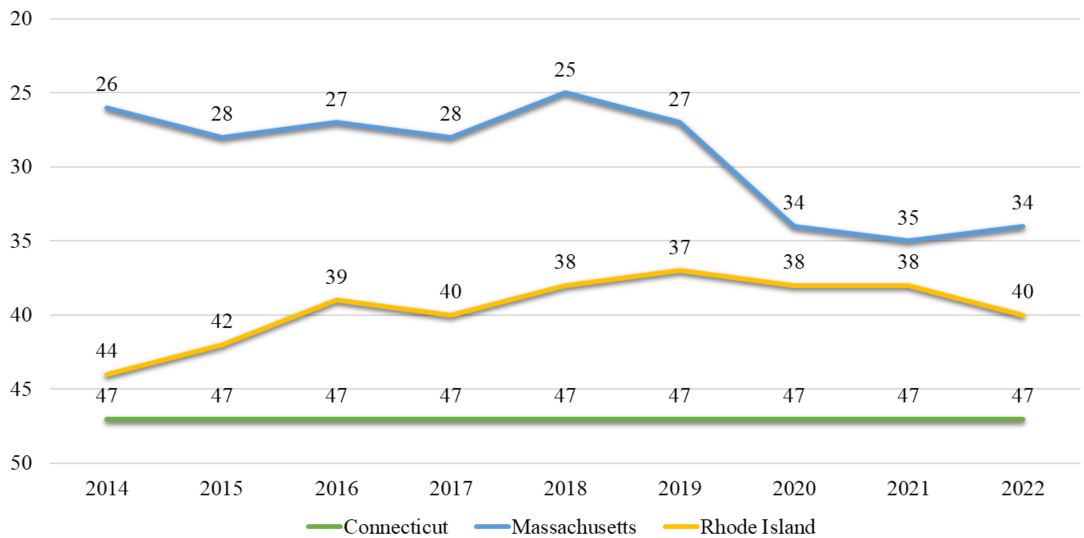
[5] New York's fiscal year begins April 1, Texas' fiscal year begins September 1, and Alabama and Michigan's fiscal years begin October 1.

Overall Ranking

Rhode Island's ranking on the 2022 *Index* is 40th highest, two spots lower than its 2021 ranking of 38th.

As Figure 2 shows, Rhode Island's rank followed a generally positive trajectory between 2014 and 2019, improving from 44th best (or seventh worst) in the country to 37th. However, in the last three years, the state has backslid. Throughout this nine-year period, Rhode Island never cracked the top two-thirds of states, but its improved score has positioned it farther ahead of Connecticut—which has stagnated at 47th—and moved Rhode Island closer in line with Massachusetts. The Bay State has become less competitive in terms of business tax policy in the last nine years, falling from 26th in 2014 to 34th in 2022, however its ranking has consistently bested that of Rhode Island.

Figure 2
State Business Tax Climate Index Rankings for CT, MA, & RI 2014-2022



Source: Tax Foundation, 2022 State Business Tax Climate Index

Figure 3 details the rank of every New England state for 2021 and 2022. As with 2021, Rhode Island's business tax climate in 2022 is more competitive than that of Vermont and Connecticut, but less competitive than that of Maine, Massachusetts, and New Hampshire. For both years, every New England state ranked in the bottom half of U.S. states except for New Hampshire, which has consistently ranked among the top ten.

Figure 3
State Business Tax Climate Rankings for New England States, 2021-2022

	2021	2022
Connecticut	47	47
Maine	29	33
Massachusetts	35	34
New Hampshire	6	6
Rhode Island	**38**	**40**
Vermont	43	43

Source: Tax Foundation, 2022 State Business Tax Climate Index

Rhode Island's rank did not worsen over the last few years because of proactive tax policy choices. Rather, while Rhode Island made no major changes—positive or negative—to the elements of its business tax climate captured in the *Index*, other states that are similarly ranked enacted policies that improved their business tax climates.[6] Specifically, both Iowa and Alabama enacted significant improvements to the structure of their corporate income tax in 2021, helping Iowa move up three spots, from 41st to 38th, and Alabama to improve its ranking from 40th to 39th. Similarly, Rhode Island's ranking for 2021 was revised downward, from 37th to 38th, because New Jersey reduced its top individual tax bracket in its 2021 legislative session and retroactively applied that change to the previous tax year; the individual income tax systems in several other states, including Rhode Island, looked somewhat less competitive in comparison.

While Rhode Island has not taken actions to improve its business tax climate in the last two years, it *has* made important changes in the last nine years that both positively and negatively impacted its *Index* ranking. The following five sections of this brief—which break down each of the five major tax categories—detail those changes.

For the overall ranking of every state and Washington D.C., see the appendix to this policy brief.

Individual Income Tax

Individual income tax is Rhode Island's single largest source of general revenue and the most heavily weighted tax component in the *Index*.[7] Studies have shown that a high or poorly structured individual income tax can adversely impact business in two ways. First, profits are reported as individual income for the many businesses that operate as sole proprietorships, partnerships, or S corporations. Second, this tax impacts the cost of labor, a significant—and often the single greatest—business expense. The *Index* considers whether a state levies this tax (seven do not), the rates applied, the graduated rate structure, and the standard deductions and exemptions applied.[8] 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 (Rhode Island does not), or if they index the tax code for inflation (as Rhode Island does).

Figure 4
Individual Income Tax Ranking for New England States, 2021-2022

	2021	2022
Connecticut	47	47
Maine	22	23
Massachusetts	16	11
New Hampshire	9	9
Rhode Island	**32**	**31**
Vermont	39	40

Source: Tax Foundation, 2022 State Business Tax Climate Index

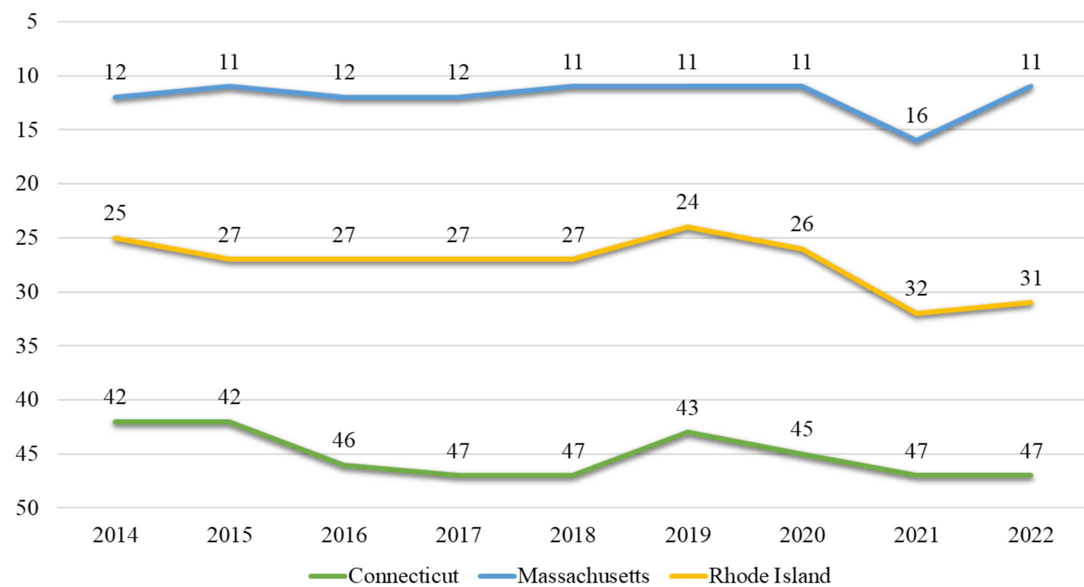
Rhode Island ranks in the bottom half of states on the individual income tax subindex, coming in at 31st, an improvement of one spot over last year. As Figure 4 shows, Rhode Island is more competitive in this category

[6] Legislation signed into Rhode Island law in July 2021 made amounts of federally forgiven Paycheck Protection Program (PPP) loans exceeding $250,000 subject to personal income and corporate income tax, retroactively applied to tax year 2020. R.I. Department of Revenue, FAQs on PPP Loan Forgiveness Treatment, November 10, 2021. This policy change impacted the state's business tax climate, but—as PPP loans were a new and one-time source of revenue—they are not factored into the *Index*.
[7] Individual income tax comprises 34.0 percent of anticipated general revenue collections in Rhode Island's FY 2022 Budget as Enacted. R.I. Office of Management and Budget, FY 2022 Budget as Enacted Executive Summary.
[8] Alaska, Florida, South Dakota, Tennessee, Texas, Washington, and Wyoming do not have an individual income tax. Alaska, Florida, South Dakota, and Wyoming receive a perfect score (10.00) on this subindex, but Tennessee, Texas, and Washington do not because they tax limited liability and S corporations through their gross receipt taxes.

than Connecticut and Vermont, but less competitive than Maine, and significantly less competitive than Massachusetts and New Hampshire. New Hampshire scores well in this category because, while it taxes interest and dividends, it does not tax wages and salaries. Massachusetts, on the other hand, has a relatively low rate (5.0 percent) and is one of ten states, including New Hampshire, with only one income tax bracket. Comparatively, Rhode Island has three brackets, with a 3.75 percent rate applied to income less than $66,200, 4.75 percent applied to income over $66,200 and less than $150,550, and 5.99 percent applied to income exceeding $150,550. Connecticut has seven brackets and a top rate of 6.99 percent for income over $500,000.

Figure 5 shows that Rhode Island's ranking has slipped in this subindex since 2014, falling from 25th to 31st. This decline, however, is a product of changes made by other states; Rhode Island's individual income tax structure has not undergone significant change in this period.

Figure 5
Individual Income Tax Rankings for CT, MA, & RI
2014-2022



Source: Tax Foundation, 2022 State Business Tax Climate Index

Sales Tax

Sales and use taxes are the second-largest source of general revenues in Rhode Island and the second most heavily weighted component of the *Index*.[9] Sales tax is an important consideration for businesses both because business inputs are typically subject to sales tax and because it affects consumer demand. Sales tax variables in the *Index* include whether a state levies a sales tax (five

[9] The sales and use tax comprises 33.9 percent of anticipated general revenue collections in Rhode Island's FY 2022 Budget as Enacted. This includes excise taxes on motor vehicles, cigarettes, alcohol, and marijuana. Excluding excise taxes, the state's general sales and use tax is anticipated to bring in 29.8 percent of general revenues. R.I. Office of Management and Budget, FY 2022 Budget as Enacted Executive Summary.

states do not) and whether it permits local governments to levy a sales tax, whether excise taxes on products such as cigarettes and alcohol are levied, the combined state and local tax rate, and sales tax base.[10] The states that have the lowest score on this subindex not only have a high combined state and local rate and high excise tax rates, but also impose sales tax on a large number of business inputs, like utilities and services.[11]

As Figure 6 shows, Rhode Island ranks in the middle nationally on the sales tax component of the *Index* (24th) but below every New England state; of all subindexes, the New England region is most competitive in sales tax. New Hampshire, which does not levy a sales tax, ranks first in the nation while Rhode Island's closest neighbor, Massachusetts, ranks 12th. Rhode Island has a relatively narrow sales tax base, and its sales tax rate of 7.0 percent is tied with Indiana, Mississippi, and Tennessee for second highest in the nation. However, 38 states, Rhode Island not included, offer a local option sales tax, and the Ocean State's combined average state and local sales tax rate is middling (tied with Indiana for 24th highest). It is still the highest in New England, however.[12]

Figure 6
Sales Tax Rank for New England States, 2021-2022

	2021	**2022**
Connecticut	25	23
Maine	8	8
Massachusetts	12	12
New Hampshire	1	1
Rhode Island	**26**	**24**
Vermont	16	16

Source: Tax Foundation, 2022 State Business Tax Climate Index

As depicted in Figure 7, Rhode Island's sales tax ranking has been relatively stable since 2014, improving from 27th in 2014 to 24th in 2021. At the same time, however, both Connecticut and Massachusetts have significantly improved their rankings, with Connecticut moving from 34th to 23rd and Massachusetts from 18th to 12th. Rhode Island's system of sales taxation has not undergone large structural change since 2014, but it has experienced shifts relevant to its overall score. It twice raised its tobacco excise tax, to $3.75 per pack of 20 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 per pack in both states).[13] While Rhode Island worsened its position 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 business inputs such as security services and software as a service to that base.[14] 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

[10] Alaska, Delaware, Montana, New Hampshire, and Oregon do not levy a state sales tax, but Alaska permits municipal governments to levy a sales tax. As all these states levy excise taxes on goods like gasoline, tobacco, and beer, none receive a perfect score on this subindex.

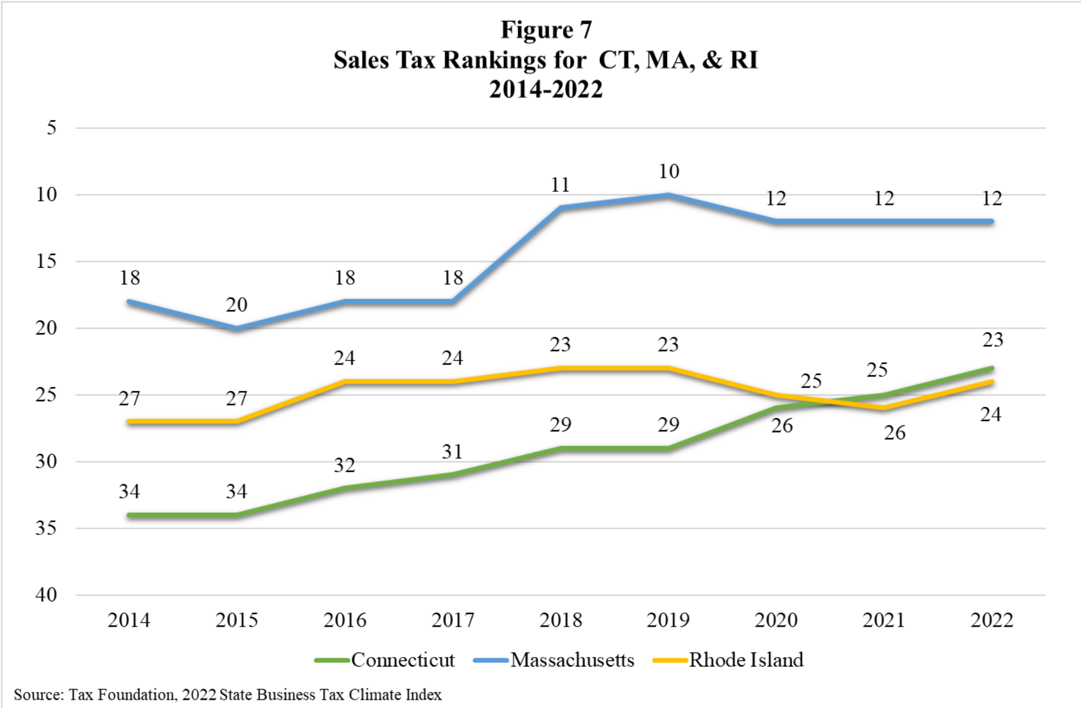
[11] The *Index* rewards states for having a broad sales tax base that includes more final retail sales of goods and services but detracts points when sales tax is applied to business inputs.

[12] Of New England states, only Vermont offers a local sales tax option.

[13] Federation of Tax Administrators, Cigarette Tax Increases: 2000-2021.

[14] National Conference of State Legislatures, State Tax Actions Database. During her tenure, Governor Gina Raimondo attempted to expand the sales tax base to cover several business services, but the General Assembly largely resisted these efforts. R.I. House Fiscal Advisory Staff, FY 2020 Budget at a Glance.

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 component of the *Index*. The two states that rank highest in this category—South Dakota and Wyoming—do not have a corporate income tax. The remaining 48 states are distinguished from each other by top tax rates and graduated rate structure. Variables that positively affect a state's score include carryback or carryforward provisions on net operating losses and whether a state conforms to federal depreciation schedules. Conversely, states are penalized for offering investment, job, and/or research and development tax credits because they "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]

Figure 8
Corporate Income Tax Ranking for New England States, 2021-2022

	2021	2022
Connecticut	27	27
Maine	37	35
Massachusetts	38	36
New Hampshire	41	41
Rhode Island	**39**	**37**
Vermont	44	43

Source: Tax Foundation, 2022 State Business Tax Climate Index

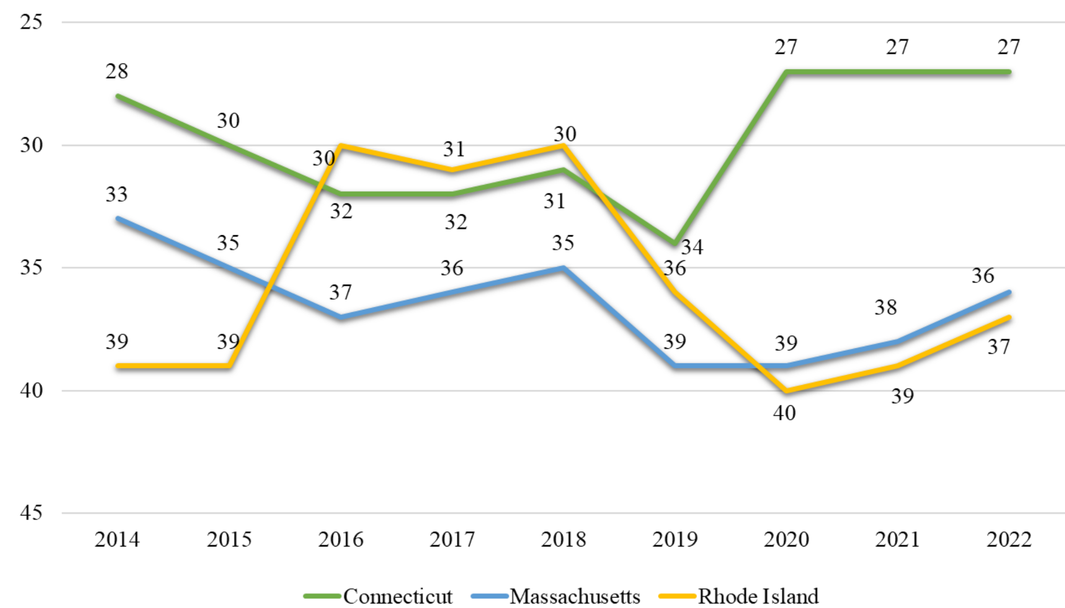
As shown in Figure 8, Rhode Island, like the rest of the region, ranks in the bottom half of states in the corporate income tax subindex. Rhode Island's rank of 37th bests that of New Hampshire and Vermont but is worse than

[15] Janelle Cammenga and Jared Walczak, *2022 State Business Tax Climate Index*, Tax Foundation, December 2021.

Maine, Massachusetts, and Connecticut. One variable positively impacting Rhode Island is that it is one of 22 states to have a single-rate system. Rhode Island also benefits from conforming to federal depreciation schedules and for having a carryforward provision, though it has the least generous carryforward provision in the country.[16] On the other hand, Rhode Island's score is negatively impacted because it offers investment, job, and/or research and development tax credits.

Figure 9 indicates that Rhode Island's corporate income tax ranking has fluctuated widely in the last nine years. The Ocean State's vastly 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.[17] Rhode Island's corporate income tax score became less competitive in the last few years both because of the actions taken by other states to improve the competitiveness of their corporate income tax structures and because Rhode Island did not adopt state tax changes consistent with the federal Tax Cuts and Jobs Act (TCJA) of 2017. For instance, while the TCJA's passage incentivized most states to improve taxpayers' ability to deduct net operating losses, Rhode Island did not follow suit.

Figure 9
Corporate Income Tax Rankings for CT, MA, & RI
2014-2022



Source: Tax Foundation, 2022 State Business Tax Climate Index

---

16 Net operating losses may be carried forward for five years in Rhode Island. In comparison, 16 states enable businesses to carryforward net operating losses for 20 years.

17 Rhode Island's 9.0 percent corporate income tax rate was tied with Connecticut and New Jersey for the sixth highest top marginal corporate income tax rate in the country in FY 2015. In comparison, Rhode Island's 7.0 rate tied with Kansas and Indiana for 21st highest the following year. For FY 2022, the Ocean State and Kansas tie for 20th highest top marginal corporate income tax rate. New Jersey applies the highest rate in the country: 11.5 percent. Jared Walczak, *Top State Corporate Income Tax Rates in 2014*, Tax Foundation, April 2014; Jared Walczak, *State Corporate Income Tax Rates and Brackets for 2015*, Tax Foundation, April 2015; Janelle Cammenga and Jared Walczak, *2022 State Business Tax Climate Index*, Tax Foundation, December 2021.

Property Tax

Unlike personal income, sales and use, and corporate income tax, property tax is levied across the United States and consequently has a lower weight in the *Index* than the preceding three categories. In further dissimilarity, property tax is levied at the municipal, rather than state, governmental level in Rhode Island. While property tax is often considered by experts to be one of the most equitable forms of taxation, studies have shown that raising property tax rates can reduce levels of business formation and, consequently, employment rates.[18] Moreover, property taxes are levied on businesses regardless of whether they turn a profit, and so can be onerous to new businesses. The property tax subindex considers variables including property tax collections per capita and as a percentage of personal income, property tax base, effective property tax rate, and whether a state enables split roll property taxation (in which different types of property, such as residential and commercial real estate, are taxed at different rates). The property tax component of the *Index* additionally considers the taxation of capital stock, tangible personal property, intangible property, inventory, real estate transfers, estates, inheritance, and gifts.

As Figure 10 indicates, Rhode Island performs poorly in the property tax subindex along with the remainder of New England, which has an outsized reliance on property tax revenues. Every New England state is ranked in the bottom ten, and two New England states—Connecticut and Vermont—respectively have the least competitive property tax systems in the country. Ranked 42nd, Rhode Island's property tax system is less competitive than that of Maine but more competitive than every other New England state. Rhode Island's low score is in part explained by aspects of its property tax law that shift the tax burden away from homeowners and towards businesses—such as the taxation of tangible personal property and the enabling of split roll property taxation. Rhode Island also ranks poorly on this subindex because of its outsized reliance on property taxes; it has the fifth highest effective property tax rate in the country, the seventh highest property tax collections per capita, and the fifth highest collections as a percentage of personal income.

Figure 10
Property Tax Rank for New England States, 2021-2022

	2021	2022
Connecticut	50	50
Maine	40	41
Massachusetts	45	45
New Hampshire	47	46
Rhode Island	**42**	**42**
Vermont	49	49

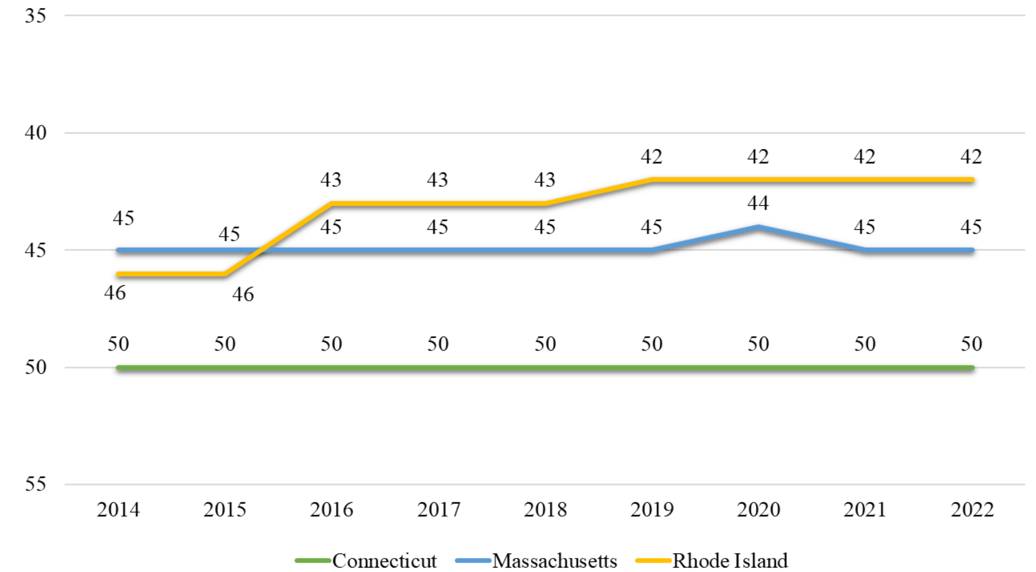
Source: Tax Foundation, 2022 State Business Tax Climate Index

As shown in Figure 11, Rhode Island's property tax ranking has improved since 2014, when it ranked 46th. The state has remained steady at 42nd since 2019, however. As with every other tax category, Rhode Island's property tax ranking 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 phaseout of its capital stock tax on January 1, 2015.[19] Conversely, Connecticut and Massachusetts tie for

[18] Stephen T. Mark, Therese J. McQuire, and Leslie E. Papke, "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington D.C. Metropolitan Area," *National Tax Journal* 53 (March 2000): 105-123.
[19] 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. 16 states currently levy capital stock taxes but several states, including Connecticut, have plans to phase out this tax.

the nation's third highest capital stock tax rates.[20] The Ocean State also began a six-year phaseout of its motor vehicle excise tax in FY 2018.[21] This change had a smaller impact on the state's ranking than the elimination of the capital stock tax, though not an entirely insignificant one; the *Index* does not include a variable for motor vehicle taxes but the phaseout positively impacted the variables of effective property tax rate, property taxes per capita, and property taxes as a percentage of personal income.

Figure 11
Property Tax Rankings for CT, MA, & RI
2014-2022



Source: Tax Foundation, 2022 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 often leads to greater mandatory payments imposed on businesses that are 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 are beyond an employer's control (such as discharge due to misconduct or an employee leaving on a voluntary basis). 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.[22]

---

[20] Massachusetts and Connecticut are the only states in New England to levy a franchise tax.
[21] R.I. Gen. Laws § 44-34.1-1.
[22] Rhode Island's Temporary Disability Insurance (TDI) and Temporary Caregiver Insurance (TCI) programs have funding streams distinct from UI, and in consequence the state is not penalized by the *Index* for its TDI/TCI programs.

As Figure 12 shows, Rhode Island scores low on the UI tax variable; only neighboring Massachusetts has a less competitive UI system. Of New England states, Vermont and Connecticut rank in the top half of states, while Maine ranks in the bottom half, though significantly above Rhode Island and Massachusetts. Rhode Island scores poorly in this subindex primarily because its unemployment insurance tax rate score—based on minimum and maximum rates, rate schedule, and taxable wage base—is ranked fifth worst among the states, but also because it ranks seventh worst in the number of exclusions from benefit charges it offers to employers.

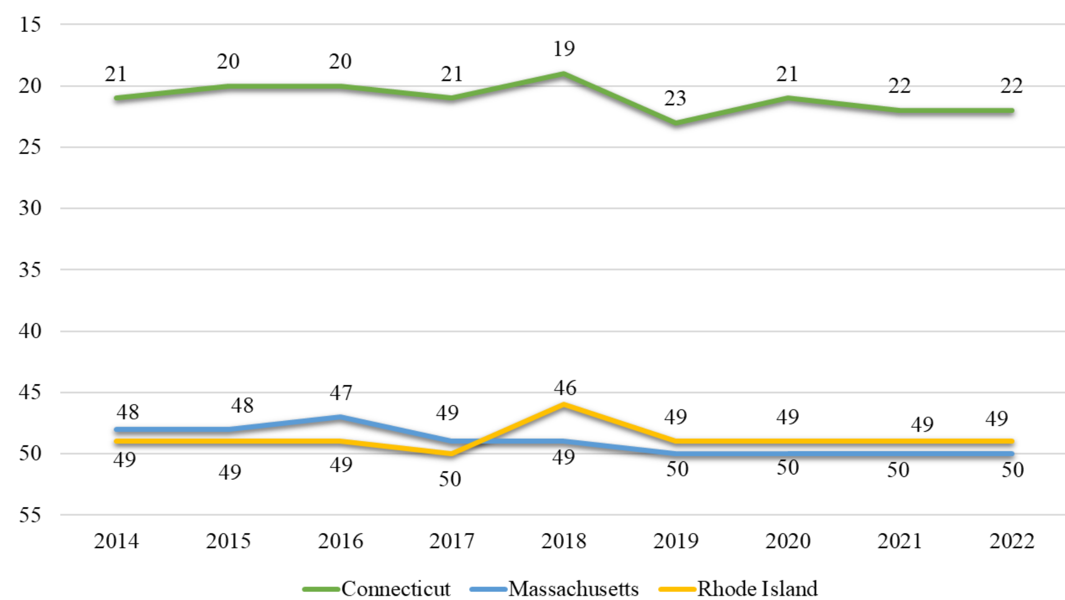
Figure 12
Unemployment Insurance Tax Rank for New England States, 2021-2022

	2021	2022
Connecticut	22	22
Maine	32	35
Massachusetts	50	50
New Hampshire	43	44
Rhode Island	**49**	**49**
Vermont	16	15

Source: Tax Foundation, 2022 State Business Tax Climate Index

Figure 13 illustrates that, like Massachusetts and Connecticut, Rhode Island's UI subindex ranking has been largely consistent since 2014. Rhode Island's ranking improved between 2017 and 2018—from 50th to 46th—due primarily to a law passed as part of the state's FY 2017 budget which reduced the level of reserves that the state's UI trust fund must maintain and significantly decreased the amount of UI taxes paid by the average employer.[23] However, as other states enacted policies to make their UI tax systems more competitive, Rhode Island's position worsened to 49th the following year.

Figure 13
Unemployment Insurance Tax Rankings for CT, MA, & RI 2014-2022



Source: Tax Foundation, 2022 State Business Tax Climate Index

[23] 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. Rhode Island remains on Schedule H, which currently has a range rate of 1.2 percent to 9.8 percent. R.I. Dept. of Labor and Training, Tax Schedules.

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 for a company to weigh when determining where to locate or whether to begin operations in the first place, this assessment typically begins with an overview of operating costs, of which taxes can be a significant component. A state's ranking is important because it demonstrates how competitive that state's business tax climate is, but also 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 improve Rhode Island's ranking in the *Index* from seventh worst (44th) in 2014 through reforms such as a reduction of the corporate income tax rate and the phaseout of its capital stock tax.

However, as other states have enacted reforms to make their business tax systems more competitive in the last few years, Rhode Island has largely stood still, causing it to fall in the rankings from 38th in 2021 to 40th in 2022. The Ocean State's competitive position in terms of business tax climate places it solidly in the bottom quarter 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 favorably than Rhode Island.

Accordingly, policymakers should consider how Rhode Island can improve on its *Index* ranking. Importantly, while reducing the tax burden for business always implicates fiscal challenges, Rhode Island arguably is in the best position in many years to make its tax structure more competitive. Large inflows of federal pandemic relief funding to state and local governments, along with surprisingly strong state general revenues, have greatly improved Rhode Island's fiscal situation.[24] In the context of the opportunity presented by these extraordinary circumstances, RIPEC recommends several areas for policymakers to prioritize:

Rhode Island should continue to improve its property tax structure. While the Ocean State has moved from a ranking of 46th in 2014 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 and relies on tangible property taxation, businesses pay a disproportionate share of the state's relatively high property taxes. It is most critical that Rhode Island does not lose ground in this area: as assessed values for residential property have increased sharply in relation to commercial property, policymakers should resist increasing the proportional tax burden imposed on businesses.

---

[24] While fiscal recovery funds provided under the American Rescue Plan Act (APRA) cannot be used directly to reduce state taxes, such funds can be used by municipalities for property tax relief. Moreover, APRA allows general use of federal funding by state governments to replace lost revenues, thereby providing greater budget flexibility to reduce taxes. U.S. Dept. of Treasury, Coronavirus State and Local Fiscal Recovery Funds, Interim Final Rule, May 2021.

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 2016, Rhode Island's rating has slipped back to 37th in the most recent *Index*, largely because of decisions to forego state tax law changes incentivized by the TCJA. At minimum, policymakers should consider improving the ability for taxpayers to deduct net operating losses.

Calls to increase individual income tax rates for high wage earners should be resisted. 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, sole proprietorships, and partnerships, and report their profits as individual income.[25] Rhode Island's ranking of 31st in this *Index* category is already in the bottom half of states and is considerably less competitive than that of Massachusetts (ranked 11th).

The state should use federal pandemic relief funding to provide relief to employers. Because the UI trust fund, entirely paid for by employers, was severely impacted by government-mandated shutdowns caused by the pandemic and by unprecedented UI fraud, the state should consider using some of its discretionary federal relief money to build up its UI trust fund balance and shield employers from future rate increases.

[25] 65,697 institutions paid business corporations tax to the State of Rhode Island in 2017. Of these, 12,839 were C corporations, many of which operate out of state. R.I. Division of Taxation, Statistics of Income, 2017 Corporate Report – All Returns, 2017 Corporate Report – C Corp Returns.

Appendix

Figure 14
2022 State Business Tax Climate Ranking

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

Source: Tax Foundation 2022 State Business Tax Climate Ranking