

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 3898S.01I
 Bill No.: SB 688
 Subject: Tax Credits
 Type: Original
 Date: January 24, 2022

Bill Summary: This proposal reauthorizes a tax credit for certain research expenses.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
General Revenue Fund*	Could Exceed (\$71,274)	Could Exceed (\$10,197,640)	Could Exceed (\$10,177,410)
Total Estimated Net Effect on General Revenue	Could Exceed (\$71,274)	Could Exceed (\$10,197,640)	Could Exceed (\$10,177,410)

*Oversight note the research expense tax credit has a \$10 M cap annually. Additionally, the proposal allows for sales tax & use tax exemptions as identified in RSMo 144.054.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
School District Trust Fund*	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)
Conservation Commission*	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)
Parks and Soils Sales Tax*	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)
Total Estimated Net Effect on <u>Other</u> State Funds	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)

*The proposal provides for a sales tax exemption for research equipment.
 Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
Total Estimated Net Effect on <u>All</u> Federal Funds			

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
General Revenue Fund – DOR	0 FTE	Up to 3 FTE	Up to 3 FTE
General Revenue Fund – DED	1 FTE	1 FTE	1 FTE
Total Estimated Net Effect on FTE	1 FTE	Up to 4 FTE	Up to 4 FTE

Estimated Net Effect (expenditures or reduced revenues) expected to exceed \$250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

Estimated Net Effect (savings or increased revenues) expected to exceed \$250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
Local Political Subdivisions*	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)
Local Government	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)

*The proposal provides for a sales tax exemption for research equipment.

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration – Budget & Planning (B&P)** assume this proposal reauthorizes the tax credit for qualified research expenses. A taxpayer may receive a tax credit in an amount up to 15% of the excess of the taxpayer’s qualified research expenses or 20% of the excess of the taxpayer’s qualified research expenses if such expenses relate to research that is conducted in conjunction with a public or private college or university located in this state. No taxpayer shall receive a tax credit in excess of \$300,000 in a calendar year.

This credit would have a 12 year carry forward provision. The credits may be transferred, sold, or assigned. The cap on the credits is \$10M, provided that \$5M shall be reserved for minority business enterprises, women’s business enterprises, and small businesses. If the entirety of the \$5M reserved for minority business enterprises, women’s business enterprises, and small businesses is not issued or awarded by November 1st of the tax year, the amount may be issued to any taxpayer otherwise eligible for the tax credit.

Purchases of Missouri qualified research and development equipment will be exempted from all state and local sales and use tax including, but not limited to, sales and use tax authorized or imposed under section 32.085 and chapter 144. It is unknown how many entities would utilize the sales tax exemption or the fiscal impact of such a sales tax exemption. Therefore general and total state revenue may be reduced by an amount that could exceed \$10M, starting in FY24.

This program may encourage economic activity. B&P cannot estimate additional induced revenues.

The proposal could impact the calculation under Article X, Section 18(e).

Officials from the **Department of Economic Development** note:

Section 620.1039.1 adds definitions for:

- (1) Additional qualified research expenses
- (2) Minority business enterprise
- (3) Missouri qualified research and development equipment
- (4) Qualified research expenses
- (5) Small business
- (7) Women’s business enterprise

Section 620.1039.2 (2) - For all tax years beginning on or after January 1, 2023, DED may authorize a tax credit in an amount equal to the greater of:

- (a) 15% of the taxpayer's additional qualified research expenses; or
- (b) If such qualified research expenses relate to research conducted in conjunction with a public or private college or university located in this state, 20% of the taxpayer's additional qualified research expenses.

However, in no case shall a tax credit be allowed for any portion of qualified research expenses that exceed 200% of the taxpayer's average qualified research expenses incurred during the three immediately preceding tax.

Section 620.1039.3 - For all tax years beginning on or after January 1, 2023, where the amount of the credit exceeds the tax liability, the difference between the credit and the tax liability may only be carried forward for the next 12 succeeding tax years or until the full credit has been claimed, whichever occurs first.

Section 620.1039.7 (2)

- (a) For all tax years beginning on or after January 1, 2023, the aggregate of all tax credits authorized under this section shall not exceed \$10M in any year.
- (b) \$5M of such \$10M dollars shall be reserved for minority business enterprises, women's business enterprises, and small businesses. Any reserved amount not issued or awarded to a minority business enterprise, women's business enterprise, or small business by November first of the tax year may be issued to any taxpayer otherwise eligible for a tax credit.
- (c) No single taxpayer shall be issued or awarded more \$300,000 in tax credits in any year.
- (d) In the event that total eligible claims for credits received in a calendar year exceed the annual cap, each eligible claimant shall be issued credits based upon a pro-rata basis, given that all new businesses, defined as a business less than 5 years old, are issued full tax credits first.

Reauthorizing the tax credit will likely reduce annual TSR by up to the annual cap on the program of \$10M.

Since this legislation requires additional duties, responsibilities, prioritization of credits, and monitoring than the prior legislation, DED will need to hire 2.0 FTE to administer the program.

Oversight notes that in response to the similar proposals, HB 1579 (2022) and SCS SB 545 (2021), the DED only requested one FTE for this program.

Oversight notes the prior Tax Credit for Qualified Research Expenses expired for all tax years beginning on or after January 1, 2005. Therefore, for purposes of this fiscal note, Oversight will

include DED's 1 FTE administrative cost(s), as reported by DED in all previous versions of this proposal, less the "In-State" and "Out of State" travel costs reported as this proposed legislation does not require that DED visit, evaluate or audit any site(s).

Officials from the **Department of Revenue (DOR)** note:

Section 620.1039 Qualified Research Tax Credit

This proposal would reinstate the expired qualified research tax credit program starting January 1, 2023. The original program stopped in 2005.

This proposal creates a tax credit in an amount up to 15% of the taxpayer's qualified research expense or 20% of the taxpayer's qualified research expense if those expenses are related to university research. Starting January 1, 2023 this allows the credit to be carried forward for twelve years and imposes a cap of \$10 million. This proposal requires that \$5 million of the credit be reserved for minority business enterprises, women's business enterprises and small businesses. Each taxpayer is limited to \$300,000 in credits.

The Department notes this proposal would begin in January 1, 2023 and would be claimed on the returns starting in January 2024 (FY 2024). The Department assumes that since this proposal has a cap of \$10 million annually it would be expected to produce a loss to general revenue of the \$10 million.

Since the previous credit expired 15 years ago, this credit is no longer listed on our MO-TC form or in our individual income tax filing system. This would require programming and form changes estimated at \$3,596. The Department would need the following FTE should the number of credits received justify the FTE.

- * 1 FTE Revenue Processing Technician for every 6,000 credits redeemed
- * 1 FTE Revenue Processing Technician 1 for every 4,000 tax credit transfers with CISCO phones and license.
- * 1 FTE Revenue Processing Technician for every 7,600 errors/correspondence generated
- * 1 FTE Revenue Processing Technician for every 1,100 refund requests

Section 620.1039.5 – Sales and Use Tax Eliminated On Qualified Research Equipment

This Section creates a state and local sales tax exemption for all purchases of qualified research and development equipment and property. This proposal does not cap the amount of sales tax exemption that can be claimed nor is it bound by the \$10 million cap of the tax credit. The proposal allows the exemption on all items that are considered "qualified research expenses" as defined by 26 U.S.C. Section 41.

The federal definition includes both equipment and salaries of employees. The Department is unable to determine how many businesses will qualify for the mix of tax credits and sales tax exemptions or the amount of equipment that would become exempt from the sales tax due to

these qualified research projects. This proposal would result in a loss to the sales tax funds. This would be an unknown loss to General Revenue, School District Trust Fund, Conservation Commission, and the Park, Soil & Water Funds.

Oversight notes that DOR officials assume most of the equipment and R&D expenses are currently covered by existing sales tax exemption; however it could potentially impact all funds receiving sales tax revenue currently. Due to the extent of current sales tax exemption as identified in RSMo 144.054 the amount newly exempt sales tax will not exceed \$250,000 annually. Therefore, Oversight will reflect range in loss of revenue \$0 to Unknown to the General Revenue, School District Trust Fund, Conservation Commission, and the Park, Soil & Water Funds.

Oversight notes that for purposes of this fiscal note, since the actual number of tax credit redemptions that will occur is unknown, Oversight will report DOR's impact "Up to" the three (3) FTE(s) estimated by DOR.

However, **Oversight** notes the first tax year in which taxpayers would qualify for the tax credit created is Tax Year 2023. Oversight notes individuals would not file their Tax Year 2023 tax returns until after January 1, 2024 (6 months after the beginning of Fiscal Year 2024).

Therefore, **Oversight** will report DOR's administrative cost(s) beginning in Fiscal Year 2024 assuming DOR can hire and train such FTE(s) within the first six (6) months of Fiscal Year 2024; before Tax Year 2023 tax returns would begin to be filed claiming the proposed tax credit.

Officials from the **Missouri Department of Commerce and Insurance (DCI)** note:

The proposal has a potential, unknown decrease of premium tax revenues (up to the tax credit limit established in the bill) in FY2024 and FY2025 as a result of the modification of the qualified research tax credit. 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 throughout 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 and which insurers will qualify for the modified tax credit.

Oversight notes this proposed legislation would, beginning in Tax Year 2023, authorize a tax credit equal to ten percent (15%) of the excess of the taxpayer's qualified research expenses within this state during the tax year over the average of the taxpayer's qualified research expenses within this state over the immediately preceding three (3) tax years.

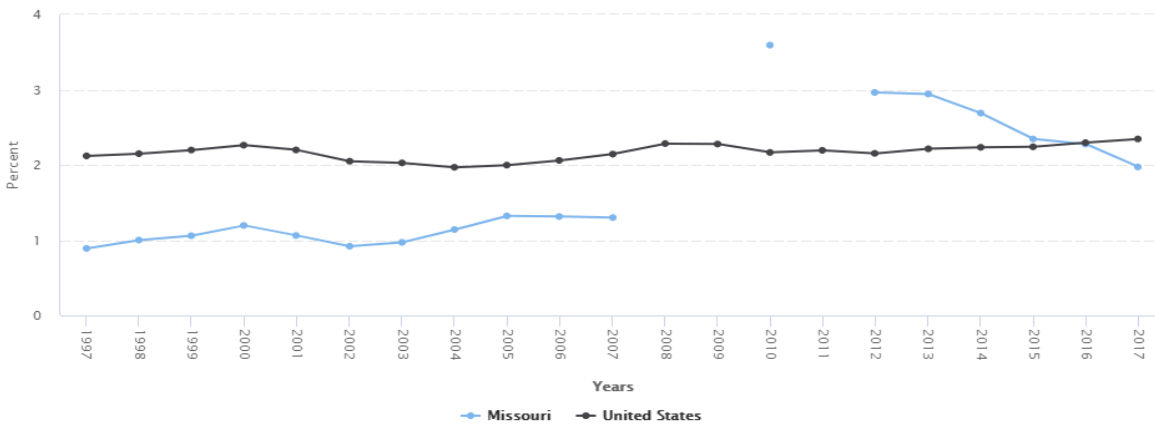
Oversight notes, should the taxpayer's qualified research expenses be related to research that is conducted in conjunction with a public or private college of or university located in this state, the tax credit authorized would be equal to twenty percent (20%) of the excess of the taxpayer's

qualified research expenses within this state during the tax year over the average of the taxpayer’s qualified research expenses within this state over the immediately preceding three (3) tax years.

Oversight notes this proposed legislation defines “Qualified Research” as “the same meaning as prescribed in 26 U.S.C. 41”. Oversight notes 26 U.S.C 41 defines “Qualified Research Expenses” as “the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer – (A) in-house research expenses, and (B) contract research expenses”. Oversight assumes, then, that the tax credit would be calculated similar to the following example:

Tax Credit Allocation Example		
Tax Year	Total Research Expense	
2019	\$85,000,000	
2020	\$96,000,000	
2021	\$100,000,000	
3 Year Average		\$93,666,667
2022	\$ 109,000,000	
Excess of Three Year Average	\$ 15,333,333	(109,000,000 - 93,666,667)
	15%	20%
Equal to 15%to 20% of Excess	\$ 2,300,000	\$ 3,066,667

Business–Performed R&D as a Percentage of Private-Industry Output



Oversight notes the trend line(s) shown above report the business-performed research and development as a percentage of private-industry output. Thus, the assumption could be that Missouri’s business-performed research and development has not truly declined; but rather Missouri’s private-industry output has continuously increased by amounts greater than the increase in Missouri’s business-performed research and development. The following data, however, suggests that Missouri’s business-performed research and development **has** been declining.

Year	Missouri Chained GSP (Actual)	Estimated Private Sector Contribution To Total GSP (89%)	Missouri Research and Development - As A Percent of Private-Industry Output	Estimated Missouri Business-Performed Research and Development (\$)
2016	\$ 276,211,000,000	\$ 245,828,000,000	2.27%	\$ 5,580,000,000
2017	\$ 279,264,000,000	\$ 248,545,000,000	1.97%	\$ 4,896,000,000
2018	\$ 284,696,000,000	\$ 253,379,000,000	2.56%	\$ 6,487,000,000
2019	\$ 287,659,000,000	\$ 256,057,000,000	2.19%	\$ 5,607,000,000
2020	\$ 227,354,000,000	\$ 246,845,060,000	2.08%	\$ 5,146,423,287

Based on the data above, Oversight assumes business-performed research and development in Missouri did decline during 2016-2019. According to the article published by Business Environment Profiles – United States R&D expenditure will R&D expenditure is expected to decline 4.8% in 2020 (from 2019 levels - 2.19% to 2.08%) due to the ongoing economic crisis and COVID-19 pandemic. ([R&D Expenditure Projections](#)).

Based on the data above, Missouri’s three (3) year average estimated business-performed research and development totals \$5,663,203,648 (2017 – 2019). Based on the data above, Missouri’s estimated business-performed research and development in 2020 totaled \$5,146,423,287. This suggests that there would be potentially no amount in excess of the three (3) year average to be used to calculate a tax credit.

Oversight notes, though, that the data reported above are a representation of the State of Missouri as a whole, and not each individual business.

Should the assumption be accepted that each of Missouri’s individual business’s research and development trends follow that of Missouri as a whole, **Oversight** assumes no tax credits would be authorized under this proposed legislation (**unless research and development has increased since the last year reported**).

Oversight assumes, though, such an assumption is not likely; some businesses in Missouri may recognize increased research and development each year, even as the state, as a whole, recognizes a continuous decrease.

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Since the actual amount of future tax credit authorization(s) is unknown, for purposes of this fiscal note, Oversight will report a revenue reduction to GR equal to an amount “Up to” the \$10,000,000 cap beginning in Fiscal Year 2024.

<u>FISCAL IMPACT – State Government</u>	FY 2023 (10 Mo.)	FY 2024	FY 2025
GENERAL REVENUE FUND			
<u>Revenue Reduction – Section 620.1039 – Tax Credit For Qualified Research Expenses</u>	\$0	Up to (\$10,000,000)	Up to (\$10,000,000)
<u>Cost – DED – Section 620.1039 – Administration Of Tax Credit Program</u>			
Personnel Services	(\$36,305)	(\$44,437)	(\$45,326)
Fringe Benefits	(\$24,500)	(\$29,692)	(\$29,990)
Equipment & Expense	(\$10,469)	(\$2,647)	(\$2,701)
Total Cost - DED	(\$71,274)	(\$76,776)	(\$78,017)
Total FTE – DED	1 FTE	1 FTE	1 FTE
<u>Cost – DOR – Section 620.1039 – Redemption/Transfer/Error Processing Of Tax Credits</u>		Up to...	Up to...
Personnel Services	\$0	(\$53,183)	(\$53,714)
Fringe Benefits	\$0	(\$44,479)	(\$44,672)
Equipment & Expense	\$0	(\$23,202)	(\$1,007)
Total Cost	\$0	(\$120,864)	(\$99,393)
FTE Change – DOR	0 FTE	3 FTE	3 FTE
<u>Loss of Revenue – 620.1039 5. –Sales & Use tax exemptions (p.6)</u>	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)
ESTIMATED NET EFFECT ON GENERAL REVENUE	<u>Could exceed (\$71,274)</u>	<u>Could Exceed (\$10,197,640)</u>	<u>Could Exceed (\$10,177,410)</u>
Estimated Net FTE Change on General Revenue	1 FTE	Up to 4 FTE	Up to 4 FTE
<u>FISCAL IMPACT – State Government (continued)</u>	FY 2023 (10 Mo.)	FY 2024	FY 2025
SCHOOL DISTRICT TRUST FUND (0688)			

<u>Loss of Revenue – 620.1039 5. –Sales & Use tax exemptions (p.6)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>
ESTIMATED NET EFFECT ON SCHOOL DISTRICT TRUST FUND	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>
CONSERVATION COMMISSION FUND (0609)			
<u>Loss of Revenue – 620.1039 5. –Sales & Use tax exemptions (p.6)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>
ESTIMATED NET EFFECT ON CONSERVATION COMMISSION FUND	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>
PARKS AND SOILS STATE SALES TAX FUND(S) (0613 & 0614)			
<u>Loss of Revenue – 620.1039 5. –Sales & Use tax exemptions (p.6)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>
ESTIMATED NET EFFECT ON PARKS AND SOILS STATE SALES TAX FUND(S)	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>
<u>FISCAL IMPACT – Local Government</u>	<u>FY 2023 (10 Mo.)</u>	<u>FY 2024</u>	<u>FY 2025</u>
LOCAL POLITICAL SUBDIVISIONS			

<u>Loss of Revenue – 620.1039 5. –Sales & Use tax exemptions (p.6)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>
NET EFFECT ON THE LOCAL POLITICAL SUBDIVISIONS	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>	<u>\$0 to (Unknown)</u>

FISCAL IMPACT – Small Business

This proposed legislation could impact any small business that qualifies for the tax credit created, as such small business could reduce or eliminate such small business’s tax liability.

FISCAL DESCRIPTION

A tax credit for a portion of qualified research expenses, as defined in federal law, expired on December 31, 2004.

This act reauthorizes such tax credit, which shall be equal to 15% of qualified research expenses, or 20% of qualified research expenses if done in conjunction with a public or private college or university located in this state, as described in the act. Tax credits shall not be issued for any qualified research expenses that exceed 200% of the taxpayer's average qualified research expenses incurred during the three immediately preceding tax years. Tax credits issued under the act shall not be refundable, but may be carried forward for the twelve succeeding tax years, and may be transferred, sold, or assigned. A taxpayer shall not receive tax credits in excess of \$300,000 in a calendar year.

This act also authorizes a sales tax exemption for the purchase of qualified research and development equipment and property, as defined in the act.

Tax credits issued under the act shall not exceed ten million dollars in any year, provided that five million dollars of such tax credits shall be reserved for minority business enterprises, women's business enterprises, and small businesses, as defined in the act.

The provisions of this act shall sunset on December 31, 2028, unless reauthorized by the General Assembly.

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 Economic Development
 Department of Revenue
 Office of Administration – Budget & Planning

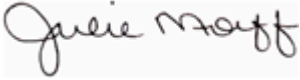
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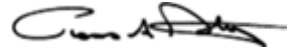
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Missouri Department of Commerce Insurance



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January 24, 2022



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