

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 733 Tax Credit for Research and Development Expenses

SPONSOR(S): Grant and others

TIED BILLS: **IDEN./SIM. BILLS:** SB 1398

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Committee on Economic Development</u>	<u>10 Y, 0 N</u>	<u>West</u>	<u>Croom</u>
2) <u>Economic Expansion & Infrastructure Council</u>	<u></u>	<u></u>	<u></u>
3) <u>Policy & Budget Council</u>	<u></u>	<u></u>	<u></u>
4) <u></u>	<u></u>	<u></u>	<u></u>
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SUMMARY ANALYSIS

This bill creates s. 220.194, F.S., the research and development tax credit that may be used to offset the state corporate income tax liability of a business engaged in research and development activities. Businesses will receive a tax credit for 10 percent of excess costs over a base amount. The base amount is determined by a mathematical equation.

Any Florida business that is engaged in the manufacturing, warehousing and distribution, processing, telecommunications, tourism, or research and development industries with qualified research expenses in Florida is eligible for the credit so long as the business is eligible to receive a federal research credit under s. 41 of the Internal Revenue Code.

The program created by this bill provides up to \$15 million in state corporate income tax credits annually, however, unused credits may be carried forward 10 years.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Ensure Lower Taxes - The program created by this bill provides a tax credit that may be used to offset Florida corporate income tax liability.

B. EFFECT OF PROPOSED CHANGES:

Background

Currently, Florida does not have a corporate income tax credit for general research and development, however, a federal tax credit for research and development does exist. Section 41 of the Internal Revenue Code provides such a credit to businesses engaged in qualified research and development activities. The federal tax credit is designed to stimulate additional research and development performed by businesses over time by reducing costs.

Under the federal program, businesses that qualify receive a credit equal to 20 percent of the qualified research expenses above a base amount against corporate income tax liabilities. The base amount is calculated by multiplying a fixed based percentage by the average annual gross receipts of the taxpayer for the four previous years for which the credit is being determined.¹

Many of Florida's competitor states provide a state-sponsored research and development tax credit. Only 64 percent of research and development conducted in Florida is performed by private-sector entities as compared to the national average of 71 percent.² Enterprise Florida, Inc. reports that: 1) the lack of a state research and development tax credit puts Florida at a competitive disadvantage in terms of attracting out-of-state businesses that engage in research and development; and 2) a state research and development tax credit would also provide an incentive to current Florida-based businesses to engage in additional research and development.

States with a research and development tax credit include:

Arkansas	Kansas	Pennsylvania
California	Maine	Rhode Island
Colorado	Maryland	South Carolina
Connecticut	Massachusetts	Texas
Delaware	Minnesota	Utah
Georgia	Missouri	Vermont
Hawaii	Montana	West Virginia
Idaho	New Jersey	Wisconsin ³
Illinois	North Carolina	
Indiana	Ohio	

¹ Section 41 (c)(1)(a,b), Internal Revenue Code.

² Enterprise Florida, Inc. Memo on R&D Tax Credits.

³ Id.

Effect of Proposed Changes

This bill creates a Florida research and development tax credit to encourage businesses to engage in research and development activities. Any business engaged in manufacturing, warehousing and distribution, processing, telecommunications, tourism, or research and development with qualified research expenses in Florida is eligible for tax credits created in this bill. Any business that utilizes the tax credits created by this bill must also be eligible to claim a federal research and development tax credit pursuant to section 41 of the Internal Revenue Code.

The base amount is determined by dividing eligible research and development expenditures by a company's gross receipts over a predetermined base period. That number is then multiplied by the average of the research and development costs for the previous four years. If the amount of eligible research and development costs exceeds the base amount, the business is eligible to receive an award equal to 10 percent of the research and development costs above the base amount. Businesses that qualify for both federal and Florida research and development tax credits will receive awards equal to 30 of research and development costs above the base amount for that tax year.

The amount of tax credit that may be taken by a business in any single tax year may not exceed 50 percent of the remaining net income tax liability after all other tax credits have been applied. Unused credits may be carried forward by a business for 10 years and used to offset future corporate income tax liability. If a business is unable to use a tax credit after it has been approved, they may be assigned or sold to another Florida taxpayer and must be used in the tax year in which they were assigned or sold. Tax credits may be assigned or sold no more than one time. Transferred tax credits may not be exchanged for less than 75 percent of the credit's value.

Credits awarded shall be limited to no more than \$15 million annually.

The bill provides the Department of Revenue the ability to adopt rules to administer the program.

C. SECTION DIRECTORY:

Section 1. Creates s. 220.194, F.S., Research and Development Tax Credit.

Section 2. Provides an effective date of July 1, 2008.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The program created by this bill provides up to \$15 million in state corporate income tax credits annually. (see Fiscal Comments)

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The program created by this bill may attract new businesses and high-wage jobs to Florida. It is possible that a positive impact on local government revenues could result in increased local tax revenues.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Businesses that qualify for the program created by this bill may receive corporate income tax credits.

D. FISCAL COMMENTS:

Despite an annual award cap of \$15 million in state tax credits, a carry forward provision allows unused tax credits to be claimed for up to 10 years after award to offset future tax liabilities. In some years, the entire \$15 million allotment may not be claimed. If multiple businesses carry forward unused tax credits and claim those credits in a single year, there is no guarantee that the amount of tax credits claimed in one year will be limited to \$15 million.

The revenue estimating conference adopted a \$15 million recurring impact to Florida's General Revenue.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not require counties or municipalities to spend funds or take action requiring the expenditure of funds. This bill does not reduce the percentage of state tax shared with counties or municipalities. This bill does not reduce the authority that municipalities have to raise revenue.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The Department of Revenue shall adopt rules for the administration of the program created by this bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The Department of Revenue (DOR) performed an analysis of this bill and raised concerns over implementation of this program. The formula used to calculate base amount of the tax credit is difficult to administer and may be subject to interpretation. The formula may not accomplish the sponsor's goal of basing the credit on the amount of increase in Florida research expenditures.

The bill requires a business to have qualified research expenses in Florida but does not clearly require those expenses to qualify under s. 41 of the Internal Revenue Code or that all research occur in Florida.

The bill provides that businesses engaged in the "manufacturing, warehousing and distribution, processing, telecommunications, tourism, or research and development" industries are eligible for credits but those terms are not defined and could be susceptible to interpretation.

The bill provides a definition of the business activities that would qualify for the research and development tax credit but adds language, "The term does not include retail businesses." It is unclear whether a retailer may qualify for the credit or whether the retailer must engage in qualifying activities. The language may be unnecessary because nothing excludes businesses with a retail component.

The bill provides a definition for "business enterprises" that could include nontaxable entities such as sole proprietorships and partnerships that are not subject to Florida corporate income tax liability. DOR has no audit authority over non-taxpayers and no access to their federal return information. DOR would not be able to verify whether a non-taxpayer is entitled to a tax credit.

The bill becomes effective on July 1, 2008. It does not specify whether \$15 million in tax credits should be issued for the 2008 calendar year and does not specify the tax years to which the first credit applies. The effective date provides insufficient time for the DOR to develop an application and adopt rules.

The \$15 million annual limit on tax credits is not specific. The bill does not specify whether the limit should be applied to individual taxpayers or to all taxpayers receiving a credit. A credit allocation method is not provided (i.e. first-come-first-serve, pro-rata).

Credits may be assigned or sold but there is no requirement that DOR be notified or approve the sale or assignment of tax credits.

The bill provides that the credit is applied after the application of all other credits. The order in which corporate income tax credits are claimed is contained in s. 220.02(8), F.S. The credit created by this bill should be incorporated into the ordering provisions of s. 220.02(8), F.S.

Unused credits may be carried forward for 10 years. Most credits contained in Chapter 220 provide for a five year carryover. Many taxpayers and DOR dispose of tax records after six years.

Section 220.192, F.S. provides a tax credit for research and development of hydrogen energy, while s. 220.191, F.S., provides a tax credit based upon a taxpayer's total expenditures. The bill does not prevent a taxpayer from claiming two or more research and development tax credits for the same activity or claiming the credit for government sponsored research.

The Revenue Estimating Conference performed an analysis of this bill and raised concerns over several issues. The terms "research and development expenditures," "research and development expenses," and "qualified research expenses" are not defined. It is assumed that these terms have definitions that match those terms defined in Section 41 of the Internal Revenue Code.

The scale (Florida, U.S., or worldwide, subsidiary or corporate) is not stated. Both “research and development expenditures” and “gross receipts” are assumed to be defined at the worldwide level.

The “predetermined base amount” is not defined.

The term “engaged in” is not defined and the types of businesses listed are not defined. It is assumed that the method for determining a company’s business sector can be made in rule, and this process will not retard the process of awarding credits.

It is not clear if the term “credit taken” means that the credit is used against tax liability or if it means the credit is acquired so as to be used, carried forward, or sold.

As written, an assigned or sold research and development tax credit could be used to offset 75 percent of any tax liability. Unlike the earning of the credit, it appears that credits may be purchased by any taxpayer, regardless of business sector. The 75 percent limitation maybe prior to, not necessarily after, all other credits have been applied.

It is unclear if the limit (cap) is based on individual companies or statewide collections. It is also unclear if the limitation is based on the incurrence of the credit or the redemption of the credit.

D. STATEMENT OF THE SPONSOR:

Thirty-one states have created research and development tax credit programs to piggy-back onto the federal program as an incentive for company-funded research and development within their state as an economic stimulus and generator of more high-wage professional research jobs.

Florida ranks 37th nationally in terms of corporate participation in research and development. We have made great strides in improving the climate for innovation in Florida by eliminating the sales tax on research and development equipment, but more needs to be done.

Creating a state research and development tax credit will help to make Florida more nationally and globally competitive, spur our innovation economy, attract high-wage professional research jobs to Florida, help level the playing field with the Florida’s regional and national competitors, and incentivize corporate R&D activity statewide.

IV. AMENDMENTS/COUNCIL SUBSTITUTE CHANGES

On Thursday March 6, 2008, the Committee on Economic Development reported the bill favorably with a strike-all amendment. The amendment:

- Deleted the formula for determining the base amount and replaced it with a formula approved by the Department of Revenue for determining the base amount;
- Added definitions for the terms “qualified research expenses”, “base period”, “manufacturing” industry, “transportation and warehousing” industry, “telecommunications” industry, “tourism” industry, “retail” industry, and “research and development” industry,
- Changed the amount of time allowed for the carry forward of unused tax credits from 10 years to 5 years;

- Added a provision that credits sold or transferred must be sold or transferred to taxpayers as defined in s. 220, F.S.;
- Replaced language stating that sold or transferred tax credits may not be used to offset more than 75 percent of the transferee's tax liability with language stating that tax credits shall not be sold for less than 75 percent of the credit's value;
- Added language allowing the Department of Revenue to create rules for the transfer of credits; and
- Added language to direct how the Department of Revenue should distribute tax credits.