The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Commerce Committee

BILL: SB 768

INTRODUCER: Senator Oelrich

SUBJECT: Tax Credits for Research & Development

DATE: March 9, 2009 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pugh	Cooper	CM	**Pre-meeting**
2.			FT	
3.			GA	
4.			WPSC	
5.				
6.				

I. Summary:

Thirty-two states and the federal government offer eligible businesses a research and development (R&D) tax credit, which is intended to stimulate scientific or technological advances, leading to high-wage, high-skilled jobs.

SB 768 creates a research and development (R&D) tax credit against Florida corporate income taxes. The Florida tax credit is modeled after the federal research tax credit in Title 26 U.S. Code section 41 and incorporates some of its definitions.

The tax credit is equal to 10 percent of the difference between a company's qualified R&D expenditures in the current taxable year and its average R&D expenditures over the previous 4 tax years. Other key points are:

- An R&D tax credit may not exceed 50 percent of a business' corporate tax liability in a tax year, after any other corporate tax credits have been applied.
- To qualify for the tax credit, business entities must be "clearly engaged in" specified R&D activities and be subject to Florida's corporate income tax.
- A business may carry forward, for up to 5 years, any unused tax credit.
- Unused tax credits may be transferred or sold <u>one time only</u> to other business entities, at no less than 75 percent of their face value.

The amount of R&D tax credits that can be approved by the state Department of Revenue (DOR) during any calendar year is capped at $15 million. DOR also is directed to adopt rules to implement and administer the new R&D tax credit.

SB 768 creates s. 220.194, F.S., and has an effective date of July 1, 2009, although tax credits cannot be used to offset corporate income taxes until the following year.

II. Present Situation:

The "U.S. Research and Experimentation Tax Credit" was created in 1981 as part of the Economic Recovery Tax Act, a comprehensive package of initiatives designed to boost the competitiveness of U.S. businesses and encourage investment and savings by American taxpayers during a period of economic recession.[1]

Originally the credit was 25 percent of qualified research expenditures in excess over the previous year's expenditures, and the types of expenditures that qualified were limited to scientific or experimental research. Over the years, the tax credit formula has been modified several times and the types of eligible expenses broadened.

Under current federal law, "qualified research expenses" include wages paid to in-house research staff, supplies used in research activities (not including land, improvements to land or certain depreciable property), and up to 65 percent of funds paid to contracted personnel for qualified research.[2] "Qualified research" includes a company's expenditures that are technological in nature and which are intended to be useful in the development of a new or improved business process, product, software, formula, invention or other business component that will be used by the company or which the company intends to sell, license or lease.[3]

The federal tax credit is an incremental tax credit because a company is only rewarded if it increases its R&D spending over a predetermined base period. The amount of the federal tax credit can be determined by three different methods, depending in part on how long the company has been in business. Under the basic formula, the tax credit is equal to 20 percent of the current tax year's qualified R&D expenses over the base amount, which is calculated using a ratio of qualified R&D expenses and gross receipts during the period of 1984 through 1988.[4] Newer companies can use simpler formulas that still compare current year R&D spending with past years. Business entities that do not pay federal corporate income tax, such as "S corporations" and partnerships, are allowed to "pass-thru" their federal research credits to shareholders or partners, based on these individuals' shares in such business entities.[5]

For the 2005 federal tax year, the amount of research tax credits taken directly was nearly $6.4 billion, with another $136.2 million claimed via "pass-thrus."[6] Manufacturing companies

[1] "The U.S. Research and Experimentation Tax Credit in the 1990s" by Francisco Moris. National Science Foundation Report #NSF05-316 published July 2005. Retrieved at http://www.nsf.gov/statistics/infbrief/nsf05316/, and "The Prospects for Economic Recovery," prepared by the Congressional Budget Office. Published February 1982. Pertinent information on pages 87-93. Retrieved at http://www.cbo.gov/ftpdocs/51xx/doc5135/doc03b-Part8.pdf. Sites last visited Feb. 28, 2009.
[2] 26 USC sec. 41(b).
[3] 26 USC sec. 41(d).
[4] 26 USC sec. 41(c).
[5] 26 USC sec. 41(g).
[6] Internal Revenue Service, Statistics of Income Division. Retrievable at: http://www.irs.gov/taxstats/article/0,,id=164402,00.html. Also see: http://www.irs.gov/pub/irs-soi/04-05crreac.pdf. Last visited Feb. 28, 2009.

claimed 71 percent of the federal research tax credits. Wages comprised about 68 percent of the qualified expenses.[7]

Other states' R&D tax credits

Thirty-two states have enacted an R&D tax credit.[8] The majority of the states appear to use the federal definitions for credit eligibility and follow the federal formula for establishing a base time period. The statutory credit percentages range from Minnesota's 2.5 percent of the difference between current R&D expenses and the average from a past, fixed period, to Hawaii's non-incremental 20 percent tax credit on all qualified R&D expenditures each year. All but three states use the federal tax credit's incremental approach to computing their R&D credits.

States with an R&D Tax Credit and the Maximum Statutory Credit Amount			
Arizona (11%)	Indiana (5%)	Missouri (6.5%)	Pennsylvania (10%)
California (15%)	Iowa (6.5%)	Montana (5%)	Rhode Island (16.9%)
Connecticut (6%)	Kansas (6.5%)	Nebraska (3%)	South Carolina (5%)
Delaware (10%)	Louisiana (8%)	New Jersey (10%)	Texas (5%)
Georgia (10%)	Maine (5%)	North Carolina (5%)	Utah (6%)
Hawaii (20%)	Maryland (10%)	North Dakota (4%)	Vermont (10%)
Idaho (5%)	Massachusetts (10%)	Ohio (7%)	West Virginia (10%)
Illinois (6.5%)	Minnesota (2.5%)	Oregon (5%)	Wisconsin (5%)

Source: Federal Reserve Bank of San Francisco, August 2007

Some states allow the tax credit to be taken only against their state income tax, while others allow it to be taken against a variety of state tax liabilities. Also, some states offer the highest tax credit rate to R&D activities done in conjunction with university partners, while others make no distinction.

Viewpoints on R&D Tax Credits[9]

Supporters of R&D tax credits say they are necessary to keep the United States competitive with other nations, to create high-wage jobs, and to fuel technological innovation in business and industry. Some economists have written research papers questioning the positive impact of

[7] Ibid.

[8] "Beggar thy Neighbor? The In-State, Out-of-State, and Aggregate Effects of R&D Tax Credits." Daniel J. Wilson of the Federal Reserve Bank of San Francisco. Retrievable at: http://www.frbsf.org/publications/economics/papers/2005/wp05-08bk.pdf Last visited Feb. 28, 2009.

[9] A sampling of sites with reports and other information in support of R&D tax credits include: "Boosting Technological Innovation through the Research and Experimentation Tax Credit." Robert D. Atkinson/Progressive Policy Institute. Published May 1, 1999. Found at: http://www.ppionline.org/ppi_ci.cfm?knlgAreaID=140&subsecID=293&contentID=1411.html.; "The Research and Experimentation Tax Credit." Chris Edwards/The Tax Foundation. Published November 1, 1993. Found at http://www.taxfoundation.org/publications/show/591.html.; and the National Association of Manufacturers website at http://www.nam.org. GAO/GGD-89-114 is found at http://archive.gao.gov/d26t7/139607.pdf. GAO/GGD-96-43 is found at http://www.gao.gov/archive/1996/gg96043.pdf. A sampling of sites with reports that question the value of R&D tax credits as zero-sum, at best, include: "Does Government R&D Policy Mainly Benefit Scientists and Engineers?" Austan Goolsbee. Presented at the National Bureau of Economic Research. April 1998. Found at http://www.nber.org/papers/w6532. "Beggar thy Neighbor? The In-State, Out-of-State, and Aggregate Effects of R&D Tax Credits." Daniel J. Wilson/Federal Reserve Bank of San Francisco. Found at http://www.frbsf.org/publications/economics/papers/2005/wp05-08bk.pdf.; and "How Important is Business R&D for Economic Growth and Should the Government Subsidise it? Rachel Griffith/Institute for Fiscal Studies. Found at http://www.ifs.org.uk/bns/bn12.pdf. These sites were last visited on Feb. 28, 2009.

R&D tax credits and whether they are cost-effective. The General Accounting Office has published reports in 1989 and in 1996 about the federal research tax credit that evaluate the tax credit's return on investment compared with foregone tax revenues.

Statistics

Internationally, the United States, in 2006, ranked first in R&D expenditures, at $344 billion, most of it spent on defense research.[10] The nation's R&D expenditures as a measure of the Gross Domestic Product have remained stable over the last several years at 2.6 percent, which ranks seventh internationally.[11]

According to research[12] provided by Enterprise Florida, Inc., in 2005 Florida's per capita industry-performed R&D was roughly 31 percent of the national average. At 23 cents per capita, Florida's private-sector R&D expenditures is lower than several of its competitor states, including New York (at 49 cents per capita), Virginia (58 cents per capita); North Carolina (59 cents per capita), California ($1.40 per capita), and Massachusetts ($2.07 per capita). Similarly, private-sector R&D investment in Florida comprises a lower percentage of total R&D investment, at 64 percent, than the national average of 71 percent and that of several competitor states.

III. Effect of Proposed Changes:

Section 1 creates s. 220.194, F.S., which authorizes an R&D tax credit against state corporate income taxes. It explains the formula that will be used to compute the actual amount of tax credit available to individual eligible businesses; basically, the tax credit will be equal to 10 percent of the difference between the current tax year's R&D expenditures and the average of R&D expenditures over the previous 4 tax years. However, if the business has existed fewer than 4 years, then the credit amount is reduced by 25 percent for each year the business did not exist within the 4-year base period.

A number of terms are defined; key among them are:

- "Business enterprise" means any corporation, as defined in s. 220.01(1)(e), F.S., that is engaged in the manufacturing, transportation and warehousing, telecommunication, tourism, or research and development industries in Florida, including retail businesses.
- "Qualified research expenses" means research expenses qualifying for the federal credit under section 41 of the Internal Revenue Code for in-house or contract research expenses within Florida. Not eligible is R&D conducted out of state, research excluded by the federal code, and R&D conducted by a business enterprise that is not within its principal business activity.
- "Research and development industry" means a corporation that is clearly engaged in the R&D business and is identified as such on its IRS returns.

[10] Briefing Note on the United States. Organisation for Economic and Cooperative Development's Science, Technology and Industry Scoreboard 2007. Retrievable at http://www.oecd.org/dataoecd/19/11/39695454.pdf. Last visited Feb. 28, 2009.
[11] Organisation for Economic and Cooperative Development's Science, Technology and Industry Scoreboard 2007. Retrievable at http://www.oecd.org/dataoecd/19/11/39695454.pdf. Last visited Feb. 28, 2009.
[12] On file with the Senate Commerce Committee.

The state tax credit taken in any tax year may not exceed 50 percent of the company's remaining net corporate income tax liability under ch. 220, F.S., after all other credits to which the business is entitled have been applied.

Any unused credits may either be carried forward by the business that originally earned them for up to 5 years following the year in which the qualified research expenses were incurred. Or, they may be assigned or sold to another corporate income taxpayer for no less than 75 percent of their value. In the latter instance:

- The business that earned R&D tax credits may assign or sell them if it has not claimed the credits within 1 year of DOR having approved them.
- The business entity that has been assigned the credits or has purchased them must use the credits in the tax year in which they were purchased or assigned.
- Assigned or sold credits may not be carried forward, carried back, resold, or refunded.

The maximum amount of R&D credits that may be approved by DOR during any calendar year is $15 million. Applications may be filed with DOR on or after March 20 for qualified research expenses incurred within the preceding calendar year, and credits shall be granted in the order in which completed applications are received.

Finally, DOR is directed to adopt rules governing the manner and form of the R&D tax credit application, and may establish guidelines for businesses seeking to affirm their qualification for the credit.

Section 2 amends s. 220.02, F.S., to establish the order in which a corporate taxpayer may claim the R&D tax credit, compared to all other potential corporate income tax credits. The R&D tax credit is last in the list.

Section 3 provides that the bill becomes law July 1, 2009, but is effective for tax years beginning on or after January 1, 2010. This latter date is important because corporate income tax filers typically use January-December as their fiscal year to conform to the federal tax period.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

At its February 19, 2009, meeting, the Revenue Estimating Conference (REC) adopted by consensus a negative fiscal impact of $15 million to the state's General Revenue Fund for FY 2009-2010, if HB 577 (the companion to SB 768) becomes law. The bill's recurring impact was estimated at $15 million annually. The REC assumed that all of the available R&D credits would be taken each fiscal year, based on a trend analysis.

B. Private Sector Impact:

Small as well as large companies engaged in R&D could benefit from a state R&D tax credit program, either directly or through the credit transfer program, as long as they meet the eligibility criteria.

C. Government Sector Impact:

Implementation of SB 768 is likely to increase DOR's workload, require changes to the state corporate income tax form, and require at least modification to existing software to track the claiming and transfer of the R&D tax credits.

VI. Technical Deficiencies:

DOR suggests rewording one provision in SB 768 to make it easier for the agency to administer the tax credit program, and to avoid confusion among companies eligible to claim the R&D tax credit.

Lines 138-141 of the bill provides that a credit may be assigned or sold if a "claim for allowance" has not been filed within one year following the date on which DOR first approved the credit. Since credits are based on a company's R&D expenditures each tax year, and since companies can wait until 9 months to file their tax returns, it may be clearer to rewrite the provision so that a tax credit can be transferred if the company is unable to use it in the year it was incurred or approved by DOR.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.