



## SELECTED STATES' R&D TAX CREDITS

By: Heather Poole, Legislative Analyst II

### ISSUE

Compare research and development (R&D) tax credits available in Connecticut, Maine, Massachusetts, New Jersey, New York, Pennsylvania, and Rhode Island (i.e., selected states).

### SUMMARY

This report compares selected states' tax credits for eligible R&D expenses that apply to income-based taxes (e.g., corporation income tax). It does not include the R&D related deductions, credits, or exemptions some states offer against other taxes, such as sales tax exemptions for R&D supplies or property tax credits for machinery used in R&D. All of the selected states, except Connecticut, offer only one R&D tax credit that is applicable against income-based taxes. Connecticut offers two, one based on total annual R&D expenditures and another based on incremental R&D expenditures.

Most of the credits we compare are available to any business that incurs eligible R&D expenses and pays the tax to which the credit may be applied. Businesses that pay corporation income-based taxes can earn R&D tax credits in all of the selected states, but those organized as pass-through entities (e.g., partnerships and limited liability companies) are eligible for credits only in the four states where the credit can be applied to the personal income tax (Maine, New York, Pennsylvania, and Rhode Island). New York's credit is available only to businesses accepted into the Empire Jobs Program, which provides different types of economic development incentives.

The selected states' R&D tax credits have very similar structures. In general, the credits:

1. are available for the same expenses eligible for the federal R&D tax credit, as defined under federal law (see below), except that the expenses must be incurred in the state offering the credit;



2. are calculated based on the amount of a business' research expenses that exceeds a certain base amount ("incremental");
3. cannot reduce a business' tax liability to less than a minimum statutory amount; and
4. can be carried forward for at least 7 years, but not carried back.

Although the credits' structures are similar, the credit amount varies significantly among the selected states. Most of the credits are incremental, so the amount is determined by the interaction of two of the credits' features: (1) the tax credit rate and (2) the base amount. The tax credit rate ranges from 5% to 22.5% of a business' qualified research expenses in excess of the base amount. States generally determine a business' base amount using a calculation based on the business' average gross receipts and research expenses during specified income years, but the years used in each state's calculation varies. For instance, New Jersey and Pennsylvania both use a business' average research expenses from 1984-1988, but while New Jersey uses gross receipts from that same time period, Pennsylvania uses average gross receipts from the most recent few years. Other states use a simpler base amount—Massachusetts allows a business to use 50% of its average research expenses in the previous 3 years as its base amount, and Connecticut allows businesses to use their prior year's research expenses. Two of the credits we compare are not incremental—New York's and Connecticut's nonincremental credits are calculated based on a business' federal R&D credit and total R&D expenditures, respectively.

## **SELECTED STATES' R&D TAX CREDITS COMPARISON**

Table 1 compares the selected states' R&D credits. For each credit, the table indicates the (1) taxes against which the credit applies, (2) eligibility criteria, (3) credit amount, (4) limitations on the amount of credit that can be claimed in a year, and (5) carryforward and other provisions related to unused credits.

**Table 1: Selected States' R&D Tax Credits**

<b>State R&amp;D Credit Program</b>	<b>Applicable Taxes</b>	<b>Eligible Companies and Activities</b>	<b>Amount</b>	<b>Limits</b>	<b>Unused Credits</b>
Connecticut— Incremental Research and Experimental (R&E) Expenditures Tax Credit ( <a href="#">CGS §12-217</a> )	Corporation	Businesses with more R&E expenditures than they had in the prior year	Credit equals 20% of in-state R&E expenditures over and above the amount spent during prior year	Credit cannot reduce a business' liability below the minimum statutory tax  Businesses cannot reduce their tax liability by more than 50%	May be carried forward for 15 years or until fully used; no carryback  Small businesses with credits they cannot claim may apply for a refund equal to 65% of the credit
Connecticut—R&D Expenses (Nonincremental) Tax Credit ( <a href="#">CGS § 12-217n</a> )	Corporation	Businesses that incur R&E expenditures and basic research payments in Connecticut	Credit determined according to statutory formula: <ul style="list-style-type: none"> <li>• Amounts range from 1% for expenditures of \$50 million or less to 6% for expenditures over \$200 million</li> <li>• Taxpayers that incur more than \$200 million in R&amp;D expenses must reduce their tax credit if they reduce their workforce by more than 2%</li> </ul>	Only one-third of credit can be taken per year Businesses cannot reduce their tax liability by more than 50%	May be carried forward until fully used; no carryback  Small businesses with credits they cannot claim may apply for a refund equal to 65% of the credit
Maine—Research Expense Tax Credit <sup>1</sup> ( <a href="#">Me. Rev. Stat. Ann. tit. 36, § 5219-K</a> )	Corporation, Personal Income	Businesses that spend money for research in Maine	Credit equals: <ul style="list-style-type: none"> <li>• 5% of in-state qualified research expenses in excess of a business' 3- year research expenses average, plus</li> <li>• 7.5% of in-state basic research payments</li> </ul>	For corporations, credit limited to: <ul style="list-style-type: none"> <li>• 100% of first \$25,000 in tax due before other credits, plus</li> <li>• 75% of tax due in excess of \$25,000</li> </ul>	May be carried forward for 15 years or until fully used; no carryback

Table 1 (continued)

<b>State R&amp;D Credit Program</b>	<b>Applicable Taxes</b>	<b>Eligible Companies and Activities</b>	<b>Amount</b>	<b>Limits</b>	<b>Unused Credits</b>
Massachusetts— Research Credit ( <a href="#">Mass Gen. Laws ch. 63, §38M</a> )	Corporation	Businesses that incurred more qualified research expenses than they had in the prior year	Businesses may choose between the regular research credit and a simplified research credit. The regular credit equals: <ul style="list-style-type: none"> <li>•10% of Massachusetts qualified research expenses in excess of the base amount (a calculation based on previous year's research expenses and average gross receipts) and</li> <li>•15% of Massachusetts basic research payments</li> </ul> The simplified credit <sup>2</sup> equals: <ul style="list-style-type: none"> <li>• 5% of a business' qualified research expenses that exceed its credit base (i.e., 50% of the businesses average qualified research expenses in the three previous years)</li> </ul>	Base amount cannot exceed 16% of a company's average gross receipts in the previous two years  Overall credit is limited to: <ul style="list-style-type: none"> <li>•100% of the first \$25,000 in tax due before any other credits, plus</li> <li>•75% of tax due in excess of \$25,000</li> </ul>	May be carried forward for 15 years or until fully used; no carryback
New Jersey— Research and Development Tax Credit ( <a href="#">N.J. Stat. Ann. §54:10A-5.24</a> )	Franchise	Businesses that perform qualified research activities in New Jersey	Credit equals: <ul style="list-style-type: none"> <li>• 10% of a business' qualified research expenses over a base amount (generally a calculation based on a business' research expenses and gross receipts between 1984 and 1988) and</li> <li>•10% of basic research payments</li> </ul>	Credit cannot reduce a business' liability below the minimum statutory tax	May be carried forward for 7 years, or in certain industries, for 15 years
New York—Excelsior Research and Development Tax Credit ( <a href="#">N.Y. Tax Law, §31(a)(3)</a> )	Franchise, Personal Income, Commuter	Businesses in targeted industries that are making significant investments to grow in NY state and have been approved by the state to participate in the program and are eligible for the federal R&D tax credit	Credit equals 50% of a business' federal R&D credit up to 3% of research expenditures in NY state	In order to claim the credit, businesses must first meet and maintain the program's minimum job and investment requirements	No carryforward or carryback, but credits are refundable

Table 1 (continued)

<b>State R&amp;D Credit Program</b>	<b>Applicable Taxes</b>	<b>Eligible Companies and Activities</b>	<b>Amount</b>	<b>Limits</b>	<b>Unused Credits</b>
Pennsylvania— Research and Development Tax Credit ( <a href="#">72 P.S. §§ 8702-B &amp; 8703-B</a> )	Capital Stock/Foreign Franchise, Corporation, Personal Income	Businesses and individuals performing qualifying research in Pennsylvania	Credit equals 10% (or 20% if the entity is a small business) of an entity's qualified research expenses over its base amount (generally a calculation based on a business' average gross receipts and research expenses between 1984 and 1988)	Program is capped at \$55 million per year, and \$11 million is set aside for small businesses. Credit is prorated if the total amount of credits exceeds the program cap.	May be carried forward for 15 years; unused credits may also be sold
Rhode Island— Research and Development Tax Credit ( <a href="#">R.I. Gen. Laws §44-32-3</a> )	Corporation, Insurance Companies, Personal Income	Businesses performing qualifying research in Rhode Island	Credit equals 22.5% of an entity's qualified research expenses over its base amount up to \$111,111, and 16.5% of expenses in excess of \$111,111 (the base amount is generally a calculation based on a business' average gross receipts and research expenses between 1984 and 1988)	Credit cannot reduce a business' taxes due (1) by more than 50% of what would otherwise be payable or (2) to less than the statutory minimum tax	Unused credit may be carried forward for up to 7 years

<sup>1</sup>Maine once offered an additional credit to businesses that substantially exceeded their R&D expenses, but it is not available for tax years beginning on or after January 1, 2014 ([Me. Rev. Stat. Ann. tit. 36 § 5219-L](#)).

<sup>2</sup>Massachusetts' simplified credit is being phased in over seven years. By 2021, the credit will equal 10% of qualified research expenses in excess of the credit base.

## **Definitions**

The selected states' credits generally use the same definitions as the federal R&D deduction and credit.

**R&E expenditures** includes (1) expenses a business incurs in connection with its trade or production that represent R&D costs in the experimental or laboratory sense; (2) costs related to developing or improving an experimental or pilot model, a plant process, a product, a formula, an invention, or similar property; and (3) costs of obtaining a patent. They do not include expenditures for (1) quality control testing; (2) advertising or promotions; (3) consumer or efficiency surveys; (4) management studies, (5) research connected with literary, historical, or similar projects; or (6) acquiring another business' patent, model, production, or process ([26 CFR § 1.174-2](#)).

**Qualified research** generally refers to those activities for which a business incurs R&E expenditures for the purpose of discovering information which is (1) technological in nature and (2) intended to develop a new or improved business component of the taxpayer. It does not include research after commercial production, adaptation of existing business components to a particular customer's needs, duplication of existing business components, surveys, computer software (with some exceptions), social science research, and funded research ([26 USCA § 41 \(d\)](#)).

**Qualified research expenses** means the sum of (1) in-house research expenses, including payments for wages and supplies related to qualified research, and (2) contract research expenses, which means 65% of any amount paid or incurred by the taxpayer to any person, other than an employee of the tax payer, for qualified research ([26 USCA § 41\(b\)](#)).

**Basic research payments** means any amount a business pays in cash to a qualified organization for basic research performed by the qualified organization under a written agreement between the two entities. Qualified organizations include educational institutions, certain scientific research organizations, scientific tax-exempt organizations, and certain grant organizations ([26 USCA § 41 \(e\)](#)).

## **HYPERLINKS**

Connecticut Incremental R&E Expenses tax credit:

<http://www.ct.gov/drs/cwp/view.asp?a=3807&q=522224>

Connecticut Nonincremental R&D Expenses Tax Credit:

<http://www.ct.gov/drs/cwp/view.asp?a=3807&q=522222>

Connecticut Nonincremental R&D Expenses Tax Credit, OLR Report:

<http://www.cga.ct.gov/2015/rpt/pdf/2015-R-0217.pdf>

Maine Research Expense Tax Credit Worksheet:

[http://www.maine.gov/revenue/forms/credits/2014/14\\_retc.pdf](http://www.maine.gov/revenue/forms/credits/2014/14_retc.pdf)

Massachusetts R&D Tax Credit Program Changes Summary, PwC:

<http://www.pwc.com/us/en/state-local-tax/newsletters/salt-insights/massachusetts-revises-research-credit-provisions.html>

New Jersey R&D credit worksheet:

<http://www.state.nj.us/treasury/taxation/pdf/current/cbt/306.pdf>

New York, Excelsior Jobs Program

<http://esd.ny.gov/BusinessPrograms/Data/Excelsior/ExcelsiorJobsProgramOverview.pdf>

Pennsylvania R&D Credit Application:

[http://www.revenue.pa.gov/FormsandPublications/FormsforBusinesses/Documents/Corporation%20Taxes/2015/2015\\_rev-545.pdf](http://www.revenue.pa.gov/FormsandPublications/FormsforBusinesses/Documents/Corporation%20Taxes/2015/2015_rev-545.pdf)

Rhode Island R&D Credit Worksheet:

<http://www.tax.ri.gov/forms/2014/Credits/2014%20RI%207695E.pdf>

HP:bs