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# **2023 Income Tax Credit Review**

**Joint Legislative Income Tax  
Credit Review Committee**

**December 12, 2023**



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# 2023 Credit Reviews

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- Annually reviews credits as determined in statute
- This year's review includes:
  - Research and Development Tax Credit
  - Pollution Control Equipment Tax Credit
  - Coal Consumed in Generating Electric Power Tax Credit
- All these credits were last reviewed in 2018

# Role of the Committee

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- Determine original purpose of credit
- Establish standards for evaluating and measuring success or failure of credit
- After review process, recommend whether credit should be amended, repealed or retained

# Standards for Evaluating Credit

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- History, rationale and revenue impact of credit
- Benefits of credit in terms of measurable economic development, investments and jobs
- Complexity of credit in terms of application, administration and approval process

# Confidential Taxpayer Information

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- Statute authorizes DOR to disclose confidential “statistical information” to the Committee, JLBC Staff and Legislative Staff
- DOR considers credit information confidential if:
  - credits were claimed by fewer than 3 taxpayers, or
  - a single taxpayer used more than 90% of total credits
- 1 of 3 credits include confidential information
- Since no material impact on evaluation, this data is excluded from credit review

# Issues Affecting Evaluation

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- Lack of performance measures
- Certain costs and benefits can be difficult to quantify

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# Research and Development Tax Credit

December 8, 2023





# Research and Development Tax Credit

## - Summary

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- Cost – \$139.9 million in *nonrefundable* credits and \$11.7 million in *refundable* credits used in FY 2023
- Purpose – attract high-tech industry and remain competitive with other states
- Complexity – unusually complex in calculation and administration; record-keeping requirement can be burdensome
- Performance Measures – none in statute

# Research and Development Tax Credit

## - Description of the Credit

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- Credit is calculated based on same definitions as under federal R&D program
- Credit applies to R&D expenses above a certain base amount (“excess expenses”)
- If excess expenses  $\leq$  \$2.5m, credit is 24% of the amount; if excess expenses  $>$  \$2.5m, credit is \$600,000 plus 15% of the amount above \$2.5m

# Research and Development Tax Credit

## - Nonrefundable R&D Credit Program

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- Nonrefundable program consists of both the standard credit and an additional credit for university research
- University research credit is an additional 10% over and above amount allowed under standard credit
- Standard research credit has no cap and allows unused amounts to be carried forward up to 15 years if claimed before 2022; credits claimed in 2022 or after have a 10-year carry forward
- University research credit is capped at \$10 million annually and provides a 5-year carry forward

# Research and Development Tax Credit

## - Refundable R&D Credit Program

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- Credit is refundable for businesses with fewer than 150 full-time employees
- Refund is limited to 75% of the amount by which the credit exceeds the taxpayer's liability
- Remaining 25% of the excess credit must be forfeited
- Up to \$5 million in refundable credits can be authorized each year

# Research and Development Tax Credit

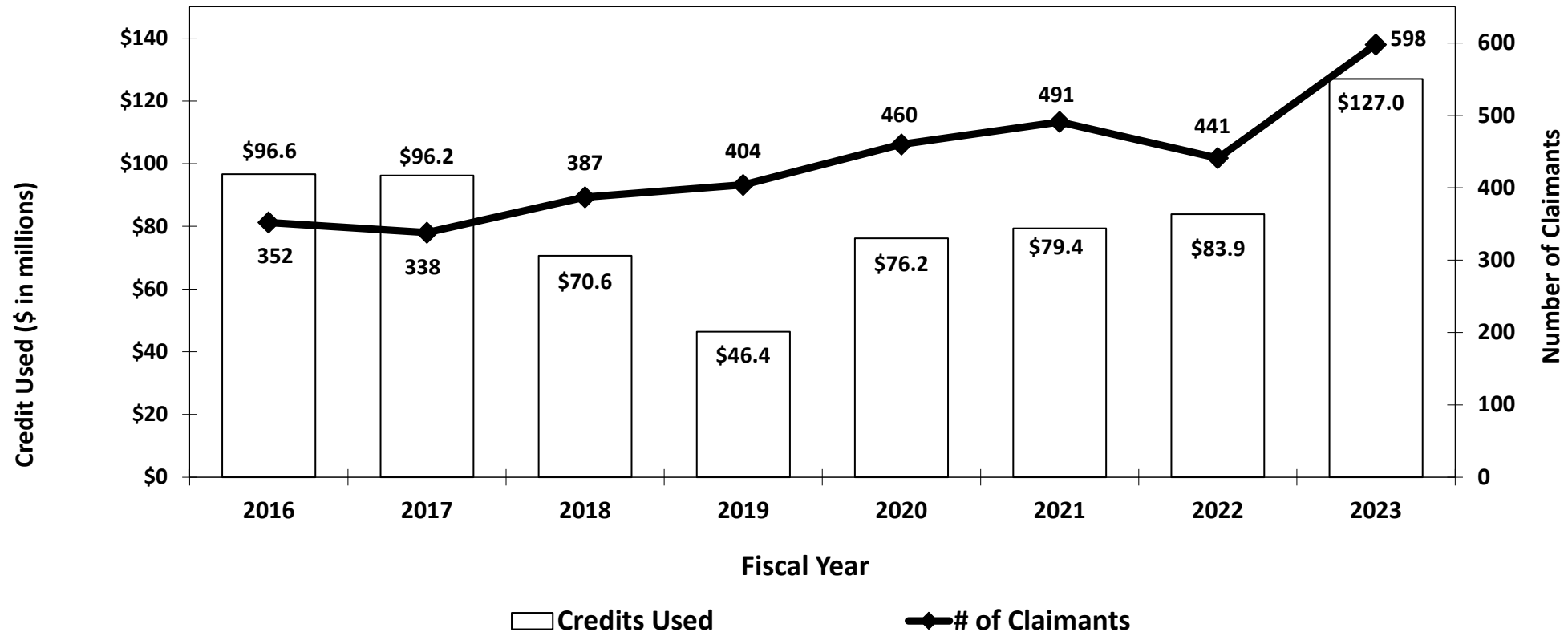
## - Carry forward of Unused Credits

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- Credit Carry forwards before 2003 are limited to \$500,000
- Limited Carry forward amounts cannot be claimed after TY 2016
- Credit carry forwards from and after 2003 are not limited
- However, unlimited carry forwards cannot exceed taxpayer's liability

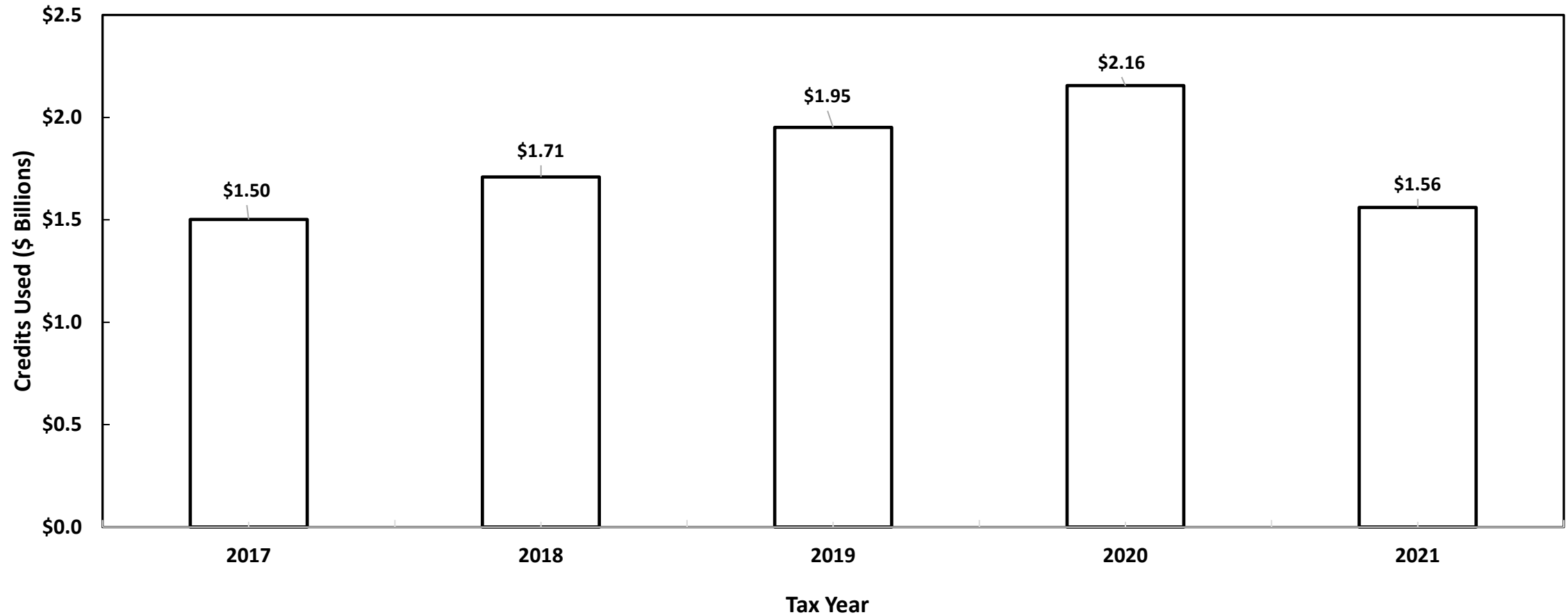
# Research and Development Tax Credit (Corporate)

- Amount of Credits Used & Number of Claimants by Fiscal Year



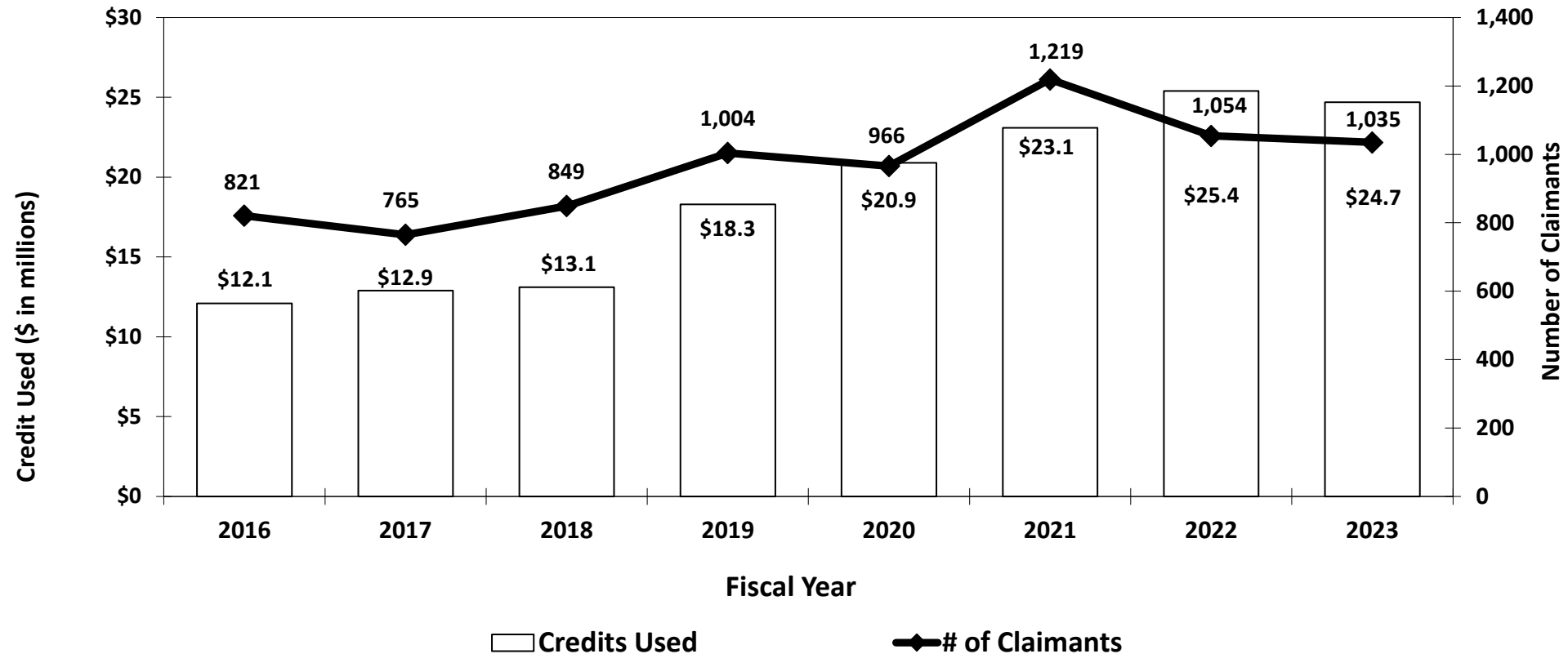
# Research and Development Tax Credit (Corporate)

## - Amount of Unlimited Credit Carry Forward



# Research and Development Tax Credit (Individual)

- Amount of Credits Used & Number of Claimants by Fiscal Year





# Research and Development Tax Credit

## - Benefits to the Arizona Economy

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- Qualified R&D spending since the program's inception is about \$28.0 billion
- It is not known, however, how much of the R&D spending was directly attributable to the credit program
- Arizona's share of national R&D spending is 1.27%, the 21<sup>st</sup> highest among states
- A relatively small number of academic studies of state R&D credits have been conducted and the results are mixed

# Research and Development Tax Credit

## - Potential Performance Measures

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- Total research dollars spent in Arizona each year
- Number of persons employed in research activities
- Total research payrolls
- The introduction of new products

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# **Pollution Control Equipment Tax Credit**

**December 8, 2023**



# Pollution Control Equipment Tax Credit

## - Summary

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- Cost – \$1.3 million for the corporate credit in FY 2023. Individual credit was repealed in 2022.
- Purpose – to encourage investment in pollution control and pollution prevention equipment
- Complexity – verification sometimes difficult for DOR, as it can require some scientific knowledge
- Performance Measures – none in statute

# Pollution Control Equipment Tax Credit

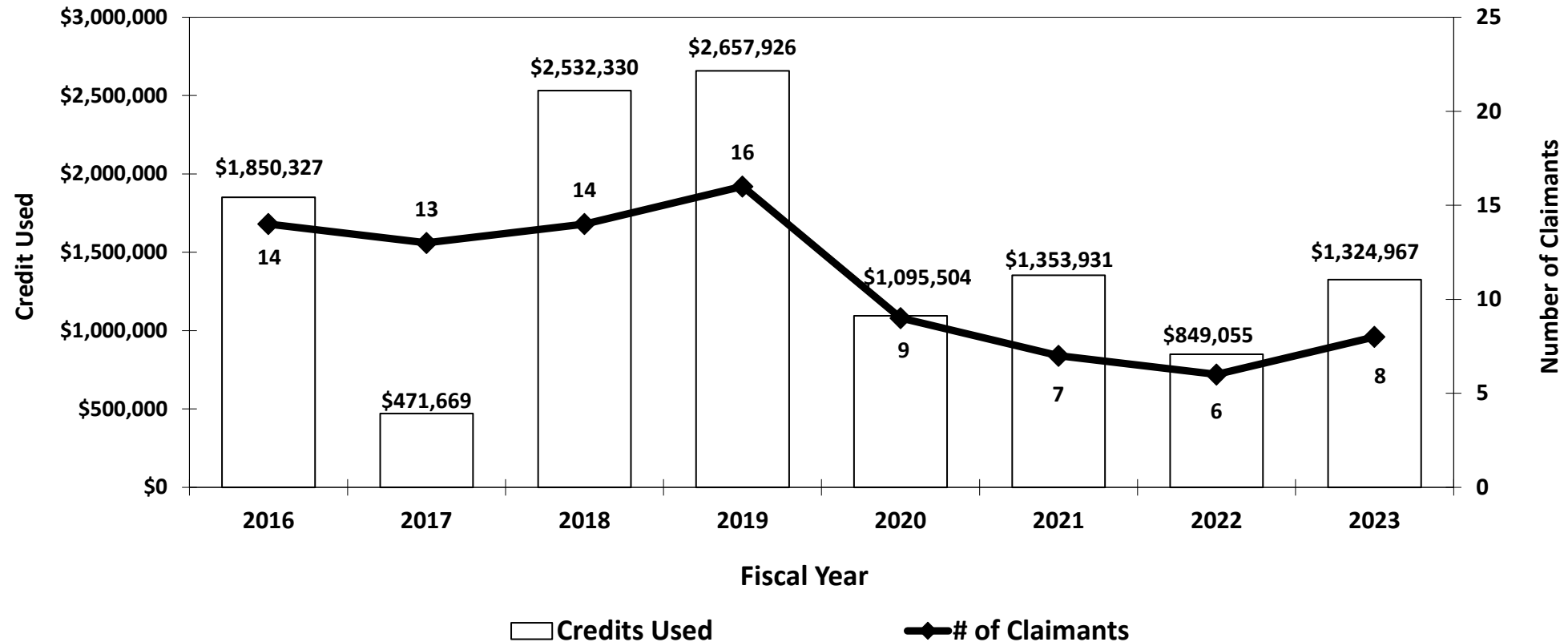
## - Description of the Credit

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- Credit is applicable to pollution control equipment required by the EPA, DEQ, or other political subdivision
- Credit is equal to the lesser of 10% of the purchase price of pollution control equipment or \$500,000
- Credit is non-refundable
- Unused credits can be carried forward for up to 5 years

# Pollution Control Equipment Tax Credit

- Amount of Corporate Credits Used & Number of Claimants by Fiscal Year



# Pollution Control Equipment Tax Credit

## - Benefits to the Arizona Economy

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- Since 1995, DOR reports the credit has been used for \$1.5 billion of anti-pollution investments.
- It is not known, however, how much of this investment was directly attributable to the tax credit
- To some extent, the credit enhances Arizona's competitiveness relative to other states by lessening tax burden for some businesses

# Pollution Control Equipment Tax Credit

## - Potential Performance Measures

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- There are no performance measures in statute
- Type of equipment purchased and its related environmental impact



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# **Coal Consumed in Generating Electric Power Tax Credit**

**December 8, 2023**



# Coal Consumption Tax Credit

## - Summary

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- Cost – \$1.1 million in FY 2021, the last year for which use of the credit has been publicly released by DOR
- Purpose – to encourage purchase and delivery of coal in Arizona, and maintain tax base in rural counties
- Complexity – simple to use and administer
- Performance Measures – none in statute

# Coal Consumption Tax Credit

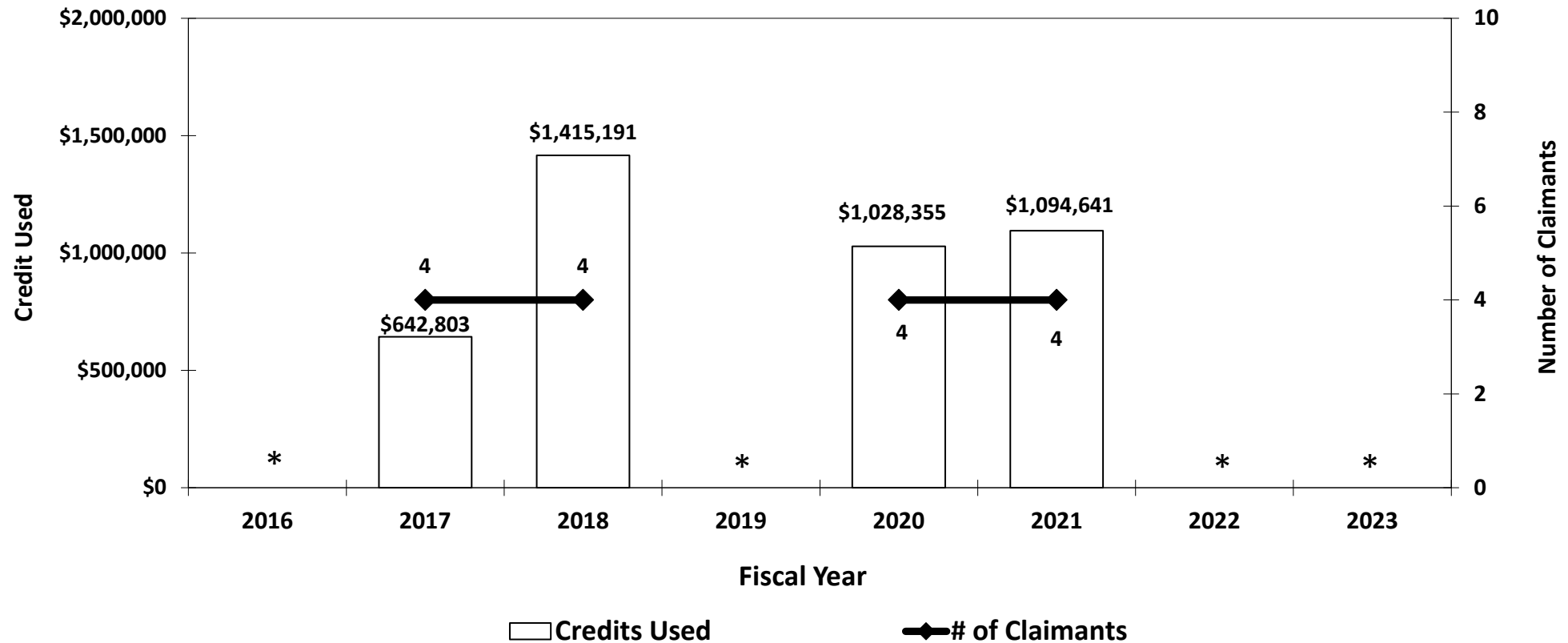
## - Description of the Credit

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- Corporate income tax credit allowed for taxpayer purchases of coal consumed in generating electricity in Arizona
- Credit is equal to 30% of the amount paid as Transaction Privilege Tax (TPT) or Use Tax with respect to the coal sold to the taxpayer
- Credit is non-refundable
- Unused credits can be carried forward for up to 5 years

# Coal Consumption Tax Credit

## - Amount of Credits Used & Number of Claimants by Fiscal Year



\* Years without data due to confidential credit information

# Coal Consumption Tax Credit

## - Benefits to the Arizona Economy

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- To the extent that coal purchases have shifted from other states to Arizona, some of the lost corporate income tax revenue from the credit would be offset by increased TPT and Use Tax revenue.
- The benefits directly resulting from this tax credit are unknown. However, by enhancing tax revenue in counties where coal purchases are made, the counties are able to maintain or improve their tax base.

# Coal Consumption Tax Credit

## - Potential Performance Measures

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- Estimates by the affected counties of the credit's net fiscal impact on their budgets
- Annual estimates of the dollar value of coal purchased for electric generation in Arizona