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FISCAL IMPACT STATEMENT

LS 7834 | **NOTE PREPARED:** Jan 13, 2005
BILL NUMBER: SB 1 | **BILL AMENDED:**

SUBJECT: Tax Incentives.

FIRST AUTHOR: Sen. Ford | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: *Property Tax Investment Deduction*: This bill establishes a property tax investment deduction in declining amounts over three years for certain real property development, redevelopment, or rehabilitation that increases assessed value and creates or retains employment. It limits the deduction to $10,000,000 of assessed value per year for real property located in a county. The bill also establishes a similar deduction for the installation of personal property other than inventory subject to the same conditions and limitation.

Sales Tax Exemption/Credit: This bill exempts a person from 100% of the Sales Tax on research and development equipment acquired after June 30, 2007. The bill provides a refund of 50% of the Sales Taxes paid on transactions involving research and development equipment acquired after June 30, 2005, and before July 1, 2007.

Indiana Economic Development Corporation: This bill provides for the Indiana Economic Development Corporation to administer the Economic Development for a Growing Economy (EDGE) tax credit program and the Hoosier Business Investment tax credit.

Research Expense Credit: The bill increases the qualified Research Expense Credit from 10% to 15% for taxable years beginning after December 31, 2007.

The bill also makes technical changes and repeals the EDGE Board.

Effective Date: July 1, 2005; January 1, 2006.

Explanation of State Expenditures: *Indiana Economic Development Corporation (IEDC):* The bill eliminates the Economic Development for a Growing Economy (EDGE) Board and transfers all administrative responsibility of EDGE credits for job creation and job retention, and the Hoosier Business Investment (HBI) Tax Credit, to the IEDC Board. Since under current statute the IEDC would have been providing administrative support to the EDGE Board, this change would simply increase the workload of the IEDC Board in awarding EDGE and HBI credits.

Under current statute, credit award decisions for the EDGE and HBI programs are made by the EDGE Board, while the Indiana Department of Commerce (IDOC) is required to provide administrative support to the EDGE Board. While current statute transfers this support responsibility to the IEDC, it does not eliminate the EDGE Board. The EDGE Board is comprised of the Director of the IDOC, the State Budget Director, the Commissioner of the Department of State Revenue, and four members appointed by the Governor. Under current statute, the IDOC is abolished on July 1, 2005, and all economic development functions are to be transferred to the IEDC.

Department of State Revenue (DOR): DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes contained in this bill. The Department's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Indiana Economic Development Corporation (IEDC):* The bill changes current law with regard to EDGE credit refunds. While EDGE credits may not exceed incremental income tax withholdings, the amount a taxpayer claims in a taxable year may exceed the taxpayer's tax liability. Under current statute, taxpayers are entitled to refund of excess EDGE credits claimed in a taxable year. Under the bill, such refunds would be made at the discretion of the IEDC. The impact of this change is indeterminable.

Sales Tax Exemption/Credit: This bill provides a refund of 50% of the Sales Taxes paid on transactions involving research and development equipment for FY 2006 and FY 2007. The bill provides an exemption from 100% of the Sales Tax on research and development equipment beginning in FY 2008.

The 50% refund is estimated to reduce state Sales Tax revenue by approximately $11.4 M to $28.3 M in FY 2006, and $12.6 M to $31.3 M in FY 2007.

The exemption that begins in FY 2008 is estimated to reduce Sales Tax revenue by approximately $26 M to $64 M in FY 2008.

Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%).

The estimate above is based on data obtained from the National Science Foundation (NSF) that describes the total value of industrial research and development performed in Indiana through CY 2000. Based on past R&D expenditures and adjusting for historical growth, it is estimated that in FY2006, Indiana firms will expend a total of approximately $2,944 M on R&D in Indiana. In FY 2007, these expenditures are expected to increase to $2,984 M. Using NSF information on how R&D funds are spent, it is estimated that approximately 14% to 35% of Indiana R&D expenditures would be subject to the state's Sales Tax.

Research Expense Income Tax Credit: This bill increases the credit from 10% to 15% for tax years beginning

January 1, 2008. The incremental revenue loss from increasing the rate of this credit is estimated to be $5 M. However, the increase in the state's liability for this credit could potentially be $25 M annually, with $20 M in liabilities being carried forward each year due to the fact that businesses qualifying for credits may have insufficient tax liabilities to use the credits earned during the taxable year. Thus, the credit increase could lead to substantial growth in the amount of credits earned each year, but also could result in a significant and increasing rate of growth in the amount of credits carried forward annually. This would depend on the frequency and cost of future research activities and income growth of taxpayers making creditable research expenditures. This increase in the amount of credit would affect revenue collections beginning in FY 2008 and years after.

Background: P.L. 242-2002 (ss) increased this credit from 5% to 10% of qualified expenses for tax years beginning January 1, 2003, and eliminated the apportionment factor used to calculate the credit. P.L. 81-2004 made this tax credit permanent. This bill will increase the credit to 15% with tax years beginning January 1, 2008.

The Research Expense Credit is available for individuals, corporations, limited liability companies, limited liability partnerships, trusts, or partnerships who have increased research activities conducted in Indiana. The credit is calculated based on the increased expenses a taxpayer incurred over their base year expenditures. The base year expenditures are measured for taxable years beginning after December 31, 1989, and are equal to the federal base amount as defined in the Internal Revenue Code (2001). A taxpayer is not entitled to a carryback or refund, but may carry forward the tax credit for 15 years. The base year expenses may not be less than 50% of the current tax year's qualified research expenses.

Preliminary data on the amount of credits claimed after the changes made by P.L. 242-2002(ss) suggest that approximately $48 M in credits have been *claimed* in the 2003 tax year. This suggests that the base of the potential credits almost doubled over prior levels. However, since there is currently such a large number of suspended returns, DOR is unable to report the level of actual credits *utilized* for tax year 2003, which would indicate the direct and immediate revenue loss from the changes in the rate and base of the credit. A simulation of taxpayers suggests that the increase in the rate from 5% to 10% double the amount of potential credits *claimed*, but only 80% of these credits would be *utilized* and 20% of the credits would be carried forward. This simulation also suggested that an increase in the rate of the credit from 10% to 15% would increase the amounts of credits *claimed* by another $25 M, but only 60% to 75% of the credits would be *utilized* with 25% to 40% of the credits being carried forward. Tax year 2001 tax return data indicates that almost 89% of individual filers reporting some business net income had income tax liabilities of $3,400 or less. For the same year, 88% of corporate filers had income tax liabilities of $10,000 or less.

A history of the Research Expense Credits taken on the individual and corporate tax returns for the last five years is reported in the table below.

History of Research Expense Credits Utilized				
Tax Year	**Tax Rate**	**Indiv. AGI Credits**	**Corp. Tax Credits**	**Total Credits**
1999	5%	$1.6 M	$25.8 M	$27.4 M
2000	5%	$1.6 M	$18.1 M	$19.7 M
2001	5%	$1.2 M	$21.6 M	$22.8 M
2002*	5%	$1.3 M	$12.3 M *	$13.6 M *
2003*	10%	$2.2 M	$14.0 M *	$16.2 M *
** 2002 & 2003 tax year estimates are preliminary due to a large number of suspended returns.*				

The credit provides $150,000 for each $1M in new research expenses. Consequently, increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment. Assuming this economic impact would not have happened absent this incentive, the actual revenue loss from this credit would be mitigated by the incremental increase in other taxes generated by the research activities.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Property Tax Investment Deduction*: Under this provision, the increase in assessed value (AV) from certain real and personal property additions would qualify for property tax deductions over a period of three years. The deduction would apply if the property owner creates or retains jobs because of the project.

The deduction would apply to:

1. Real property AV that is added due to development, redevelopment, or rehabilitation; and
2. Personal property installed by the owner that was never before used by its owner in Indiana.

The real property deduction would not be available for the following facilities: golf courses, country clubs, massage parlors, tennis clubs, racetracks, package liquor stores, residential property unless it is low income or in a residentially distressed area, or facilities for skating, racquet sport, hot tubs, suntans, retail food and beverage sales, automobile sales or service, or other retail facilities.

The deductions for both real and personal property would equal 100% of the AV increase in the first assessment year, 66% in the second year, and 33% in the third year. Each deduction would be limited to $10M AV. The real and personal property deductions are separate deductions and would each have a $10M limit.

Taxpayers would not be permitted to claim more than one deduction for which the project may qualify. So, for example, a taxpayer could not claim both an abatement and this deduction on the same property. Taxpayers who are located in a TIF area would not be eligible for the deduction.

The real property deduction is much like the existing 3-year abatement for real property. The personal property deduction differs from the current personal property abatement in that the current abatement is available only for manufacturing, research, and logistic equipment. The proposed deduction has no such requirement on the use of the equipment.

The eligible real property would be identified by the township assessor, and the deduction would be granted by the county auditor without application by the taxpayer. Taxpayers seeking the personal property deduction would have to claim the deduction on their personal property tax return.

The investment deduction would slow the growth of both real and personal property AV. There would be no effect on the assessed value of existing property.

Tax shifts between existing and new or rehabilitated property. Generally speaking, the addition of assessed value to the tax base provides a tax shift from existing property to new property by spreading the tax levy over a larger tax base. The proposed deduction would slow this shift.

Tax shifts between property classes. The varying rates at which assessed values in each class of property grow in relation to each other determine each class's relative share of the tax burden. The extent to which the growth rate for each class is reduced by this bill will determine whether any tax shifts will occur between classes. In general, this bill would shift taxes from businesses to other property classes.

State Agencies Affected: Indiana Economic Development Corporation; EDGE Board; Department of Local Government Finance; Department of State Revenue.

Local Agencies Affected:

Information Sources: National Science Foundation, *Survey of Industry Research and Development*; Township assessors; County auditors; Department of State Revenue.

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