

ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE

February 18, 2011
3:21 p.m.

MEMBERS PRESENT

Representative Kurt Olson, Chair
Representative Craig Johnson, Vice Chair
Representative Paul Seaton
Representative Lindsey Holmes

MEMBERS ABSENT

Representative Dan Saddler
Representative Bob Miller
Representative Steve Thompson

COMMITTEE CALENDAR

HOUSE BILL NO. 118

"An Act relating to a tax credit for corporate income taxes paid for qualified research and development expenditures; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 125

"An Act moving the Alcoholic Beverage Control Board to the Department of Commerce, Community, and Economic Development and relating to duties of that department; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

PREVIOUS COMMITTEE ACTION

BILL: HB 118

SHORT TITLE: RESEARCH AND DEVELOPMENT TAX CREDIT

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/24/11	(H)	READ THE FIRST TIME - REFERRALS
01/24/11	(H)	L&C, FIN
02/18/11	(H)	L&C AT 3:15 PM CAPITOL 106

WITNESS REGISTER

CURTIS THAYER, Deputy Commissioner
Department of Commerce, Community & Economic Development (DCCED)
Juneau, Alaska

POSITION STATEMENT: Testified and answered questions during the discussion of HB 118.

WANETTA AYERS, Manager
Office of Economic Development
Department of Commerce, Community & Economic Development (DCCED)
Anchorage, Alaska

POSITION STATEMENT: Presented PowerPoint slides and answered questions during the discussion of HB 118.

JOHANNA BALES, Deputy Director
Tax Division
Anchorage Office
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Testified and answered questions during the discussion of HB 118.

MARK MEYERS, Vice Chancellor, Research
University of Alaska
Anchorage, Alaska

POSITION STATEMENT: Testified during the discussion of HB 118.

KATHRYN DODGE, Economic Development Specialist
Fairbanks North Star Borough (FNSB)
Fairbanks, Alaska

POSITION STATEMENT: Testified in support of HB 118.

ACTION NARRATIVE

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CHAIR KURT OLSON called the House Labor and Commerce Standing Committee meeting to order at 3:21 p.m. Representatives Olson Holmes, Seaton, and Johnson were present at the call to order.

HB 118-RESEARCH AND DEVELOPMENT TAX CREDIT

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CHAIR OLSON announced that the only order of business would be HOUSE BILL NO. 118, "An Act relating to a tax credit for

corporate income taxes paid for qualified research and development expenditures; and providing for an effective date."

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CURTIS THAYER, Deputy Commissioner, Department of Commerce, Community & Economic Development (DCCED), explained that HB 118 would provide a 20 percent tax credit for qualified research and development conducted by corporate taxpayers in Alaska. The research and development (R&D) tax credit is intended to stimulate private sector investment, entrepreneurial activity, and business expansion in Alaska. Other states offer similar credits and this bill would allow Alaska to compete with them and bring long-term benefits to our economy. The cap on the research and development tax credit may not exceed \$10 million per taxpayer per year. The research and development activities or the payroll of the employees must take place in Alaska, he stated.

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MR. THAYER related that purpose of the R&D tax credit is to discover informational technologies and other R&D activities. In order to qualify for R&D activities, a corporation must meet the purpose, which is to discover informational technologies and any application that would be useful in developing new or improved components. All of the R&D activities must constitute a process of experimentation, such as development of a new or improved product, process or formula, development of prototypes or models, building or improving manufacturing facilities, development or improvement of software technologies, certificate testing, and development or application for patents. Activities that do not qualify for the R&D tax credit would include exploration activity for asserting the existence, location extent or quality of ore or mineral deposit, duplication of existing business components, surveys or studies such as market research, advertising, or routine data collection, or research in the social sciences, arts, or humanities.

MR. THAYER related the R&D tax credit could induce corporations to conduct independent research in Alaska. The R&D tax credit is supported by the Department of Commerce, Community, and the Economic Development Advisory Council, which has been directed to identify means to induce investment and to help increase the viability of business. Other supporters of the R&D tax credit include Alaska businesses and chambers of commerce, as well as municipalities and economic development councils. This

initiative also parallels efforts by the Anchorage Economic Development Corporation to establish relationships with corporations looking to relocate to favorable locations in Alaska.

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MR. THAYER stated HB 118 would also impose a reporting requirement on the Department of Revenue (DOR) so the legislature and the public will be aware of the fiscal impact and economic benefits of the R&D to the state.

MR. THAYER explained that the R&D tax credit would be offered for 20 percent of qualified R&D expenditures that exceed the average qualified R&D expenditures as defined in 26 U.S.C 41(d) (Internal Revenue Code) for the three years immediately preceding the year in which the credit is claimed. Unused R&D tax credits may be carried forward for up to seven years after the expenditure for which the credit is claimed.

MR. THAYER related that in order to prevent a corporate taxpayer from claiming more than one benefit for a single expenditure the bill also provides that a R&D tax credit may not be claimed for expenditures that a corporation deducted in calculating its tax liability or for which it claimed a federal credit apportioned to Alaska. This bill would help put Alaska on a level playing field since over half of other states have similar programs. The R&D tax credit would stimulate private-sector investment, entrepreneurial activity, and business expansion in Alaska that will bring opportunity and sustainable long-term benefits to our economy. He characterized HB 118 as good for economy and Alaskan families.

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WANETTA AYERS, Manager, Office of Economic Development, Department of Commerce, Community & Economic Development (DCCED), provided background information on HB 118. She stated that the federal research and development (R&D) tax credit was established in 1981, has been reauthorized 14 times, and is authorized through 2011 [slide 1]. There has been substantial interest in permanently extending the R&D tax credit to help companies create good jobs and increase future productivity and growth.

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MS. AYERS outlined the four part test to determine what constitutes R&D according to the Internal Revenue Code (IRC) [slide 2], as follows:

Technological in Nature - must fundamentally rely on the principles of physics, biology, chemistry, mathematics, and computer science.

Level of Technological Uncertainty - activities have an associated level of uncertainty related to the development or improvement of a product or process.

Process of Experimentation - incorporates a process of theoretical and physical evaluation designed to evaluate one or more alternatives.

Permitted Purpose - requires that the goal of the activity is to improve the fit, form, or function of a product or process for a business component.

MS. AYERS commented that much of the permitted purpose was outlined by Mr. Thayer's information.

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MS. AYERS discussed the Innovation Agenda [slide 3], which she said is being discussed at the national level. The America COMPETES Act changes the approach to economic development, she said. A large part of this seeks to strengthen the capacity of the U.S. Economic Development Administration (EDA) to accelerate the commercialization of new technologies, products, processes, and services. The EDA has been restructured and the federal act formally establishes the EDA's Office of Innovation and Entrepreneurship at the Department of Commerce to foster innovation and the commercialization of new technologies, products, processes, and services with the goal of promoting productivity and economic growth in the United States.

MS. AYERS related that U.S. President Barack Obama wants to out-build, out-innovate, out-educate, and out-hustle and be the economic survivors [slide 4].

MS. AYERS referred to the U.S. map that highlight the 34 U.S. states that have some form of R&D tax credits or incentives [slide 5].

MS. AYERS related that HB 118 would create a new tax credit for qualified R&D development, essentially for every five dollars spent by the private sector for R&D, one dollar would be credited back against the state's tax obligation. Corporations are allowed a total R&D credit up to \$10 million per taxpayer per tax year for the three years immediately preceding the year in which the credit is claimed, she said.

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JOHANNA BALES, Deputy Director, Tax Division, Anchorage Office, Department of Revenue (DOR), stated that the governor is hoping to bring in new businesses to Alaska and to entice R&D in Alaska. The main focus of HB 118 is to help diversify the economy, she said.

MS. BALES provided a section-by-section analysis of the bill. Section one would allow a taxpayer 20 percent credit on the R&D expenditures that are incurred in Alaska that exceed a three year average of R&D expenditures in the prior three years. She said that any existing R&D would not qualify for a credit unless the R&D increased or if new R&D activity happened. The corporate taxpayer would be allowed 20 percent credit not to exceed \$10 million per year. The corporate taxpayer could carry forward any credit towards tax liability for up to seven years. As Deputy Commissioner Thayer previously pointed out, a taxpayer could not take a deduction for the expenses in the calculation for the corporate income tax liability. She related that a federal R&D tax credit also exists. Currently, under Alaska's corporate tax structure, companies can apportion a part of the federal credit for business in Alaska, but they would not be allowed to take the federal credit, as well. She commented that the Department of Revenue (DOR) would report back to the legislature any R&D activity.

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REPRESENTATIVE HOLMES said it sounds like a good idea. She referred to state and federal credit. She wondered what the advantage would be since a federal credit process exists. She asked for the necessity of allowing a state R&D tax credit since the corporation would not be eligible for both the state and federal credit.

MS. BALES explained the federal process. Taxpayers perform a calculation of all the R&D activity conducted throughout the nation. The corporate tax is based on a "water's edge basis" so even though the activity is not conducted in Alaska, the corporation can take a credit in Alaska. She pointed out that the credit is generally very small since the portion of the activity that took place in Alaska is also very small. This bill would allow a 20 percent R&D tax credit on expenditures that took place in Alaska. The state is hoping to entice corporations to do R&D in Alaska. She related a scenario in which a company performs cold regions R&D, which might be conducted in a northern state such as Minnesota or Wisconsin. She related that if those states offer tax credits and Alaska does not, that this bill would help entice the corporations to do business in Alaska. She predicted that the R&D tax credit offered credit directly for those expenses would be larger than the federal credit the corporation is currently taking.

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MS. BALES, in response to Representative Holmes, explained that R&D tax credits offered by other states vary significantly from state to state. Some do not have a limit and some have a credit for the amount of expenses until the corporation has exhausted the credit. Some offer six percent tax credits and other states offer 20 percent R&D tax credit. She said it is difficult to find an average. The DOR piggybacked the federal law, which allows corporations R&D tax credits ranging from 14 to 25 percent, depending on whether the expenditures are new expenditures or prior expenditures. She stated that even federal calculation is complicated and diverse. The DOR reviewed other states and took a mid-range approach of 20 percent, but only for expenditures that were increasing in the state.

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REPRESENTATIVE HOLMES said it would be helpful to have something in writing that outlines the exceptions. She asked to what extent these credits are applicable to oil and gas, and mining. She offered her belief that the R&D tax credits would not apply to oil and gas but she thought perhaps some technology research might qualify.

MS. BALES explained that with respect to mineral exploration that if the corporation qualifies for federal credit the

corporation would qualify for the proposed R&D tax credit in Alaska. She noted that federal law does not allow expenses for exploration to ascertain the existence, location, or extent of a mineral ore deposit. The reason for this is because under federal law those activities are allowed to use an exploration incentive credit. Thus, the federal law would not also offer a R&D tax credit. She offered her belief that would be the only limitation for oil and gas companies. She pointed out that if the oil and gas corporation also performed other R&D, such as tertiary recovery or other activities, the credit would apply in Alaska so long as it qualified under federal law. She offered to provide research on the types of expenses oil and gas companies could use.

REPRESENTATIVE HOLMES also asked her to address the extent that this would overlap with existing credits in the oil and gas arena. She referred to the zero fiscal note. She asked whether the department could provide a ballpark figure on the anticipated credits, and if it would range from \$10 million or \$10 billion.

MS. BALES suggested that the state would like to attract new corporations so any additional activity would bring in increased revenues from corporate taxes. She said she was unsure of the level of current activity, but she offered to try to provide the committee with some ideas on the amount of projected activity.

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MARK MEYERS, Vice Chancellor, Research, University of Alaska, explained that the overall research at University of Alaska (UA), is approximately \$123 million per year, largely stemming from the National Science Foundation grants. He stated the UA also conducts some private research. He related that the UA is interested in stronger private public partnerships in research. He said that his office sees some significant opportunities to do so. Thus, the UA is forming an office for intellectual property and commercialization. The lab capacity is quite sizeable and other states have used that to their advantage to develop private/public partnerships. He said that in developing intellectual property, some of the money returns to the state in the form of royalties on the developed intellectual property. Along that line, there are many opportunities for ongoing research in biomedical fields, advanced instrumentation for space craft, for unmanned aircraft, and unmanned submarine vehicles. He suggested a substantial work is also performed in engineering design, energy technology, aviation technology,

transportation infrastructure and construction. Thus, any credit the state could offer may help entice additional research. Alaska has a unique natural laboratory for this type of research, including the ability to use air space to fly unmanned vehicles since there are few places in the country this activity can happen. He said that the unique environment offers opportunities to train Alaskans at the UA to use these research capacities and to develop the research themselves. He offered his support for HB 118 as a means to strengthen the state's economy.

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CHAIR OLSON asked whether his research at the UAA is similar to the research he conducted at the federal United States Geological Survey (USGS).

MR. MEYERS answered yes, but his research ranges from biology, water, remote sensing, atmospheric and geophysics. The difference at UAA is that his research also involves the humanities, arts, and engineering.

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KATHRYN DODGE, Economic Development Specialist, Fairbanks North Star Borough (FNSB), stated that the Fairbanks North Star Borough (FNSB) supports HB 118. She explained that the FNSB has worked with the University of Alaska Fairbanks (UAF) to strengthen the private industry funded research and the federally funded research in the community and in the state. This bill provides a tool to help move that effort forward. She related that she works with oil and gas recovery. While the UAF and FNSB have developed some relationships with private industry, additional effort could be made. Big companies tend to conduct research in their headquarter areas and the R&D tax credits provide enough of an incentive for companies to at least consider conducting research in Alaska. She offered her belief that this is a very strong and important tool to move Alaska towards an innovative economy. The state has struggled with low numbers of patents. She anticipated that HB 118 would increase the number of patents, which is indicative of an entrepreneurial economy. The FNSB has also worked to commercialize the technology but the research doesn't necessarily lend itself as well, but she thought this bill could help focus on research with commercial potential. She concluded by offering support for HB 118. She encouraged members to move the bill forward.

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CHAIR OLSON stated his intention to keep the public testimony open.

[HB 118 was held over.]

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ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 3:49 p.m.