TO: Oregon legislators
FROM: Oregon Center for Public Policy
DATE: 3/30/23
SUBJECT: **Recommendations to improve proposed Research and Development (R&D) tax credits**

We respectfully submit this memorandum setting out ways to improve a proposed Research and Development (R&D) tax credit. While we believe the evidence shows that an R&D tax credit is ineffective and potentially counterproductive in capturing federal CHIPS Act funding, we recognize that interest remains to create a credit. To improve legislative proposals on an R&D tax credit, we offer recommendations summarized here and explained in more detail below.

Target the credit to small, startup companies

- The credit should only be available for companies with less than $50 million in national gross receipts
- Smaller companies can qualify for a bigger, partially refundable credit
- To target startups, companies can only claim the credit for up to 5 tax years

Safeguard Oregon's resources

- Set a total credit cap of $20 million per tax year
- Cap the size of the credit that individual companies can claim at $2.5 million per company
- Cap the qualified percentage at 7% for activities in urban counties and 10% in rural counties
- Limit to only businesses eligible for Oregon CHIPS Act funding (semiconductors and advanced manufacturing firms only)
- Do not permit the credit to be transferred

Demand accountability and transparency

- Require credits to be certified by the Department of Revenue
- Require companies receiving the tax credit to disclose certain information
- Require a study of the effectiveness of the R&D tax credit

We elaborate on each of these points in the section that follows.

Target the credit to small, startup companies

Limit credit availability to smaller companies. Evidence suggests that state research and development tax credits are more effective for small and startup companies. In light of this, we recommend making the tax credit available only to companies with national gross receipts under $50 million. Smaller companies could claim a larger, partially refundable, credit.

- $0 - $5 million in national gross receipts: Credit capped at $2.5 million, with 50% of the credit refunded
- $5 million - $50 million in national gross receipts: Credit capped at $1 million, with none of it refunded
- More than $50 million in national gross receipts: No credit is available

Allow the tax credit to be used for up to 5 years. Because the goal is to help startups, rather than create a permanent subsidy for companies, the legislature should put a limit on how many years a company can claim the credit.

Safeguard Oregon's resources

Set a total credit cap of $20 million per year. To prevent runaway costs, the legislature should set a limit of $20 million dollars per year for the total program cost. This is generous: it would add up to $120 million before the policy sunsets in 2030 and would be the largest active corporate income tax credit in Oregon. It would roughly be double the size of the next largest Oregon corporate income tax expenditure, the Oregon Affordable Housing Lender's Credit.

Cap the credit at $2.5 million per business. Each business would be able to claim a credit of up to $2.5 million dollars in qualifying research and development expenses per year. The $2.5 million cap more than doubles the previous credit cap of $1 million.

Cap the qualified percentage at 7% for expenses in urban counties and 10% in rural counties. In recent decades, income growth in Oregon's urban areas has outpaced gains in rural areas considerably. To help level up parts of the state, projects in rural areas would get an extra 3 percentage point boost. This could be catalyzing for the semiconductor industry, where much of the industry is clustered in urban parts of the state.

Limit the credit to businesses eligible for Oregon CHIPS Act funding. Oregon has limited resources to invest in economic development, so it should use those dollars in the most targeted and effective way. Given that the state has identified priorities in supporting

6420 S Macadam, Suite 200 ■ Portland, OR 97239-0127 ■ 971-279-4732 ■ **OCPP.org**

the semiconductor and advanced manufacturing industry, it's important to keep the R&D credit targeted to companies eligible for the Oregon CHIPS Act funding.

Do not permit the credit to be transferred. When a credit is transferred to another business, there is usually an intermediary that facilitates the transfer for a fee. This pulls some of the value of the credit away from research activities and creates a transaction cost that doesn't help Oregon's semiconductor research. This contrasts with a refundable credit, where all of it is targeted to the business.

Demand accountability and transparency

Require credits to be certified by the Oregon Department of Revenue each year. The certification process ensures that credit issuance does not exceed the total credit cap and that the companies claiming the credit meet all the eligibility requirements.

Require companies receiving the tax credit to disclose certain financial and tax information. Oregonians should be able to know which companies they are subsidizing and what they are getting in return. Thus, companies that receive the credits should be required to disclose their business revenue, profits, total employment and compensation levels, full-time employee wages hired as a result of the credit, environmental regulation compliance, and other relevant financial information. In the interest of accountability and transparency, the data should be made public.

Require a study on the effectiveness of the tax credit. There exists significant doubt on the effectiveness of R&D tax credits to provide community benefit, return on state investment, and actual stimulation of new research spending. If passed, millions of dollars will be diverted from public schools and rural infrastructure spending to corporations. It's important to determine if the benefits are worth the cost.

Accordingly, the legislature should require a study to be conducted by an independent research team. This study should not only evaluate financial returns and new spending, but also the geographic distribution of benefits, racial and ethnic distribution of beneficiaries, environmental implications, income distribution, and any other metrics the legislature deems helpful. The results of the study should be made public and shared with the Legislature's Revenue Committees three years after the effective date of the credit.

For more information, please contact:

Daniel Hauser
(503) 970-4614
dhauser@ocpp.org