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## FISCAL IMPACT REPORT

ORIGINAL DATE 1/28/08  
 SPONSOR Heaton LAST UPDATED 2/09/08 HB 325  
 SHORT TITLE Extend Small Business Tax Credit Eligibility SB \_\_\_\_\_  
 ANALYST Schardin

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY08	FY09	FY10		
		(161.2)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)  
 Economic Development Department (EDD)

### SUMMARY

#### Synopsis of Bill

House Bill 325 would extend the current June 30, 2009 sunset of the research and development small business tax credit to June 30, 2013. Since the bill does not have an effective date, it would go into effect 90 days after adjournment of the 2008 legislature on May 14, 2008.

### FISCAL IMPLICATIONS

TRD reports that since the research and development small business tax credit became effective on July 1, 2005, a total of 15 taxpayers have applied for the credit. Of those, seven have been approved and only five have actually claimed the credit. Credits claimed by these five taxpayers have totaled \$370.9 thousand since July 1, 2005, or an average of \$12.8 thousand per month, or \$153.6 thousand per year. TRD assumes credit claims will grow by about 5 percent per year, totaling \$161.2 thousand by FY10, the first year when the credit would be repealed under current law.

## **SIGNIFICANT ISSUES**

The research and development small business tax credit was enacted in 2005 as part of that year's omnibus tax bill (HB410). When the research and development small business tax credit was enacted in 2005, analysis from TRD indicated that more than 250 firms with combined tax liabilities of \$3.8 million would be eligible for the credit. It was assumed at that time that about half of those businesses would claim their credits in the first year with participation rising after that. However, as stated in the Fiscal Implications section of this analysis, only five taxpayers have claimed the credit so far with credits totaling \$370.9 thousand.

LFC notes that while individual credits, deductions and exemptions from the gross receipts tax may have small fiscal impacts, their cumulative effect significantly narrows the gross receipts tax base. Narrowing the gross receipts tax base increases revenue volatility and requires a higher tax rate to generate the same amount of revenue.

To qualify as a “qualified research and development small business,” a business must employ no more than 25 full-time employees, have total revenues of no more than \$5 million in any prior fiscal year, not have had, in any prior calendar month, more than 50 percent of its voting securities or other equity interest owned by another business, and has made qualified research expenditures for the period of 12 calendar months ending with the month for which the credit is sought of at least 20 percent of its total expenditures.

In calculating its qualified research expenditures, a business cannot include grant-funded research, property expenditures in connection with industrial revenue bonds, or property for which the taxpayer has received a capital equipment tax credit, an investment credit or a technology jobs tax credit. A qualified research expenditure is defined as an expenditure related to qualified research, meaning research that (1) it is undertaken for the purpose of discovering information that is technological in nature and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer; and (2) in which substantially all activities constitute elements of a process of experimentation related to new or improved function, performance, reliability or quality, but not related to style, taste, cosmetic, or seasonal design factors.

## **PERFORMANCE IMPLICATIONS**

EDD reports that this credit is regularly used as an incentive to attract and retain research and development businesses. However, the fact that only five taxpayers have claimed the research and development small business tax credit since it became effective in July 2005 calls into question the net benefit of the credit. Limited use of the credit suggests the costs of administration and tax code complexity associated with having the credit in statute may outweigh the benefits to taxpayers.

## **ADMINISTRATIVE IMPLICATIONS**

The administrative impacts of continuing the credit are minimal.

SS/bb