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:	CS/SB 1398
INTRODUCER:	Commerce Committee and Senator Oelrich
SUBJECT:	Tax Credit/Research & Development Expenses
DATE:	March 25, 2008
REVISED:	

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pugh	Cooper	CM	**Fav/CS**
2.			FT	
3.			GA	
4.				
5.				
6.				

I. Summary:

The Committee Substitute for Senate Bill 1398 creates a research and development (R&D) tax credit against state corporate income taxes. The tax credit's purpose is to stimulate the development of scientific and technological advances by a variety of businesses, which in turn may increase their competitiveness and create high-wage research jobs in Florida. 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.

CS/SB 1398 outlines a formula for computing the tax credit; basically, the credit is equal to 10 percent of the difference between the qualified R&D expenditures in the current taxable year and the 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 to certain other business entities, if a claim has not been made for their use within a year of when the credits were originally approved. The purchasing business or assignee must use the tax credits in the same year that the transfer or purchase was made, and may not offset more than 75 percent of its corporate tax liability. Transferred or sold credits may not be carried over, carried back, resold, or refunded. Also, the businesses using transferred credits must be subject to the state's corporate income tax and be engaged in R& D activities.

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 is directed to adopt rules to implement and administer the new R&D tax credit.

CS/SB 1398 creates s. 220.194, F.S.

II. Present Situation:

Federal tax credit

The "U.S. Research and Experimentation Tax Credit" was created in 1981as part of the Economic Recovery Tax Act, a comprehensive package of initiatives designed to boost U.S. business competititiveness 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]

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[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. 29, 2008.
[2] 26 USC sec. 41(b)
[3] 26 USC sec. 41(d).
[4] 26 USC sec. 41(c)
[5] 26 USC sec. 41 (g)

For the 2003 federal tax year, the amount of research tax credits taken directly was nearly $5.4 billion, with another $124.5 million claimed via "pass-thrus."[6] Manufacturing companies claimed the largest percentage of research tax credits, $3.8 billion worth. Wages comprised about 68 percent of the qualified expenses. [7]

The tax credit expired Dec. 31, 2007, but legislation has been filed to extend it permanently.[8]

Other states' R&D tax credits

Thirty-two states have enacted an R&D tax credit.[9] 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.

[6] Internal Revenue Service, Statistics of Income Division. Retrievable at http://www.irs.gov/taxstats/article/0,,id=164402,00.html. Last visited March 4, 2008.
[7] Ibid.
[8] S. 2209 by Sen. Orrin Hatch and others. Access bill and track its progress at http://thomas.loc.gov.
[9] "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 March 5, 2008.

Viewpoints on R&D Tax Credits[10]

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 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.[11] 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.[12]

According to research[13] 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

[10] 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/s_nam/sec.asp?CID=514&DID=512. 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 visited between March 3-8, 2008.

[11] "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 March 9, 2008.

[12] Organisation for Economic and Cooperative Development's Science, Technology and Industry Scoreboard 2007. Retrievable at http://miranda.sourceoecd.org/vl=1907122/cl=75/nw=1/rpsv/sti2007/ga2-1.htm. Last visited March 9, 2008.

[13] On file with the Senate Commerce Committee.

the difference between the current tax year's R&D expenditures and the average of R&D expenditures over the previous 4 tax years. 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 and allocated 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.

The state tax credit taken in any 1 tax year may not exceed 50 percent of the original business enterprise'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 it 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 who is engaged in R&D activities. 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 the Department of Revenue 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 purchased credits may not be used to offset more than 75 percent of the business entity's corporate tax liability for that taxable year.
- 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 set at $15 million.

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., establishes 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, 2008, but is effective for tax years beginning on or after January 1, 2009. 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:

None.

B. Private Sector Impact:

Startups as well as established companies could benefit from a state R&D tax credit program, either directly and through the credit transfer program, as long as they met the eligibility criteria.

C. Government Sector Impact:

On February 8, 2008, the Revenue Estimating Conference adopted by consensus a negative cash fiscal impact of $7.5 million to the state's General Revenue Fund for FY 2008-2009, if HB 773 (the companion to CS/SB 1398) becomes law with an annual cap of $15 million for approved tax credits. The bill's recurring impact was estimated at $15 million annually.

DOR estimates that implementation of CS/SB 1398 will require one new FTE and cost $54,219 in salaries, benefits and non-recurring expenses in FY 07-08.

VI. Technical Deficiencies:

None.

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.)

CS by the Commerce Committee on March 25, 2008:

- Establishes a $15 million cap on the maximum amount of R&D tax credits that may be granted and approved by DOR each year.
- Rewords and simplifies the definition for "base amount" to mean the average of the eligible business enterprise's qualified research expenses allowed by the IRS for the 4 taxable years preceding the year in which the state credit is being sought.
- Amends the definition for "business enterprise" to include the requirement that enterprise must be a corporation as defined in s. 220.03(1)(e), F.S., meaning it is subject to the corporate income tax.
- Adds definitions for "qualified research expenses," "manufacturing industry," "transportation and warehousing industry," "telecommunications industry," "tourism industry," "retail industry," and "research and development industry."
- Reduces the carry-forward period from 10 years to 5 years for the business enterprises that originally obtain the R&D tax credit.
- Clarifies that the tax credits may be assigned or sold to another corporate
- income taxpayer who performs R&D research.
- Broadens DOR's rulemaking authority under the bill to include, but not be limited to, rules prescribing forms, application procedures and dates, and notification or other procedures for the sale or assignment of a tax credit. DOR also may establish rules requiring the type of evidence a business enterprise might need to provide the agency with in order to substantiate its claim for an R&D tax credit.
- Establishes that the R&D tax credit is last in the queue of existing corporate income tax credits that may be taken.

B. Amendments:

Not applicable.