

Fiscal Note

BILL # HB 2771

TITLE: tax credits; qualified facilities; extension

SPONSOR: Toma

STATUS: House Engrossed

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Description

The House Engrossed version of HB 2771 would make changes to 3 existing income tax credit programs, as outlined below.

Research and Development (R&D) Credit

- Extends the current corporate credit rates of 15% and 24% from Tax Year (TY) 2021 to TY 2030.
- Provides that the corporate credit rates of 11% and 20%, which are scheduled to go into effect in TY 2022, be delayed until TY 2031.
- Reduces the carryforward period from 15 years to 10 years for new credits claimed after TY 2021.

Qualified Facility Credit

- Extends the individual and corporate credit from TY 2022 to TY 2030.
- Provides that capital investments made by a company in a qualified facility up to 36 months before applying for preapproval by the Arizona Commerce Authority (ACA) be included in the computation of the credit.

Renewable Energy Investment and Production for Self-Consumption by International Operations Centers (IOC) Credit

- Extends the due date to make the required minimum investment to qualify for the sales tax exemption on electricity and natural gas from December 31, 2018 to December 31, 2030. However, according to Legislative Council, a company can already qualify for the sales tax exemption at any time so long as it meets the investment requirements for IOC certification.
- Expands the definition of IOC to include "connected facilities under the same ownership."

Estimated Impact

Relative to the Baseline, the extension of the R&D credit and qualified facility credit are not expected to result in any additional revenue loss. However, the General Fund would forego any potential revenue gain that would occur absent the credit extensions.

Extending the IOC minimum investment due date would have no new fiscal impact since current law does not place a time cap on qualifying for the sales tax exemption.

Analysis

Research and Development (R&D) Credit

The Research and Development (R&D) credit is a corporate and individual income tax credit for increased research activities conducted in this state, including research conducted at a state university and funded by the taxpayer. The current R&D program provides both nonrefundable and refundable tax credits. The nonrefundable credit program is administered by the Department of Revenue (DOR) whereas the refundable program is administered by the Arizona Commerce Authority (ACA).

The R&D credit is calculated as a percentage of a company's research expenditures in excess of a base amount (hereafter referred to as the "excess amount). Through TY 2021, if the excess amount is \$2.5 million or less, the credit is 24% of this amount, up to a maximum of \$600,000. For excess expenditures greater than \$2.5 million, the credit is equal to \$600,000 plus 15% of the amount exceeding \$2.5 million.

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Beginning in TY 2022, if the excess amount is \$2.5 million or less, the credit is 20% of this amount, up to a maximum of \$500,000. For excess expenditures greater than \$2.5 million, the credit is equal to \$500,000 plus 11% of the amount exceeding \$2.5 million.

The House Engrossed version of HB 2771 would extend the higher credit percentages of 15% and 24%, as described above, through TY 2030. Beginning in TY 2031, the credit percentages would be lowered to 11% and 20%. These changes would apply only to the corporate R&D credit.

Since the Baseline already reflects the higher credit percentages of 15% and 24%, as described above, this provision would not result in any additional revenue loss relative to current law. However, since the credit percentages under current law decrease to 11% and 20%, beginning in TY 2022, the General Fund would forego any potential revenue gain that would occur absent the extension, beginning in FY 2023.

Qualified Facility Credit

This is a refundable credit for a company expanding or locating a qualified facility in Arizona. To qualify for the credit, the company's capital investment must be at least \$250,000 during the first 12 months following pre-approval by the Arizona Commerce Authority (ACA). A "qualified facility" is a facility that devotes at least 80% of the property and payroll at the facility to manufacturing or research activities, or to serve as a headquarter.

The credit is the least of the following 3 conditions: (1) 10% of the total qualified investment made at the facility, (2) \$20,000 per qualified job created at the facility, or (3) \$30 million per taxpayer per year. The credit must be taken in 5 equal annual installments. The credit, which must be approved by the ACA, has an aggregate cap of \$70 million per calendar year and is available through TY 2022.

The House Engrossed version of HB 2771 would extend the credit program through TY 2030. In addition, the bill would provide that capital investments made by a company in a qualified facility up to 36 months before applying for preapproval are included in the calculation of the credit.

To date, ACA has pre-approved 52 companies for the credit and issued 16 post-approvals. Due to the consider lag between pre-approval, post-approval and credit claim, it is difficult to "translate" the ACA approvals into actual General Fund cost. According to the DOR, the individual credit has only been claimed in TY 2016 and TY 2017 at a General Fund cost of \$26,000 each year. While the corporate credit has been claimed in 3 tax years, DOR has only released data (due to taxpayer confidentiality concerns) for TY 2017, when the General Fund cost was slightly less than \$3 million.

When the credit was enacted in 2012, the JLBC Staff initially estimated that the General Fund cost would increase by \$4 million annually, beginning in FY 2014. By the 5th year, or FY 2019, our analysis assumed that credit use would reach a "steady state" level after which the cost of the credit program would remain essentially unchanged. Based on limited data from ACA and DOR, it appears that the cost of the program over time has remained relatively flat albeit a lower level than originally estimated.

Without access to detailed information from the credit applications submitted to ACA or tax returns received by DOR, we are not able to determine the reason for the lower-than-estimated credit use to date. In the absence of such information, our analysis currently assumes that credit use will continue roughly at the same level under the bill as under current law. Under this assumption, which is speculative, there would be no additional revenue loss from this provision in the bill. As a result of the credit extension, however, the General Fund would forego any potential revenue gain that would occur absent this change, beginning in FY 2023.

Renewable Energy Investment and Production for Self-Consumption by International Operations Centers (IOC) Credit

This is a corporate income tax credit for investment in new renewable energy facilities that produce energy for self-consumption using renewable energy sources if the power is primarily used for an International Operations Center (IOC). To qualify for the credit, the IOC is required to: (1) invest at least \$100 million in one or more renewable energy facilities by December 31, 2018, and (2) use at least 51% of the energy produced at each facility for self-consumption by an IOC by the 5th year in operation.

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The amount of the credit per taxpayer is \$5 million per year for 5 years, for a total of \$25 million. The aggregate credit cap per year is \$10 million. No new credits can be claimed after TY 2025. According to DOR, only 1 company was certified as an IOC and qualified for the credit before the program's due date to fulfill its initial investment requirement expired on December 31, 2018. The annual credit cost of the one company that was certified as an IOC is expected to be \$5 million, for a total of \$25 million over 5 years. This means that \$5 million of the maximum allowable credit amount of \$10 million per year is used under current law. The House Engrossed version of the bill prohibits any IOC initially certified after December 31, 2018 from claiming the income tax credit. For this reason, there is no additional cost associated with the credit program.

In addition to the income tax credit, IOCs are also provided "utility relief," which is a sales tax exemption on electricity or natural gas purchased from utilities. Our understanding is that the Arizona Commerce Authority believed that the sales tax exemption was conditional upon qualifying for the income tax credit. According to Legislative Council, however, the sales tax exemption is not conditional upon qualifying for the credit. This means that unlike the income tax credit, there is no statutory due date for the sales tax exemption on electricity or natural gas. Under current law, IOC certification for purposes of receiving utility relief requires a minimum annual capital investment of \$100 million in each of 10 consecutive years and \$1.25 billion cumulatively by the 10th year in operation.

Local Government Impact

Incorporated cities and towns would forego any potential revenue gain that would occur absent the extension of the R&D credit and Qualified Facility Credit.

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