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 and Tourism Committee

BILL: SB 942

INTRODUCER: Senator Bogdanoff

SUBJECT: Tax Credits for Research and Development

DATE: March 30, 2011 REVISED:

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

I. Summary:

Congress first enacted a research and development (R&D) tax credit in 1981 to encourage scientific initiatives and innovation among U.S. businesses. Currently, 38 states offer R&D tax credits against corporate or other state tax liability.

SB 942 creates an R&D tax credit against Florida corporate income tax liability. The maximum amount of R&D tax credits that can be approved by the Department of Revenue (DOR) during any calendar year is $15 million. Credits cannot be claimed until the tax year that begins on or after January 1, 2012.

The bill outlines a formula for computing the tax credit. Basically, the credit is equal to 10 percent of the difference between a business' 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 enterprise's corporate tax liability in a taxable year, after any other corporate tax credits have been applied.
- To qualify for the tax credit, a business enterprise must be a target industry, as defined in s. 288.106, F.S.
- A business enterprise may carry forward any unused tax credit for up to 5 years.
- A business enterprise may transfer or sell its unused credits within 1 year after they were originally approved to another business enterprise. The purchasing business or assignee must use the tax credits in the same year that the transfer or purchase was made.

DOR is directed to adopt rules to implement and administer the new R&D tax credit.
SB 942 creates s. 220.194, F.S., and amends s. 220.02, F.S.

II. Present Situation:

Federal tax credit

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 U.S. business competitiveness 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.[2]

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.[3] "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.[4]

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.[5] 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-through" their federal R&D credits to shareholders or partners, based on these individuals' shares in such business entities.[6]

For the 2008 federal tax year, some 12,736 companies claimed $8.3 billion in R&D tax credits, including $167.7 million claimed via "pass-throughs."[7] Manufacturing companies claimed the

[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 March 30, 2011.

[2] The U.S. General Accounting Office has prepared two reports over the years that examine changes in the tax credit program and analyze the program's impact. 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.

[3] 26 USC sec. 41(b).

[4] 26 USC sec. 41(d).

[5] 26 USC sec. 41(c).

[6] 26 USC sec. 41 (g).

[7] Internal Revenue Service, Statistics of Income Division. Retrievable at http://www.irs.gov/taxstats/article/0,,id=164402,00.html. Last visited March 30, 2011.

largest percentage of research tax credits, $5.78 billion worth.[8] Wages comprised nearly $55.6 billion of the $67.3 billion in qualified R&D expenditures reported by businesses to the IRS. [9]

Congress reauthorized the R&D tax credit in December through tax year 2011.[10]

Other states' R&D tax credits

Thirty-eight states have enacted an R&D tax credit.[11] 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. 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. Five states[12] offer refundable tax credits, meaning those states remit to eligible businesses the excess difference between their taxes owed and the amount of R&D tax credit they earned.

Statistics

Internationally, the United States, in 2007, ranked first in R&D expenditures, at $344 billion, most of it spent on defense research.[13] The nation's R&D expenditures as a measure of the Gross Domestic Product have remained stable over the last several years around 2.6 percent, which ranks 4th internationally, behind Israel, Sweden, and Finland.[14] Many nations offer a version of R&D tax credits, which are considered an important economic-development tool.[15]

According to research[16] compiled by the Alliance for Science & Technology Research in America, in 2007 Florida's business R&D ranked 17th in the nation, totaling less than 2 percent of the U.S., but private- and public-sector R&D affiliated with state universities ranked in the top 10 nationally, based on 2006 statistics.

III. Effect of Proposed Changes:

SB 942 creates a Florida R&D tax credit program designed to stimulate the development of scientific and technological advances by target industry businesses, which in turn may increase business competitiveness, create high-wage research jobs in Florida, and develop new products

[8] Ibid.
[9] Ibid.
[10] P.L.111 - 312, December 17, 2010.
[11] "Iowa's Research Activities Tax Credit Tax Credits Program Evaluation Study." Iowa Department of Revenue. Published January 2008. Appendix/Chart 6, on pages 37-41 of the report lists details of all 38 states' R&D tax credits. See: http://www.iowa.gov/tax/taxlaw/IDRTaxCreditEvalJan2008.pdf.
[12] Hawaii, Iowa, Louisiana, Nebraska, and New York are the states. Ibid.
[13] "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 30, 2011.
[14] Organisation for Economic and Cooperative Development's Fact Book for 2009. Retrievable at: http://oberon.sourceoecd.org/vl=5806526/cl=18/nw=1/rpsv/factbook/07/01/01/index.htm. Last visited March 30, 2011.
[15] "2010 Global Survey of R&D Tax Incentives," prepared by Deloitte and published in January 2011. Available at: http://www.nam.org/~/media/C917926074BE4CE8A4E7AF2C017D67A2/Global_RD_Survey_Final.pdf.
[16] The Alliance for Science & Technology Research in America, 2010 report. Available at http://www.usinnovation.org/state/pdf_cvd/CVD10FloridaR&D.pdf. Last visited March 30,2011.

and services for market. 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.

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.

For established businesses, 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 taxable years. For businesses in existence fewer than 4 years, the credit amount is reduced by 25 percent for each year the business did not exist within the 4-year base period.

The bill defines a number of terms; key among them are:

- Business enterprise means any corporation as defined in s. 220.03, F.S., that is also a target industry business[17] as defined in s. 288.106(1)(o), F.S. *(This is erroneous cross-reference. The correct cross-reference is s. 288.106(2)(t), F.S.)*; and
- Qualified research expenses mean 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.

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 also is a business enterprise, and thus a target industry. 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 that has been assigned the credits or has purchased them must use the credits in the same taxable year in which they were purchased or assigned.
- Assigned or purchased credits must have been exchanged for at least 75 percent of their face value.

The maximum amount of R&D credits that may be approved by DOR during any calendar year is $15 million.

[17] The "target industry list" actually is a list of industry sectors that meet criteria related to high wage, high growth potential, and market independence. It is developed by the Governor's Office of Tourism, Trade, and Economic Development, in consultation with Enterprise Florida, Inc. The 2011 targeted industry list was approved by OTTED in January and includes eight categories: Clean Tech; Life Sciences; Information Technology; Aviation/Aerospace; Homeland Security/Defense; Financial/Professional Services; Emerging Technologies; and Other Manufacturing.

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: Specifies that the bill becomes law July 1, 2011, but that the credits cannot be claimed prior to the taxable year beginning on or after January 1, 2012.

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 March 4, 2011, meeting, the Revenue Estimating Conference determined by consensus that SB 942 will have a negative fiscal impact of $5 million in cash for FY 2011-2012 and negative $15 million in cash for FYs 2012-2013, 2013-2014, and 2014-2015.

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 meet the eligibility criteria.

C. Government Sector Impact:

Indeterminate. DOR is likely to incur some personnel and other administrative costs in administering the tax credit program, and in modifying forms and software.

VI. Technical Deficiencies:

As stated above, the reference to the definition for “target industry” is erroneous and should be corrected to s. 288.106(2)(t), F.S.

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.