F I S C A L I M P A C T R E P O R T

SPONSOR HBIC **DATE TYPED** 2/9/2005 **HB** 51 and 245/HBICS

SHORT TITLE Research and Development Small Business Tax Credit Act **SB**

ANALYST Taylor

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY06	**FY07**			
($1,500.0)	($2,200)	Increasing	Recurring	General Fund
($300.0)	($450.0)	Increasing	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates: Is similar to Senate Bill 53

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

The House Business and Industry Committee substitute for House Bills 51 and 245 enacts the Research and Development Small Business Tax Credit Act.

The act provides qualified research and development small businesses with a tax credit equal to the sum of all gross receipts taxes, compensating taxes or withholding taxes due to the state. A qualified business is defined as a corporation, general partnership, limited partnership, limited liability company, sole proprietorship or similar entity with fewer than 25 employees, revenues of less than $5 million per year and qualified research expenditures equal to 20 percent of total expenditures for the year the credit is claimed. Qualified expenditures are expenditures for research which is technological in nature and intended to be useful in the development of new or improved business components (excluding style, taste, cosmetic or seasonal design factors).
The taxpayer may claim the credit for a period ending 35 consecutive months after the month the

credit is claimed. A credit may not be claimed for a calendar month before July 2005. The taxpayer is no longer eligible for the tax credit in a fiscal year in which total employment exceeds 25 persons or revenues exceed $25 million. The credit sunsets on June 30, 2009.

Taxpayers who claim this credit may not claim credits with respect to the Capital Equipment Tax Act, The Investment Credit Act or the Technology Jobs Tax Credit Act.

The Taxation and Revenue Department is charged with administering this act, pursuant to the Tax Administration Act.

The bill has effective date of July 1, 2005.

FISCAL IMPLICATIONS

The TRD fiscal impact estimate indicates this bill will reduce state general fund revenues by $1.5 million in million in FY06 and a total of 2.2 million in FY07; local governments would decrease by $300 thousand in FY06 and $450 thousand in FY07. According to the TRD analysis, tax return data indicates that there are more than 250 firms eligible for the proposed credits. In the most recent year, TRD estimates that these firms had combined gross receipts tax, compensating tax and withholding tax liability of approximately $3.8 million. Thus, $3.8 represents the total potential fiscal impact. TRD assumes that nearly half of eligible taxpayers will take advantage of the credit in the first year, and that participation will increase in following years.

The share of reduced revenues absorbed by local governments is due to that part of the credit affecting gross receipts taxes.

ADMINISTRATIVE IMPLICATIONS

TRD would be responsible for providing the credit claim forms for the proposed credits. According to TRD, new forms would be needed and instructions and publications would have to be modified. Manual review and tracking of the credit would be required. An approval process would be needed. TRD would require 0.5 additional FTE to administer the bill's provisions.

OTHER SUBSTANTIVE ISSUES

TRD made the following point:

According to the 1997 Economic Census, payroll expenditures alone for R&D firms average 36 percent of total receipts. This is almost twice the 20 percent criterion for determining credit eligibility. Thus the 20 percent criterion does little to limit eligibility for among R&D firms.

BT/yr