



Legislative Fiscal Bureau

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February 10, 2016

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 525/Assembly Bill 757: Create a Research and Development Tax Credit for Industry Clusters

Senate Bill 525 (SB 525) was introduced on January 7, 2016, and was referred to the Senate Committee on Economic Development and Commerce. On January 28, 2016, that Committee adopted Senate Amendment 1 (SA 1) to SB 525 on a vote of 3 to 2, and recommended passage of the bill as amended on a vote of 3 to 2. The bill was referred to the Joint Committee on Finance on February 2, 2016.

Assembly Bill 757 (AB 757) was introduced on January 20, 2016, and was referred to the Assembly Committee on Jobs and the Economy. On February 2, 2016, that Committee adopted Assembly Amendment 1 (AA 1) to AB 757 on a vote of 15 to 0 and recommended passage of the bill as amended on a vote of 14 to 1.

SB 525 and AB 757 are identical companion bills, and SA 1 and AA 1 are identical amendments to their respective bills.

BACKGROUND

Current law provides a nonrefundable research credit which may be claimed against the individual income tax, including the alternative minimum tax, and the corporate income/franchise tax. The method for calculating the state research credit was modified under 2015 Wisconsin Act 55 to simplify how taxpayers must calculate the credit. In general, a credit is provided to offset a portion of qualified research expenses and is calculated in a similar manner to how the federal credit for increasing research activities is calculated to offset federal income taxes.

For taxable years beginning after December 31, 2014, the state research credit is equal to 5.75% of the amount by which the claimant's qualified research expenses for the taxable year exceed 50% of the claimant's average qualified research expenses for the three preceding years.

The credit is equal to 2.875% of the current year's qualified research expenses if the claimant had no qualified research expenses in one or more of the three preceding years. For research related to internal combustion engines, including vehicles powered by such engines, and energy efficient lighting systems, building automation and control systems, or automotive batteries, the state credit percentages are 11.5% and 5.75%, respectively.

SUMMARY OF BILLS

SB 525/AB 757 would create a nonrefundable credit that could be claimed against the individual income tax, including the alternative minimum tax, and the corporate income/franchise tax equal to 25% of qualified research expenses, as defined under Section 41 of the Internal Revenue Code (IRC), incurred for research conducted in this state for the taxable year, provided the research is approved by an industry cluster partnership. To determine the amount of a person's qualified research expenses eligible for the credit, the person could elect an alternative computation of the credit, as provided under federal law, and that election would apply until the Department of Revenue (DOR) permits its revocation. Section 41 (h) of the IRC, which temporarily terminated the alternative computation of the credit, would not apply to the research credit for industry cluster partners. A person who files a claim for the credit with DOR would have to include with the person's return a copy of the person's approval from the industry cluster partnership. This credit would be in addition to any other research credit available to the claimant under current law.

As noted, in order to claim the credit, the person would have had to incur qualified research expenses in research approved by an industry cluster partnership. The bills would specify that an industry cluster partnership means a nonprofit organization that satisfies all of the following conditions:

- a. Its primary purpose is to assist in developing and supporting a regional concentration of private sector businesses in this state that share a common interest in fostering industry-specific research and development, worker skills training, and market development;
- b. It collaborates with institutions of higher education, including technical colleges, in this state for the purpose of transferring to the private sector, and commercializing, technology related to specific industries and developed at those institutions;
- c. It is governed by a board of directors with members from the public and private sectors who represent the industries and interests necessary to ensure a collaborative, strategic approach to supporting economic development, job growth, and the development of marketable products and services in a specific industry; and
- d. It is a participant in the National Science Foundation's industry and university cooperative research center program.

Partnerships, limited liability companies (LLCs), and tax-option corporations (S corporations) would not be allowed to claim the research and development credit for industry cluster partnerships, but the eligibility for, and the amount of, the credit would be based on their

payment of amounts eligible for the credit. A partnership, LLC, or S corporation would have to compute the amount of credit that each of its partners, members of LLCs, or shareholders of S corporations could claim and would have to provide that information to each of them. Partners, members, and shareholders could claim the credit in proportion to their ownership interests. The claimant would have to include a copy of the claimant's certification for tax benefits with the claimant's return in order to claim the credit.

As noted, the credit would not be refundable. However, unused credits could be carried forward for 15 years.

DOR would be authorized to administer the credit, and take any action, conduct any proceeding, and proceed as authorized under state income and franchise tax laws. State tax provisions related to timely claims, assessments, refunds, appeals, collection, interest, and penalties would apply to the credit.

A person who claims the research credit for an industry cluster partnership may also be eligible to claim the other research credits available under current law for the same qualified research expenditures. These provisions would take effect on the day following publication of either of the bills, and would first apply for taxable years beginning after December 31, 2015.

SUMMARY OF SENATE AMENDMENT 1 AND ASSEMBLY AMENDMENT 1

SA 1 to SB 525 and AA 1 to AB 757 would specify that a person could claim the credit if the industry cluster partnership certifies that the claimant is a member of the cluster, rather than allowing the credit only if the research is approved by an industry cluster partnership. SA 1/AA 1 would also require that a person who files a claim with DOR for the credit include a copy of the person's certification from the industry cluster partnership that the person is a member of the cluster, rather than a copy of the person's approval from the industry cluster partnership.

The amendments would make two changes to the bill that would make the calculation of the research and development credit for industry cluster partnerships consistent with how qualified research expenses are calculated for the other research credits provided under current law. First, the amendments would disallow a person from electing the alternative computation for the credit that is available under federal law. Second, the amendments would specify that IRC Sections 41 (f) (1), (2), (5), and (6), which generally refer to federal provisions specific to combined groups that are not applicable to combined groups under state law, do not apply to credit.

The amendments would provide a further limitation to the types of qualified research expenses that would be eligible for the research and development credit for industry cluster partnerships beyond the federal limitations. For purposes of claiming the credit, qualified research expenses would also have to satisfy at least one of the following conditions: (a) they are paid by the person claiming the credit; (b) they are paid pursuant to a contract with a Wisconsin research institution or university; or (c) they are paid pursuant to a contract with a Wisconsin-based early stage company that has licensed intellectual property from a Wisconsin university.

FISCAL EFFECT

According to DOR, there are two centers that would currently be eligible to meet the definition of an industry cluster partnership for the proposed credit in Wisconsin: (a) the Water and Equipment Policy Center in Milwaukee; and (b) the Power Systems Engineering Research Center at UW-Madison. DOR reviewed research credit claims of companies participating in the programs of the two centers and estimates that SB 525/AB 757 would reduce state tax revenues by \$1.2 million in 2015-16, \$4.9 million in 2016-17, \$5.2 million in 2017-18, and \$5.4 million in 2018-19. SA 1/AA 1 are not anticipated to have a significant fiscal impact.

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