# Full Evaluation of Tax Expenditures:
# Research Expense Tax Credit
# Background and Evaluation Parameters
# Presented to the Government Oversight Committee on 4/23/21

| Enacted | Statute(s) | Taxpayers Affected | Est. Revenue Loss |
|---|---|---|---|
| 1995 | 36 MRSA §5219-K | Approximately 175 taxpayers affected | FY22 $1,650,000<br>FY23 $2,180,000 |

*Source for Estimated Revenue Loss: Maine State Tax Expenditure Report 2022 – 2023.*

## Program Description

The Research Expense Tax Credit (R&D Credit) under 36 MRSA §5219-K provides an income tax credit to taxpayers for qualified research expenses associated with certain technological research. It is available to Maine taxpayers who also claim the federal Credit for Increasing Research Activities (federal R&D credit). The credit is non-refundable and may be carried forward for up to 15 years.[1]

The Maine R&D Credit is built upon the federal Credit for Increasing Research Activities and relies upon definitions specified in the Internal Revenue Code (IRC). Like the federal R&D credit, the Maine R&D credit is incremental—providing a credit for qualified research expenses above a base amount dependent upon the taxpayer's previous qualifying research expenses. The Maine R&D Credit applies only to expenses incurred in Maine.

The Maine R&D Credit (36 MRSA §5219-K) is the sum of two amounts:

> (1) An amount equal to 5% of the excess, if any, of the taxpayer's <u>qualified research expenses</u> for the taxable year over the base amount.[2]
>
> (2) An amount equal to 7.5% of the taxpayer's <u>basic research payments</u> as determined under the federal tax code (IRC §41(e)(1)(A)); and

<u>Qualified research expenses</u> include amounts paid for research performed by qualified organizations under contract which fall below the federal base amount. These expenses can also include wages and supplies. <u>Basic research payments</u> include amounts paid for research performed by qualified organizations under contract which exceed a federal base amount.

[1] The program description is derived from a combination of statute, IRC, and OPEGA's understanding of the program.
[2] For the purposes of the Maine credit, the base amount for qualified research expenses is the average amount per year spent on qualified research expenses over the previous 3 taxable years by the taxpayer (§5219-K).

The maximum amount of the Maine R&D credit is limited to 100% of a corporation's first $25,000 of tax due, as determined before the allowance of any credits, plus 75% of the corporation's tax due as determined in excess of $25,000.

Maine Revenue Services (MRS) administers the Maine R&D Credit through the state tax system. Under current law, no other agency has administrative responsibility for or oversight of this credit.

### Proposed Changes to the Credit

LD 308, currently before the 130th Legislature, proposes changes to the Maine R&D Credit. The bill would increase the allowed credit by doubling the percentage of the eligible expenditures used in the calculation of the credit and increasing the maximum amount of the credit that may be claimed. The bill also provides for ongoing funds of $100,000 per year beginning in fiscal year 2021-22 to the Department of Economic and Community Development to advertise and market the credit.

## Evaluation Parameters

### Statutory Guidance

Pursuant to Maine Revised Statutes, Title 3, section 999, prior to the beginning of a full tax expenditure evaluation, the GOC is required to approve:

> (1) the purpose, intents or goals of the tax expenditure, as informed by original legislative intent as well as subsequent legislative and policy developments.
>
> (2) the intended beneficiaries of the tax expenditure
>
> (3) the evaluation objectives, and
>
> (4) performance measures appropriate for analyzing the evaluation objectives.

### Purpose, intents or goals

Based on a review of the enabling statute and subsequent legislative developments, OPEGA did not identify a clear statement of legislative intent for the Maine R&D credit.

Absent a clearly stated legislative intent, OPEGA researched and identified goals that might be associated with this tax credit. Research included the following sources: statements of intent for the federal credit, upon which the state credit is based, and Maine legislation related to the credit (specifically LD 977 'An Act to Restore the Super Credit for Substantially Increased Research and

Development'[3] in the 129th Legislature). From this research, OPEGA presents possible goals for the GOC to consider as they decide on the program intents for the purpose of OPEGA's evaluation. The GOC may determine that some or all of them are appropriate for evaluation or may determine different goals than OPEGA provides here.

| Possible Goals to Be Evaluated | Sources |
|---|---|
| (1) To stimulate more business R&D investment than otherwise would take place by lowering the after-tax cost of engaging in qualified research | • The Congressional Research Service characterization of the intent of the federal credit, upon which Maine's credit piggy-backs.[4] |
| (2) To create high-quality jobs in the State by encouraging investments in research and development in this State and to encourage the recruitment and training of employees | • LD 977, as amended by Committee Amendment "A." |
| (3) To directly and indirectly improve the overall economy of the State by expanding the number of businesses conducting and investing in research and development in the State | • LD 977, as amended by Committee Amendment "A." |

Goal (1) is the Congressional Research Service's characterization of the intent of the federal R&D credit. OPEGA suggests that goals (2) and (3), stated in the Committee Amendment to LD 977, are also applicable to the R&D Credit and present the clearest statement of Maine legislative intent for the R&D Credit for the following reason:

> The Super Credit, when it was in place, was built directly upon the R&D Credit indicating a shared purpose.

The Super Credit was found in §5219-L and stated that "a taxpayer qualifying for a research expense tax credit under section 5219-K is allowed an additional credit against the tax due equal to the excess, if any, of the qualified research expenses for the taxable year over the super credit base amount."[5]

## Intended Beneficiaries

There are no intended beneficiaries stated in statute or in subsequent legislative developments.

[3] LD 977 was introduced in the First Regular Session of the 129th Legislature and in June 2019, the bill (as amended by Committee Amendment "A" (H-621)) was carried over on the Special Appropriations Table. LD 977 died upon conclusion of the 129th Legislature in November 2020.

[4] "Research Tax Credit: Current Law and Policy Issues for the 114th Congress." *Congressional Research Service*. June 2016, pg. 2. https://crsreports.congress.gov.

[5] The Super Credit for Substantially Increasing Research and Development was established in 1997 (118th), implemented in 1998 and dropped in 2014 to close the supplemental budget gap.

The possible goals identified in the previous table and the structure of the credit might suggest the following beneficiaries:

1. Businesses conducting and investing in research and development in the State; and

2. Indirectly, qualified organizations performing research in the State.

## Evaluation objectives

The evaluation objectives specify what OPEGA will assess in its evaluation of the Research Expense Tax Credit. The statute governing the full evaluation of tax expenditures outlines a menu of possible evaluation objectives which may include:

| Objectives Allowed Under 3 MRSA §999 subsection 1 paragraph A |
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| (a) The fiscal impact of the tax expenditure, including past and estimated future impacts; |
| (b) The extent to which the design of the tax expenditure is effective in accomplishing the tax expenditure's purposes, intent or goals and consistent with best practices; |
| (c) The extent to which the tax expenditure is achieving its purposes, intent or goals, taking into consideration the economic context, market conditions and indirect benefits; |
| (d) The extent to which those actually benefiting from the tax expenditure are the intended beneficiaries; |
| (e) The extent to which it is likely that the desired behavior might have occurred without the tax expenditure, taking into consideration similar tax expenditures offered by other states; |
| (f) The extent to which the State's administration of the tax expenditure, including enforcement efforts, is efficient and effective; |
| (g) The extent to which there are other state or federal tax expenditures, direct expenditures or other programs that have similar purposes, intent or goals as the tax expenditure, and the extent to which such similar initiatives are coordinated, complementary or duplicative; |
| (h) The extent to which the tax expenditure is a cost-effective use resources compared to other options for using the same resources or addressing the same purposes, intent or goals; and |
| (i) Any opportunities to improve the effectiveness of the tax expenditure in meeting its purposes, intent or goals. |

For the R&D Credit, OPEGA recommends that the evaluation address each of objectives listed above ((a)-(i)) to the extent warranted based on assessment of the relevance of the objective to this tax credit, the availability of necessary data and the level of resources required.

OPEGA will perform additional work as necessary, and as possible within existing resources, to provide context for OPEGA's assessment of this program in Maine, including review of literature or reports concerning these programs nationally or in other states.

## Performance measures for analyzing evaluation objectives

In accordance with statute, the performance measures used to address the evaluation objectives must be clear and relevant to the specific tax expenditure and the approved objectives. Measures will be addressed in the report to the degree possible based on the level of resources required and the availability of necessary data.

| Possible performance measures for GOC consideration |
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| (a) $ Amount of tax credits claimed (in past and future estimates) |
| (b) $ Impact on State budget (revenue loss and net impact) |
| (c) The number, geographic distribution and income of full-time employees added or retained during the period being reviewed who would not have been added or retained in the absence of the credit* |
| (d) The number and amount of investments in research and development made by credit recipients during the review period* |
| (e) Direct and indirect improvement in the economy of the State attributable to activities entitled to a credit under this section* |

*Performance measures in LD 977, as amended