



MEMORANDUM

TO: Representative Stoltze, Co-Chair
Representative Thomas, Co-Chair
House Finance Committee

FROM: Susan K. Bell, Commissioner
Department of Commerce, Community,
and Economic Development

DATE: April 8, 2011

RE: HB 118 – Research and Development

[Handwritten signature of Susan K. Bell]
Representatives Stoltze and Thomas,

Several questions were asked during the House Finance Committee hearing on HB 118 – Research and Development. The questions and answers are as follows:

Why is there the seven-year carry forward?

- Other states allow the credit to be carried forward between five and 15 years, some states allow the credit to be carried forward until completely exhausted regardless of how long it takes. We believe seven years is an attractive amount of time for potential investors, recognizing that it commonly takes several years before corporations see increased revenue or net income from the R&D investments they've made.

- Also, other Alaska programs tax credits can be carried forward for as little as three years up to 15 years and, in some cases, credits can be carried forward until exhausted. Some examples of Alaska credits and carry forward provisions are:

- Film credit – Three years
- Salmon product development credit – Three years
- Minerals exploration credit – 15 years
- Gas exploration and development tax credit – Five years
- Production tax credits (.023(a) and (b)) – indefinite (until exhausted)
- Tax credit for oil and gas exploration (.025) – either refundable or can be indefinite

Should there be a cap on the tax credit limit?

- It is very difficult to put a cap on the entire program. We would have to have a preapproval process, similar to what we do with the film credit, and we believe this would limit the appeal of the credit program. Our goal is to attract new investment and innovation, which in turn we would hope would increase the competitive position, profitability, and taxes paid by Alaskan corporations.

- We want to point that several limiting factors are in place in the current bill:

- We have a limited number of corporate taxpayers.
- Taxpayers cannot claim this credit unless they have tax liability.
- The credit is applied only to investment made above the baseline, determined as an average of qualified expenditures over the three prior years.

- In addition, taxpayers would have to have at least \$50 million in increased R&D expenses before reaching the maximum credit. Other states, such as Arizona, Illinois, Texas and Vermont, have no cap on their credit.

Does this credit affect the fish tax and community revenue sharing?

- DOR shares the fisheries business tax, not the corporate income tax, with communities. The R&D credit would not be applied against the fisheries business tax; as a result community revenue sharing is not affected by this bill.

If the credit is claimed by an oil/gas development corporation under the R & D credit, can we prevent it from being claimed in other incentives?

- As currently written, there is a remote possibility that some expenses could qualify under the production tax and the R & D credit. We have suggested language that eliminates this chance.

Is this tax credit stackable with other state or federal credits?

- Taxpayers cannot claim both the federal tax credit and the state tax credit against their Alaska tax liability. In terms of Alaska corporate income tax, this credit is not stackable. The Administration is proposing changes that would ensure that the credits are not stackable in other state tax credit programs.

Why is this credit necessary if there is already a federal tax credit?

- The federal credit of 17% is allowed against federal tax liability, not Alaska tax liability. Current Alaska law allows a taxpayer to take only 18% of the federal credit against their Alaska tax liability. This bill would allow an Alaskan corporation with tax liability the opportunity to apply the 20% credit if expenses qualified and were incurred in Alaska.

- For example, if a taxpayer has \$100,000 of qualified research expenses, a taxpayer is allowed a federal credit against their federal tax liability of \$17,000. However, under current Alaska law, the taxpayer may only take a credit of \$3,060 against their Alaska tax liability and only if all of the research expenses were apportioned to Alaska. Under this bill, the taxpayer could take a credit of \$20,000 against their Alaska tax liability, significantly enhancing the appeal of conducting research in Alaska.

Is there a federal definition for “research” and for “development” or a single definition for “research and development”?

- “Qualified research and development” under this bill is defined as “qualified research” under the federal internal revenue code. There is not a separate definition for “research” or for “development”.

Should we define research and development further in the bill instead of just referring to the federal definition in 26 USC 41(d)?

- Under Alaska corporate income tax statutes, Alaska adopts the federal internal revenue code, except for provisions in conflict with specific Alaska statutes. By adopting the federal internal revenue code, we can rely on audits conducted by the Internal Revenue Service and both the State and taxpayers can rely on federal tax court decisions interpreting the definition of qualified research. If we had our own definition of “research and development,” we could no longer rely on those resources. By adopting our own definition, we would also be departing from longstanding practice of “piggybacking” federal tax laws. The effect would also make the program much more difficult to administer and it would create greater challenges for taxpayers to comply..