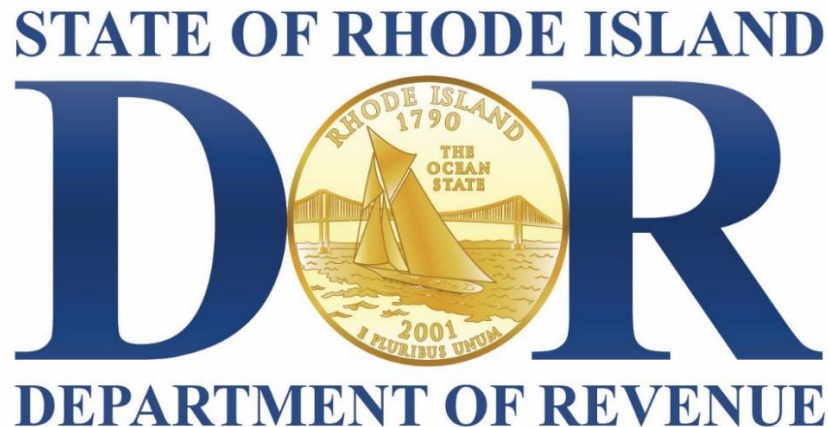


**STATE OF RHODE ISLAND**

**Governor Daniel J. McKee**



# **Economic Development Tax Incentives Evaluation Act:**

*Evaluation of  
Research & Development Tax Incentive Programs  
(including “New Research & Development Facilities Deduction”,  
“Research & Development Property Credit” and  
“Research & Development Expense Credit”)*

**(R.I. Gen. Laws §§ 44-32-1, 44-32-2, & 44-32-3)**

***Tax Years 2016 through 2018***

**Office of Revenue Analysis**

**ORA Completion Date: April 22, 2022**

**Publication Date: May 17, 2022**

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## **Foreword**

The evaluation of the Research and Development Tax Incentives, *Tax Years 2016 through 2018* was prepared at the request of Paul L. Dion, Ph.D., Chief of the Rhode Island Department of Revenue, Office of Revenue Analysis in accordance with Rhode Island General Laws § 44-48.2-4. Madiha Zaffou, Ph.D., Chief Economic and Policy Analyst in the Office of Revenue Analysis was project leader for the production and writing of this report, under the guidance of Mr. Dion. Ms. Zaffou was assisted by Emily Fazio, Senior Economic and Policy Analyst in the Office of Revenue Analysis.

Much of the information needed to complete the analysis contained in this report was provided by the Rhode Island Department of Revenue, Division of Taxation, under the direction of Neena Sinha Savage, State Tax Administrator. The compilation of the data that was provided to the Office of Revenue Analysis was due to the tremendous efforts of Tracy Wunder, Data Analyst III in the Division of Taxation. Tracy was assisted in this task by Donna Dube, Chief Revenue Agent, Forms, Credits, and Incentives.

The Office of Revenue Analysis is appreciative of the efforts made by the Division of Taxation to provide us with the best information available at the time this report was written.

## **Executive Summary**

This report is the second evaluation of the Research & Development Tax Incentives conducted by the Department of Revenue, Office of Revenue Analysis (ORA) in accordance with Rhode Island General Laws (R.I. Gen. Laws) Chapter 44-48.2.<sup>1</sup> The report provides an estimate of the economic and fiscal impacts of this tax incentive for tax years 2016 through 2018. ORA relied primarily on data provided by the Department of Revenue, Division of Taxation (Taxation) to conduct the analysis. The following is a summary of this evaluation:

### **The Tax Incentive Provision:**

R.I. Gen. Laws Chapter 44-32, entitled “Elective Deduction for Research and Development Facilities” establishes three tax incentive programs related to taxpayers engaged in research and development, as follows:

- The “Elective deduction against allocated entire net income”, which establishes the program referred to in this report as the “New Research and Development Facilities Deduction.” This section provides for a deduction against the tax imposed by R.I. Gen. Laws Chapter 44-11 (entitled “Business Corporation Tax”) and Chapter 44-30 (“Personal Income Tax”) for all expenditures paid or incurred for the construction, reconstruction, erection, or acquisition of any new tangible property that is depreciable, was acquired by purchase, is located in the state, and is used in the taxpayer’s trade or business for purposes of research and development in the experimental or laboratory sense. This deduction is in lieu of depreciation or the Investment Tax Credit (R.I. Gen. Laws Chapter 44-31). The deduction is not refundable and has no provision for carryforward.
- The “Credit for research and development property acquired, constructed, or reconstructed after July 1, 1994”, establishes the program referred to in this report as the “Research and Development Property Credit.” Under this section, a taxpayer is allowed a credit against the tax imposed by R.I. Gen. Laws Chapters 44-11 (entitled “Business Corporation Tax”) and 44-17 (“Taxation of Insurance Companies”) for tangible personal property and other tangible property, including buildings and structural components of buildings that is acquired, constructed or reconstructed, or erected after July 1, 1994. The amount of credit is equal to 10% of the cost or other basis of the property for federal income tax purposes. The credit allowed cannot reduce the tax due for corporations to less than the minimum tax as set in R.I. Gen. Laws § 44-11-2(e). Unused amounts of the credit earned in a taxable year may be carried forward for seven tax years.
- The “Credit for qualified research expenses”, establishes the program referred to in this report as the “Research and Development Expense Credit.” Under this section, a taxpayer is allowed a credit against the business corporation tax imposed by R.I. Gen. Laws Chapters 44-11 (entitled “Business Corporation Tax”) and 44-17 (“Taxation of Insurance Companies”) for the excess, if any, of the qualified research expenses for the taxable year over the base period research expenses, where qualified and base period research expenses are as defined in 26 U.S.C. § 41. The amount of credit is equal to 22.5% of expenses for

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<sup>1</sup> The first evaluation of this program was published on June 29<sup>th</sup>, 2018 and covered Tax Years 2013 through 2015.

the first \$25,000 worth of credit taken and 16.9% of expenses for any amount of applicable credit above \$25,000. The credit allowed cannot reduce the tax due for any taxable year by more than 50% of the tax liability that would be payable and for corporations to no less than the minimum tax as set in R.I. Gen. Laws § 44-11-2(e). Unused amounts of the credit earned in a taxable year may be carried forward for seven tax years.

- As of January 1, 2011, the Research and Development Property Credit and Research and Development Expense Credit are no longer allowed against the Rhode Island personal income tax imposed by R.I. Gen. Laws Chapter 44-30.

### **The Main Goals and Objectives of the Tax Incentive:**

Statutory and programmatic goals and the intent of the New Research and Development Facilities Deduction, Research and Development Property Credit, and Research and Development Expense Credit are not defined in the enabling statute.

### **The Report's Key Findings:**

- According to Taxation, an average of 64 companies received the Research and Development tax incentives with an average tax savings amount of \$3,146,073 over tax years 2016 through 2018.
- In an average year, 33.5% of R&D tax incentive recipients were companies operating in manufacturing industries. However, 71.8% of the amount of R&D tax incentives was received by companies in non-manufacturing industries for tax years 2016 through 2018.
- On average, the value of the R&D tax incentives represents 75.1% of the total state tax incentives received by firms that utilize the R&D tax incentives.
- On average, every \$1.00 of R&D tax incentives claimed, the same taxpayers claim an additional \$0.33 in other tax credits.
- Taxation reported an average of 10,370 employees working for R&D tax credits beneficiary firms across 75 different industries over tax years 2016 through 2018.
- The \$69,415 average median annual wage earned by employees of R&D tax incentive of recipients is 165.1% of the annual median wage of \$42,040 in 2018 for all occupations in Rhode Island.
- Under the assumption that R&D tax incentives are 100% responsible for taxpayer behavior, one dollar of investment in R&D tax incentives returned \$3.73 in state revenues.
- ORA conducted a “break-even” analysis to estimate the minimum percentage of the net economic activity created by the tax incentive beneficiaries that would have to be new to the Rhode Island economy, and thus, would not exist without the tax incentive, in order for the tax benefit to “pay” for itself.
  - ORA estimated these minimum percentages as follows:
    - i. With respect to Rhode Island net general revenues, the R&D program breaks even if at least 28.0% of the economic activity directly related to the provision of the tax incentive would not have occurred without the tax incentive.

- ii. With respect to Rhode Island employment, the R&D program breaks even if at least 1.8% of the economic activity directly related to the tax incentive's utilization would not have resulted except for the tax incentive.
- iii. With respect to Rhode Island Gross Domestic Product, the R&D program breaks even if at least 1.5% of the economic activity directly related to the availability of the tax incentive would not have occurred without the tax incentive being available.

## **Part I: Introduction**

Pursuant to Rhode Island General Laws § 44-48.2-4, titled *Rhode Island Economic Development Tax Incentives Evaluation Act of 2013*, the Chief of the Office of Revenue Analysis (ORA) is required to produce, in consultation with the Director of the Rhode Island Commerce Corporation (CommerceRI), the Director of the Office of Management and Budget, and the Director of the Department of Labor and Training, a report that contains analyses of economic development tax incentives as listed in R.I. Gen. Laws § 44-48.2-3(1). According to R.I. Gen. Laws § 44-48.2-4(1), the report “[s]hall be completed at least once between July 1, 2014, and June 30, 2017, and no less than once every three (3) years thereafter”.

The additional analysis as required by R.I. Gen. Laws § 44-48.2-4(1) shall include, but not be limited to the following items as indicated in R.I. Gen. Laws § 44-48.2-5(a):

- 1) A baseline assessment of the tax incentive, including, if applicable, the number of aggregate jobs associated with the taxpayers receiving such tax incentive and the aggregate annual revenue that such taxpayers generate for the state through the direct taxes applied to them and through taxes applied to their employees;
- 2) The statutory and programmatic goals and intent of the tax incentive, if said goals and intentions are included in the incentive's enabling statute or legislation;
- 3) The number of taxpayers granted the tax incentive during the previous twelve-month (12) period;
- 4) The value of the tax incentive granted, and ultimately claimed, listed by the North American Industrial Classification System (NAICS) Code associated with the taxpayers receiving such benefit, if such NAICS Code is available;
- 5) An assessment and five-year (5) projection of the potential impact on the state's revenue stream from carry forwards allowed under such tax incentive;
- 6) An estimate of the economic impact of the tax incentive including, but not limited to:
  - i. A cost-benefit comparison of the revenue forgone by allowing the tax incentive compared to tax revenue generated by the taxpayer receiving the credit, including direct taxes applied to them and taxes applied to their employees;
  - ii. An estimate of the number of jobs that were the direct result of the incentive; and
  - iii. A statement by the Chief Executive Officer of the Commerce Corporation, as to whether, in his or her judgment, the statutory and programmatic goals of the tax benefit are being met, with obstacles to such goals identified, if possible;
- 7) The estimated cost to the state to administer the tax incentive if such information is available;
- 8) An estimate of the extent to which benefits of the tax incentive remained in state or flowed outside the state, if such information is available;
- 9) In the case of economic development tax incentives where measuring the economic impact is significantly limited due to data constraints, whether any changes in statute would facilitate data collection in a way that would allow for better analysis;

- 10) Whether the effectiveness of the tax incentive could be determined more definitively if the General Assembly were to clarify or modify the tax incentive's goals and intended purpose;
- 11) A recommendation as to whether the tax incentive should be continued, modified, or terminated; the basis for such recommendation; and the expected impact of such recommendation on the state's economy;
- 12) The methodology and assumptions used in carrying out the assessments, projections and analyses required pursuant to subdivisions (1) through (8) of this section.

The current report is one part of a series of reports for each one of the tax credits to be analyzed according to R.I. Gen. Laws § 44-48.2-3(1). This report concerns the credits contained within R.I. Gen. Laws Chapter 44-32 entitled “Elective Deduction for Research and Development Facilities” containing sections 44-32-1 (“Elective Deduction against Allocated Entire Net Income”), 44-32-2 (“Credit for Research and Development Property Acquired, Constructed, or Reconstructed after July 1, 1994”), and 44-32-3 (“Credit for Qualified Research Expenses”). This report measures the economic impact associated with these Research and Development related tax incentives during tax years 2016 through 2018. This analysis is performed at the micro level using employment and wages information provided by the Division of Taxation. The report is divided into five sections. Section I provides a detailed description of the tax incentives and related statutory programmatic goals and intents. Section II provides background and benchmarking analysis related to these tax incentive programs. Section III presents a description of the data provided and used in the analysis by ORA. Section IV assesses the economic impact generated under these Research and Development related tax incentives using a “breakeven” cost-benefit analysis. Section V discusses relevant policy recommendations that could help in the decision process as to whether these programs should be continued, modified, or terminated.

## **1. Description of the Incentive**

R.I. Gen. Laws Chapter 44-32, entitled “Elective Deduction for Research and Development Facilities” establishes three tax incentive programs related to taxpayers engaged in research and development.

R.I. Gen. Laws § 44-32-1, entitled “Elective deduction against allocated entire net income”, establishes the program referred to in this report as the “New Research and Development Facilities Deduction.” This section provides for a deduction for all expenditures paid or incurred for the construction, reconstruction, erection, or acquisition of any new tangible property that is depreciable under Chapter 26 of the United States Code (26 U.S.C.) § 167, was acquired by purchase as defined in 26 U.S.C. § 179(d), is located in the state, and is used in the taxpayer’s trade or business for purposes of research and development in the experimental or laboratory sense. The deduction shall be allowed against the portion of its entire net income allocated to Rhode Island during the taxable year. The deduction can be taken against the business corporation tax imposed by R.I. Gen. Laws Chapter 44-11 and the personal income tax imposed by R.I. Gen. Laws Chapter 44-30 and is in lieu of depreciation or the Investment Tax Credit (R.I. Gen. Laws Chapter 44-31). The deduction is not refundable and has no provision for carryforward.



R.I. Gen. Laws § 44-32-2, entitled “Credit for research and development property acquired, constructed, or reconstructed after July 1, 1994”, establishes the program referred to in this report as the “Research and Development Property Credit.” Under this section, a taxpayer is allowed a credit against the business corporation tax imposed under R.I. Gen. Laws Chapter 44-11 and the taxation of insurance companies imposed by R.I. Gen. Laws Chapter 44-17 for tangible personal property and other tangible property, including buildings and structural components of buildings that is acquired, constructed or reconstructed, or erected after July 1, 1994. The property must be depreciable or a recovery property as determined under 26 U.S.C. § 167 and § 168, have a useful life of at least three years, have a situs in the state, and used principally for purposes of research and development in the experimental or laboratory sense. The amount of credit is equal to 10% of the cost or other basis of the property for federal income tax purposes. The credit allowed cannot reduce the tax due for corporations to less than the minimum tax as set in R.I. Gen. Laws § 44-11-2(e). Unused amounts of the credit earned in a taxable year may be carried forward to not more than seven succeeding tax years.

R.I. Gen. Laws § 44-32-3, entitled “Credit for qualified research expenses”, establishes the program referred to in this report as the “Research and Development Expense Credit.” Under this section, a taxpayer is allowed a credit against the business corporation tax imposed under R.I. Gen. Laws Chapter 44-11 and the taxation of insurance companies imposed by R.I. Gen. Laws Chapter 44-17 for the excess, if any, of the qualified research expenses for the taxable year over the base period research expenses, where qualified and base period research expenses are as defined in 26 U.S.C. § 41. The amount of credit is equal to 22.5% of expenses for the first \$25,000 worth of credit taken and 16.9% of expenses for any amount of applicable credit above \$25,000. The credit allowed cannot reduce the tax due for any taxable year by more than 50% of the tax liability that would be payable and for corporations to no less than the minimum tax as set in R.I. Gen. Laws § 44-11-2(e). Unused amounts of the credit earned in a taxable year may be carried forward to not more than seven succeeding tax years.

As of January 1, 2011, the Research and Development Property Credit and Research and Development Expense Credit are no longer allowed against the Rhode Island personal income tax imposed by R.I. Gen. Laws Chapter 44-30.

## **2. Statutory and Programmatic Goals and Intent of the Tax Incentive**

This information is unavailable. Statutory and programmatic goals and the intent of the New Research and Development Facilities Deduction, Research and Development Property Credit, and Research and Development Expense Credit are not defined in the enabling statute.

## **Part II: Background and Benchmarking**

This background and benchmarking section presents information useful for understanding how Rhode Island research and development (R&D) tax incentive programs function and the economic environment in which they operate. Because state-level research and development tax incentives, including those offered by Rhode Island, are constructed in terms of federal rules and definitions, first this section presents information on the federal research tax credit and deduction programs. Next, this section compares Rhode Island research and development tax incentives with similar programs offered by selected comparison states. Finally, this section highlights levels and trends of research and development activity occurring in Rhode Island, selected comparison states, and nationwide.

To the extent that the availability of research and development-related tax incentives influences a multi-state firm's decision to conduct business activity in Rhode Island *vs.* a competitive out-of-state location, it is important to consider the economic conditions and tax incentive features of the Rhode Island R&D tax incentives to that of other states. For this purpose, ORA selected four comparison states: Massachusetts and Connecticut, Rhode Island's two neighboring states, in addition to California and Delaware, two national leaders in R&D. ORA identified these leading states as those with a research and development tax incentive comparable to Rhode Islands and the highest concentration of R&D activity after ranking all fifty states by their ratios of average R&D spending to average state gross domestic product in 2016 through 2018.<sup>2</sup>

Throughout the benchmarking and background section, data are presented for Rhode Island, comparison states, and the United States whenever possible. ORA acknowledges that it may be useful to look beyond these four comparison states. This comparison is simply intended to be a concise starting point for future discussions.

Part III of this report reveals that a majority of Rhode Island research and development incentive usage was claimed by manufacturing industry recipients. For additional information concerning levels and trends of manufacturing industries economic activity in Rhode Island, selected comparison states, and nationwide, please refer to the "Part II: Benchmarking and Background" of the previously published *Tax Incentives Evaluation Act Report on "Investment Tax Credits"*.<sup>3</sup>

### **1. Federal Research Credit and Deduction Programs**

Federal law per 26 U.S.C. §§ 41 and 174 provides relief to taxpayers engaged in R&D by establishing a tax credit and deduction to reduce the tax liability of businesses based on their level of qualified research expenditures. The Federal Credit for Increasing Research Activities ("Federal Research Credit) created by 26 U.S.C. § 41 is analogous to Rhode Island's R&D Property and Expense Credit programs. The Federal Research and Experimental Expenditure Deduction ("Federal Research Deduction") created by 26 U.S.C. § 174. allows for the immediate expensing of certain property investments related to R&D that would otherwise be subject to depreciation.

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<sup>2</sup> For 2016 through 2018, California ranked 1<sup>st</sup> for R&D spending as a share of total GDP at 4.7%. Washington had the second highest R&D spending to total GDP ratio at 4.5%. However, Washington's R&D tax credit was eliminated in 2015. Massachusetts ranked 3<sup>rd</sup> at 4.4%. Michigan and Oregon followed with 4.1% and 3.4%, respectively, but neither has a R&D tax credit. Delaware ranks 6<sup>th</sup> with a R&D spending to total GDP ratio of 3.0%.

<sup>3</sup> Available: <http://www.dor.ri.gov/Reports/>

The Federal Research Deduction is analogous to the Rhode Island New R&D Facilities Deduction program.

Qualified research expenditures may consist of in-house research expenses (*e.g.*, wages paid to employees engaged in R&D or purchases of equipment related to R&D) as well as purchased research services (*e.g.*, professional or technical services purchased from an outside firm, contractor, or research consortium). Most, but not all, qualified research expenses can be included in the credit calculation formula at 100%.

26 U.S.C. § 41(d) and Chapter 26 of the Code of Federal Regulations (26 C.F.R.) § 1.41-4 establish a four-part test to determine if an expense shall be considered a qualified research expenditure:<sup>4</sup>

**“The Section 174 Test”** The expense must be related to the elimination of uncertainty concerning the development or improvement of a product. The qualifying activity must represent a research cost in the experimental or laboratory sense.

**“The Discovering Technological Information Test”** The process of experimentation used to discover information must fundamentally rely on principles of the physical or biological sciences, engineering, or computer science. The issuance of a patent as the result of the research activity is sufficient by itself, but not necessary, to satisfy this test.

**“The Business Component Test”** The taxpayer must intend to apply the new information being discovered to develop a new or improved product, process, computer software, formula, or invention. Research must be intended to improve function, performance, reliability, or quality of a business component and is not qualified if it relates to style, taste, cosmetic factors, or seasonal design. It is not acceptable for a taxpayer to group all research into a single broad category without identifying the specific business component to which the research activity relates.

**“The Process of Experimentation Test”** Qualified research must reflect the three core elements of a process of experimentation including:

- 1) Identify an aspect of uncertainty related to a product or business component
- 2) Identify one or more alternatives intended to eliminate that uncertainty
- 3) Identify a process of evaluating the alternatives.

Expenditures qualifying as deductions under 26 U.S.C. § 174. must satisfy only the “Section 174” test above. Expenditures qualifying for tax credits under 26 U.S.C. § 41. must satisfy all four tests.

The Rhode Island R&D Property and Expense Credit programs generally conform with these federal definitions. The only additional stipulation is that Rhode Island deduction or credit-eligible expenditures must have situs or take place in Rhode Island.

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<sup>4</sup> Four-part test description is paraphrased and quoted from “Audit Techniques Guide: Credit for Increasing Research Activities (i.e., Research Credit) IRC § 41 – Qualified Research Activities” Internal Revenue Service, June 2005, Available: <https://www.irs.gov/businesses/audit-techniques-guide-credit-for-increasing-research-activities-i-e-research-tax-credit-irc-41-qualified-research-activities>

The Federal Research Credit amount is calculated based on the amount of qualified research expenditures utilizing one of the following two formulas at the election of the taxpayer:<sup>5</sup>

**The Regular Research Credit (RRC).** This credit calculation methodology awards a tax credit equal to 20% of a taxpayer's qualified research expenditures in excess of the base amount. The base amount is equal to the percentage of a firm's gross receipts devoted to research expenditures during a historical base period<sup>6</sup> multiplied by the average annual gross receipts of the most recent four years.

**The Alternative Simplified Credit (ASC).** This simplified credit calculation is offered as an alternative to the RRC. This formula awards a tax credit equal to 14% of current year qualified research expenditures above the base amount, where the base amount is equal to 50% of the average annual amount of qualified research expenditures of the previous three tax years. If the taxpayer had zero qualified research expenditures in any of the three previous years, then the taxpayer may claim credit for 6% of the total qualified research expenditures for the current year.

By granting credit for only those expenditures above some base level, both formulas are intended to reward taxpayers only for incremental research activity, rather than subsidize research activity that may have happened anyway. The Rhode Island R&D Expense Credit is calculated based on the federally-defined base period amount and current year qualified research expenditures amount according to whichever credit calculation method was elected by the taxpayer when filing their federal return.

## **2. Comparison of State Research and Development Credits**

The following table compares the Rhode Island Research and Development Expense Credit to the federal Research Credit.

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<sup>5</sup> This report intends to only present a general overview of the Federal Research Credit calculation procedure. The RRC calculation involves a detailed consideration of taxpayer characteristics and filing choices. For full calculation please refer to IRS Form 6765 and accompanying instructions available at: <https://www.irs.gov/pub/irs-pdf/f6765.pdf> and <https://www.irs.gov/pub/irs-pdf/i6765.pdf>

<sup>6</sup> The historical base period is typically a four-year period early in the existence of the firm. The exact years and assumptions used in this determination vary based on the taxpayer characteristics but is not allowed to exceed 16 percent. A detailed discussion of this calculation is beyond the scope of this report.

## Comparison of the RI R&D Expense Credit to the Federal Research Credit

	<b>Federal</b>	<b>RI</b>
<b>Tax Credit Rate</b>	Statutory rate of 20% or 14% depending on credit calculation method*	22.5% for the first \$25,000 and 16.9% on the excess
<b>Eligibility of Business Type</b>	C-Corporation, S-Corp, Partnership, S-Partnership subject to corporate or personal income tax	C-Corporations subject to business corporation tax or insurance company gross premiums tax
<b>Carryforward Period</b>	20 Years	7 Years
<b>Carryback Period</b>	1 Year	None
<b>Refundability</b>	Generally non-refundable; total of Federal Research Credit and other business tax credits capped at 25% of liability for certain taxpayers; limited refundability available to qualifying start-ups for which credit is allowed to offset payroll taxes	Non-refundable; capped at 50% of liability; shall not reduce tax below minimum tax

**Source:** <https://www.irs.gov/businesses/audit-techniques-guide-credit-for-increasing-research-activities-i-e-research-tax-credit-irc-41-table-of-contents>; and R.I. Gen. Law § 44-32-3

\* According to 26 U.S.C. § 280C, taxpayers claiming both the Federal Research Deduction and Credit simultaneously shall reduce the credit claimed by the amount of their deduction or elect to utilize a reduced credit rate equal to the full credit rate reduced by the statutory corporate tax rate (*i.e.*, During tax years 2016 and 2017, the federal corporate income tax rate was 35%; therefore, the credit rates for taxpayers electing the reduced rate calculation were 13% or 9.1% for RRC and ASC, respectively. In 2018, the federal corporate tax rate was lowered to 21%; therefore, the credit rates for taxpayers electing the reduced rate calculation were 10.3% (*i.e.*,  $0.20 \times (1 - 0.21)$ ) and 7.2% (*i.e.*,  $0.14 \times (1 - 0.21)$ ) for RRC and ASC, respectively). A 2016 U.S. Treasury Office of Tax Analysis Report indicates that 90% of taxpayers claiming both the Federal Research Deduction and Credit elect to utilize the reduced rate.<sup>7</sup>

As shown in the table above, Rhode Island’s R&D Expense Credit is distinguished from the Federal Research Credit by its tiered credit rate. The Rhode Island credit provides a higher credit rate of 22.5% for the first \$111,111 of qualified research expenses and a reduced credit rate of 16.9% for amounts greater than \$111,111. This feature provides greater marginal benefits for taxpayers with smaller amounts of R&D expenditures. The Rhode Island credit has a shorter carryforward period than the federal credit and no carryback period, unlike the federal credit. Both the federal and state credits are non-refundable, which limits the value of the credit to only those taxpayers who anticipate having a tax liability within the carryforward period.

R&D tax incentives are common across the United States. The *2021 State Business Tax Climate Index* published by the Tax Foundation indicates that 37 out of 51 states plus Washington D.C. offered some type of R&D credit or deduction against the state corporate income or gross receipts tax.<sup>8</sup> The following table provides a comparison of the basic features of Rhode Island’s R&D Expense Credit with similar credits in the comparison states of California, Connecticut, Massachusetts, and Delaware:

<sup>7</sup> Available: <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/RE-Credit.pdf>

<sup>8</sup> *2021 State Business Tax Climate Index*, Tax Foundation. Refer to Table 9, Page 57. Available: <https://taxfoundation.org/2021-state-business-tax-climate-index/>

### Research & Development Tax Credits in Rhode Island and Selected Comparison States

	<b>Rhode Island</b>	<b>Massachusetts</b>	<b>Connecticut</b>	<b>California</b>	<b>Delaware</b>
<b>Credit Name</b>	R&D Expense Credit	R&D Tax Credit	Research & Experimental (Incremental) Expenditures Credit	California Research Credit	Credit for Research and Development Expenses
<b>Statutory Reference</b>	R.I. Gen. Laws § 44-32-3	Mass. Gen. Laws ch.63, § 38M	Conn. Gen. Stat. § 12-217j	CA R&TC 17052.12 and 23609	30 Del. Laws § 2070 - 2075
<b>Credit Rate</b>	22.5% for the first \$25,000 and 16.9% on any excess	10% for qualified research expenses; 15% for basic research payments	20%	15% on qualified research expenses; 24% for basic research payments	10% of qualified in-state research expenditures; or 50% of the apportioned share of the federal alternative simplified credit (ASC)
<b>Qualifying R&amp;D Expenses</b>	All in-state qualified research expenses above the federal base amount	All in-state qualified research expenses above the federal base amount	All in-state qualified research expenses above the federal base amount	15% of the excess of current year research expenditures over a computed base amount.	All in-state qualified research expenses above the Delaware base amount
<b>Refundability &amp; Limitations</b>	Non-refundable; credit cannot reduce tax liability by more than 50% or the minimum tax.	Non-refundable; credit cannot reduce liability below the minimum tax.	Limited refundability; qualified small businesses may receive a refund equal to 65% of credit amount up to \$1,500,000.	Non-refundable, but may reduce regular tax below the CA “tentative minimum tax.”	Refundable; No credit cap.
<b>Carryforward</b>	Up to 7 years	Up to 15 years	Up to 15 years	Unlimited	NA
<b>Source</b>	<a href="http://webserver.rilin.state.ri.us/Statutes/TITLE44/44-32/44-32-3.HTM">http://webserver.rilin.state.ri.us/Statutes/TITLE44/44-32/44-32-3.HTM</a>	<a href="https://malegislature.gov/laws/generallaws/parti/titleix/chapter63/section38m">https://malegislature.gov/laws/generallaws/parti/titleix/chapter63/section38m</a>	<a href="http://www.ct.gov/drs/cwp/view.asp?a=3807&amp;q=522224">http://www.ct.gov/drs/cwp/view.asp?a=3807&amp;q=522224</a>	<a href="https://apps.leg.wa.gov/WAC/default.aspx?cite=458-20-24003">https://apps.leg.wa.gov/WAC/default.aspx?cite=458-20-24003</a>	<a href="https://www.ftb.ca.gov/file/business/credits/california-research.html">https://www.ftb.ca.gov/file/business/credits/california-research.html</a>

Note: Credit characteristics reflects current policy as identified by ORA in April 2022. This table presents a single comparison credit program for each comparison state determined by ORA to be most similar to the Rhode Island R&D Expense Credit.

All four of the comparison states, Massachusetts, Connecticut, California, and Delaware, have tax credit programs that are similar to the Rhode Island R&D Expense Credit. These states award credit only for the in-state portion of incremental research expenditures as defined by 26 U.S.C. § 41. This generally means that taxpayers receive credit for only the portion of qualified research expenses that exceed the federal “base amount” as defined by either the RRC or ASC calculation methodology elected by the taxpayer when filing their federal corporate income taxes.<sup>9</sup> Additionally, Rhode Island’s credit rate is generally comparable to these four comparison states. Rhode Island’s tiered rate structure at 16.9% / 22.5% overlaps the 20% credit rate in Connecticut and the 15% / 24% rate structure in California. Rhode Island’s rate is higher than the 10% / 15% rate structure offered by Massachusetts and the 10% rate offered by Delaware.

Three out of five states offered non-refundable tax credit. Connecticut was the only state that offered limited refundability to qualified small businesses and Delaware is the only state that has no expenditure cap and a fully refundable tax credit. The Rhode Island credit is not only nonrefundable, but the credit is capped at 50% of tax liability. Some evaluators perceive the lack of refundability of R&D tax credits as reducing their effectiveness. For example, a 2012 evaluation of the Washington State High Technology R&D Tax Credit conducted by the Washington State Joint Legislative Audit & Review Committee notes that 30% credit recipients utilized the full extent of the allowable credit.<sup>10</sup> Taxpayers having claimed the maximum credit amount allowed by their tax liability have a reduced marginal incentive to increase R&D expenditures. These taxpayers will receive zero additional tax savings in the current year even if they were to increase R&D expenses. Taxpayers may receive a future benefit if they anticipate being able to carryforward the credit and apply it to their liability in some future year.

A unique feature of the Rhode Island R&D Expense Credit is the tiered credit rate structure. The Rhode Island credit is structured such that a higher credit rate of 22.5% is applied to the first \$111,111 of qualified research expenses (or \$25,000 of credit). Firms may then claim a credit rate of 16.9% for expenses in excess of this amount. The tiered credit rate provides greater marginal incentive to smaller firms. However, further empirical analysis is necessary to evaluate the effectiveness of this provision in actually encouraging R&D spending among smaller-scale firms.

The table above only contains a single tax credit from each state determined by ORA to be most comparable to the Rhode Island R&D Expense Credit, which is the most heavily utilized of the three R&D tax incentives Rhode Island offers. For example, Connecticut offers at least two R&D Credit programs: an incremental credit for R&D expenses above the federally defined base amount with a credit rate of 20% per Conn. Gen. Stat. § 12-217j; and also, a non-incremental credit for R&D expenses applied to *all* in-state R&D expenses per Conn. Gen. Stat. § 12-217n.

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<sup>9</sup> These states generally make use of federal definitions and calculation methodologies, with certain adjustments and exceptions in each state. For example, the California credit calculation method supports the RRC, but not the ASC credit calculation methodology.

<sup>10</sup> State of Washington Joint Legislative Audit & Review Committee, *2012 Tax Preference Performance Reviews*, (Report 13-1), page 104. Available: <http://leg.wa.gov/JLARC/AuditAndStudyReports/Documents/13-1.pdf>



### 3. Research and Development Activity in Rhode Island, Comparison States, and Nationwide

ORA found that R&D activity is primarily driven by manufacturing industries. The following chart summarizes data from the National Science Foundation on R&D spending throughout the United States. Note that this table, and all that follow, depict *business* R&D which excludes certain research activities conducted by government and non-profit institutions such as hospitals or universities.

**United States Funds Spent for Domestic Business R&D**  
(Spending in Millions of Dollars, Calendar Years 2016 – 2018)

	CY 2016	CY 2017	CY 2018	Average	
				Amount	Percent
Manufacturing Industries	\$250,553	\$257,227	\$274,075	\$260,618	64.3%
Non-Manufacturing Industries	\$124,132	\$142,874	\$166,961	\$144,656	35.7%
<b>All U.S. Businesses</b>	<b>\$374,685</b>	<b>\$400,100</b>	<b>\$441,036</b>	<b>\$405,274</b>	<b>100.0%</b>

**Source:** National Science Foundation, <https://www.nsf.gov/statistics/industry/#tabs-1>

**Notes:** Manufacturing industries is comprised of NAICS Codes 31-33. Non-Manufacturing industries is comprised of NAICS Codes 21-23 and 42-81.

These national data show that manufacturing industries are responsible for nearly two-thirds, or 64.3% , of R&D expenditures nationwide. The data also indicate that R&D spending was on an upward trend from calendar years 2016 through 2018. R&D spending increased from \$374.7 billion to \$441.0 billion during this time period, an average annual growth rate of 8.5%.

The following chart provides further detail on the concentration of R&D activity within the manufacturing industries by presenting R&D expenditures as a percent of sales revenues. The data is presented for calendar year 2018, the most recent year for which data was available at the time of this report’s publication.

**Domestic Business R&D as a Percent of Domestic Sales**  
**by Manufacturing and Non-Manufacturing Industries**  
(Spending in Millions of Dollars, Calendar Year 2018)

	<b>R&amp;D Spending as Percent of Sales</b>
Manufacturing Industries	4.6%
Non-Manufacturing Industries	3.5%
<b>All Industries</b>	<b>4.1%</b>

**Source:** National Science Foundation, National Center for Science and Engineering Statistics, and U.S. Census Bureau, Business Research and Development: 2018, <https://nces.nsf.gov/pubs/nsf21312#data-tables>

**Notes:** Manufacturing industries is comprised of NAICS Codes 31-33. Non-Manufacturing industries is comprised of NAICS Codes 21-23 and 42-81.

These data indicate that manufacturing industries not only generate a majority of R&D expenditures when measured in absolute terms, but these industries spend more on R&D when measured in relative terms. An average United States manufacturer spends 4.6% of sales on R&D,



while the average non-manufacturing firm spends 3.5%. This indicates that manufacturing firms spend a larger proportion of revenue on R&D compared with firms in other industries.

There is considerable variation among specialized manufacturing industries with respect to the concentration of R&D spending. The following table shows the ten specialized manufacturing industries nationwide with the most concentrated R&D spending determined by a ranking of industry R&D spending as a proportion of sales.

**Domestic Business R&D as a Percent of Domestic Sales**  
**Among Specialized Manufacturing Industries**  
 (Calendar Year 2018)

<b>Rank / Specialized Industry</b>	<b>NAICS Code/s</b>	<b>R&amp;D as Percent of Sales</b>
Semiconductor machinery	333242	19.2%
Communications equipment	3342	15.5%
Electromedical, electrotherapeutic, and irradiation apparatus	334510, 334517	11.5%
Pharmaceuticals and medicines	3254	11.4%
Search, detection, navigation, guidance, aeronautical, and nautical system and instrument	334511	11.2%
Semiconductor and other electronic components	3344	10.3%
Computer and electronic products	334	10.2%
Navigational, measuring, electromedical, and control instruments	3345	9.3%
Other computer and electronic products	other 334	9%
Guided missile, space vehicle, and related parts	336414–15, 336419	7.7%

**Source:** National Science Foundation, National Center for Science and Engineering Statistics, and U.S. Census Bureau, Business R&D and Innovation Survey, Table 17, 2018. <https://nces.nsf.gov/pubs/nsf21312#data-tables>

The table above indicates that the most specialized manufacturing industries devote between 7.7 and 19.2% of sales to R&D expenses.

R&D spending also varies considerably by state as shown in the following table, which depicts various measures of R&D spending in Rhode Island, comparison states, and nationwide.

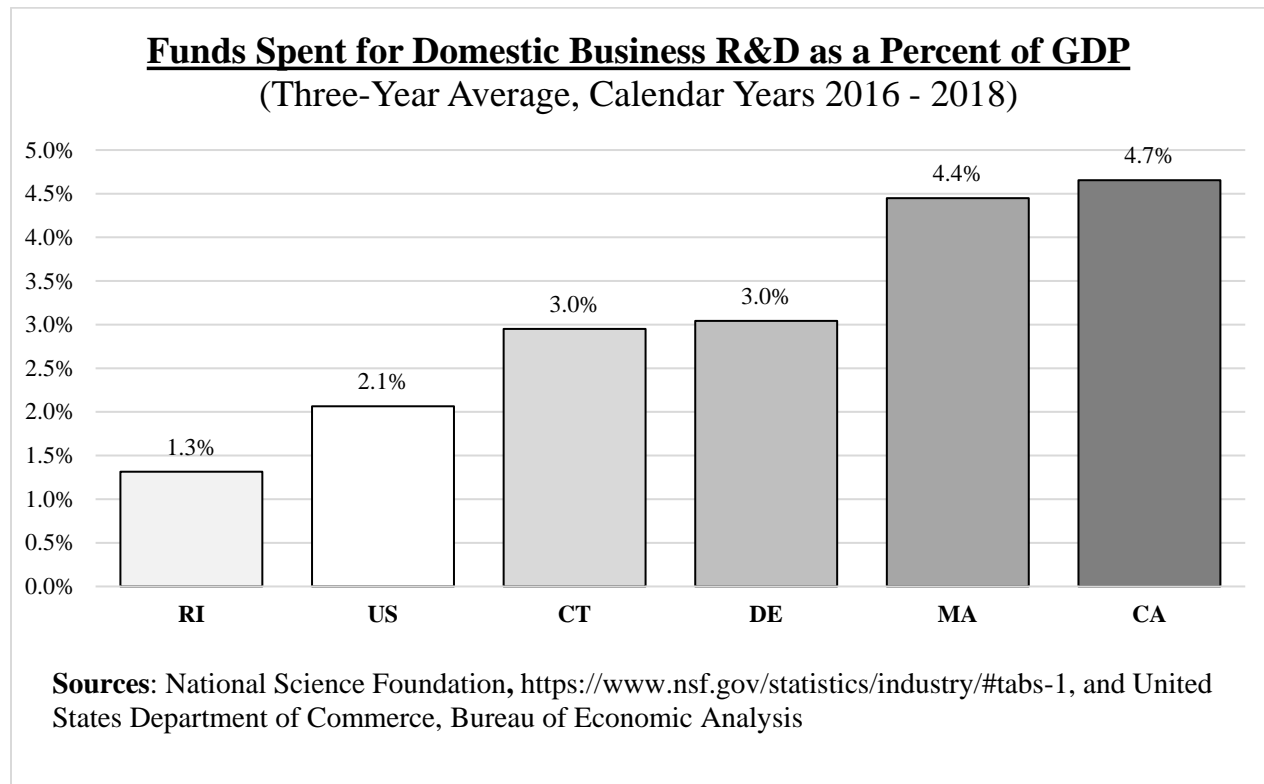
**Funds Spent for Domestic Business R&D**  
**In Rhode Island, Comparison States, and United States**  
 (Spending in Millions of Dollars, Calendar Years 2016 – 2018)

<b>State</b>	<b>R&amp;D Spending</b>				<b>Average R&amp;D as Percent of GDP</b>
	<b>CY 2016</b>	<b>CY 2017</b>	<b>CY 2018</b>	<b>3-Year Average</b>	
California	\$117,569	\$132,473	\$144,524	\$131,522	4.7%
Massachusetts	\$21,560	\$23,655	\$27,282	\$24,166	4.4%
Delaware	\$2,069	\$2,048	\$2,375	\$2,164	3.0%
Connecticut	\$7,987	\$8,694	\$7,488	\$8,056	3.0%
<b>United States</b>	<b>\$374,685</b>	<b>\$400,100</b>	<b>\$441,036</b>	<b>\$405,274</b>	<b>2.1%</b>
<i>Rhode Island</i>	<i>\$875</i>	<i>\$730</i>	<i>\$703</i>	<i>\$769</i>	<i>1.3%</i>

Sources: National Science Foundation, <https://www.nsf.gov/statistics/industry/#tabs-1>; and United States Department of Commerce, Bureau of Economic Analysis.

As shown in the table, all four comparison states had levels of R&D spending above the national average when scaled for the size of each state’s economy. Rhode Island business R&D spending, at 1.3% as a proportion of GDP, was below the national average of 2.1%. Rhode Island R&D spending is also more volatile than comparison states and nationwide. Comparison states, with the exception of Delaware and Connecticut, showed a pattern of consistent year-over-year growth in CY 2017 and 2018. However, Rhode Island showed a 16.6% decline in R&D spending from CY 2016 to CY 2017 followed by a 3.7% decline in R&D spending in CY 2018.<sup>11</sup>

The following bar graph summarizes the data in the previous table and provides a visual illustration of Rhode Island under-indexing comparison states and the national average with respect to R&D spending.



The bar graph depicts clustering of domestic business R&D spending in the top two states above 4.0% of GDP. It should be noted that while California ranked first across all U.S. states in terms of concentration of R&D spending, neighboring Massachusetts is the third-ranked state nationwide, trailing Washington in the rankings by a small margin. Delaware ranked sixth, narrowly outperforming Connecticut, which is ranked 7<sup>th</sup> among fifty states, both standing above the national average at 2.1 percent. Rhode Island, ranked 25<sup>th</sup>, stands below the national average at 1.3 percent.

<sup>11</sup> Delaware’s pattern was a 1.0% decrease in CY 2017 followed by a 16.0% increase in CY 2018. Connecticut’s pattern was an 8.9% increase in CY 2017 followed by a 13.9% decrease in CY 2018.

### **Part III: Report Data Description**

The analysis of the R&D programs in this report required an analysis of micro-level taxpayer data. ORA encountered significant challenges related to data access. In order to gain sufficient access to data while respecting confidentiality concerns, ORA entered into Memoranda of Understanding (MOU) with the Rhode Island Department of Revenue, Division of Taxation (Division of Taxation), Rhode Island Department of Labor and Training, and Rhode Island Commerce Corporation (CommerceRI). These MOUs sought to preserve the confidentiality of individually identifiable taxpayers consistent with the statutory mandates regarding secrecy and confidentiality of taxpayer information. In this context, ORA relied on data provided by credit recipients to Taxation for tax years 2016, 2017, and 2018, to the extent such information were provided, as required by Rhode Island General Law § 44-48.2-5(b). The data provided by the Division of Taxation to ORA consisted of the following:

- Credit amounts, recipient firms, and employment information.
- Withholding tax payment records on file provided by Taxation in each tax year subject to the current analysis.
- Corporate tax payments on file provided by Taxation in each tax year subject to the current analysis.
- Cost of administration of the tax incentive.

ORA made no attempt to verify the accuracy of the data provided and made minimal corrections to the data in order to be able to execute specific calculations for the report. The data included in this report are unaudited and reported as compiled.

ORA utilized several data sources in this report that did not differentiate between the New R&D Facilities Deduction, R&D Property Credit, and R&D Expense Credit as they are frequently consolidated into the same line item for reporting purposes. When sources were able to distinguish credit usage between the three R&D tax incentives programs, ORA observed that the R&D Expense Credit represented virtually all of the credit usage when measured in terms of dollars of usage. Specifically, for the time period of tax years 2016 through 2018, the R&D Expense credit represented 98.4%, or \$9.29 million out of \$9.44 million, total R&D tax incentive usage. Furthermore, differentiating between the three incentives would require reporting certain data in groups consisting of only a few taxpayers, which would potentially compromise taxpayer confidentiality. For these reasons, some tables in this section aggregates usage of all three programs and refers to them collectively as “R&D tax incentives”.

#### **1. Number of Taxpayers Granted Tax Credit**

According to the Division of Taxation, an average of 64 companies received the R&D credits (i.e. R&D Property Credit and R&D Expense Credit) over tax years 2016 through 2018 with an average value of \$3.14 million. The following table provides a breakdown of the number of R&D credits recipients and the corresponding tax credit amounts received by tax year and tax type:

### **R&D Tax Credit Amounts and Recipients by Tax Type**

(Millions of Dollars, Tax Years 2016 – 2018)

	TY 2016	TY 2017	TY 2018	Three-Year Total	Three-Year Average
<b><i>Business Corporation Tax</i></b>					
Incentive Amount	\$1.26	\$1.68	\$2.83	<b>\$5.76</b>	<b>\$1.92</b>
Number of Recipients *	59	63	63	<b>185</b>	<b>62</b>
<b><i>Insurance Premiums Tax</i></b>					
Incentive Amount	\$0.73	\$1.05	\$1.87	<b>\$3.66</b>	<b>\$1.22</b>
Number of Recipients	<10	<10	<10	<b>ND</b>	<b>&lt;10</b>
<b><i>Total</i></b>					
Incentive Amount	<b>\$1.99</b>	<b>\$2.73</b>	<b>\$4.70</b>	<b>\$9.42</b>	<b>\$3.14</b>
Number of Recipients	<b>ND</b>	<b>ND</b>	<b>ND</b>	<b>ND</b>	<b>64</b>

**Source:** Division of Taxation

**Note:**

This table includes credit amounts for the R&D Property Credit and R&D Expense Credit. Usage of the New R&D Facilities Deduction is not reflected in this table.

ND indicates the number of recipients is not disclosed by Taxation due to taxpayer confidentiality.

\* Number of Recipients do not include an undisclosed number less than 10 of recipients who received the R&D Property tax incentive

The breakdown of the three R&D tax incentives programs is provided in the following table:

### **R&D Tax Incentives Amount by Incentive**

(Tax Years 2016 – 2018)

	TY 2016	TY 2017	TY 2018	Three- Year Total	Three- Year Average
New R&D Facilities Deduction	\$800	\$2,200	\$13,324	\$16,324	\$5,441
R&D Property Credit	\$13,817	\$0	\$121,567	\$135,384	\$45,128
R&D Expense Credit	\$1,978,157	\$2,729,960	\$4,578,395	\$9,286,512	\$3,095,504
<b><i>Total</i></b>	<b>\$1,992,774</b>	<b>\$2,732,160</b>	<b>\$4,713,286</b>	<b>\$9,438,220</b>	<b>\$3,146,073</b>

**Source:** Division of Taxation & 2016 – 2018 Taxation Statistics of Income reports

## **2. Value of Tax Incentive Granted by NAICS Code**

ORA obtained data from the Taxation regarding R&D tax incentive amounts received by firms for tax years 2016 through 2018 broken down by their North American Industry Classification System (NAICS) code for modeling purposes. ORA used the provided 75 NAICS industries to accurately simulate direct shocks to the Rhode Island economy with the REMI model.<sup>12</sup> ORA found that some of the industries were represented by only one or two R&D tax incentive recipients. In this context, ORA is unable to disclose R&D tax incentive amounts received by NAICS code as it may

<sup>12</sup> Refer to “‘Breakeven’ Cost-Benefit Analysis” section below for more information regarding the REMI Tax-PI model utilized in this analysis.

violate taxpayer confidentiality. ORA broke down the R&D tax incentive amounts received in tax year 2016 through 2018 into manufacturing and non-manufacturing sectors. The following table depicts the amount of the R&D tax incentives received by firms in those two industry groups during tax year 2016 through 2018:

**R&D Tax Credit Amounts and Recipients by Tax Type**

(Tax Years 2016 – 2018)

	TY 2016	TY 2017	TY 2018	Three-Year Average
<b>Manufacturing Industries</b>				
Count of Recipients	18	21	26	22
<i>Percent of Total</i>	29.5%	32.3%	38.8%	33.5%
Credit Amount	\$572,753	\$648,125	\$1,506,484	909,121
<i>Percent of Total</i>	28.8%	23.7%	32.1%	28.2%
<b>Non-Manufacturing Industries</b>				
Count of Recipients	43	44	41	43
<i>Percent of Total</i>	70.5%	67.7%	61.2%	66.5%
Credit Amount	\$1,419,221	\$2,081,835	\$3,193,478	2,231,511
<i>Percent of Total</i>	71.2%	76.3%	67.9%	71.8%
<b>Total</b>				
Count of Recipients	61	65	67	64
Credit Amount	\$1,991,974	\$2,729,960	\$4,699,962	\$3,140,632

**Source:** Division of Taxation

**Note:**

This table includes credit amounts for the R&D Property Credit and R&D Expense Credit. Usage of the New R&D Facilities Deduction is not reflected in this table.

### 3. Cost of Administration

ORA surveyed the Division of Taxation to ascertain the cost for the administration of the R&D tax incentives. The table below provides information on the direct cost incurred by the Division of Taxation during tax years 2016 through 2018 to administer these tax incentives.

**R&D Tax Incentives Cost of Administration**

(Tax Years 2016 – 2018)

Cost-Incurring Entity	TY 2016	TY 2017	TY 2018	Total	Average
Division of Taxation	\$4,037	\$4,358	\$4,687	\$13,083	\$4,361

**Source:** Division of Taxation

#### 4. Number of Aggregate Jobs and Direct Taxes Paid by Recipient's Employees

The Division of Taxation provided ORA with data on taxes paid by employees of the R&D tax incentive-recipient firms for tax years 2016 through 2018. The following table describes the breakdown of this information by taxpayer's residency status.

<b><u>R&amp;D Tax Credits</u></b>				
<b><u>Personal Income Taxes Paid by Recipient Firms' Employees</u></b>				
(Tax Years 2016 – 2018)				
	TY 2016	TY 2017	TY 2018	Three Year Average
<b><u>RI Residents</u></b>				
Count of Taxpayers	5,347	6,840	11,234	7,807
Taxes Paid *	\$16,972,988	\$24,286,572	\$28,022,667	\$23,094,076
Avg Taxes Paid	\$3,174	\$3,551	\$2,494	\$3,073
<b><u>Non-Residents</u></b>				
Count of Taxpayers	2,020	2,555	3,114	2,563
Taxes Paid	\$6,198,699	\$8,022,672	\$9,100,338	\$7,773,903
Avg Taxes Paid	\$3,069	\$3,140	\$2,922	\$3,044
<b><u>Total</u></b>				
Count of Taxpayers	7,367	9,395	14,348	<b>10,370</b>
Taxes Paid	\$23,171,687	\$32,309,244	\$37,123,005	<b>\$30,867,979</b>
Avg Taxes Paid	\$3,145	\$3,439	\$2,587	<b>\$3,057</b>

**Source:** Division of Taxation

**Notes:**

This table includes taxes paid by the employees of the recipient firms of the R&D Property Credit and R&D Expense Credit.

\* Taxes paid are estimated by Taxation using Fed AGI minus "Property Tax Credit" minus "RI Earned Income Credit" minus "Lead Paint Credit" if applicable. It should be noted that when Fed AGI is higher than wages derived from the tax incentive, the taxes paid are apportioned using the ratio of those wages to the total reported Fed AGI.

For tax years 2016 through 2018, an average of 7,807 Rhode Island resident employees of R&D tax incentive recipient firms paid an average of \$23.1 million in personal income taxes, or \$3,073 per person. Personal income taxes paid by Rhode Island resident employees represent 74.8% of average total personal income taxes paid by R&D tax incentive recipient employees in 2016 through 2018. The 2,563 non-Rhode Island resident employees of R&D tax incentive recipient firms paid an average of \$7.8 million in personal income taxes over tax year 2016 through 2018, which is an average of \$3,044 in personal income taxes paid per person. This represents 25.2% of average total personal income taxes paid by R&D tax incentive recipient employees in 2016 through 2018.

#### 5. Direct Taxes Paid by Recipients

The Division of Taxation provided ORA with data on taxes paid by the 64 R&D tax incentive-recipient firms in tax years 2016 through 2018. The following table describes the breakdown of this information by firms' location of domicile.

**R&D Tax Credits**  
**Taxes Paid by Recipient Firms by Location of Domicile**

(Tax Years 2016 - 2018)

	TY 2016	TY 2017	TY 2018	Average
<b><u>RI Firms</u></b>				
Percent of Taxpayers	29%	35%	41%	35%
Taxes Paid	\$859,793	\$942,083	\$1,078,046	\$959,974
<b><u>Non-RI Firms</u></b>				
Percent of Taxpayers	71%	65%	59%	65%
Taxes Paid	3,244,081	2,710,083	7,504,128	\$4,486,097
<b><u>Total</u></b>				
Percent of Taxpayers	100%	100%	100%	100%
Taxes Paid	\$4,103,873	\$3,652,166	\$8,582,174	\$5,446,071

**Source:** Division of Taxation

## 6. Measuring the Extent to which Benefits Remained in the State

R.I. Gen. Laws § 44-48.2-5(a)(8) requires that this analysis report on the extent to which benefits associated with the tax incentive remained in the state, if such information is available. In consideration of this requirement, ORA has presented tables on taxes paid by recipient firms by location of domicile and their employees by resident *vs.* non-resident status.

The amount of R&D tax incentives earned by a firm is tied to its research and development spending, including expenditures on buildings, equipment and supplies, as well as computer hardware and software. While the final destination of these purchases must be within Rhode Island, ORA has no data available to confirm the extent to which these research expenses resulted from purchases from Rhode Island vendors or out-of-state vendors. These purchases are modeled as “Production Cost” in the “breakeven” cost-benefit analysis in this report, which allows the REMI Tax-PI economic modeling software to allocate spending consumption by Rhode Island firms between in-state *vs.* out-of-state vendors according to standard assumptions, calibrated based on historical data describing the regional and national economy.

## 7. Additional Data Analysis

Using tax credit data provided by Taxation, ORA identified firms receiving multiple incentive programs in addition to the investment tax credit in tax years 2016 through 2018. The following table describes R&D tax incentives recipients that received additional Rhode Island tax incentives:

**Identifying Additional Tax Credits Received by R&D-Recipient Taxpayers**

(Average, Tax Year 2016-2018)

<b>Tax Incentive</b>	<b>Incentive Amount</b>
R&D Tax Credit – Total, All Firms	\$3,140,632
<i>R&amp;D – Firms Claiming R&amp;D and Additional Credit/s</i>	<i>\$1,118,059</i>
<i>R&amp;D – Firms Claiming R&amp;D only</i>	<i>\$2,022,573</i>
<b>Other Tax Incentive Claimed</b>	<b>Incentive Amount</b>
Historic Tax Credit	\$522,119
Investment Tax Credit	\$505,377
Jobs Training Tax Credit	\$16,094
<b>Total Other Credits</b>	<b>\$1,043,590</b>

**Source:** Division of Taxation

This table indicates that, in addition to the R&D tax credits, some R&D tax credits firms received other Rhode Island business tax credits. These other tax credits include the Historic Structures Tax Credit (R.I. Gen. Laws § 44-33.2-3), Investment Tax Credit (R.I. Gen. Laws Chapter 44-31-1), and the Jobs Training Tax Credit (R.I. Gen. Laws § 42-64.6-4). The number of taxpayers claiming each additional credit cannot be reported due to taxpayer confidentiality constraints. However, based on the data presented in the table above, ORA determined that for every \$1.00 of R&D tax incentives claimed, the same taxpayers claim an additional \$0.33 in other tax credits. On average R&D Tax incentives represent approximately 75.1% of the total value of tax incentives claimed by the taxpayer.

ORA analyzed data provided by Taxation on employment and wages paid to the employees of the R&D tax incentive recipients.

**Employees of R&D Recipient Firms:  
Wages of R&D Recipient Employees**

(Tax Years 2016-2018)

<b>Tax Year</b>	<b>Number of Employees</b>	<b>Sum of Wages</b>	<b>Average Wage</b>	<b>Median Wage</b>
2016	7,367	\$649,070,774	\$106,400	\$71,014
2017	9,395	\$859,592,617	\$111,854	\$70,750
2018	14,348	\$1,059,307,240	\$98,918	\$66,480
<b>Total / Average</b>	<b>31,110</b>	<b>\$2,567,970,631</b>	<b>\$105,724</b>	<b>\$69,415</b>

**Source:** Rhode Island Department of Revenue, Division of Taxation

In tax years 2016 through 2018, employees working for a R&D tax incentive recipient firm earned a total of \$2.57 billion at an average median annual wage of \$69,415. The average median annual



wage earned by employees of R&D tax incentive recipients is 165.1% of the annual median wage of \$42,040 in 2018 for all occupations in Rhode Island.<sup>13</sup>

## Part IV: Evaluation of the Economic Impact of the Tax Incentives

This section of the report addresses two major objectives defined in R.I. Gen. Laws § 44-48.2-5: first, to provide a projection of the potential impact of the R&D tax incentives on state revenues from projected future use and carryforward; and, second, to produce a breakeven cost-benefit analysis that can determine the net impact on state revenues resulting from the R&D tax credits.

### 1. Assessment and Five-Year Projection of Revenue

ORA assumes that the issuance of the R&D tax credits under current law will follow historical issuance patterns. Therefore, ORA assumed a three-year moving average in the total amount of the tax incentives that would be assigned in future calendar years. Usage is divided between the New R&D Facilities Deduction, R&D Property Credit, and R&D Expense Credit according to the three-year historical average from 2016 through 2018. The following table provides the distribution of the anticipated amount of the R&D tax incentives to be issued in each fiscal year.

#### **R&D Tax Incentives: Revenue Projections**

(Millions of Dollars)

	<b>Fiscal Year</b>	<b>New R&amp;D Facilities Deduction</b>	<b>R&amp;D Property Credit</b>	<b>R&amp;D Expense Credit</b>	<b>Total R&amp;D Tax Incentive Usage</b>
	2016	\$0.00	\$0.02	\$1.57	\$1.59
	2017	\$0.00	\$0.03	\$2.70	\$2.73
Actual	2018	\$0.00	\$0.04	\$4.05	\$4.09
	2019	\$0.00	\$0.04	\$4.40	\$4.45
	2020	\$0.00	\$0.04	\$4.53	\$4.58
	2021	\$0.00	\$0.04	\$4.51	\$4.55
	2022	\$0.00	\$0.04	\$4.48	\$4.53
Projected	2023	\$0.00	\$0.04	\$4.51	\$4.55
	2024	\$0.00	\$0.04	\$4.50	\$4.54
	2025	\$0.00	\$0.04	\$4.50	\$4.54

**Source:** ORA calculations based on Taxation testimony at the November 2021 Revenue Estimating Conference

**Notes:** Projections are constructed as a three-year moving average of R&D tax credits usage by tax year. Most recent three years of historical data included in moving average are tax years 2018 through 2020. Projected credit usage by tax year is converted into fiscal year under the assumption that each fiscal year represents the average of the two constituent tax years (*e.g.*, assume FY 2021 is equal to average of TY 2020 and TY 2021).

<sup>13</sup> According to the U.S. Bureau of Labor Statistics' May 2018 State Occupational Employment and Wage Estimates for Rhode Island the median annual wage for all occupations in Rhode Island was \$42,040.

## 2. “Breakeven” Cost-Benefit Analysis

- *Introduction to “Breakeven” Cost-Benefit Analysis Methodology*

Pursuant to R.I. Gen. Laws § 44-48.2-5(6), ORA conducted a “breakeven” cost-benefit analysis to measure the fiscal impacts on the state economy resulting from the R&D program under a variety of assumptions. To provide additional insight, ORA also produced breakeven analyses with respect to Rhode Island employment and Rhode Island gross domestic product (GDP).

To execute these cost-benefit analyses, ORA utilized Regional Economic Models, Incorporated’s (REMI) 70-sector model of the Rhode Island economy via the REMI Tax-PI software platform to produce estimates of the total economic effects of the tax credits issued in tax years 2016 through 2018.<sup>14</sup> The dynamic capabilities of the REMI Tax-PI model allows one to estimate the impacts of exogenous shocks to the state’s economy, including changes to public policy, shifts in consumer behavior and demand, and developments in industry. The REMI Tax-PI operationalizes these insights by augmenting REMI’s base economic and demographic model, PI+, with a module that allows the user to enter a state’s customized budget, to run fiscal and economic forecasts. Specifically, for each budget item, one can choose an “Indicator”, which is the economic or demographic driver of that budget item (e.g., personal income for personal income tax revenue, or age 5-18 population for K-12 education spending), and a “Policy Variable”, which is the economic or demographic change associated with a change to the structure of that budget item (e.g., a change in consumer prices for a change in the sales tax).

The analysis is based on self-reported firm-level data on employment and wages provided by Taxation and publicly available historical data on the regional and national economies. Direct benefits are input into the REMI model as policy variables simulating changes in personal taxes, production cost, and industry sales. ORA assigned the three-year average R&D amount of \$3,146,073 as the cost of the incentive.

The “breakeven” approach developed for this report allows a reader to assume that the R&D leveraged various levels of economic activity required of recipient firms to receive a tax incentive. This assumption means that some varying portion of the economic activity required of recipient firms to receive a tax incentive would not have occurred in the absence of the tax incentive. Under this assumption, firms made some portion of their long-term production decisions based on the availability of an incentive over time, and removal of that tax benefit in a particular year would undo all such decisions.

- *Modeling Costs*

ORA assumes that the tax incentive is funded by an equivalent reduction in state government spending – that is, when the state government forgoes revenue by allowing a tax rate reduction, there are fewer funds available for other spending priorities. ORA modeled these adjustments based on a comprehensive historical analysis of Rhode Island general fund expenditures for fiscal year 2018, which represent the most recent expenditure data at the time of the analysis. ORA

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<sup>14</sup> Detailed documentation on the REMI Tax-PI v2.3.1 model employed in this analysis is available at: <http://www.remi.com/resources/documentation>

compiled all state general fund expenditures and assumed that the level of these expenditures could be adjusted to maintain a balanced general fund budget. The breakdown of general fund expenditures by category is shown in the following table:

**Rhode Island General Fund Expenditures by NAICS**  
(Fiscal Year 2018)

<b>Industry Description</b>	<b>NAICS Code</b>	<b>Percent of Total</b>
Ambulatory Healthcare Services	621	32.1%
Educational Services	61	30.5%
State Wages, Salary, and other Compensation	n/a (entered as “state/local govt. compensation” and “employment”)	25.6%
Social Assistance	624	2.9%
Local Government Spending	n/a (entered as “local government spending”)	2.9%
Professional, Scientific, and Technical Services	54	1.4%
Administrative and Support Services	561	1.5%
Wholesale Trade	42	0.6%
Remaining/Other	19 additional industries, and non-residential capital investment	2.6%
<b>Total:</b>		<b>100.0%</b>

**Source:** ORA analysis of Rhode Island FY 2018 general fund expenditure data.

In addition, ORA decomposed the FY 2018 general fund expenditures data to look at spending by each state government agency, then ORA combined these agencies into different groups based on their functions and duties. The following table describes this breakdown:

**Rhode Island General Fund Expenditures by Agency Groups**  
(Fiscal Year 2018)

<b>Agency Groups *</b>	<b>Percent of Total</b>
Elementary and Secondary Education	38.80%
Health Care Services (Medicaid)	37.78%
Behavioral Health and State Hospitals	5.15%
Children, Youth and Families	4.94%
Health and Human Services (Non-Medicaid)	2.78%
Higher Education	2.72%
General Government	2.31%
Corrections	1.81%
Economic Development	1.52%
Courts	0.69%
Public Safety	0.50%
Elected Officials	0.46%
Environment	0.45%
Other	0.10%
<b>Grand Total</b>	<b>100.00%</b>

**Source:** ORA analysis of Rhode Island general fund expenditure data.

**Note:**

\*Breakdown of these groups can be found in Appendix A.

- *Modeling Benefits*

The lack of statutory purpose in the enabling statute of the R&D tax incentive programs complicates the modeling of benefits. A cost-benefit analysis would yield significantly different results depending on the extent to which the incentive is assumed to have influenced firms' location decisions. Possessing virtually no data on how the credit was used by recipient firms, ORA is unable to make any empirical statement regarding the efficacy of the tax credit in increasing the amount of research activity in Rhode Island, influencing firms' business location decisions, or the extent to which any incentivized research activity had spillover effects for the Rhode Island economy. Instead, ORA had to construct various assumptions to model the fiscal and economic impacts from the R&D tax incentives.

The cost-benefit methodology employed by this report assumes that the availability of the R&D incentives impacted some portion of recipient firms' decisions to locate not only their research activity but some portion of their general business operations in Rhode Island.<sup>15</sup> In this way, the methodology assumes that the R&D tax incentives provided a marginal production cost savings that tipped the balance in favor of locating a business in Rhode Island *vs.* some competitive out-of-state location.

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<sup>15</sup> ORA tested the assumption that the R&D tax incentives influenced a firms' decisions to locate research activity in Rhode Island while having no impact on the location of the remainder of their business operations. Under this assumption, the R&D tax incentives failed to breakeven with respect to state general revenues. Therefore, it is only plausible for the R&D tax incentives to have a net positive impact on state general revenues if one were to assume that the R&D activity had significant spillover effects on the local economy or if it positively influenced firms in their decision to locate business operations, beyond research activity, in Rhode Island.

For purposes of modeling the economic impact of the R&D tax incentives, ORA examined the three components of the R&D tax incentives: The New R&D Facilities Deduction, the R&D Property credit, and the R&D Expense credit. ORA modeled the \$5,441 three-year average of New R&D Facilities Deduction as a decrease in personal income taxes. The usage of the R&D Property credit might have generated an investment activity as a result of the acquisition, construction or reconstruction of the eligible property. However, in the absence of data on the cost of such investments, ORA combined the R&D Property credit with the R&D Expense credit, yielding a three-year average of credit usage equal to \$3,140,632. ORA determined this to be appropriate considering that the R&D Expense Credit represented 98.6% of R&D tax credit usage from the period of calendar year 2016 through 2018.

ORA modeled the benefits of the R&D Property credit and the R&D Expense credit as a reduction in production costs equal to credit usage and an increase in industry sales. ORA estimated the ratio of R&D tax incentives to research expenses and firm sales based on the following assumptions:

For calendar years 2016 through 2018, Taxation indicated an average of \$3,140,632 in R&D tax credit usage by 64 recipients per year. This implies an average annual tax credit amount of \$49,072 per recipient. Applying the two-tiered R&D Expense Credit rate of 22.5% for the first \$25,000 of credit and 16.9% on any excess reveals that the average credit supported \$253,551 in credit eligible research expenses at an effective credit rate of 19.4% (*i.e.*,  $\$25,000 \div 22.5\% + \$24,072 \div 16.9\% = \$253,551$ ;  $\$49,072 / \$253,551 = 19.4\%$ ).

In order to estimate the ratio of credit-eligible research expenses to total qualified research expenses, ORA assumed that all R&D credit-recipient firms had stable research spending (*i.e.*, 0% average annual growth) and calculated their Federal Research Credit according to the Alternative Simplified Credit (ASC) calculation methodology. Under the ASC methodology, firms can claim credit for the amount of research expenses exceeding 50% of their average annual research expense of the past three years. Under these assumptions, a taxpayer could claim credit for 50% of their current year qualified research spending. ORA therefore assumed an average R&D tax incentive recipient conducted \$507,102 in total qualified research expenses (*i.e.*,  $\$253,551 \times 2$ ).

National Science Foundation data indicates that an average United States firm devotes 4.1% of sales to research activities.<sup>16</sup> Therefore, ORA assumes that an average R&D tax credit recipient has average annual sales of \$12,368,351 (*i.e.*,  $\$507,102 \div 4.1\%$ ).

In summary, a typical recipient of R&D tax incentives received \$49,072 in tax credits, in relation to \$507,102 of total research activity, and \$12,368,351 of industry sales. Simplifying these calculations results in the assumption that \$1.00 of R&D tax incentives is associated with \$5.17 in total research expenses and \$252.04 in industry sales (*i.e.*,  $\$49,072 / \$253,551$ ;  $\$12,368,351 / \$49,072$ ). In an average year, representative of the three-year period of calendar years 2016 through 2018, taxpayers claimed a total of \$3,140,632 in R&D tax credits which ORA assumed to

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<sup>16</sup> National Science Foundation, National Center for Science and Engineering Statistics, and U.S. Census Bureau, Business R&D and Innovation Survey, 2018. Available: <https://nces.nsf.gov/pubs/nsf21312#data-tables>

be generated in relation to \$32,454,554 (i.e., \$253,551 \* 64) of total qualifying research expenses and \$791,574,478 (i.e., \$12,368,351 \* 64) in industry sales.

Prior to entering policy impacts into the REMI model, ORA discounted the impact of the R&D tax credits on industry sales by 50% to account for the fact that a portion of a firm's gross sales originated from customers inside the state of Rhode Island and/or may have cannibalized sales that would otherwise have been made by other Rhode Island firms. This is consistent with RI Gen. Laws § 44-31-1(b)(3)(v)(B)(I). Multiplying the \$791,574,478 in industry sales referenced above by 50% yields \$395,787,239 in industry sales assumed to be attributable to R&D credits after accounting for the portion of sales originated from customers within the state or supplanted from Rhode Island competitors.

In summary, for purposes of modeling the economic impact of the R&D tax incentives, ORA employed the following inputs: The New R&D Facilities Deduction component was modeled as a \$5,441 decrease in personal income taxes. The benefits of the R&D Property credit and the R&D Expense credit components were modeled as a \$3,140,632 reduction in production costs and a \$395,787,239 increase in industry sales. Industry sales and production cost impacts were distributed across industries in proportion with the industries of the actual R&D Expense Credit recipients in tax year 2016 through 2018.

- *The “Breakeven” Approach*

A fundamental challenge in evaluating economic development incentives is determining the extent to which an incentive actually stimulated or attracted new economic activity rather than subsidized economic activity that would have been largely present even in the absence of the incentive. On one hand, the availability of a tax incentive might have a decisive influence on a firm's production decision. In this case it might be appropriate for an evaluator to attribute all of the firm's economic activity to the incentive. On the other hand, an incentive program may simply reward or subsidize behavior that likely would have occurred anyway. In this case the tax incentive might have an impact on a firm's marginal productivity, but it would be inappropriate to attribute the full economic activity of the firm solely to the availability of the tax incentive. Real world conditions often make it difficult or impossible for an evaluator to assess where on this continuum the impact of any given tax incentive falls.

In the case of R&D tax incentive programs, the determination of the extent to which research activity would have taken place in the absence of the incentives is further complicated by a lack of statutory clarity. For example, a common feature of an economic development tax incentive is a “but for” provision, whereby recipients attest that they would not have engaged in the underlying activity if the incentive were not available, possibly with some amount of due diligence taking place to confirm this attestation during the application process. While it should be made clear that a “but for” provision does not represent sufficient evidence by itself that the incentive-related activity is net new to the state, its presence at least signals the intent of lawmakers that the incentive ought to be awarded to projects that might not otherwise have been undertaken. However, the only provision of the R&D tax incentives that encourages its use against incremental research activities is the federal RRC or ASC methodology to determine the portion of qualified research expenses eligible to be counted in the credit calculation. These calculation methodologies do not consider

whether the taxpayer business had considered competitive out-of-state alternative locations. Considering the availability of R&D incentives across states, it is possible that some portion of R&D spending would not have located in Rhode Island but for the availability of the Rhode Island incentive. However, it would overstate the economic benefits of the Rhode Island R&D tax incentive programs to assume that all research activity would not have occurred but for the availability of the incentives. Furthermore, to assume that R&D tax incentives influenced firms' location decisions would require the assumption that the incentive was sufficient to overcome the significant cost of relocating capital-intensive research activities and relocating or rehiring specialized research personnel across state lines.

In this context, ORA conducted a breakeven analysis. This analysis allows for the evaluation of an incentive program's performance under a wide range of assumptions regarding the level of economic activity that would have taken place if the program had not been available. Furthermore, the breakeven analysis specifies the proportion of economic activity associated with the incentive program recipient that one must assume to have been attributable to the incentive program in order for the total benefits to equal its total costs, where benefits and costs are measured as the impact on state general revenues (*i.e.*, the condition that must be satisfied for the incentive program to "pay for itself").

The breakeven percentage should be interpreted as follows: if the reader believes the assumption to be plausible, that at least the amount of economic activity implied by the breakeven percentage can be attributed to the availability of the tax incentive, then one can infer that the incentive has a net positive impact on state general revenues. In the opposite case, if the reader believes that the amount of economic activity attributable to the tax incentive was less than the level implied by the breakeven percentage, then one can infer that the incentive had a net negative impact on state general revenues. Holding other factors equal, a lower breakeven percentage is more desirable than a higher breakeven percentage if the goal of an incentive program is to cost the state as little revenue as possible.

A tax incentive program fails to breakeven, under any counterfactual assumption, when the breakeven percentage is greater than 100%. This implies that even if 100% of the economic activity associated with the incentive recipient was assumed to have taken place strictly because of the incentive's availability, a net negative impact on state general revenues would have resulted. Because breakeven percentages above 100% do not have a meaningful interpretation, under this outcome ORA simply publishes that the incentive program fails to breakeven.

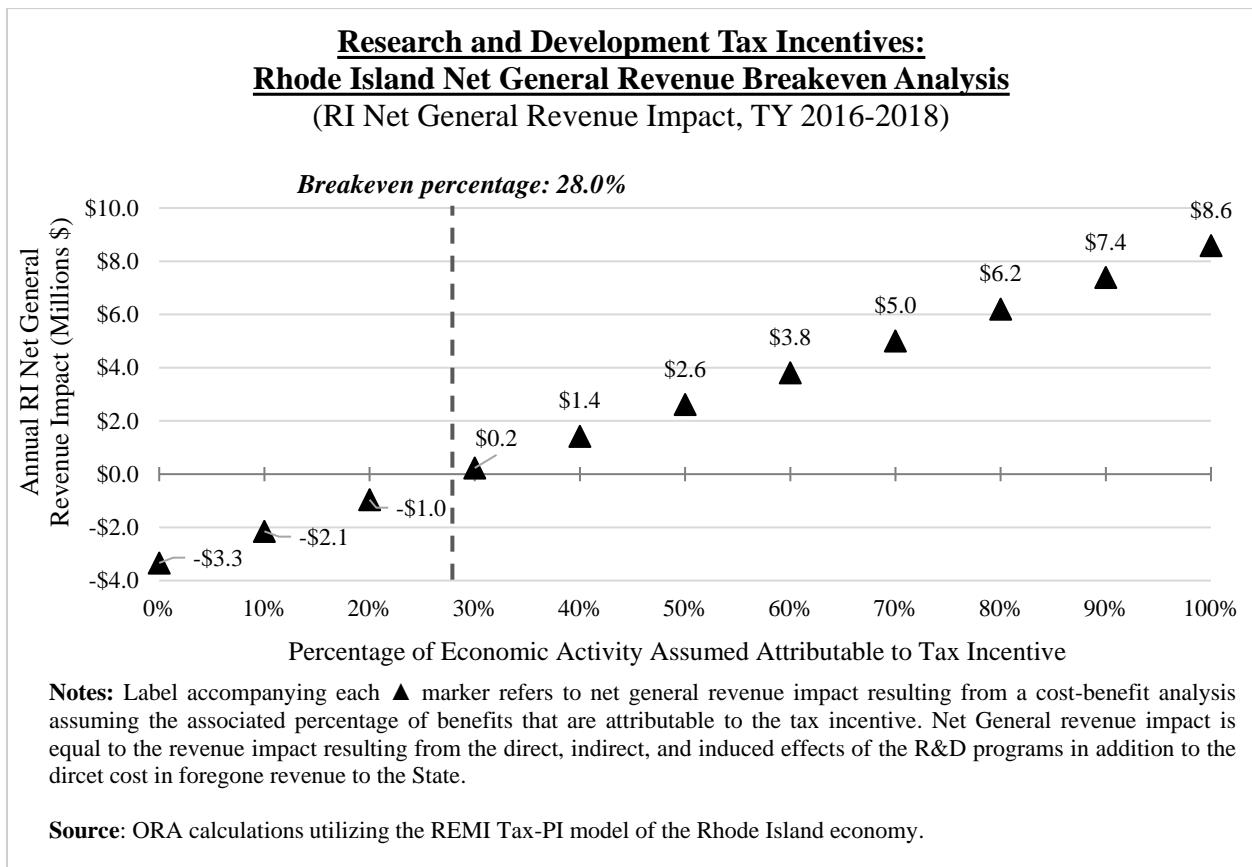
As a summary of the calculations of the cost and benefits sections above, the "breakeven" cost-benefit analysis models 100% of R&D tax incentive costs as a \$3,146,073 reduction in state government spending, where this amount is equal to the average R&D tax incentives usage for tax years 2016 through 2018. This cost is distributed across industries in proportion with historical discretionary state general fund expenditures for calendar year 2018 as compiled by ORA. Benefits are modeled at 100% as an increase in industry sales of \$395,787,239 as well as a reduction in industry production costs in the amount of \$3,140,632 and a reduction in personal taxes of \$5,441. Industry sales and production cost impacts were distributed across industries in proportion with the industries of the actual R&D Expense Credit recipients in tax year 2016 through 2018. The

amount of benefits were scaled according to the assumed percentages listed in the state general revenues, state gross domestic product, and employment breakeven results charts below, but the costs are always held fixed at 100%.

It should be noted that the estimated results below cannot solely be attributed to the availability of the R&D tax incentives. As indicated in the “Additional Data Analysis” section, the value of the R&D tax incentives represents 75.1% of the total state tax incentives received by firms that utilize the R&D tax incentives in tax years 2016 through 2018. Therefore, the impact of the additional state tax incentives utilized by R&D tax incentive recipient firms is also contained in these results.

- *The Breakeven Analysis for State General Revenues*

The following chart provides results of the breakeven analysis with respect to Rhode Island general revenues.



The chart above shows the estimated new general revenue that results for different scenarios regarding how much economic activity was caused by the R&D tax incentives. These results indicate that, under a best-case scenario, ORA estimated a net revenue gain of \$8.6 million. Under the worst-case scenario, the estimated net revenue impact is a loss of \$3.3 million. These revenue estimates reflect an assumption that Rhode Island forgoes revenues and state government spending to provide the tax incentives to eligible companies.

The break-even point, where revenue losses from foregone state government spending are offset by revenue gains due to the tax incentives, is when approximately 28.0% of economic activity



generated by firms receiving the R&D tax incentives is caused by the availability of the tax incentives. In other words, the revenue breakeven percentage of 28.0% implies that the R&D tax incentives have a net positive impact on Rhode Island net general revenues if at least 28.0% of the economic activity associated with the R&D tax incentive-recipient firms would not have occurred but for the availability of the tax incentive. In addition, a breakeven percent of 28.0% implies that one must assume that at least \$110.9 million of industry sales would not have taken place but for the availability of the tax credit. Only if a reader considers it to be plausible that at least this level of economic activity can be attributed to the credit is it appropriate to consider that the R&D tax incentives “pays for itself” in terms of state general revenues.

The following table provides more detailed information regarding the state general revenue impact resulting from the economic activity associated with R&D tax incentive recipient firms strictly due to the availability of the R&D tax incentives. In other words, the table shows the detailed general revenue impact under the “best case” assumption that 100% of the economic activity associated with the R&D tax incentives was “caused” by the tax incentives:

**Research & Development Tax Incentives: Detailed Revenue Impacts**  
(Annual RI General Revenue Impact, Calendar Years 2016-2018)

Item Description	Amount
<b><i>General Revenue Generated by Credit by Component</i></b>	
Personal Income Tax	\$4,459,766
General Business Taxes	\$1,837,711
Sales and Use Taxes	\$4,142,405
Other Taxes	\$200,438
Total Departmental Receipts	\$537,150
Other Sources	\$557,889
<b>Total General Revenue Generated by Credit</b>	<b>\$11,735,361</b>
<b>Revenue Forgone Due to Credit</b>	<b>\$(3,146,073)</b>
<b>Net Change in General Revenue, After Paying for Incentive</b>	<b>\$8,589,287</b>
<b>New Revenues Generated for Every Dollar of Credit</b>	<b>\$3.73</b>

**Note:** Revenue impacts under the “best case” scenario that assumes 100% of economic activity associated with R&D tax incentives is attributable to the availability of the R&D tax incentives.

**Source:** ORA calculations based on historical Rhode Island revenue amounts and REMI Tax-PI simulation.

The table above provides the REMI Tax-PI model of the Rhode Island economy simulation results after removing the \$3.1 million cost of the R&D tax incentives from state government spending to account for the forgone revenue that the state incurs due to the issuance of the R&D tax incentives, and simultaneously adding industry sales amounts and reducing production costs and personal income tax (the metrics used to account for economic activity) resulting due to the availability of the R&D tax incentives.

These results indicate that, if 100% of the economic activity associated with the R&D tax incentives was “caused” by the tax credit, then the R&D tax incentives generated a total \$11.7 million of state general revenues. The generated total general revenue of \$11.7 million does not account for the \$3.1 million cost of the tax incentive itself. To take into consideration the cost of the tax incentive, ORA subtracted the \$3.1 million average cost of the R&D tax incentives in tax years 2016-2018 from the \$11.7 million generated revenue. This is equal to an average annual *net*

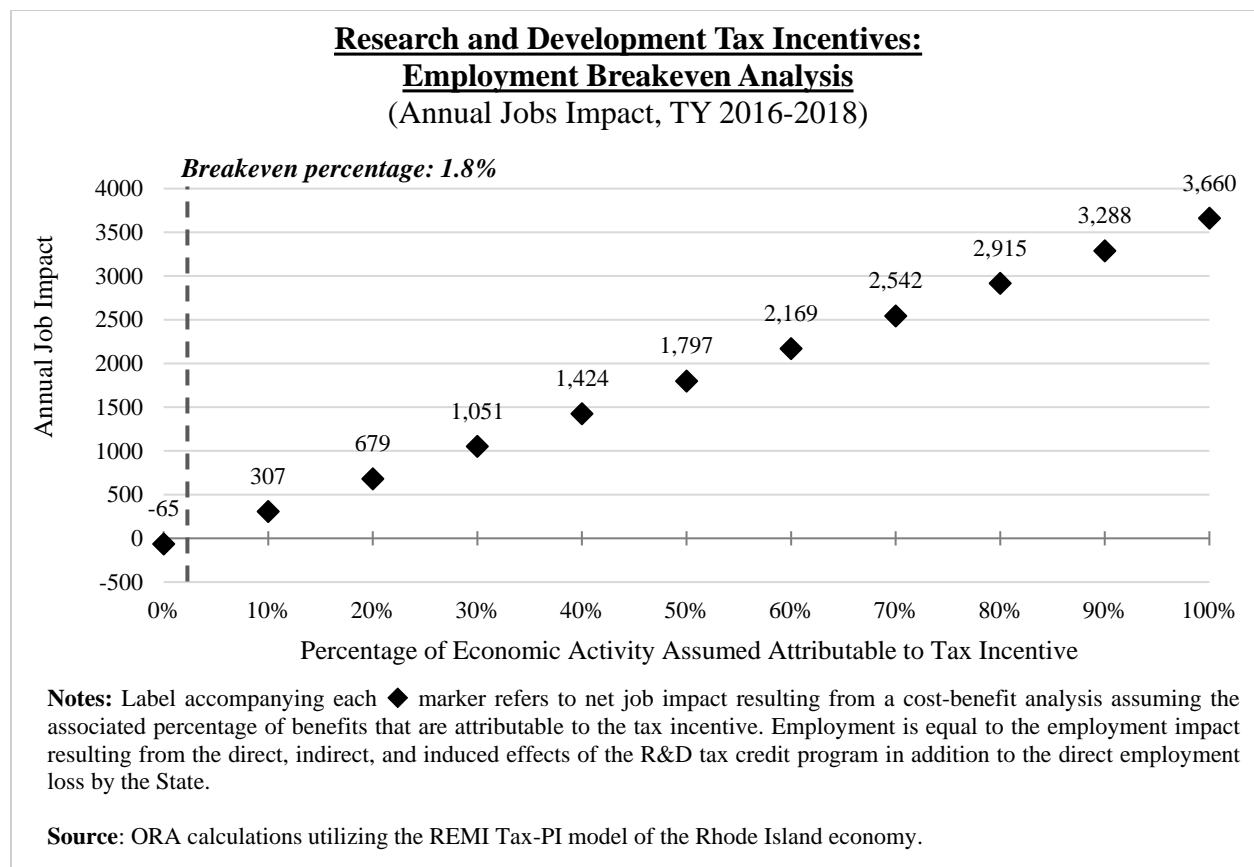
gain of \$8.6 million in *net* general revenue. Expressed another way, for every one dollar of R&D tax incentives claimed by recipient firms the state generates \$3.73 of new revenue under this scenario.

This payback ratio shows that new revenues generated from the R&D tax incentives related to research activity exceed the total costs of the R&D tax incentives and add a new net positive revenue amount to the state under the assumption that all the research activity associated with the R&D tax incentives recipient firms would not exist in Rhode Island if not for the availability of the tax incentive. Additional detailed revenue results from different percentage of assumed benefits attributable to the R&D tax incentives are provided in Appendix B

- *The Breakeven Analysis for Rhode Island Total Employment*

The breakeven framework can also be extended to employment. In this context, the breakeven percentage can be interpreted as the percentage of economic activity associated with R&D-recipient firms assumed to be attributable to the availability of the tax incentive necessary for the increase in employment resulting from new economic activity to outweigh the employment losses resulting in the reduction in government spending necessary to fund the incentive.

The following chart shows the results of a breakeven analysis with respect to employment.



ORA tested a variety of assumptions regarding the level of economic activity taking place in Rhode Island due to the R&D tax incentives. The chart above shows the estimated new employment results for different scenarios on how much economic activity was caused by the R&D tax

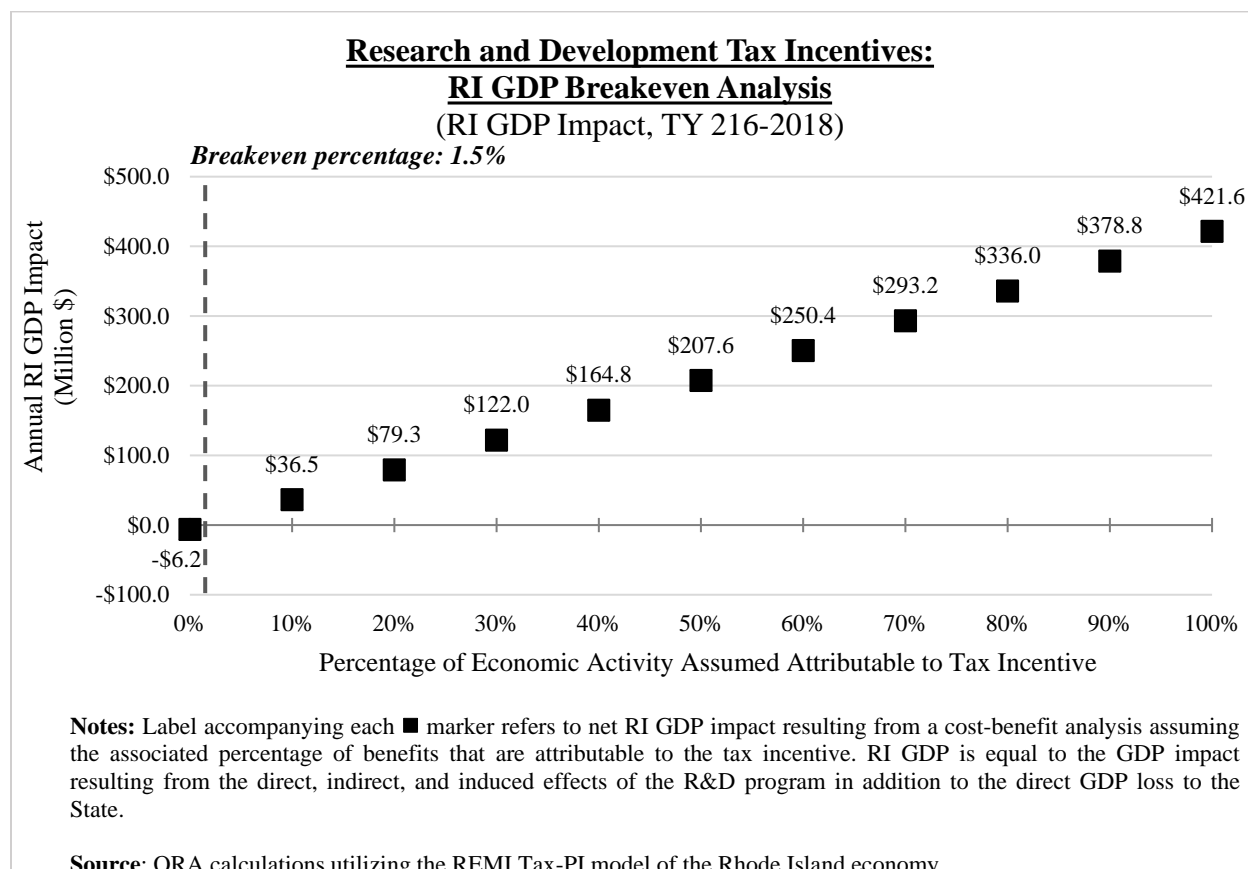
incentives. These results indicate that, under a best-case scenario, ORA estimated a net gain of 3,660 economy-wide jobs. Under the worst-case scenario, the estimated net loss is 65 jobs across the state economy. These job estimates reflect an assumption that Rhode Island forgoes state government spending and employment to provide the tax credit to eligible companies.

The employment breakeven point, where job losses from foregone state government spending are offset by job gains due to the tax incentive, is when about 1.8% of economic activity generated by R&D recipient firms is caused by the tax incentive. In other words, the employment breakeven percentage of approximately 1.8% implies that the R&D tax incentives have a net positive impact on Rhode Island total employment if at least 1.8% of the economic activity associated with the R&D tax incentive recipient firms would not have occurred but for the availability of the tax incentives.

- *The Breakeven Analysis for Rhode Island Gross Domestic Product*

The breakeven framework can also be extended to Rhode Island Gross Domestic Product (GDP). In this context, the breakeven percentage can be interpreted as the percentage of economic activity associated with R&D-recipient firms assumed to be attributable to the availability of the R&D tax incentives necessary for the increase in GDP resulting from new economic activity to outweigh the GDP losses resulting in the reduction in government spending necessary to fund the incentives.

The following chart shows the results of a breakeven analysis with respect to RI GDP.



The chart above shows the estimated Rhode Island GDP results for different scenarios regarding how much economic activity was caused by the R&D tax incentives. These results indicate that, under a best-case scenario, ORA estimated a net gain of \$421.6 million of GDP in the state. Under the worst-case scenario, the estimated net loss is \$6.2 million of GDP across the state economy. These GDP estimates reflect an assumption that Rhode Island forgoes state government spending to provide the tax incentives to eligible companies.

The break-even point, where GDP losses from forgone state government spending are offset by GDP gains due to the economic activity generated by the research activity associated with the R&D tax incentives, is when approximately 1.5% of economic activity generated by firms receiving R&D tax incentive benefits is caused by the tax incentives. In other words, The Rhode Island GDP breakeven percentage of approximately 1.5% implies that the R&D tax incentives have a net positive impact on Rhode Island GDP as long as at least 1.5% of the economic activity associated with the R&D tax incentive recipient companies would not have occurred but for the availability of the tax incentive.

## Part V: Discussion and Recommendations

### 1. Statement by the CEO of the Commerce Corporation

The Secretary of Commerce, who serves as Chief Executive Officer of the Rhode Island Commerce Corporation pursuant to R.I. Gen. Laws § 42-64-1.1(b), provided the following statement pursuant to R.I. Gen. Laws § 44-48.2-5(a)(6)(iii):

**Statement from the CEO of the Commerce Corporation:**

The Commerce Corporation believes that strong research and development activity is critical for a healthy economy and that such activity should return significant benefits to the state and taxpayers. As demonstrated by ORA's report, the current R&D Tax Credits result in a net positive revenue to the state (assuming certain conditions). Between 2016 and 2018 Rhode Island businesses spent more R&D than between 2013 and 2015, but still at a lower rate than the national average. The Commerce Corporation believes that this disparity represents a clear opportunity to grow Rhode Island's economy. Over the last several years the administration has taken steps to increase the commercialization of R&D in Rhode Island -- including the creation of the Innovation Voucher program and the development of the Innovation Campus competition in partnership with URI. Additionally, states like Massachusetts and California have significantly stronger R&D incentives, besting Rhode Island in areas like length of the carry-forward period and the level to which they reduce tax liability. Outside the United States, models like Australia provide examples of strong R&D tax credits that include refundable components for small and medium sized businesses which Rhode Island might emulate in order to truly stand out. The Commerce Corporation encourages the strengthening of our R&D Tax Credits as they are important to the competitiveness of our innovation economy. Such reforms such be aimed at encouraging greater investment in R&D activities in our state and, in doing so, contributing to Rhode Island's economic growth.

### 2. ORA Recommendations

**Finding #1:** The statutory goals of the New Research and Development Facilities Deduction, Research and Development Property Credit, and Research and Development Expense Credit are not defined in R.I. Gen. Laws § 44-32-1, § 44-32-2, or § 44-32-3. Therefore, it is not possible to measure performance against statutory objectives.

**Related Recommendations:**

- Policymakers should determine goals and objectives of the R&D tax incentive programs in order to provide guidance to evaluators.

*Discussion Supporting Finding #1:*

R.I. Gen. Laws § 44-48.2-5(a)(10) requires the Office of Revenue Analysis to offer recommendations "as to whether the effectiveness of the tax incentive could be determined more

definitively if the general assembly were to clarify or modify the tax incentive’s goals and intended purpose.” Discussion related to the goals and purposes of the R&D credits are as follows:

The success of a tax incentive program is usually related to the extent to which its goals and objectives were achieved. In this context, the lack of statutory goals makes it very difficult to evaluate the R&D tax incentive programs given that desired outcomes are not defined under the program’s governing statute. A major ambiguity is the extent to which the R&D tax incentive programs are intended to provide a marginal cost savings to local firms undertaking research activity vs. attracting research activity from competitive out-of-state locations. While this difference is subtle, making this determination will help to inform cost-effective incentive design and evaluation.

The impact of the R&D tax incentive programs is affected by whether the incentives represent only a marginal cost savings to the firm or if the incentives attracted research activity from other states or facilitated projects that would not have otherwise been possible. However, there is little or no data to track the extent to which R&D tax incentives actually attracted research activity from other states. Considering that this distinction has a potentially determinative impact on the cost-effectiveness of the program, ORA recommends that lawmakers construct a statutory purpose that emphasizes the goals such as targeting research with locally impactful spillover effects, building industry clusters, and attracting research projects from competitive out-of-state locations.

Taxpayer confidentiality, restrictions related to federal taxpayer information, and insufficient data collection mechanisms pose major obstacles to evaluators of these R&D tax incentives. Policymakers should determine what enhanced data collection, reporting, disclosure rules might be put in place to facilitate measurement of tax incentive program performance relative to statutory goals.

**Finding #2:** While adequate from a standpoint of confirming taxpayer compliance with eligibility requirements, current reporting requirements are inadequate for economic analysis. The fact that Rhode Island R&D tax incentives conform with the definitions and formulas utilized to calculate the Federal Research Credit is a double-edged sword – creating administrative efficiencies and data access challenges.

**Related Recommendations:**

- Consider legislative changes to enhance data reporting and revise disclosure rules for R&D incentive recipients similar to those required by recipients of credits covered by the Division of Taxation’s annual *Tax Credit & Incentive Report*.
- Maintain conformance with Federal Research Credit definitions and calculation procedures while expanding the data collected on Rhode Island tax forms.
- To produce more rigorous analysis than what is contained in this report would require modifications to Rhode Island tax forms and/or establishing new data collection mechanisms.

*Discussion Supporting Finding #2:*

R.I. Gen. Laws § 44-48.2-5(a)(9) requires the Office of Revenue Analysis to offer recommendations “[i]n the case of economic development tax incentives where measuring the economic impact is significantly limited due to data constraints, whether any changes in statute would facilitate data collection in a way that would allow for better analysis.” Discussion related to this topic is as follows:

Tying the state research credit to federal definitions and forms minimizes administrative burden for taxpayers and administrators. Taxpayers do not need to maintain duplicative records, other than monitoring which qualifying research expenditures occur in Rhode Island. Rhode Island tax administrators benefit from compliance instigated by enforcement of the Federal Research Credit. Because Rhode Island R&D tax incentives are calculated based on amounts claimed on the taxpayer’s federal return, a taxpayer attempting to fraudulently claim a state credit would have to duplicate their fraud at the federal level – magnifying the incentive for taxpayers to comply with the law by reporting research expenditures faithfully.

However, this connection to the Federal Research Credit also creates data access and evaluation issues. While Rhode Island lawmakers and administrators have some independence in setting rules for granting evaluators access to Rhode Island taxpayer information in appropriately anonymized or aggregated form, Rhode Island lawmakers and administrators have minimal independence in granting access to federal taxpayer information.

Rhode Island forms currently lack the specificity necessary for economic analysis. For example, lines 1 through 8 of IRS Form 6765 require the taxpayer to provide some detail on the types of qualified research expenditures undertaken by the taxpayer (*e.g.*, basic research payments to qualified organizations, wages, supplies, rental or lease costs of computers, *etc.*). However, Rhode Island Form 7695E asks taxpayers simply for the portion of the aggregate amount that takes place in Rhode Island, with no breakdown of expenses by type.<sup>17</sup> A marginal improvement to Rhode Island’s form would be to adopt some of the elements of Minnesota’s Form 2021 RD, utilized for the administration of the Minnesota Credit for Increasing Research Activities.<sup>18</sup> This form requires taxpayers to list Minnesota qualified research expenditures according to the same categories as on the federal form. By including these data on a *state* tax form rather than the federal form only, state tax officials may have greater knowledge of the composition of state research expenditures and greater flexibility in sharing aggregated taxpayer information with evaluators and the public.

Examples of more stringent improvements to data collection from R&D tax incentive recipients would be to create entirely new data collection mechanism. For example, the State of Washington requires recipients of nearly all of its state tax incentives to file an Annual Tax Performance Report.<sup>19</sup> Incentive recipients must comply with the reporting requirement as a condition of receiving a state tax credit. The report includes information regarding the impact of tax incentive

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<sup>17</sup> See Appendix C.

<sup>18</sup> Minnesota Form 2021 RD available at: [https://www.revenue.state.mn.us/sites/default/files/2021-10/rd\\_21.pdf](https://www.revenue.state.mn.us/sites/default/files/2021-10/rd_21.pdf)

<sup>19</sup> Washington State Annual Tax Performance Report, RCW 82.32.534. See: <https://app.leg.wa.gov/rcw/default.aspx?cite=82.32.534>

awards on business activities such as employment and investment. While Washington statutorily compels compliance with reporting requirements, other states such as Minnesota collect evaluation data through voluntary surveys and interviews with tax incentive recipient taxpayers.<sup>20</sup> ORA currently lacks the practical capacity to administer a rigorous evaluation survey.<sup>21</sup> Further investigation is necessary as to whether ORA and/or the Division of Taxation possesses the legal authority to contact taxpayers directly for purposes of compelling a response to a mandatory survey or requesting response to a voluntary evaluation survey.<sup>22</sup>

Public reporting of R&D tax incentive usage, including revealing the identity and amount of tax incentive usage by recipient, would increase transparency and facilitate improvements to program evaluation. For example, the Division of Taxation's annual *Tax Credit & Incentive Report* provides a framework for this type of reporting – but is limited by statute to only certain incentives, of which the R&D tax incentives are not included.<sup>23</sup> Recipients of tax incentives covered by the *Tax Credit & Incentive Report* are required to file an annual report with the Division of Taxation listing the amount of tax incentive utilized and also containing certain data necessary for confirming compliance with tax incentive eligibility requirements. These taxpayers claim tax benefits with the understanding that their identifying information and amount of credit usage will be disclosed publicly. To minimize the administrative burden, such reporting could only be required for taxpayers claiming more than some minimum threshold (*e.g.*, basic disclosure might only apply to taxpayers claiming more than \$5,000 of R&D tax incentives; requirement to file more detailed annual report might apply to taxpayers claiming more than \$10,000).

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<sup>20</sup> The 2017 evaluation of the Minnesota Research Credit conducted by the Program Evaluation Division of the State of Minnesota Office of the Legislative Auditor is available at: [http://www.ncsl.org/Portals/1/Documents/fiscal/evaluation\\_database/MN\\_Research\\_Tax\\_Credit\\_2017\\_Evaluation\\_Report.pdf](http://www.ncsl.org/Portals/1/Documents/fiscal/evaluation_database/MN_Research_Tax_Credit_2017_Evaluation_Report.pdf)

<sup>21</sup> It is difficult for a small state such as Rhode Island to replicate scale and capacity of program evaluation staffs in other states. For example, ORA devotes two staff, who split their time among other responsibilities, to tax incentive evaluation. The Minnesota 2017 Evaluation of the Research Tax Credit lists 19 staff members in the Program Evaluation Division in the Office of the Legislative Auditor.

<sup>22</sup> The fact that ORA is not part of the Division of Taxation, the entity within Rhode Island government that is responsible for administering the tax system, creates legal and practical challenges in terms of accessing taxpayer data necessary for evaluation. However, it should be noted that many states, including the Minnesota Office of the Legislative Auditor and the Washington State Joint Legislative Audit & Review Committee, conduct incentive evaluation in the legislative branch, which is not only outside of the tax administration agency, but outside of the executive branch entirely. Evidence of such collaboration in other states indicates that impediments to data-sharing for purposes of tax incentive evaluation can be overcome. ORA welcomes incremental legislative and administrative changes that would facilitate enhanced data sharing and cooperation over the long term while maintaining taxpayer confidentiality.

<sup>23</sup> Credits covered by the *Tax Credit & Incentive Report* include Rhode Island Commerce Corporation Project Status (R.I. Gen. Laws § 42-64-10), Incentives for Innovation and Growth (R.I. Gen. Laws Chapter 44-63), Jobs Development Act (R.I. Gen. Laws Chapter 42-64.5), Distressed Areas Economic Revitalization Act – Enterprise Zones (R.I. Gen. Laws Chapter 42-64.3), Motion Picture Production Tax Credit (R.I. Gen. Laws Chapter 44-31.2), and Historic Preservation Tax Credits 2013 (R.I. Gen. Laws Chapter 44-33.6).

Further information regarding reporting requirements applicable to these tax credit recipients is contained in Rhode Island Division of Taxation Notice 2016-03 available at:

<http://www.tax.ri.gov/Tax%20Website/TAX/notice/Notice%202016-03%20--%20Tax%20credits%20and%20incentives.pdf>



**Finding #3:** A best practice of tax incentive design is the inclusion of a sunset provision. Neither the New R&D Facilities Deduction, R&D Property Credit, nor the R&D Expense Credit contain sunset provisions.

**Related Recommendations:**

- Add sunset provisions to the R&D tax incentive programs.

*Discussion Supporting Finding #4:*

An important feature of a sunset is that it provides legislators with a regular opportunity to reconsider the continued relevance of the tax credit program and revise program features as needed. For example, the 2015 Rhode Island corporate tax reform had a major impact on the local business tax landscape, which presumably had an impact on the effectiveness and necessity of tax incentive programs such as the R&D tax incentive programs, but no legislative changes were made to the R&D tax incentives in response to this change. A sunset provision would help to ensure that such reconsiderations and revisions occurred at regular intervals.

**Finding #4:** Under the assumption that incentives are 100% responsible for taxpayer behavior, one dollar of investment in R&D tax incentives returned \$3.73 in state revenues.

The following observations regarding incentive recipients may guide policymakers in evaluating current program performance and designing modifications to further improve its cost-effectiveness:

- R&D tax credit recipients paid relatively little in state taxes.
- The non-refundability and credit cap provisions of the R&D credits may impact many credit users.

**Related Recommendations:**

- Implement new data collection procedures and create authority to collect data on what, if any, research activity was attributable to R&D tax incentives.
- Explore the extent to which the current structure of the R&D tax credits limits the effectiveness of the R&D tax credit programs.
- Consider whether alternatives or modifications to the current policy would enhance the marginal impact of the R&D tax incentives and improve cost-effectiveness.
- Prior to implementing any enhancements to the R&D Property and Expense Credit programs ascertain what best practices can be put in place to ensure the cost-effectiveness of the program.

*Discussion Supporting Finding #5:*

This analysis found, if R&D tax incentives are 100% responsible for firms' location decisions, that every dollar invested in R&D tax incentives returned \$3.73 in state general revenue. However, the value of the R&D tax incentives represents 75.1% of the total state tax incentives received by firms that utilize the R&D tax incentives. Therefore, the impact of the additional state tax incentives

utilized by R&D tax incentive recipient firms is also contained in these results, and the R&D tax incentives cannot be considered 100% responsible for firms' location decision.

While the credit caps and non-refundability provisions of the R&D Property and Expense Credits limit the population of taxpayers that could potentially benefit from the tax credits, ORA cautions against making the terms of the credit more generous without putting policies in place that enhance the cost-effectiveness of the programs. Further investigation is necessary to determine what if any research activity was actually "caused" by the availability of the credit; ORA possesses neither the capacity nor legal authority to implement the data collection mechanisms such as surveys and detailed state tax forms that would be necessary to gather these data.

ORA assumes that a justification for the R&D Property and Expense Credits is that a high state tax burden is an impediment to firms interested in conducting research activity in the state; however, recipients of the R&D Property and Expense Credits do not pay significant state taxes relative to the amount of credit received.<sup>24</sup> In tax year 2016 through 2018, an average of 64 users of the R&D Property and Expense Credits received an average of \$3.14 million in R&D Property and Expense Credits, \$1.04 million in additional business tax incentives, and paid an average of \$5.45 million in state business corporation tax and insurance companies gross premiums tax. The average Rhode Island taxable income for the 64 R&D Property and Expense Credit recipients was \$1.71 million and average taxes paid by each R&D Property and Expense Credit recipient was about \$85,095. The tax years 2016 through 2018 effective tax rate paid by these firms, calculated as tax liability as a percent of apportioned Rhode Island taxable income, was approximately 5.0% (for comparison, the statutory business corporation tax rate 7% in tax year 2016-2018). Considering the modest tax burden of most R&D Property and Expense Credit recipients, it is likely that some recipients trigger the credit caps and non-refundability provisions of the credit programs.

The tax liability cap and non-refundability provisions of R&D Property and Expense Credits may have limited the amount of credit claimed by taxpayers. The R&D Property Credit is non-refundable and cannot reduce a taxpayer's liability below the statutory minimum tax. The R&D Expense Credit is non-refundable and cannot reduce a taxpayer's liability below the greater of 50% of the pre-credit tax liability or the statutory minimum tax.

It is also important to note that the R&D Expense Credit provides no marginal incentive to increase research activities for entities impacted by the non-refundability or tax liability cap provisions. An increase in current year research expenditures will result in no additional current year tax benefits – aside from the possibility of carrying credits forward to a future year. Firms that consistently conduct a level of research activities that are sufficiently high relative to their state tax liability

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<sup>24</sup> ORA was able to obtain data on the business corporation tax and insurance company gross premiums tax paid by R&D tax incentive recipients. It is possible that some recipients face significant commercial real estate or tangible personal property taxes paid to municipalities related to their capital-intensive research activities, but ORA does not have a reliable method of obtaining this information. While Rhode Island's high property tax burden may be an impediment to firm's conducting R&D, and the R&D tax incentives may serve to offset a portion of this tax burden, the R&D incentives have no statutory purpose to indicate this. Further information regarding property tax burdens in Rhode Island and comparison states can be found in the previously published *Tax Incentives Evaluation Act Report* covering "Investment Tax Credits."

may find themselves in this situation year after year. In this way, the marginal value of the R&D Expense Credit diminishes as firm size increases. The larger the amount of research activities conducted by a firm relative to its state tax liability, the more likely it is that the R&D credit is rewarding firms for activity that would have taken place anyway without the credit.

Policymakers should consider recalibrating the credit calculation procedure so that the Rhode Island R&D Expense Credit pays for each firm's *last* dollar of research expenditures rather than the *first*. This could be achieved by changing the credit rate and/or decoupling from the federal credit calculation methodology. The federal credit calculation methodology is such that taxpayers are granted credits only for research activities in excess of the historical base level. By increasing the historical base level, it is possible that fewer taxpayers would be impacted by the credit cap or non-refundability provisions. However, policymakers should consider the challenges to administrators and taxpayers that might result from decoupling with the Federal Research Credit.

Another option would be to replace the tax credit programs with some other targeted incentive that focuses resources on the highest priority outcomes and contains provisions to facilitate transparency, protections of taxpayer funds, and ongoing program evaluation. Considering that the current R&D incentive has no statutory goals or intents, ORA is unable to recommend or endorse a specific program, but a possible option to consider may be a targeted grant program that is subject to appropriation and an application process. Making such a program subject to appropriation would ensure that grant amounts would not unexpectedly reach unmanageable levels. A grant program would provide certainty to recipients, making it more likely that small firms with uncertain tax liability would be able to rely upon the full value of the incentives when making location or investment decisions. Administrators could incorporate statewide economic development strategic goals into the eligibility and selection criteria. Additionally, the application process could incorporate some level of "but for" due diligence and follow-up data collection to ensure that incentive awards leverage the maximum level of private investment and locally impactful spillover effects.

Whether the R&D tax incentives are allowed to continue "as is" or modifications are made, ORA strongly urges that policymakers solicit testimony from credit recipients and rigorous surveys on the extent to which the R&D tax incentives facilitated investments that would not have been possible but for the availability of the credit.

**Finding #5:** ORA found limited usage of the New R&D Facilities Deduction, and only slightly more usage for the R&D Property Tax Credit:

- Over the period tax years 2016 through 2018, the average amount of New R&D Facilities Deduction claimed \$5,441.
- Over the period tax years 2016 through 2018, the average amount of R&D Property Tax Credit claimed was \$45,128, with no usage in TY 2017.

**Related Recommendations:**

- Consider repeal of R.I. Gen. Laws § 44-32-1 due to underutilization and incorporation of R.I. Gen. Laws § 44-32-2 into the Investment Tax Credit programs.

*Discussion Supporting Finding #6:*

It may be economically worthwhile to encourage firms to invest in research-related property and facilities in Rhode Island. Such investments have a lasting impact on the economy and anchor a firm to the state. However, the New R&D Facilities Deduction and the R&D Property Tax Credit had minimal usage over the past several years. This may be because firms that would be eligible for these R&D tax incentives are making use of other tax incentives instead. This assumption is supported by the fact that an average user of R&D tax incentives makes extensive use of additional state tax incentive programs.

ORA assumes that low utilization of the New R&D Facilities Deduction and R&D Property Tax Credit is due the program's interaction with other tax credit programs – for example, the Rhode Island Investment Tax Credit (ITC) programs offered pursuant to R.I. Gen. Laws Chapter 44-31. Per R.I. Gen. Laws § 44-32-1(a), taxpayers utilizing the New R&D Facilities Deduction do so “in lieu of depreciation or [the] investment tax credit.” Low utilization levels may indicate that taxpayers may find the Investment Tax Credit more valuable than the New R&D Facilities Deduction and elect to use the ITC in place of the R&D deduction.

Furthermore, per R.I. Gen. Laws §§ 44-32-2(h) and 44-32-2(i), taxpayers claiming the R&D Property Tax Credit shall not be allowed to also take the Investment Tax Credit in relation to the same property expenses, and these taxpayers must apply the Investment Tax Credit prior to the R&D Property Tax Credit when calculating their tax liability. Some taxpayers may find the Investment Tax Credit more valuable than the R&D Property Tax Credit, and others may have exhausted their credit cap prior to the application of the R&D Property Tax Credit in their tax liability calculation.

While ORA finds it difficult to justify the administrative cost of maintaining a tax credit with little or no historical usage, policymakers should consider the program's alignment with the Federal Research Credit and related deduction as well as interaction with other state tax credit. The little utilized R&D incentive programs are generally analogous to similar federal deductions and credits, so policymakers may find it worthwhile to keep them on the books to maintain consistency with the federal tax code. If policymakers plan to modify other state tax credits, such as the Investment

Tax Credit, that are applied prior to the R&D tax incentives, ORA recommends that they consider potential impacts on R&D tax credit usage. Similarly, if the terms of the R&D tax incentives are changed so as to become more valuable than alternative tax credits, it is possible that taxpayers may elect to take the R&D tax incentives over less valuable alternatives. For example, if policymakers were to make the Investment Tax Credit less valuable to taxpayers, it would likely lead to a spike in R&D incentive usage.

### **3. ORA Conclusion and Overall Recommendation**

R.I. Gen. Laws § 44-48.2-5(a) (11) requires the Office of Revenue analysis to make a recommendation “as to whether the tax incentive should be continued, modified, or terminated.” The Office of Revenue Analysis recommends that the Research and Development Credits be reconsidered according to the recommendations described in the previous section.

## Appendices

### Appendix A: Agency Groups Breakdown

ORA Categorization	Agency Name
<b>Behavioral Health and State Hospitals</b>	<ul style="list-style-type: none"><li>•Department of Behavioral Healthcare, Developmental Disabilities, and Hospitals</li><li>•Office of the Mental Health Advocate</li></ul>
<b>Children, Youth, and Families</b>	<ul style="list-style-type: none"><li>•Department of Children, Youth, and Families</li><li>•Office of the Child Advocate</li></ul>
<b>Corrections</b>	<ul style="list-style-type: none"><li>•Department of Corrections</li></ul>
<b>Courts</b>	<ul style="list-style-type: none"><li>•Judicial Department - Constitution</li><li>•Office of Public Defender</li></ul>
<b>Economic Development</b>	<ul style="list-style-type: none"><li>•Department of Business Regulation</li><li>•Department of Labor and Training</li><li>•Executive Office of Commerce</li></ul>
<b>Elected Officials</b>	<ul style="list-style-type: none"><li>•Department of Attorney General</li><li>•General Assembly</li><li>•Office of Lieutenant Governor</li><li>•Office of the Governor</li><li>•Secretary of State</li><li>•Treasury Department</li></ul>
<b>Environment</b>	<ul style="list-style-type: none"><li>•Coastal Resources Management Council</li><li>•Department of Environmental Management</li></ul>

## ORA Categorization

## Agency Name

<b>General Government</b>	<ul style="list-style-type: none"><li>•Department of Administration</li><li>•Department of Revenue</li></ul>
<b>Health and Human Services</b>	<ul style="list-style-type: none"><li>•Department of Health</li><li>•Department of Human Services</li></ul>
<b>Health Services</b>	<ul style="list-style-type: none"><li>•Executive Office of Health and Human Services</li></ul>
<b>Higher Education</b>	<ul style="list-style-type: none"><li>•Community College of Rhode Island</li><li>•Office of the Postsecondary Commissioner</li><li>•Rhode Island Atomic Energy Commission</li><li>•Rhode Island College</li><li>•University of Rhode Island</li></ul>
<b>Other</b>	<ul style="list-style-type: none"><li>•Board of Elections</li><li>•Commission on the Deaf &amp; Hard of Hearing</li><li>•Govrnor's Commission on Disabilities</li><li>•Historical Preservation and Heritage Commission</li><li>•Rhode Island Commission for Human Rights</li><li>•Rhode Island Council of the Arts</li><li>•Rhode Island Ethics Commission</li></ul>
<b>Public Education</b>	<ul style="list-style-type: none"><li>•Elementary and Secondary Education</li></ul>
<b>Public Safety</b>	<ul style="list-style-type: none"><li>•Department of Public Safety</li><li>•Military Staff</li><li>•Rhode Island Emergency Management Agency</li><li>•State Fire Marshal</li></ul>

## Appendix B: Additional Breakeven Scenarios

The following table presents a sensitivity analysis of the Research and Development Tax Incentives. ORA ran different economic scenarios across which the input parameters are being varied accordingly to provide the reader with additional possible breakeven analysis outcomes.

<b>Research and Development Tax Incentives</b>											
<b>Detailed Economic &amp; Revenue Impacts TY 2016 - 2018</b>											
<i>Policy Variable Percentage Assumed</i>											
	100%	90%	80%	70%	60%	50%	40%	30%	20%	10%	0%
<i>Economic &amp; Revenue Impacts Calculated</i>											
<b>Total Employment</b>	<b>3,660</b>	<b>3,288</b>	<b>2,915</b>	<b>2,542</b>	<b>2,169</b>	<b>1,797</b>	<b>1,424</b>	<b>1,051</b>	<b>679</b>	<b>307</b>	<b>-65</b>
<b>Gov Employment</b>	<b>106</b>	<b>92</b>	<b>78</b>	<b>64</b>	<b>50</b>	<b>36</b>	<b>22</b>	<b>8</b>	<b>-6</b>	<b>-20</b>	<b>-34</b>
<b>Private Non-Farm Employment</b>	<b>3,554</b>	<b>3,196</b>	<b>2,837</b>	<b>2,478</b>	<b>2,119</b>	<b>1,761</b>	<b>1,402</b>	<b>1,043</b>	<b>685</b>	<b>327</b>	<b>-31</b>
<b>Total GDP (\$000)</b>	<b>\$421,635</b>	<b>\$378,825</b>	<b>\$336,022</b>	<b>\$293,221</b>	<b>\$250,420</b>	<b>\$207,619</b>	<b>\$164,818</b>	<b>\$122,027</b>	<b>\$79,272</b>	<b>\$36,517</b>	<b>(\$6,218)</b>
<b>Generated Revenues by Component (\$000)</b>											
<i>Personal Income Tax</i>	\$4,460	\$4,006	\$3,552	\$3,098	\$2,644	\$2,190	\$1,736	\$1,282	\$830	\$377	(\$75)
<i>General Business Taxes</i>	\$1,838	\$1,652	\$1,466	\$1,280	\$1,094	\$908	\$722	\$537	\$351	\$166	(\$20)
<i>Sales and Use Taxes</i>	\$4,142	\$3,721	\$3,299	\$2,877	\$2,456	\$2,034	\$1,612	\$1,191	\$771	\$351	(\$69)
<i>Other Taxes</i>	\$200	\$180	\$160	\$139	\$119	\$98	\$78	\$58	\$37	\$17	(\$3)
<i>Total Departmental Receipts</i>	\$537	\$482	\$427	\$372	\$317	\$262	\$207	\$152	\$97	\$42	(\$12)
<i>Other Sources</i>	\$558	\$501	\$444	\$386	\$329	\$272	\$215	\$158	\$101	\$44	(\$12)
<b>Cost of Incentive (\$000)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>	<b>(\$3,146)</b>
<b>Total Net Revenues (\$000)*</b>	<b>\$8,589</b>	<b>\$7,395</b>	<b>\$6,200</b>	<b>\$5,006</b>	<b>\$3,812</b>	<b>\$2,618</b>	<b>\$1,424</b>	<b>\$231</b>	<b>(\$959)</b>	<b>(\$2,149)</b>	<b>(\$3,338)</b>

**Source:** ORA calculations based on historical Rhode Island revenue amounts and REMI Tax-PI simulations.

**Note:** \* The total net revenues represent the difference between the sum of generated revenues and the cost of the tax incentive.



# Appendix C: Rhode Island Form 7695E

State of Rhode Island and Providence Plantations  
**Form RI-7695E**  
 Research & Development Expense Credit



15131699990101

Name	Federal employer identification number	For the period ending:

1	Federal Qualified Research Expenses from Federal Form 6765, line 9 or line 28 ..	1		
2	Federal Base Amount from Federal Form 6765, line 12 or 14, or line 30 .....	2		
3	Federal Excess Expenses. Subtract line 2 from line 1 .....	3		
4	Amount of Federal Excess Expenses from line 3 incurred in Rhode Island .....	4		
5	CREDIT - (22.5% on expenditures up to \$111,111.00 and 16.9% on expenditures over \$111,111.00) .....	5		
6	Unused R&D Expense Credit from preceding year(s). Attach a schedule with amounts and year of origination .....	6		
7	Total R&D Expense Credit Available. Add lines 5 and 6 .....	7		
8	Tax amount from Form RI-1120C, line 13 or Form T-71, line 7 .....	8		
9	MAXIMUM R&D Expense Credit. Multiply line 8 by 50%. Enter here and on Schedule B-CR .....	9		
10	Credit carryover. Subtract line 9 from line 7 .....	10		

### INSTRUCTIONS

#### GENERAL

The credit is available to corporations for qualified research expenses. The credit is of the excess (if any) of the qualifying research expenses in the taxable year over the base period expenses from 7/1/1994 through 12/31/1997; for periods 1/1/1998 and therefore the rate shall be 22.5% for expenditures up to \$111,111.00 and 16.9% for the remaining expenditures over the \$111,111.00.

#### DEFINITIONS AND CALCULATION OF THE CREDIT

The terms "qualified research expenses" and "base period research expenses" shall have the same meaning as defined in section 41 of the Internal Revenue Code, provided however, that such expenses shall have been incurred in this state after July 1, 1994. The credit is based on the amount of the taxpayer's Federal excess and is calculated by first determining what of the taxpayer's Federal excess were incurred in Rhode Island after July 1, 1994 and then multiplying that amount by the appropriate rate to yield the Rhode Island credit.

#### EXAMPLE:

Taxpayer A has completed and claimed its Federal Credit and has qualified research expenses for its Federal Credit of \$100,000. A's Federal base amount is \$75,000. All expenses were incurred in Rhode Island and were incurred evenly throughout 2002. A has a calendar year end.

#### Taxpayer A's 2002 Rhode Island R & D Expense Credit is calculated as:

Federal Qualified Research Expenses	\$100,000
Federal Base Amount	75,000
Federal Excess Expense	25,000

Amount of Federal Excess Expenses in Rhode Island	25,000
Amount of Expenses in Rhode Island after January 1, 1998	25,000
Credit @ 22.5%	\$ 5,625

#### MINIMUM TAX AND CARRYOVER

In the case of corporations, the credit allowed shall not reduce the tax due to less than the minimum fixed by section 44-11-2(e); however, if the amount of credit allowable reduces the tax to the minimum fixed by section 44-11-2(e), any amount of credit not used may be carried over a maximum of seven (7) years.

#### USING THE CREDIT

Enter the amount from line 9 above on the "RI-7695E - Research & Development Facilities Expense Credit" line of Schedule B-CR, Business Entity Credit Schedule. Attach Schedule B-CR, Form RI-7695E and supporting documentation to your return.

#### ORDER OF CREDITS

For purposes of determining the order in which carry-overs shall be taken into consideration, the credit allowed by section 44-32-2 (credit for research and development property) shall be used before the credit described in this regulation.

#### COMBINED RETURNS

The credit earned before January 1, 2015, shall be allowed to offset only the tax liability of the corporation that earned the credit; such credit cannot be shared with other members of the combined group. The credit earned in tax years beginning on or after January 1, 2015, may be applied to other members of the group. Refer to the latest version of the Combined Reporting regulation for more details.

R.I. Gen. Laws § 44-32-3