

Research and Development Credit

Federal Conformity Can Help State Keep Innovative Edge

Summary

Background

California's research and development (R&D) credit, enacted in 1986, provides an income and corporate tax credit for certain types of R&D expenditures in order to incentivize and reward companies that invest in R&D within California.

In terms of R&D performance, California ranks first among all 50 states. California alone accounts for more than one-fifth of total R&D in the United States. California industry ranked first in R&D expenditures, accounting for \$47.1 million in 2003. California universities rank No. 5 in U.S. R&D among universities. More than half of the R&D performed in the United States by computer and electronics product manufacturers is located in California, Massachusetts and Texas. California also is the national leader in R&D knowledge capital.

Nevertheless, recent studies show that growing numbers of Silicon Valley professionals are heading to India to start new businesses with U.S. funding or to expand R&D labs for Silicon Valley companies. Meanwhile, the Chinese government has tripled its spending on R&D since 1998.

Current State/Federal Policy

Both the federal government and the state of California offer businesses an R&D credit. The federal R&D credit differs from California's in several ways. One difference is that the federal R&D credit is not permanent like California's and must be renewed periodically. The federal R&D credit is better than California's in other respects, however: the federal R&D credit is 20 percent, while California's is only 15 percent, and as a result of 2006 legislation, the federal R&D credit now also offers a desirable new alternative simplified credit not available in California.

Recent Legislative Developments

As part of the 2008-09 budget, California imposed a significant two-year limitation on the ability to use the R&D credit. AB 1452 (Committee on Budget) capped all business credits at half the taxpayer's tax liability. The R&D credit, along with the state's enterprise zone credit, is one of the state's two most significant statewide business tax credits. The estimated loss to businesses due to the limit on the business credits is \$900 million.

The 2008-09 budget legislation provided an offsetting improvement for businesses by allowing, effective January 2010, the R&D tax credit to be shared among a related group of affiliate or subsidiary companies, sometimes referred to as unitary utilization. This change will help some employers who are not currently able to fully utilize their promised tax credits, despite having engaged in the desired R&D activities. It also improved taxpayer equity. The state has been able to have it both ways—businesses are "unitary" for the purpose of taxation, but separate entities when applying tax credits. There should be consistent tax treatment of the members of a unitary group.

As the *Guide* went to print, two ballot initiative proposals were pending that would repeal the credit sharing improvement.

CalChamber Position

The CalChamber opposes any attempt to undermine, suspend or reduce the R&D credit. The CalChamber supports strengthening California's R&D credit by bringing it into conformity with positive aspects of the federal R&D credit.

Reasons for Position

- California needs to maintain and expand its leading edge in R&D innovation and talent as it competes for R&D investments, jobs and knowledge capital with other states and countries.
- Strengthening California's R&D credit will bolster R&D activity in industry and the state's universities, stimulating the economy with additional investments and jobs and helping boost state tax revenues.

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January 2010