COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 3958-01
Bill No.: HB 1615
Subject: Business and Commerce; Revenue Department; Tax Credits; Taxation and Revenue
Type: Original
Date: February 1, 2010

Bill Summary: This proposal authorizes a tax credit for qualified research expenses.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
General Revenue	($63,561)	($96,214 to $10,096,214)	($112,217 to $10,112,217)
Total Estimated Net Effect on General Revenue Fund*	**($63,561)**	**($96,214 to $10,096,214)**	**($112,217 to $10,112,217)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on Other State Funds*	**$0**	**$0**	**$0**

*** The fiscal impact could be divided between the General Revenue Fund and the County Foreign Insurance Fund (which ultimately goes to local school districts) if some of the tax credits are utilized against insurance premium taxes.**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 8 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
General Revenue	1 FTE	2 FTE	2 FTE
Total Estimated Net Effect on FTE	**1**	**2**	**2**

☐ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☒ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Local Government*	**$0**	**$0**	**$0**

*** The fiscal impact could be divided between the General Revenue Fund and the County Foreign Insurance Fund (which ultimately goes to local school districts) if some of the tax credits are utilized against insurance premium taxes.**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Department of Economic Development (DED)** state the proposed legislation creates a new Qualified Research Expense Tax Credit program. The cap for the tax credit is $10 million with at least $6 million used for distressed communities. DED would be required to administer the tax credit program.

DED's Business and Community Services (BCS) assumes the need for one additional FTE and related costs to administer the program. This FTE would be an Economic Development Incentive Specialist III and would be responsible for reviewing the tax credit applications to make sure they meet the criteria of the program, drafting and sending the tax credit awards and ensuring compliance with the program. The related costs for this FTE include one-time expenditures for systems furniture, a side chair, file cabinet, calculator and telephone and recurring costs for office supplies, computer, professional development and travel. The cap for this new tax credit is $10 million so there would be a negative impact to total state revenue. However, there would be an offset of unknown positive economic benefits as a result of this increase so the exact amount of the impact cannot be determined.

Oversight assumes DED's estimate of expense and equipment cost for the new FTE could be overstated. If DED is able to use existing desks, file cabinets, chairs, etc., the estimate for equipment for fiscal year 2011 could be reduced by roughly $6,000.

In response to a similar proposal from 2009 (HB 985), officials from the **Office of Administration - Budget and Planning (BAP)** stated the proposal creates a tax credit for qualified research costs. The total amount of tax credits available under this program is $10 million. This proposal could therefore reduce general and total state revenues by that amount.

Officials from the **Department of Revenue (DOR)** state their response to a proposal similar to or identical to this one in a previous session indicated DOR planned to absorb the administrative costs to implement the proposal. Due to budget constraints, reduction of staff and the limitations within DOR's tax systems, changes cannot be made without significant impact to the DOR's resources and budget. Therefore, the IT portion of the fiscal impact is estimated with a level of effort valued at $22,260 (840 FTE hours to make programming changes to the individual income tax processing system (MINITS) and the corporate income tax processing system (COINS)).

ASSUMPTION (continued)

DOR also states they will need one FTE Revenue Processing Technician I in Personal Tax for every 6,000 credits claimed. DOR also assumed the need for one FTE Revenue Processing Technician I in Corporate Tax for every 6,000 credits claimed. The total cost for the two additional FTE is estimated to be roughly $85,000 per year.

Oversight assumes OA-ITSD (DOR) is provided with core funding to handle a certain amount of activity each year. Oversight assumes OA-ITSD (DOR) could absorb the ITSD costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, OA-ITSD (DOR) could request funding through the appropriation process.

Oversight will assume enough companies will qualify for the benefits of this proposal to only justify one FTE each for the Department of Revenue. If the program is successful and more companies qualify for the benefits than what Oversight anticipates, Oversight assumes DOR could request additional FTE through the appropriations process.

Oversight has, for fiscal note purposes only, changed the starting salary for DOR's additional employee to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research. Also, Oversight assumes that the relatively small number of additional staff can be located in existing office space. Oversight also assumes since the program is for all years beginning on or after January 1, 2011, DOR would not require an additional FTE until those returns are filed beginning in January 2012; therefore Oversight will assume six months of FTE expense in FY 2012.

Oversight assumes DOR's estimate of expense and equipment cost for the new FTEs could be overstated. If DOR is able to use existing desks, file cabinets, chairs, etc., the estimate for equipment for fiscal year 2012 could be reduced by roughly $5,600.

Officials from the **Department of Insurance, Financial Institutions and Professional Registration (DIFP)** state it is unknown how many insurance companies will choose to participate in this program and take advantage of the tax credits. Premium tax revenue is split 50/50 between General Revenue and County Foreign Insurance Fund except for domestic Stock Property and Casualty Companies who pay premium tax to the County Stock Fund. The County Foreign Insurance Fund is later distributed to school districts through out the state. County Stock Funds are later distributed to the school district and county treasurer of the county in which the principal office of the insurer is located. It is unknown how each of these funds may be impacted by tax credits each year.

ASSUMPTION (continued)

Officials from the **Office of the Secretary of State (SOS)** assume many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the Secretary of State's Office for Administrative Rules is less than $2,500. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, we also recognize that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what our office can sustain with our core budget. Therefore, we reserve the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

Oversight compared the total tax credit issuances relative to the total tax credit redemptions for the previous three years in order to determine a relationship between the two. Oversight discovered that the annual redemptions ranged from 85 percent to 106 percent of the annual issuances. Depending on the program, the redeemed credits may have been issued several years prior and carried forward to the years studied; however, Oversight will utilize an estimated redemption total of 95 percent of tax credits issued. Therefore, if $10 million credits are issued, Oversight would assume $9,500,000 credits would be redeemed.

Oversight will range the fiscal impact of the programs from $0 (no additional tax credits will be issued) to the annual limit of $10 million. Oversight assumes there would be some positive economic benefit to the state as a result of the changes in this proposal; however, Oversight considers these benefits to be indirect and therefore, have not reflected them in the fiscal note.

This proposal could reduce Total State Revenues.

FISCAL IMPACT - State Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
GENERAL REVENUE			
Costs - Department of Economic Development			
Personal Service (1 FTE)	($35,803)	($44,253)	($45,580)
Fringe Benefits	($18,775)	($23,206)	($23,902)
Expense and Equipment	($8,983)	($4,293)	($4,422)
Total Costs - DED	($63,561)	($71,752)	($73,904)
FTE Change - DED	1 FTE	1 FTE	1 FTE
Costs - Department of Revenue			
Personal Service (1 FTE)	$0	($12,031)	($24,783)
Fringe Benefits	$0	($6,309)	($12,996)
Expense and Equipment	$0	($6,122)	($534)
Total Costs - DOR	$0	($24,462)	($38,313)
FTE Change - DOR		1 FTE	1 FTE
Loss - Tax credit fo r qualified research expenses incurred	$0	$0 to ($10,000,000)	$0 to ($10,000,000)
ESTIMATED NET EFFECT TO GENERAL REVENUE FUND	**($63,561)**	**($96,214 to $10,096,214)**	**($112,217 to $10,112,217)**
Estimated Net FTE Change for General Revenue Fund	1 FTE	2 FTE	2 FTE

Note: This does not reflect the possibility that some of the tax credits could be utilized by insurance companies against insurance premium taxes. If this occurs, the loss in tax revenue would be split between the General Revenue Fund and the County Foreign Insurance Fund, which ultimately goes to local school districts.

FISCAL IMPACT - Local Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

Small businesses that qualify under the program could be positively impacted as a result of this proposal.

FISCAL DESCRIPTION

Beginning January 1, 2011, this bill authorizes a tax credit for qualified research expenses. The tax credit will be equal to 10% of qualified research expenses, up to $500,000, or 25% of the qualified research expenses, up to $1 million, if the expenses are incurred in a distressed community.

No more than $10 million in tax credits may be issued in any fiscal year. At least $6 million of these tax credits must be issued for qualified research expenses incurred in distressed communities. The bill specifies what constitutes a qualified research expense.

To claim the tax credit, a taxpayer must submit an application for a tax credit certificate to the Department of Economic Development and any fee imposed by the department. The application must be filed at the end of the calendar year in which a qualified research expense was paid or incurred. The application must include any certified documentation and information required by the department. The tax credit may be carried forward for 10 years and may be sold or transferred.

The provisions of the bill will expire December 31 six years from the effective date.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Revenue
Office of Administration - Budget and Planning
Department of Insurance, Financial Institutions and Professional Registration
Department of Economic Development
Office of the Secretary of State

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