

2008 Income Tax Credit Review

**Joint Legislative Income Tax
Credit Review Committee**

December 9, 2008

JLBC

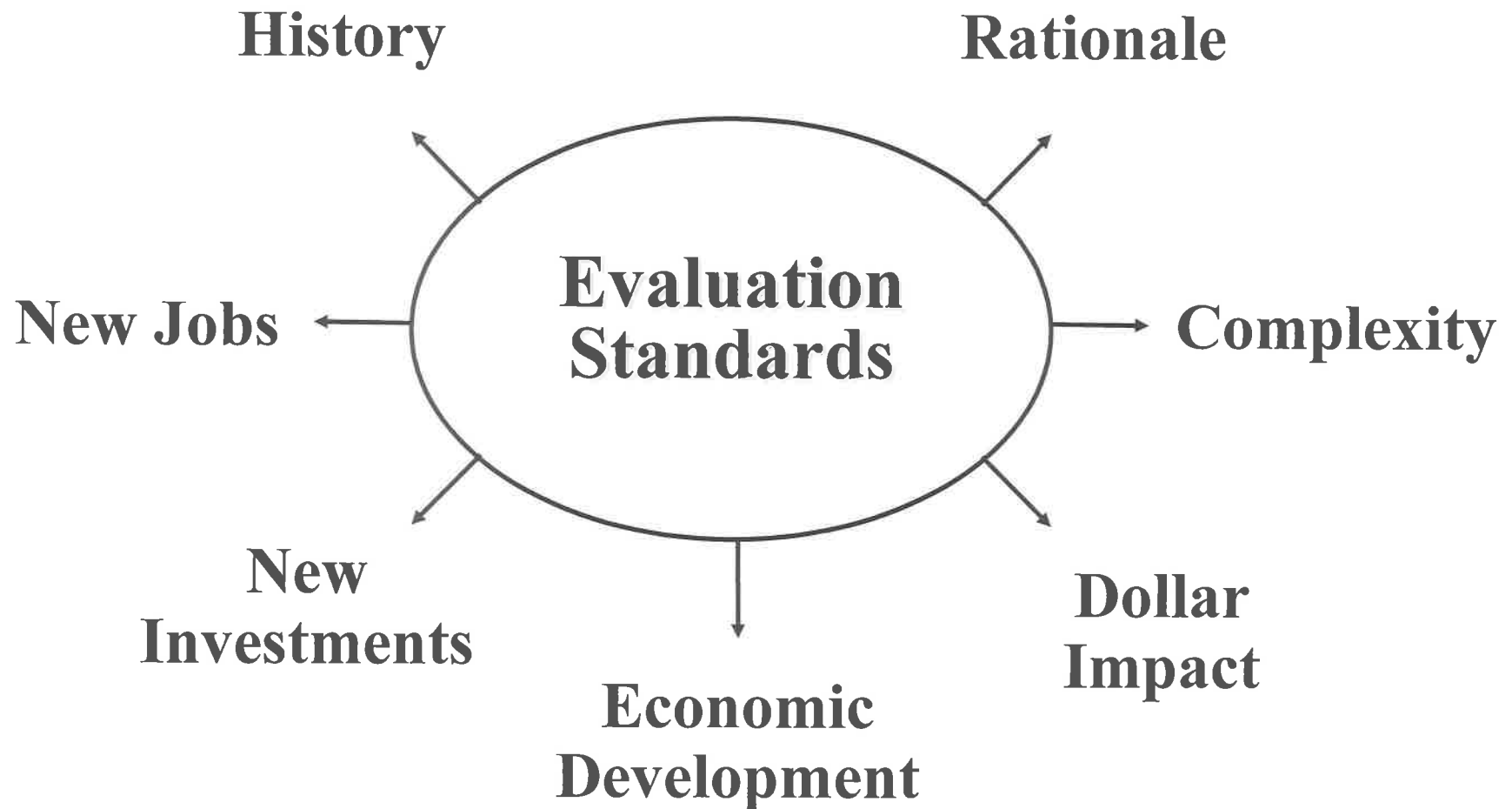
Joint Legislative Income Tax Credit Review Committee

- Annually reviews credits as determined in statute.
- This year's review includes:
 - Research and Development Credit
 - Pollution Control Equipment Credit
 - Coal Consumption Credit
- Last reviewed in 2003.

Role of the Committee

- Determine original purpose of tax credit.
- Establish standards for evaluating and measuring success or failure.
- Recommend changes.

Statute Provides Possible Standards



Issues Affecting Evaluation

- Confidentiality.
- Timeliness of data.
- Lack of performance measures.

Research and Development Credit

Summary

Cost – \$46.7 million in tax year 2006 for the corporate credit and \$3.6 million for the individual credit.

– In total, 454 corporate taxpayers and 348 individual taxpayers have claimed the credit since it's inception.

Purpose – attract high-tech industry and remain competitive with other states.

Complexity – unusually complex in calculation and administration – record-keeping requirements can be burdensome.

Performance Measures – none in statute.

Research and Development Credit

Description of Credit

- Uses federal credit as starting point to establish base qualifying credit amount.
- Credit is based on the amount that exceeds base amount.
- Following table provides credit percentages by year:

Tax Year	If Expenses \leq \$2.5 million, R&D Credit is:	If Expenses $>$ \$2.5 million, R&D Credit is:
2009	20% of amount up to \$500,000	\$500,000 plus 11% of amount exceeding \$2.5 M
2010	22% of amount up to \$550,000	\$550,000 plus 13% of amount exceeding \$2.5 M
2011 - 2017	24% of amount up to \$600,000	\$600,000 plus 15% of amount exceeding \$2.5 M
2018 - beyond	20% of amount up to \$500,000	\$500,000 plus 11% of amount exceeding \$2.5 M

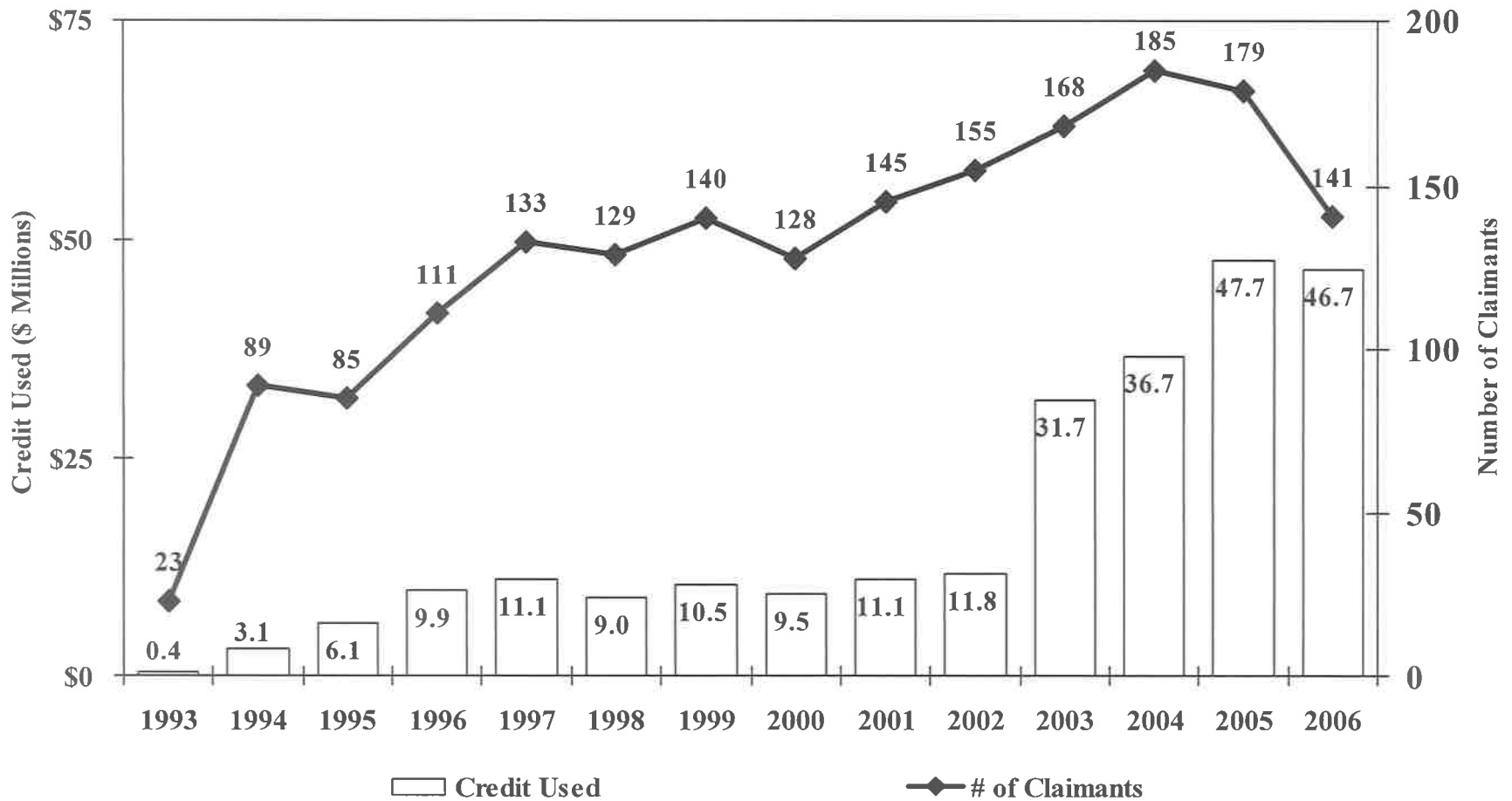
Research and Development Credit

Description of Credit (Cont.)

- Credit is nonrefundable.
- Credit has a 15-year carry forward provision.
- Carry forwards before 2003 are limited to \$500,000.
- Carry forwards from and after 2003 are not limited.
- Unlimited carry forwards cannot exceed taxpayer's liability.

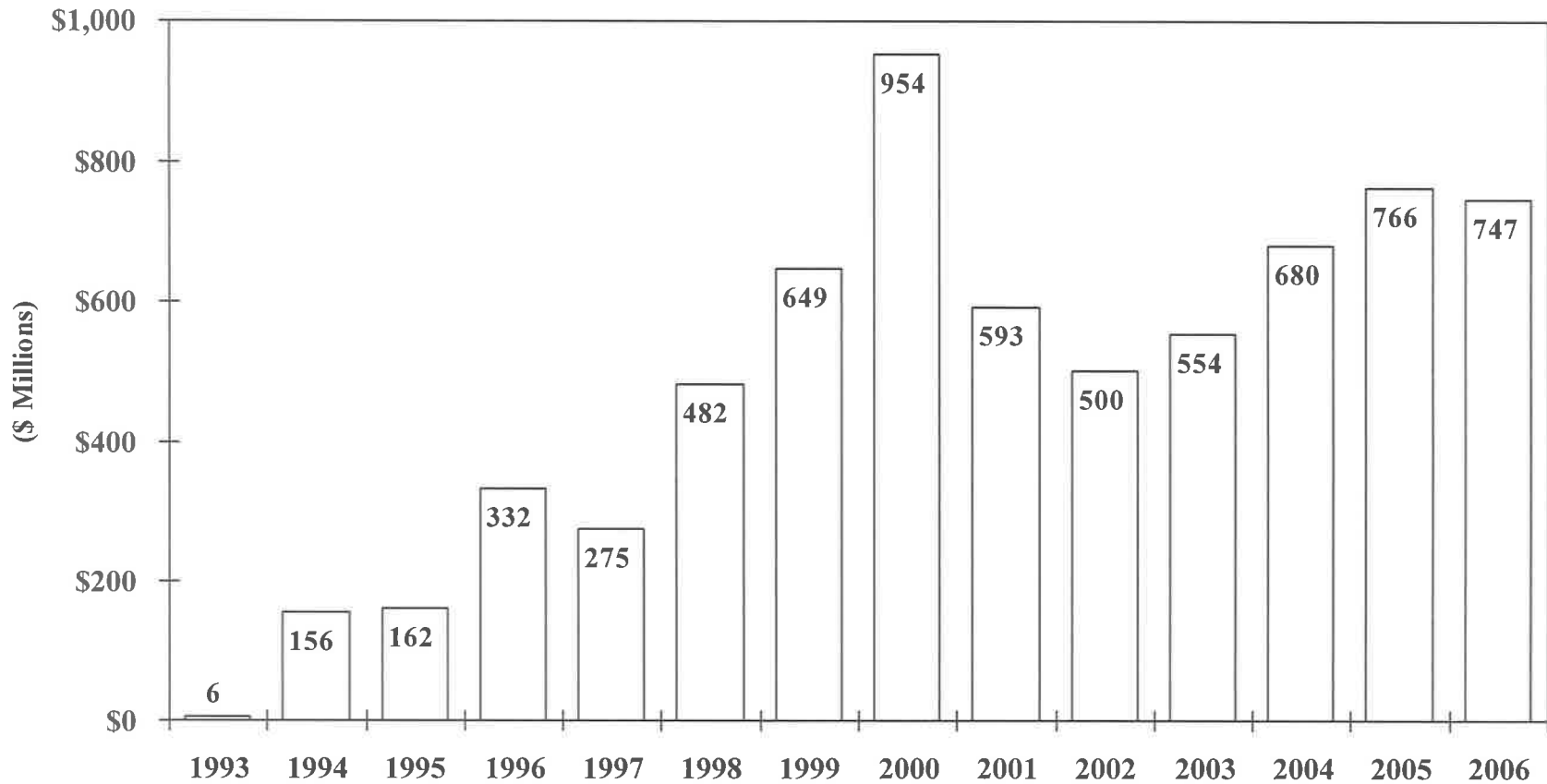
Research and Development Credit (Corporate)

Amount of Credit Used & Number of Claimants



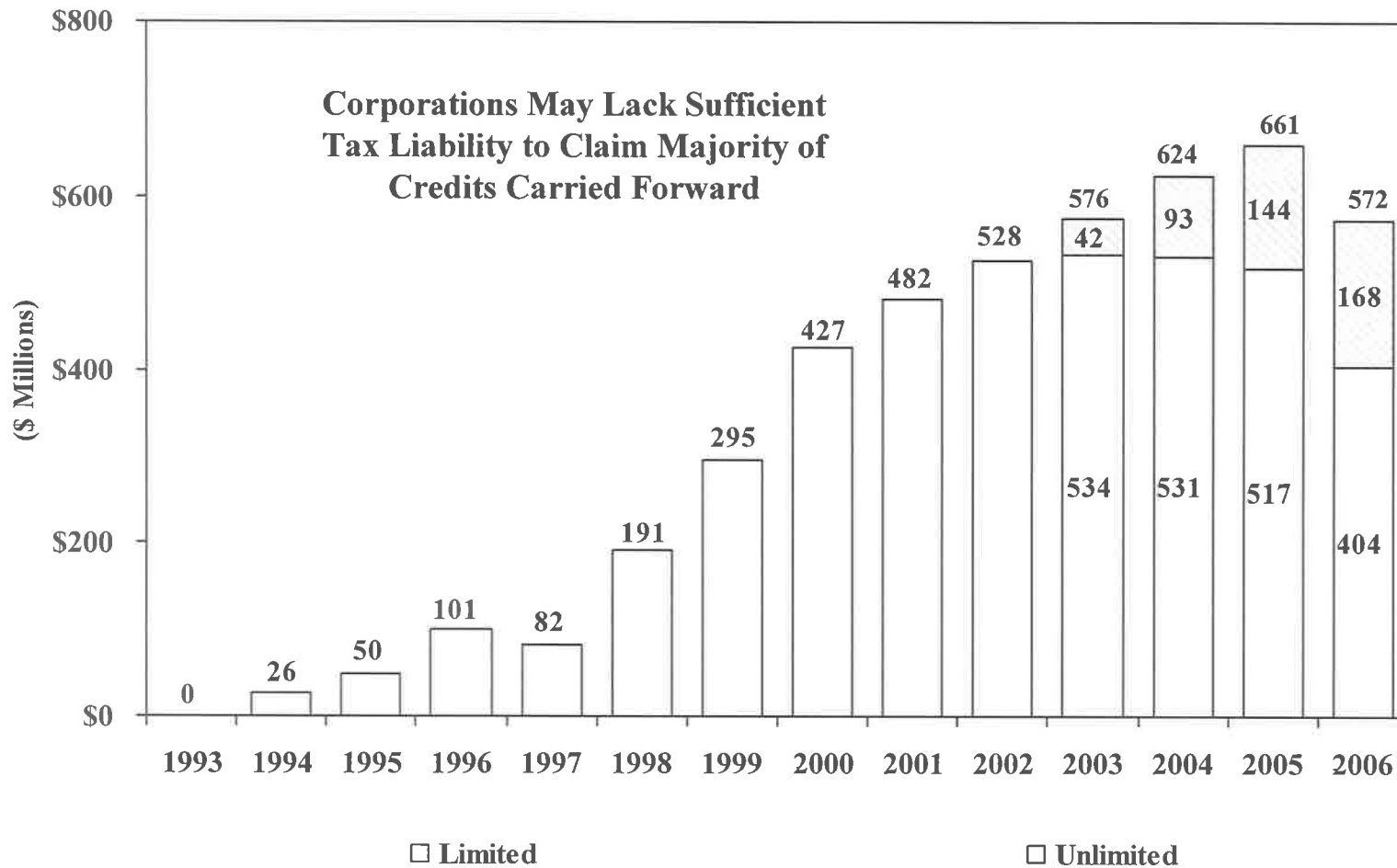
Research and Development Credit (Corporate)

Amount of Qualified R&D Expenses



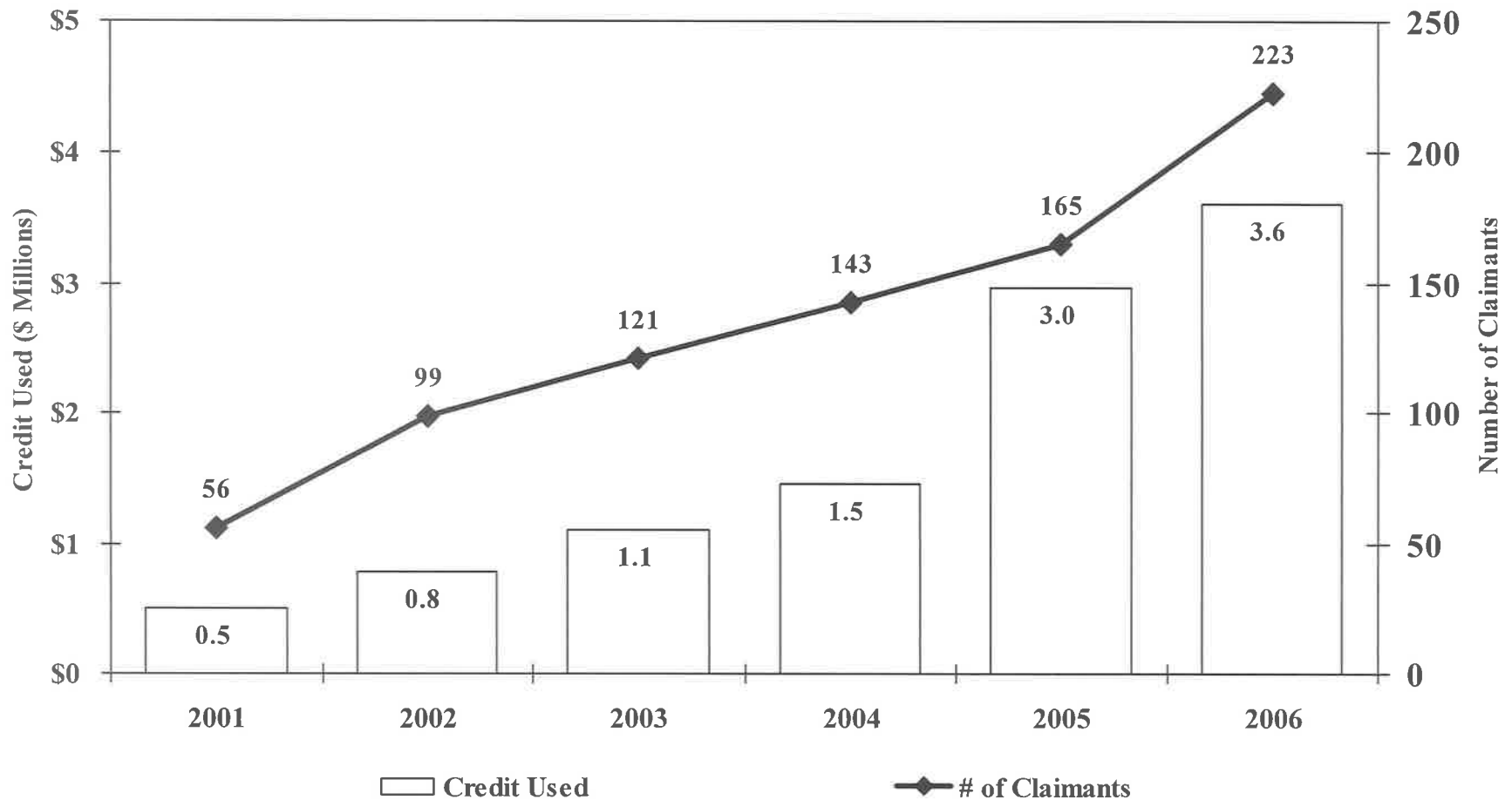
Research and Development Credit (Corporate)

Amount of Limited and Unlimited Carry Forward



Research and Development Credit (Individual)

Amount of Credit Used & Number of Claimants



Research and Development Credit

Benefits to the Arizona Economy

- Tax incentive may have benefited the Arizona economy insofar as it has resulted in capital investments and job creation that would not have occurred in the absence of the credit.
- However, no empirical evaluation of the credit has been conducted to date.
- Academic studies of R&D credits at the state-level show varied results.
- *State Tax Notes* study concludes Arizona has second most favorable R&D credit (behind California).

Research and Development Credit

Potential Performance Measures

- Total research dollars spent in Arizona each year.
- Numbers of persons employed in research activities.
- Total research payrolls.
- The introduction of new products as a result of research and development.
- Last reviewed in 2003
 - Committee recommended the continuation of the credit with no changes or modifications.

Pollution Control Equipment Credit Summary

Cost – \$1,344,448 in tax year 2006, with a carry forward of \$522,734.

– In total, 91 taxpayers have claimed the credit since it's inception.

Purpose – To encourage investment in pollution control or prevention equipment.

Complexity – Not complex in administration and record keeping is not difficult.

Performance Measures – none in statute.

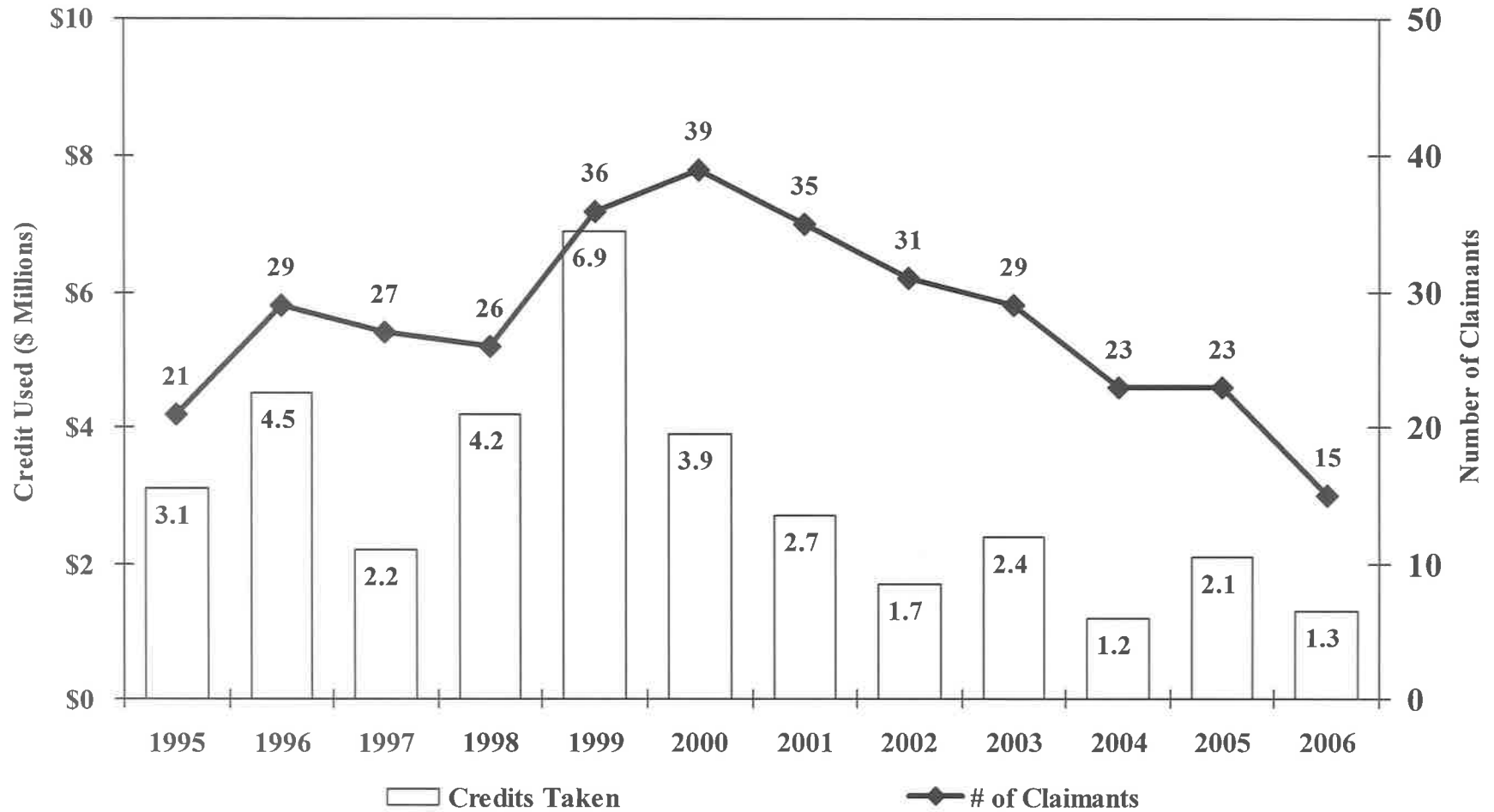
Pollution Control Equipment Credit

Description of Credit

- The credit is applicable to pollution control equipment required by the EPA, DEQ, or other political subdivision.
- The credit in a taxable year is equal to the lesser of 10% of the purchase price of pollution control equipment or \$500,000.
- Credit is nonrefundable.
- Carry forward is 5 years.

Pollution Control Equipment Credit (Corporate)

Amount of Credits Taken & Number of Claimants



Pollution Control Equipment Credit

Benefits to the Arizona Economy

- Tax incentive may have benefited the Arizona economy insofar as it has resulted in capital investments, job creation, and mitigation of pollution that would not have occurred in the absence of the credit.
- However, no empirical evaluation of the credit has been conducted to date.

Pollution Control Equipment Credit

Potential Performance Measures

- Type of equipment purchased and its related environmental impact.
- Number of other states where a business receives a comparable credit.
- Last reviewed in 2003
 - Committee recommended the continuation of the credit with no changes or modifications.

Coal Consumption Credit Summary

Cost – \$929,098 in tax year 2006, with a carry forward of \$2.0 million.

– In total 5 taxpayers have claimed the credit since it's inception.

Purpose – To encourage construction of environmental technology manufacturing or processing facilities.

Complexity – Certification process is not complex, but tracking asset values can be difficult.

Performance Measures – none in statute.

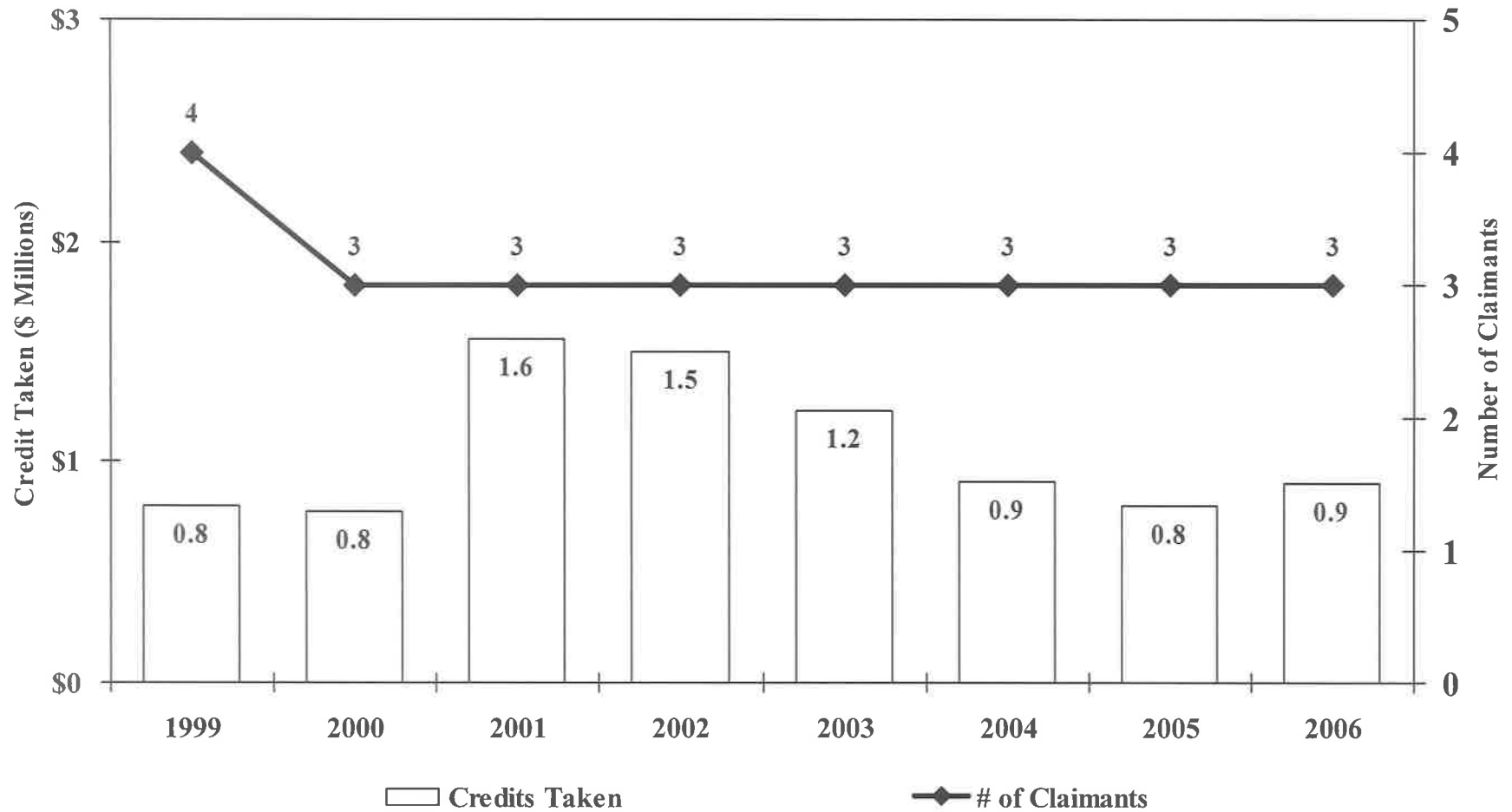
Coal Consumption Credit

Description of Credit

- An income tax credit is allowed for taxpayer purchases of coal consumed in generating electricity in Arizona.
- The credit is equal to 30% of the amount paid by the seller or purchaser as transaction privilege or use tax with respect to the coal sold to the taxpayer.
- The credit is non-refundable.
- The tax credit may be carried forward for the next five consecutive taxable years.

Coal Consumption Credit

Amount of Credits Taken & Number of Claimants



Coal Consumption Credit

Benefits to the Arizona Economy

- Given the confidentiality of the tax credits claimed, the specific benefits of the tax cannot be determined.
- To the extent that coal purchases have shifted from other states to Arizona, some of the lost corporate income tax revenue would be offset by increased sales and use tax revenue.
- The impact on economic development, new investments, or jobs created or retained as a direct result of this tax credit is unknown. However, by enhancing revenue in counties where coal purchases are made, the counties are able to maintain or improve their tax base.

Coal Consumption Credit

Potential Performance Measures

- Estimates by the affected counties of the credit's net fiscal impact on their budgets.
- Annual estimates and the dollar value of coal purchased for electrical generation in Arizona.
- Last reviewed in 2003
 - Committee recommended the continuation of the credit with no changes or modifications.