BILL # SB 1370 **TITLE:** research and development; tax credits

SPONSOR: Giffords **STATUS:** As Introduced

REQUESTED BY: House **PREPARED BY:** Brian Cary

FISCAL ANALYSIS

Description

The bill would change the formula for the amount of research and development (R&D) tax credit (both corporate and individual) that can be claimed. The credit is based on the amount of the taxpayer's qualifying research expenses in Arizona. The current formula calculates the income tax credit as 20% of the first $2.5 million in qualifying expenses plus 11% of the amount exceeding $2.5 million. The bill would increase the tax credit to 30% of the first $2.5 million in qualifying expenses plus 21% of the amount exceeding $2.5 million if the research is performed at a university in Arizona.

Estimated Impact

This bill would reduce corporate and individual income tax revenue to the General Fund based on the revised formula for calculating the tax credit. JLBC Staff, however, does not have access to the taxpayer data needed to derive an independent estimate of the impact. The Department of Revenue (DOR) maintains taxpayer records and concluded that a rough estimate of the bill's impact would be to reduce revenue by $(5) million per year.

While SB 1370 would lead to a direct reduction in corporate and individual tax liabilities, the bill would create a more favorable tax environment. As a result, the bill could stimulate additional research at the state's universities, generating additional economic activity that would lead to an offsetting increase in tax collections. This type of secondary, or dynamic impact, is difficult to estimate. The State of California has the most advanced state government level dynamic forecasting model. Based on their model, 18% of corporate tax reductions are offset by additional state revenue within 5 years.

Analysis

As described above, the bill would increase the tax credit in two ways. The amount of the credits claimed would be constrained by two significant factors: total taxpayer liability and the research expenses generated at the universities that were funded by taxpayers claiming the R&D credit. For example, a previous analysis by DOR determined that in tax year 2000 there was only $6.3 million in additional liability that could have been offset by a change in the formula. Taxpayers would not have been able to take credits exceeding that amount in tax year 2000, although they could have carried forward the remaining tax credit. As the economy grows and corporate profits increase, more tax liability is generated, providing more opportunities to claim credits that reduce tax payments.

DOR analyzed the R&D credits claimed for tax year 2001 and concluded that, if the $1.5 million limit in effect at the time were removed, the bill would have potentially increased the credits claimed to $61 million from $40 million. DOR is unable to determine whether eligible taxpayers would have sufficient liability to take full advantage of the expanded credit, nor do they have the information to determine how much qualified research expense was occurring at universities in the state.

If the effective date of the bill were to begin with tax year 2005, the revenue loss in FY 2005 would be about one-half of the 2005 tax year estimate, or about $(2.5) million, followed by losses of about $(5) million in subsequent fiscal years. Although tax liability is accrued on a calendar year basis, final tax payments and refunds are not issued until the following calendar year.

There is another concern in directly translating historical tax data from 2000 and 2001 into a cost estimate for FY 2005 and later years. We do not know exactly when companies will elect to take the tax credits, especially when the long carry forward period for qualifying expenses (15 years) is taken into account.

Local Government Impact

Each year cities and towns receive an amount equal to 15% of income tax collections from two years prior. The reductions in corporate income tax collections would result in a reduction in local government distributions of $(375,000) in FY 2007 and $(750,000) in FY 2008 and later years.

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