STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

Governor Gina M. Raimondo

STATE OF RHODE ISLAND

DEPARTMENT OF REVENUE

Economic Development Tax Incentives Evaluation Act:

Evaluation of

"Distressed Areas Economic Revitalization Act"

(including "Enterprise Zone Wage Tax Credit" and

"Enterprise Zone Resident Business Owner Tax Modification")

(R.I. Gen. Laws §§ 42-64.3-6 & 42-64.3-7)

Tax Years 2013 through 2015

Office of Revenue Analysis

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Foreword

The *Economic Development Tax Incentives Evaluation Act: Tax Years 2013 through 2015* was prepared at the request of Paul L. Dion, Ph.D., Chief of the Office of Revenue Analysis in accordance with Rhode Island General Laws § 44-48.2-4. This report was prepared by the Office of Revenue Analysis team which includes Bethany Scanlon, Senior Economic and Policy Analyst, Joseph Codega Jr., Data Analyst III, and Madiha Zaffou, Principal Economic and Policy Analyst under the direction of Mr. Dion.

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, 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 of the tax credits to be analyzed according to R.I. Gen. Laws § 44-48.2-3(1). This report concerns R.I. Gen. Laws Chapter 42-64.3 entitled "Distressed Areas Economic Revitalization Act"- which is commonly known as Enterprise Zone (EZ) tax incentives containing Rhode Island Gen. Laws § 42-64.3-6 ("Business Tax Credits") and Rhode Island Gen. Laws § 42-64.3-7 ("Resident Business Owner Tax Modification"). This report measures the economic impact associated with the tax incentives during tax years 2013 through 2015. The analysis is performed at the micro level using employment and wage information provided by Division of Taxation. The report is divided into four sections. Section I provides a detailed description of the tax credits and its statutory programmatic goals and intent. Section II provides a description of the data provided and used in the analysis by ORA. Section IIII assesses the economic impact generated under the EZ tax incentives program using a "breakeven" cost-benefit analysis. Section IV discusses policy recommendations that could help in the decision process as to whether the tax credit should be continued, modified, or terminated.

1. Description of the Incentive

- *Rhode Island Gen. Laws § 42-64.3-6: Distressed Areas Economic Revitalization Act-Business Tax Credits*

Titled *Business Tax Credits*, Rhode Island General Laws § 42-64.3-6 is commonly referred to as the Enterprise Zone Wage Tax Credit. This program provides for a tax credit against the business corporation tax (Rhode Island General Law Chapter 44-11), the public service corporation tax (Rhode Island General Law Chapter 44-13 except for § 44-13-13), the taxation of banks (Rhode Island General Law Chapter 44-14), the taxation of insurance companies (Rhode Island General Law Chapter 44-17), or the personal income tax (Rhode Island General Law Chapter 44-30).[1] Only companies located in a designated enterprise zone, as determined by the Rhode Island Enterprise Zone Council (RIEZC), are eligible for the credit.[2] No new Enterprise Zone Wage Tax Credits will be issued on or after July 1, 2015 unless the business has received certification prior to this date.

The allowable tax credit is equal to 50 percent of the wages paid to a newly hired employee, up to a maximum of $2,500, if the employee does not reside in a designated enterprise zone, or 75 percent of wages paid, up to a maximum of $5,000, if the employee is domiciled in a designated enterprise zone. In order to qualify for the credit, the qualifying company must increase total employment by at least five percent from the previous calendar year and have its total Rhode Island payroll exceed the prior year's total Rhode Island payroll. There are no benefit criteria that must

[1] The Enterprise Zone Wage Tax Credit was allowed against the personal income tax for tax years ending on or before December 31, 2010.

[2] According to R.I. Gen Laws § 42-64.3-3(2), defines an Enterprise Zone as "an economically distressed United States Bureau of the Census division or delineation in need of expansion of business and industry, and the creation of jobs, which is designated to be eligible for the benefits of this chapter." R.I. Gen. Laws § 42-64.3-5 lists the criteria for Enterprise Zone designation.

be met to receive this tax credit. Unused amounts of the tax credit can be carried forward for up to three years provided that when the carry forward amount is used, the tax credit recipient has not lowered its employment below the levels that were required for the recipient to earn the tax credit in the first place.

- *Rhode Island Gen. Laws § 42-64.3-7: Distressed Areas Economic Revitalization Act-Resident Business Owner Tax Modification*

Titled *Resident Business Owner Tax Modification*, Rhode Island General Laws § 42-64.3-7 provides that a domiciliary of an enterprise zone who owns and operates a qualified business facility in that zone and which business is not required to file under Rhode Island General Laws Chapters 44-11, 44-13, 44-14, or 44-17 may, when "computing his or her annual tax liability pursuant to the provisions of chapter 11 or 30 of title 44", take as a modification decreasing federal adjusted gross income an amount of $50,000 during the first three years after certification and operations in the zone and may deduct $25,000 in the fourth and fifth year. In the case of multiple owners of the qualified business, the modification shall be apportioned according to the ownership interests of each business owner.

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

Based on Rhode Island Gen. Laws § 42-64.3-2, the legislative findings with respect to the EZ tax incentives are stated verbatim as follows:

> (1) That there are certain distressed areas in this state which are characterized by substantial and persistent levels of unemployment; blighted areas; obsolete, dilapidated, and abandoned industrial and commercial structures; and, as a consequence, continually shrinking tax bases which threaten their very existence;
>
> (2) That the numerous programs undertaken by the federal government and the state…to stop the deterioration and stimulate economic activity in these urban areas have, in large part, failed;
>
> (3) That it is the public policy of this state to undertake an experimental program to stimulate economic revitalization, promote employment opportunities, and encourage business development and expansion in distressed areas.

Part III: Report Data Description

The analysis of the EZ tax incentives 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. 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 the Division of Taxation for tax years 2013, 2014, and 2015, 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:

- Self-reported firm data as submitted by firms on ZNO2A forms and provided by the Division of Taxation's Forms, Credits and Incentives Section;[3]
- ORA Personal Income Tax Simulation Model (ORA PIT Model). The ORA PIT Model is constructed using the most recent data made available by the Division of Taxation. At the time of analysis, the most recent personal income tax data made available to ORA related to tax year 2015.
- Cost of tax credit administration.

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.

Data sources were available to ORA to help distinguish credit usage between the EZ Wage Tax Credit and the EZ Resident Business Owner Tax Modification. However, ORA observed that the EZ Wage Tax Credit represented 97 percent of the incentive usage when measured in terms of dollars. Furthermore, differentiating between the two incentives would require reporting certain data in groups consisting of only a few taxpayers, which would potentially compromise taxpayer confidentiality. For these reasons, some of the sections in this report are comprised of the aggregate usage of both programs and refer to them collectively as "EZ credits".

1. Number of Taxpayers Granted Tax Credit

- *EZ Wage Tax Credit*

According to the Division of Taxation an average of three companies received the EZ Wage Tax Credit over tax years 2013 through 2015 with a total value of $1,326,101 and an average annual value of $442,034. The following table provides a description of the number of recipients of the EZ Wage Tax Credit and the corresponding credit amounts received in each tax year:

[3] A copy of this form is provided in the Appendix under Exhibit A.

EZ Wage Tax Credit Amounts and Recipients
(Tax Years 2013 – 2015)

Tax Year	Number of Recipients	Total Credit Received
2013*	4	$191,188
2014	3	$278,981
2015**	3	$790,932
Three-Year Total	**10**	**$1,326,101**
Three-Year Average	**3**	**$442,034**

Source: Tax Credit & Incentive Reports fiscal years 2014 through 2016 published by the Division of Taxation.
*Two out of four companies received the tax credit but did not respond to notification from the Division of Taxation and thus failed to provide the information required by R.I. Gen. Laws § 42-64.3-6.1(h).
**One out of three companies received the tax credit but did not respond to notification from the Division of Taxation and thus failed to provide the information required by R.I. Gen. Laws § 42-64.3-6.1(h).

- *EZ Resident Business Owner Tax Modification.*

According to the Division of Taxation an average of 42 individuals received the EZ Resident Business Owner Tax Modification over tax years 2013 through 2015. The number of taxpayers includes those resident taxpayers with a modification that decreased their federal Adjusted Gross Income (AGI). ORA calculated the Rhode Island tax liability for each taxpayer under TY 2013, TY 2014 and TY 2015 Rhode Island personal income tax laws and the Rhode Island tax liability for each taxpayer without the modification for the same tax years, then summed the results for both calculations across all taxpayers. Revenue foregone is determined by taking the difference between the two tax liability calculations.

The following table provides a description of the number of recipients of the EZ Resident Business Owner Tax Modification and the corresponding forgone revenue amounts in each tax year:

EZ Resident Business Owner Modification:
Number of Recipients & Revenue Forgone
(Tax Years 2013 – 2015)

Tax Year	Number of Recipients	Revenue Forgone
2013	42	$9,968
2014	34	$14,087
2015	49	$19,522
Three-Year Total	**125**	**$43,577**
Three-Year Average	**42**	**$14,526**

Source: Calculations based on data provided by the Division of Taxation and ORA PIT Simulation Model.

2. Value of Tax Credit Granted by NAICS Code

During tax years 2013 through 2015, the total amount of the EZ Wage Tax Credit was $1,326,101. ORA matched each recipient firm to its corresponding industry code according to the North

American Industry Classification System (NAICS) in order to accurately simulate direct shocks to the Rhode Island economy with the REMI model.[4] The following table depicts the amount of the EZ Wage Tax Credit received by firms in each industry during tax years 2013 through 2015:

Enterprise Zone Wage Tax Credit Amount by NAICS Industry
(Tax Years 2013 – 2015)

Industry Description (NAICS Code)	Three-Year Total	Three-Year Average
Educational Services (61)	$237	$79
Management of companies and enterprises (55)	$370,052	$123,351
Miscellaneous manufacturing (339)	$946,216	$236,554
Retail Trade (44-45)	$7,096	$2,365
Wholesale Trade (42)	$2,500	$833
All Industries	**$1,326,101**	**$363,182**

Source: Assignment of beneficiary firms into NAICS classifications is based on ORA assumptions. EZ amounts are based on compilation of Division of Taxation *Tax Credit & Incentive Reports.*

3. Cost of Administration

The administration of the EZ credits involves both the Rhode Island Commerce Corporation and the Division of Taxation. Using data provided by the two agencies, ORA found that the total cost to administer the tax credit was $41,103 in tax years 2013-2015. The total direct cost incurred by RI Commerce Corporation in tax years 2013-2015 to administer the EZ credits was $37,580 while the indirect costs incurred by the Division of Taxation to administer the tax credit were $3,523 for the same time period. The following table provides a description on the cost of administration in each tax year:

Enterprise Zone Credits Cost of Administration
(Tax Years 2013 – 2015)

Cost-Incurring Entity	TY 13	TY 14	TY 15	Total	Average
Taxation Cost	$1,648	$1,017	$858	$3,523	$1,174
Commerce Cost	$20,708	$11,062	$5,810	$37,580	$12,527
Total Cost	**$22,356**	**$12,078**	**$6,669**	**$41,103**	**$13,701**

Source: Division of Taxation and Commerce Corporation.

4. Number of Aggregate Jobs

Based on wages and employment data submitted by the EZ Wage Tax Credit recipients to the Division of Taxation, ORA was able to compile the total number of employees for most of the recipient firms. The following table provides a description of employment under the EZ Wage Tax Credit in tax years 2013 through 2015. To earn the credit, a tax credit recipient is required to

[4] The REMI model consists of four economic impact methodologies: input-output analysis, computable general equilibrium dynamics, econometric estimation techniques, and economic geography and migration flows. Detailed documentation on the REMI PI+ v2.0.6 model employed in this analysis is available at: http://www.remi.com/resources/documentation

increase employment by five percent over the recipient's benchmark employment level. This employment measure is captured under "Required" employment in the table below. The "Reported" employment reflects the number of full-time employees added in order to receive the EZ Wage Tax Credit as determined by the Enterprise Zone Council.[5]

EZ Wage Tax Credit Employee Count
(Tax Years 2013 – 2015)

	TY 2013		TY 2014		TY 2015	
Recipient Name	**Required**	**Reported**	**Required**	**Reported**	**Required**	**Reported**
Advance Store Company, Inc.	†	†	1	2	†	†
Child Care Connection, Inc.	*	*	†	†	†	†
Ronstan International, Inc	*	*	†	†	†	†
Tiffany and Company	†	†	25	218	25	218
United Natural Foods, Inc.	16	56	19	47	19	47
WaterRower, Inc.	3	31	†	†	*	*
Total	**19**	**87**	**45**	**267**	**44**	**265**

Source: ORA Calculations based on Rhode Island Form ZN02A.

Notes: Employee count uses an "Enterprise Job Employee" counting methodology as specified in R.I. Gen. Laws §42-64.3-3(6).

***** Firm did not respond to notification from the Division of Taxation and thus did not provide the information required by R. I. Gen. Laws § 42-64.3-6.1(h).

† Firm did not utilize the EZ wage tax credit in designated tax year.

5. Direct Taxes Paid by Recipients

Due to statutory confidentiality mandates under R.I. Gen. Laws §§ 44-1-14, 44-19-30, 44-11-21, 44-14-23 and 44-30-95(c) and the risk of disclosure of taxpayer information, the Division of Taxation is unable to approve disclosure of information by ORA as required by R.I. Gen. Laws § 44-48.2-5(a)(1) as it pertains to the "the aggregate annual revenue that such taxpayers generate for the state through the direct taxes applied to them."

6. Direct Taxes Paid by Recipients' Employees

The Division of Taxation provided ORA with data on taxes paid by employees of the EZ credits recipient firms. ORA utilized its personal income tax simulation model to determine employee statistics as well as the taxes they paid. The following table provides the number of EZ credits

[5] According to Rhode Island General Laws § 42-64.3-3(6), "Enterprise job employees means those full-time employees whose business activity originates and terminates from within the enterprise zone business and facility on a daily basis, and who are domiciled residents of the state (or who, in the case of employees of a high performance manufacturer as that term is defined in [Rhode Island Gen. Laws] § 44-31-1(b)(3)(i), pay personal income taxes to the state) and hired (or transferred, in the case of existing out-of-state employees) and employed by the qualified business in the enterprise zone after the effective date of certification or annual recertification in excess of those full-time employees employed by the qualified business in any Rhode Island enterprise zone in the prior calendar year. An employee who is hired and terminated in the same certification period does not constitute an enterprise job employee."

firms' employees as identified by both the Division of Taxation and ORA and the breakdown of this information by residence status.

Employees of EZ-Beneficiary Firms:
Identified Tax Filings by Resident and Non-Resident Status
(Tax Years 2013 – 2015)

	TY 2013	TY 2014	TY 2015
Total Employees Reported	**1,047**	**1,476**	**1,110**
Count of Employees Identified by Taxation	1,047 of 1,047	1,453 of 1,476	1,004 of 1,110
Count of Employees Identified by ORA	789 of 1,047	917 of 1,453	817 of 1,110
Identified	***789***	***917***	***822***
Resident	582	760	631
Non-Resident	207	157	191
Not Identified	***258***	***559***	***288***
Resident	unknown	unknown	unknown
Non-Resident	unknown	unknown	unknown

Source: Division of Taxation, Office of Revenue Analysis personal income tax model

In order to determine taxes paid, ORA utilized the ratio of reported wages through the EZ credits firms compared to total federal adjusted gross income listed on the tax return for the tax year. This ratio was multiplied by the total taxes paid in that tax year to report total apportioned taxes paid for income earned from the EZ credits recipient firm. The taxes paid that are shown below are for all of the employees of a recipient firm and not just the new employees added by a firm in order to receive the EZ incentive.

Employees of EZ-Beneficiary Firms:
Personal Income Taxes Paid by Identified Taxpayers
(Tax Years 2013 – 2015)

	TY 2013	TY 2014	TY 2015
Total RI Personal Income Taxes Paid†	***$1,293,440***	***$1,290,203***	***$1,362,286***
Resident	$750,665	$844,864	$851,350
Non-Resident	$542,776	$445,339	$510,953
Taxes paid per Identified Job	***$1,639***	***$1,407***	***$1,657***
Resident	$1,290	$1,112	$1,349
Non-Resident	$2,622	$2,837	$2,675

Source: Division of Taxation

† Taxes paid reflects only the amounts paid by employees for which the Division of Taxation and ORA were able to identify a tax filing. Also, taxes paid reflects apportioned taxes by amount of reported wages attributable to employment with EZ-beneficiary firms. The above taxes paid do not reflect total taxes paid by identified taxpayers.

7. Additional Data Analysis

Additionally, using data provided by Taxation through the annual *Tax Credit & Incentive Report*, ORA identified the following firms to be recipients of multiple incentive programs:

Other Tax Credits Received by EZ Credits Recipient Firms

(Tax Years 2013 – 2015)

Year	Company Name	Investment Tax Credit	R&D	Total
2013	None	-	-	**-**
2014	Tiffany and Company	$160,190	$75,053	**$235,243**
2015	Tiffany and Company	$159,407	$158,072	**$317,479**
	WaterRower, Inc.	$9,641	-	**$9,641**
	Grand Total	$329,238	$233,125	**$562,363**

Source: Division of Taxation, *Tax Credits & Incentives Reports*

Note: As noted in "Data Description" above, ORA assumes that credit usage reported in each fiscal year edition of Taxation's *Tax Credit & Incentive Report* corresponds with the prior tax year.

The table shows that in total, beneficiaries of the EZ credits received $562,363 in state incentives and credits during tax years 2013 through 2015 *in addition* to the value of the EZ credits. In other words, the amount of EZ credits received by these selected EZ-beneficiary firms represents 70 percent of the total amount of tax credits and incentives they received during that three-year time period. The fact that these firms received these additional tax benefits makes it inappropriate to attribute one hundred percent of the economic benefits associated with their presence in the state solely to the EZ credits because this would imply that these additional credits had zero economic impact.

Map of Rhode Island Enterprise Zones

Source: Constructed using shapefiles from Rhode Island Geographic Information Systems (RIGIS) available at http://www.rigis.org/datasets?q=enterprise%20zones

Notes: Shaded regions indicate Rhode Island Enterprise Zones. Exact locations, boundaries, and count of Enterprise Zones have been subject to modification over the lifetime of the program per processes established by R.I. General Laws, the Rhode Island Enterprise Zone Council, and revision of U.S. Census boundaries. The boundaries presented in this map are presented without modification from the original source, which notes a publication date of Feb. 23, 2015.

<u>Descriptions and Selected Demographic Statistics of Rhode Island Enterprise Zones</u>
(American Community Survey, 2015 Five-Year Estimates)

#	Zone Name	Municipality	Population	Poverty Rate	Unemployment Rate
1	Cranston	Cranston	16,870	13.4%	12.7%
2	Port of Providence	Providence	19,677	32.0%	21.6%
3	Portsmouth/Tiverton	Portsmouth	10,911	5.0%	7.7%
4	Bristol/Warren (Mt. Hope)	Bristol	14,384	7.7%	7.2%
5	Bristol/Warren (Mt. Hope)	Warren	10,532	8.4%	8.7%
6	Providence II	Providence	31,258	28.8%	16.7%
7	Central Falls/Cumberland	Central Falls	19,378	31.2%	12.4%
8	Central Falls/Cumberland	Cumberland	6,965	13.1%	3.1%
9	Pawtucket II	Pawtucket	4,580	21.3%	13.7%
10	West Warwick	West Warwick	28,891	12.1%	9.3%
11	Woonsocket/Cumberland	Cumberland	4,349	0.7%	4.9%
12	Woonsocket/Cumberland	Woonsocket	12,717	33.9%	9.0%
13	Pawtucket/Lincoln	Lincoln	556	2.3%	4.6%
14	Pawtucket/Lincoln	Pawtucket	16,522	20.4%	13.1%
15	East Providence	East Providence	30,083	12.0%	10.3%
16	Portsmouth/Tiverton	Tiverton	10,688	4.7%	8.2%
	All Enterprise Zones Total / Average:		238,361	18.1%	11.7%
	Non-Enterprise Zones Total / Average:		815,300	8.3%	7.7%
	Statewide Total / Average:		1,053,661	10.6%	8.7%

Source: Population and poverty rates estimated by ORA using American Community Survey 2015, five-year average data by Census Tract and RIGIS geography shapefiles available at: http://www.rigis.org/datasets?q=enterprise%20zones

Notes: Zone numbers correspond with map on previous page. Zone names and geographies were utilized as described by RIGIS. ORA was able to obtain population, poverty, and unemployment data by U.S. Census tract. In the majority of cases, Enterprise Zone boundaries could be defined by tract and population characteristics could be calculated with precision. In other cases, Enterprise Zone characteristics were approximated by ORA based on the portion of each census tract included in the Enterprise Zone.

According to American Community Survey (ACS), 2015 five-year estimates, a total of 238,361 Rhode Island residents live in Enterprise Zones, or 22.6 percent of the total state population of 1,053,661. The table above indicates that Enterprise Zones, on average, contain portions of the state with higher poverty and unemployment than the rest of the state. The 2015 five-year ACS estimate of the percentage of the Rhode Island population living in households below the federal poverty level is 10.6 percent, but an analysis of economic characteristics by Enterprise Zone residency reveals that the average poverty rate inside of zones is 18.1 percent and outside is 8.3 percent. A similar pattern holds with respect to the unemployment rate. While the 2015 five-year ACS estimate of the statewide unemployment rate is 8.7 percent, the average unemployment rate inside zones is 11.7 percent and outside of Enterprise Zones it is 7.7 percent. These data show, on average, that Enterprise Zones are more economically distressed than the rest of the state with respect to the poverty and unemployment rates, although some designated Enterprise Zone areas fall below the non-Enterprise Zones and/or the Statewide averages for both measures. For example, the Portsmouth/Tiverton and Bristol Warren (Mt. Hope) Enterprise Zones have both poverty and unemployment rates at or below the state average. Additionally, the Cumberland portion of the

Woonsocket/Cumberland zone and the Lincoln portion of the Pawtucket/Lincoln zone have both poverty and unemployment rates at or below the state average.

Part III: Evaluation of the Economic Impact of the Tax Credit

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 EZ credits 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 EZ credits.

1. Assessment and Five-Year Projection of Revenue

Pursuant to R.I. Gen. Laws § 42-64.3-6(7), the program was repealed and no new credits shall be issued on or after July 1, 2015. As a result, no projection of revenue is appropriate.

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 net impact on state revenues resulting from the EZ Wage Tax Credit under a variety of assumptions regarding what would have happened in the Rhode Island economy if the credit had not been available. To provide additional insight, ORA also produced breakeven analyses with respect to employment and Rhode Island gross domestic product (RI 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 PI+ software platform to produce estimates of the total economic effects of the tax credit issued in tax years 2013 through 2015.[6] The dynamic capabilities of the REMI 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 analysis is based on self-reported firm-level data on employment and wages provided by the Division of Taxation and publicly available historical data on the regional and national economies. Direct benefits are entered into the REMI model as policy variables simulating changes in industry sales, exogenous final demand, employment, and compensation or wages. ORA assigned these benefits to a profile of sectors among the 70 sectors available in the REMI PI+ model in proportion with the amount of the three-year average EZ Wage Tax Credit amounts.

The "breakeven" approach developed for this report allows a reader to assume that the EZ Wage Tax Credit leveraged various levels of economic activity required of recipient firms to receive a tax credit. This assumption means that some varying portion of the economic activity required of recipient firms to receive a tax credit would not have occurred in the absence of the tax credit. Under this assumption, firms made some portion of their long-term employment decisions based on the availability of an incentive over a period of time, and removal of that tax credit in a given year would undo all such decisions.

[6] The REMI model consists of four economic impact methodologies: input-output analysis, computable general equilibrium dynamics, econometric estimation techniques, and economic geography and migration flows. Detailed documentation on the REMI PI+ v2.0.6 model employed in this analysis is available at: http://www.remi.com/resources/documentation

- *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 issuing tax credits, 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 each tax year within the scope of this analysis. This analysis 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:

Three Year Average of Rhode Island General Fund Expenditures

(Calendar Years 2013 - 2015)

Industry Description	NAICS Code	Percent of Total
Ambulatory Healthcare Services [7]	621	33.8%
Educational Services	61	31.7%
State Wages, Salary, and other Compensation	n/a (entered as "state/local govt. compensation" and "employment")	23.3%
Social Assistance	624	3.4%
Local Government Spending	n/a (entered as "local government spending")	2.3%
Professional, Scientific, and Technical Services	54	1.2%
Administrative and Support Services	561	1.0%
Wholesale Trade	42	0.96%
Remaining/Other	19 additional industries, and also non-residential capital investment	2.3%
	Total:	**100.0%**

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

- *Modeling Benefits*

The cost-benefit methodology employed by this report modeled the benefits associated with the EZ credit program as the minimum level of employment and compensation necessary to generate the historical credit issuance amount. This assumes that some portion of a firm's employment is attributable to the availability of the EZ credit program, and would not have otherwise taken place in Rhode Island.

ORA utilized actual employment counts and wage levels as reported by recipients on required annual reports filed with the Rhode Island Division of Taxation (RI Form ZN02A) according to three-year average, calendar year 2013 through 2015, levels. ORA excluded from analysis the benefits associated with Child Care Connection, Inc., Ronstan International, Inc., and WaterRower as these companies failed to file RI Form ZN02A in violation of R.I. Gen. Laws § 42-64.3-6.1(h).

- *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 credit 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 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 percent. This implies that even if 100 percent 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.

The amount of benefits is scaled according to the assumed percentages listed in each results chart, but the costs are always held fixed at 100 percent. All costs and benefits are modeled as the three-year average, calendar year 2013 through 2015, credit usage amount and entered into the REMI model in calendar year 2015. At 100 percent, the costs are equal to a $419,455 reduction in government spending, and the benefits are equal to an increase in employment of 206 jobs with $38,106,004 in associated compensation.[8]

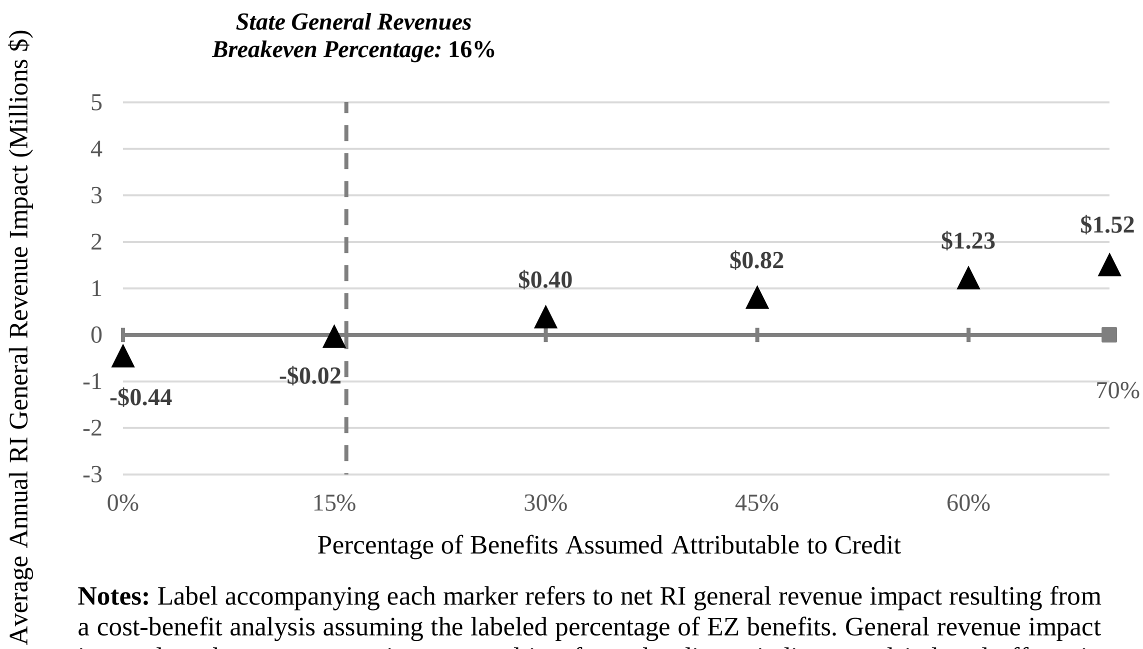
In all of the following analyses, the range of breakeven percentages is limited to between zero and 70 percent. According to the *Tax Credit & Incentive Reports* published by the Division of Taxation, the value of the EZ credit represents 70 percent of the total state tax incentives received by EZ-recipient firms that are subject to reporting requirements. Because data on all EZ credit users cannot be released in order to preserve taxpayer confidentiality, ORA assumes that this percentage is representative of all EZ credit usage. In this context, it is not logical to interpret breakeven percentages above 70 percent because doing so would disregard the impact of the additional state tax credits utilized by EZ-recipient firms. In other words, if the EZ credits represented 70 percent of the total incentive value claimed by an average firm, it would be inappropriate to attribute greater than 70 percent of the firm's presence to the availability of the EZ credit program.

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

[8] This figure excludes the amount of EZ credits, $67,737 in total, received by Child Care Connection, Inc, Ronstan International, Inc, and WaterRower, Inc as these companies failed to provide the required data to the Division of Taxation under R.I. Gen. Laws § 42-64.3-6.1(h). Both the costs and benefits associated with credit usage by these taxpayers were excluded from the cost-benefit analysis.

A technical note for readers familiar with the REMI model: The EZ credit program has a long-standing presence, and its economic impact is reflected in the historical data with which the REMI model baseline is calibrated. Adding additional EZ credit-related economic activity to the REMI model would double count the impact of the program. For this reason, ORA modeled the impact of the EZ credit in the REMI model by *removing* the costs and benefits associated with the ITC. The signs of the REMI output were then reversed when presenting results in this report so that they would have a more logical, natural interpretation.

Enterprise Zone Wage Tax Credit:
Rhode Island General Revenue Breakeven Analysis
(Average Annual RI General Revenue Impact, Calendar Years 2013-2015)



Notes: Label accompanying each marker refers to net RI general revenue impact resulting from a cost-benefit analysis assuming the labeled percentage of EZ benefits. General revenue impact is equal to the net revenue impact resulting from the direct, indirect, and induced effects in addition to the cost of paying back the cost of the tax credit. Note that the breakeven percentage is defined as the percent of benefits included in a cost-benefit analysis resulting in a net zero state RI GDP impact.

Source: ORA calculations utilizing REMI PI+

A breakeven percentage of 16 percent can be interpreted to mean that if one assumes that 16 percent or more of the employment associated with EZ firms would not have been located in the state if not for the availability of the EZ Wage Tax Credit, then the tax credit “pays for itself” in terms of state general revenues.

To estimate the impact on state general revenues, ORA found it necessary to make an assumption regarding what level of economic activity would have taken place in the absence of the EZ Wage Tax Credits. ORA considered that in order for the tax credit to have an impact on a firm’s location decision, the value of the credit to the firm would have to be relatively large. However, the EZ Wage Tax Credit amounts granted every year are relatively small when compared to other tax incentives offered by the state. In the absence of any reliable data that could help determine the level of economic activity associated with the EZ Wage Tax Credit ORA made the assumption that 15 percent of the economic activity associated with EZ beneficiaries were “caused” by the tax credit. This percentage falls in the range of percentages of prior tax incentive evaluation reports published by ORA.[9]

The following table provides more detailed information regarding the state general revenue impact. This table assumes that 15 percent of the economic activity associated with EZ beneficiaries were “caused” by the credit.

EZ Wage Tax Credit: Detailed Revenue Impacts

(Average Annual RI General Revenue Impact, Calendar Years 2013-2015)

Item Description	Amount
General Revenue Generated by Incentive by Component	
Personal Income Tax	$130,805
Sales and Use Taxes	$128,048
Other Taxes	$5,851
Total Departmental Receipts	$40,363
Other Sources	$44,547
Total General Revenue Generated by Incentive	**$395,582**
Forgone Revenue Due to Incentive	**$(419,455)**
Net Change in General Revenue, After Paying for Incentive	**$(23,873)**
New Revenues Generated for Every Dollar of Incentive	**$0.94**

Note: Revenue impacts assume that 15 percent of economic activity associated with the EZ credit program is attributable to the availability of the EZ credit.

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

This table shows the detailed revenue impact under the ORA assumption that 15 percent of the economic activity associated with the EZ Wage Tax Credit was “caused” by the credit. This shows that the activity associated with the EZ Wage Tax Credit generated a total $395,582 of state general revenues – however, this figure does not include the $419,455 cost of the credit itself. Therefore, in an average year during the period of calendar years 2013 through 2015 Rhode Island gives up $419,455 in revenue on the EZ Wage Tax Credit and receives $395,582 of new revenues in return, equal to an average annual net loss of $23,873 in net general revenue. Expressed another way, for every dollar spent on the EZ Wage Tax Credit the state generates $0.94 of new revenue. This payback ratio shows that the total costs of the EZ Wage Tax Credit exceeds the new revenues generated from the incentivized activity and adds a new net negative revenue amount to the state under the assumption that 15 percent of the employment at EZ beneficiary firms would not exist in Rhode Island if not for the availability of the tax credit.

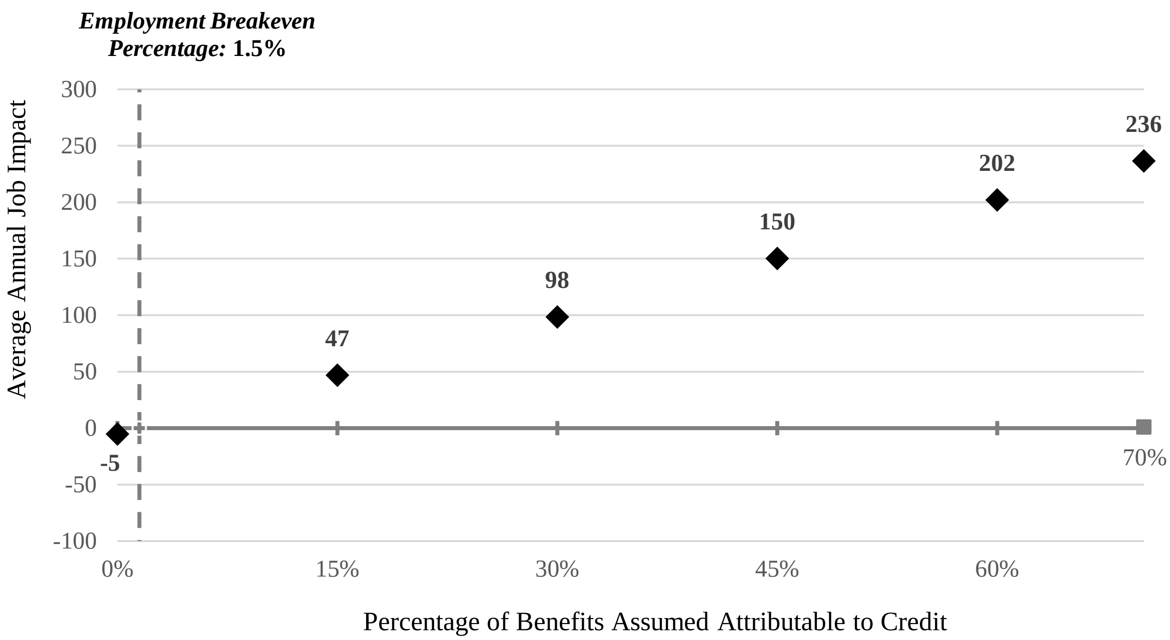
The breakeven framework can also be extended to employment and Rhode Island GDP. In these contexts, the breakeven percentage can be interpreted as the percentage of economic activity associated with EZ Wage Tax Credit recipient firms assumed to be attributable to the availability of the tax credit necessary for the increase in employment or GDP resulting from new economic

[9] In prior tax incentive evaluation reports, ORA determined that 12.5 percent of economic activity was associated with the availability of the Investment Tax Credit (ITC) and that 17.5 percent of economic activity was associated with the availability of Research & Development Credits (R&D).

activity to outweigh the employment or GDP losses resulting in the reduction in government spending necessary to fund the credit.

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

Enterprise Zone Wage Tax Credit:
Employment Breakeven Analysis
(Average Annual Jobs Impact, Calendar Years 2013-2015)



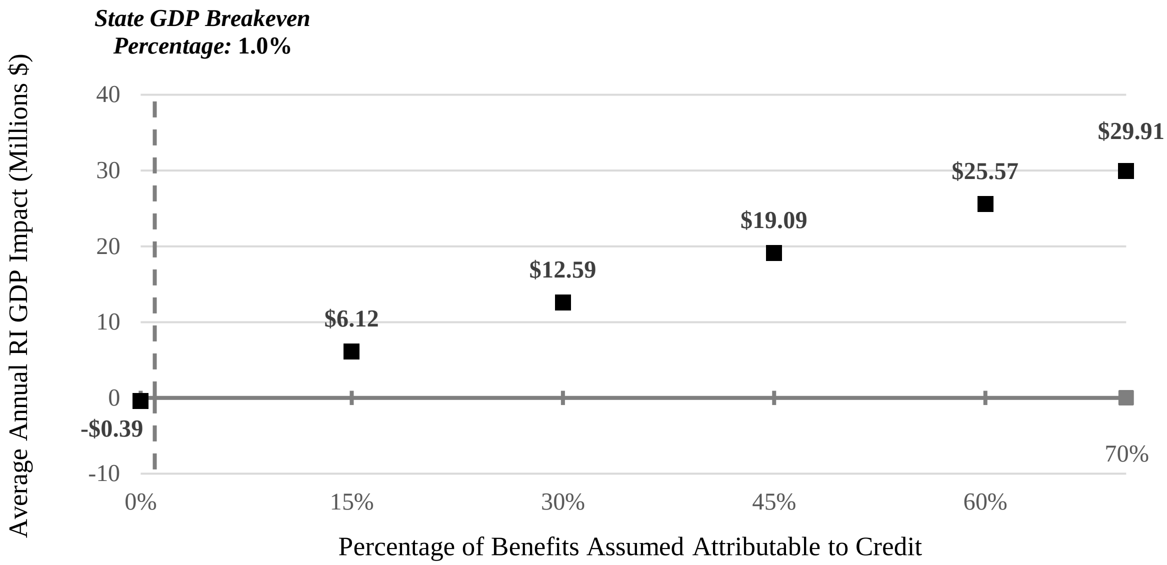
Notes: Label accompanying each marker refers to net job impact resulting from a cost-benefit analysis assuming the labeled percentage of EZ benefits. Employment impact includes the direct, indirect, and induced employment effects in all industries. Note that the breakeven percentage is defined as the percent of benefits included in a cost-benefit analysis resulting in a net zero employment impact.

Source: ORA calculations utilizing REMI PI+

The employment breakeven percentage of 1.5 percent implies that the EZ Wage Tax Credit has a net positive impact on Rhode Island employment if at least 1.5 percent of economic activity associated with the EZ-recipient firms would not have occurred but for the availability of the tax incentive.

The following chart shows the results of a breakeven analysis with respect to Rhode Island gross domestic product (RI GDP).

Enterprise Zone Wage Tax Credit:
Rhode Island Gross Domestic Product (RI GDP) Breakeven Analysis
(Average Annual RI GDP Impact, Calendar Years 2013-2015)



Notes: Label accompanying each marker refers to net RI GDP impact resulting from a cost-benefit analysis assuming the labeled percentage of EZ benefits. RI GDP impact includes the direct, indirect, and induced GDP effects in all industries. Note that the breakeven percentage is defined as the percent of benefits included in a cost-benefit analysis resulting in a net zero state RI GDP impact.

Source: ORA calculations utilizing REMI PI+

The RI GDP breakeven percentage of 1.0 percent implies that the EZ Wage Tax Credit has a net positive impact on RI GDP as long as at least 1.0 percent of economic activity associated with the EZ-recipient companies would not have occurred but for the availability of the tax incentive.

Part IV: 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 concurs with the analysis of ORA that the Enterprise Zone Wage Tax Credit warrants no further recommendation as it has already been repealed.

Encouraging job creation in distressed Rhode Island communities is a top priority for the Commerce Corporation. In designing new, powerful and responsible economic development incentives in 2015, the Commerce Corporation made sure to prioritize lowering the thresholds that applicants in Hope Communities (municipalities with a percentage of families below the poverty level that is greater than the percentage of families below the poverty level for the state as a whole) must satisfy to be eligible for programs such as Rebuild RI and the Qualified Jobs Incentive. In May 2018, the federal government approved Rhode Island's designation of "Opportunity Zones" which allow for certain federal tax benefits for investments in 25 Rhode Island census tracts of a similar profile to areas designated as Enterprise Zones, and thus a similar incentive for investment will exist once the Internal Revenue Service issues regulations for the Opportunity Zone program.

Without strengthened reporting to enable further analysis of the Enterprise Zone Business Tax Modification's outcomes, it is difficult to assess whether the program is achieving its stated goals. However, given that the average benefit is only about $333 per recipient in a given tax year, the Commerce Corporation concurs with ORA's assessment that the program is unlikely to catalyze significant net new economic activity.

2. Discussion of Data Concerns

- *Inconsistency in Data Reporting*

While the Enterprise Zone Wage Tax Credit is one of the tax incentives where the level of data reporting compliance is relatively good, there are still significant data quality issues. The lack of clear guidance and definitions on the Form ZN02A makes the data insufficient for purposes of tax incentive evaluation.

- *Difficulty Accessing Taxation Data*

It is essential that all data necessary for the evaluation of Rhode Island tax incentive programs such as the EZ credit program are captured by Rhode Island tax forms. Beneficiaries of tax incentive programs must specifically consent to sharing these data with any state agencies tasked with evaluation as a condition of receiving the tax benefit. Such data must be reviewed for completeness and accuracy prior to award of any tax credit.

In creating this and other reports, it typically takes a significant period of time following the close of a tax year for the Division of Taxation to provide ORA with all necessary data to complete its required evaluation. For example, ORA relies on the Division of Taxation to construct a personal income tax simulation model to estimate the total taxes paid by credit recipients. The data necessary to construct this model typically is not available until 15 or more months following the close of the tax year. This is due in part to the fact that personal income tax returns are filed throughout the calendar year immediately following the close of the tax year and it is not until the end of the calendar year that the overwhelming majority of personal income tax returns have been filed and processed. For many other ad hoc data requests, federal privacy laws and regulations make it difficult or impossible to utilize administrative taxpayer data for tax incentive evaluation. For ORA to conduct evaluations, better access to data under Division of Taxation control, an agency whose primary mission is processing tax returns fairly and efficiently for taxpayers and ensuring compliance with the state's tax code, or improving data collection tools so that tax incentive recipient firms themselves submit required data in a manner suitable for evaluation is necessary.

3. ORA Recommendations

Pursuant to § 42-64.3-6(7), the Enterprise Zone Wage Tax Credit was repealed and no new credits shall be issued on or after July 1, 2015. Therefore, ORA is not providing any recommendations related to this tax credit.

The Office of Revenue Analysis recommends a reconsideration of the Enterprise Zone Resident Business Owner Tax Modification. Although the utilization of this incentive is more widespread than that of the Enterprise Zone Wage Tax Credit with an average of 42 users per year over the calendar year 2013 – 2015 period versus three users of the Enterprise Zone Wage Tax Credit, the amount of revenue forgone from the use of the modification is very modest at an average of $14,526 per year vs. $442,034 per year for the EZ Wage Tax credit. It is hard to believe that at such low levels of revenue impact the employment or GDP impact would be measurable in any meaningful way. Thus, the reconsideration of the incentive should strongly consider the repeal of the incentive as a potential outcome.

Appendix

Exhibit A: Rhode Island Form ZN02A

Form ZN02A

Annual Report

State of Rhode Island and Providence Plantations

Division of Taxation

Distressed Areas Economic Revitalization Act - Enterprise Zones - Annual Employee Report

Due September 1, 2017

NAME OF ENTITY	
ADDRESS	
CITY	STATE
FEDERAL IDENTIFICATION NUMBER	

TOTAL NUMBER OF EMPLOYEES	
TOTAL PAYROLL - JULY 1, 2016 - JUNE 30, 2017	

*** **ALL INFORMATION IS REQUIRED FOR ALL EMPLOYEES** ***

Indicate Employee Type: Full time, Part time or Seasonal Employee	Employee Name	Social Security Number	Date of Hire	Hourly Wage as of 7/1/2017	Hours Worked Per Week Within Rhode Island	City/Town of Employee's Residence	City/Town of Employee's Workplace	Health Insurance Y/N	Pension Benefits Y/N

If additional space is needed, please attach a separate sheet(s) with the additional information.

Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct and complete .

Signature of authorized officer　　Date　　Signature of preparer　　Date

Title　　MAY THE DIVISION CONTACT YOUR PREPARER ABOUT THIS RETURN? Y　N　　Telephone number

07/2017 **MAILING ADDRESS: DONNA DUBE, RHODE ISLAND DIVISION OF TAXATION, FORMS, CREDITS & INCENTIVES SECTION, ONE CAPITOL HILL, PROVIDENCE, RI 02908**

Instructions for Form ZN02A
Distressed Areas Economic Revitalization Act - Enterprise Zones
Annual Employee Report

Due September 1, 2017

Complete all informational lines at the top of the form, including name, address, city, state and ZIP code, and federal identification number.

In addition, please provide your total number of employees and your total payroll for the period of July 1, 2016 through June 30, 2017.

In the first column, please indicate if the employee is a full time employee, a part time employee or a seasonal employee.

In the space provided, or on a separate sheet(s), provide the following information for each employee: name, **full social security number**, date of hire, hourly wage as of July 1, 2017, the number of hours worked per week within the State of Rhode Island by the employee, city/town of employee's residence and the city/town where the employee works.

In the last two columns, please indicate with either a yes or no, whether or not health insurance benefits and/or pension benefits are offered to the employee.

All information is required for all company employees, not just those new employees used to qualify for the enterprise zone credit.

This form must be filed by September 1, annually.

This Annual Report is being sent as a guide. A fillable version can be found online. You may either complete the fillable version on-line, print it out and send it in; send the report as an Excel spreadsheet or a txt (csv) file (be sure to send in the file format) via CD-ROM or DVD; or you may send the file via secure ftp. In order to file via secure ftp, send an email to Donna.Dube@tax.ri.gov. You will then be sent an email containing the secure link.

Regardless of format, the report must contain all required information as shown on the Annual Report form.

A fillable version of this form is available online at: www.tax.ri.gov/taxforms/misc.php#reporting .

All Annual Reports, regardless of format, shall be submitted to Donna Dube by either

mail: Rhode Island Division of Taxation
Forms, Credits & Incentives Section
One Capitol Hill
Providence, RI 02908
Attn: Donna Dube

or email: Donna.Dube@tax.ri.gov

Pursuant to RIGL 42-64.3-6.1, all companies receiving credit under § 42-64.3 - Distressed Areas Economic Revitalization Act - Enterprise Zones shall file an annual report with the tax administrator containing information on each employee as deemed necessary by the tax administrator.

Important Definitions:

"Health Insurance Benefits" means any health insurance plan offered by the eligible company to its employees regardless of whether or not the employee takes advantage of the plan.

"Retirement Benefits" means any retirement plan offered by the eligible company to its employees regardless of whether or not the employee takes advantage of the plan. This could be in the form of a SEP, a SIMPLE, a 401K plan, a profit sharing plan, a defined benefit plan, a deferred compensation plan or any qualified employer plan.

NOTE: An employee who is required to complete a reasonable probationary period to be eligible for healthcare or retirement benefits is deemed to have "earned" those benefits from day one of their employment.