



Legislative Budget and Finance Committee

A JOINT COMMITTEE OF THE PENNSYLVANIA GENERAL ASSEMBLY

Offices: Room 400 Finance Building, 613 North Street, Harrisburg

Mailing Address: P.O. Box 8737, Harrisburg, PA 17105-8737

Tel: (717) 783-1600 • Fax: (717) 787-5487 • Web: <http://lbfc.legis.state.pa.us>

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Preliminary Report on Pennsylvania's Research and Development Tax Credit Program

Conducted Pursuant to Senate Resolution 2009-20 and
House Resolution 2009-127

June 2009

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I. Introduction

Senate Resolution 2009-20 and a companion resolution, House Resolution 2009-127, direct the Legislative Budget and Finance Committee (LB&FC) to study the impact and effectiveness of 18 Pennsylvania tax credit programs. Although the final report is not due until March 2010, we were requested to review the four tax credit programs with the greatest fiscal impact in an expedited manner. These four are the Keystone Opportunity Zone (KOZ) program, the Film Production Tax Credit program, the Educational Improvement Tax Credit program (EITC), and the Research and Development Tax Credit program (R&D).

Our report on the Film Production Tax Credit program was released on June 3, 2009, and a report on the KOZ and EITC programs are planned to be released in late June 2009. This report contains our preliminary analysis of the R&D tax credit program. Work will continue on this program as well as the remaining tax credit programs, with studies to be released at a later date.

Study Objectives

The study seeks to identify:

- if participant applications ask the questions necessary to determine (1) if applicants are eligible to participate in their respective programs and (2) that the activities for which credits are being awarded are in accordance with statute and program guidelines; and
- if the Department of Revenue takes reasonable steps to verify the accuracy of the information provided on the applications.

Scope and Methodology

To conduct this review we:

- reviewed pertinent statutes, regulations, and guidelines;
- developed information requests of the Department of Revenue;
- met with relevant department staff at all levels;
- conducted file reviews of various program participants to ascertain compliance with administrative controls and review compliance with departmental guidelines;
- conducted phone surveys of program participants;
- conducted meetings and information gathering sessions with key stakeholders and stakeholder organizations;

- gathered and analyzed fiscal and program information; and
- compiled other state information and compared Pennsylvania's programs to several other states.

Acknowledgements

We acknowledge and appreciate the assistance provided by staff in the Bureau of Corporation Taxes at the Department of Revenue. We also thank the other interested persons and organizations who worked with us to identify issues and provide data for this review.

Important Note

This report was developed by Legislative Budget and Finance Committee staff. It is preliminary in nature and will be followed by a complete report on all of the tax credit programs identified in the Senate and House resolutions. The release of this preliminary report should not be construed as an indication that the Committee or its individual members necessarily concur with the report's findings and recommendations.

Any questions or comments regarding the contents of this report should be directed to Philip R. Durgin, Executive Director, Legislative Budget and Finance Committee, P.O. Box 8737, Harrisburg, Pennsylvania 17105-8737.

II. Research and Development Tax Credit

Background and Overview

In 1981, the federal government began a program to provide tax credits to businesses that were increasing their research activities. It was quickly followed the next year by Minnesota, which was the first state to enact such a program. Pennsylvania's research and development tax credit program was created in 1997 by Act 1997-7, as an amendment to the Tax Reform Code. The program is administered primarily by the Pennsylvania Department of Revenue. Currently, more than 30 states offer some form of tax credit for business's research and development expenditures, many of which are patterned after the federal program.

The specific definitions used in Act 7 to define research and development expenditures are based on the federal Internal Revenue Code, 26 U.S.C. §41. In general, §41 defines qualified research as:

. . . that which is undertaken for the purpose of discovering information, which is technological in nature, and the application of which is intended to be useful in the development of a new or improved business component¹ of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for a new or improved function, performance, or reliability or quality.²

Act 7 provides that each fiscal year, the Department of Revenue may approve not more than \$40 million in research and development tax credits, with \$8 million of this amount set aside for small businesses. Tax credits are only available for increases in qualified research expenses incurred in Pennsylvania over the taxpayer's

¹The term "business component" means any product, process, computer software, technique, formula, or invention which is to be held for sale, lease, or license, or used by the taxpayer in a trade or business of the taxpayer.

²As provided by 26 U.S.C. §41(d), the term "qualified research" shall not include any of the following: (1) any research conducted after the beginning of commercial production of the business component; (2) any research related to the adaptation of an existing business component to a particular customer's requirement or need; (3) any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component; (4) surveys including any efficiency survey, activity relating to management function or technique, market research, testing, or development (including advertising or promotions), routine data collection, or routine or ordinary testing or inspection for quality control; (5) certain computer software related activities; (6) any research conducted outside the United States, Puerto Rico, or any possession of the United States; any research in the social sciences, arts, or humanities; and (7) any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity). Research relating to style, taste, cosmetic, or seasonal design factors of a product is not considered to be qualified research.

base amount.³ Business with total assets of \$5 million or more (nonsmall) are eligible for credit of 10 percent of the excess of qualified expenses over the taxpayer's base amount. Businesses with total assets of under \$5 million are eligible for a credit of 20 percent. Unused tax credits may be carried from year to year for up to 15 taxable years.

Every year, the program receives applications from nonsmall businesses for more tax credits than are available (for 2008, the applications totaled approximately \$82.7 million). As a result, the amount of available tax credit is prorated significantly for all approved nonsmall business participants.⁴ In recent years, small businesses have also requested more tax credits than are available, although the resulting loss in credits due to proration has not been significant.

The Department of Revenue relies, in large measure, on the federal program's standards and methodology when approving tax credits in Pennsylvania. Pennsylvania applicants' submittals are to include Internal Revenue Service Form 6765 (or similar document), on which applicants report their expenditures using the federal definition of qualified research expenses. A copy of Pennsylvania's application and corresponding instructions are attached as Appendix B.

Unlike the federal program, businesses conducting qualified research in Pennsylvania can receive tax credits even though they have no tax liability. In these situations, the business may sell or assign the tax credit, either in whole or in part, upon approval by the Department of Community and Economic Development, which oversees this part of the program. Of the \$40 million in tax credits awarded in December 2007, 41 different taxpayers sold or assigned \$2.2 million in unused credits. The DCED reports that the unused credits were sold for \$2.0 million, or 92.5 percent of their value. DCED allows the use of facilitators who retain a portion of the sale amount for coordinating the transaction.

As provided for in statute, the research and development tax credit is no longer available to taxpayers for expenses incurred in taxable years ending after December 31, 2015. Each year the Secretary of the Department of Revenue is required to submit a report to the General Assembly indicating the effectiveness of the tax credit. This report is to indicate the names of all taxpayers claiming the credit and the amount of credits approved and utilized.

³The "base amount" is defined in the Internal Revenue Code as:

. . . the product of (1) the fixed-base percentage, and (2) the average annualized gross receipts of the taxpayer for up to the four taxable years preceding the taxable year for which the credit is being determined. In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

⁴As provided by 72 P.S. §8709-B.

Table 1 shows the number of businesses that have applied for the research and development tax credit program, by year and size, since the beginning of the program.

Table 1

Number of Program Participants by Year and Size		
<u>Year</u>	<u>Small Businesses (Businesses with assets less than \$5 million)</u>	<u>Nonsmall Businesses (Businesses with assets at or exceeding \$5 million)</u>
1997.....	89	259
1998.....	106	219
1999.....	110	226
2000.....	98	236
2001.....	98	267
2002.....	96	227
2003.....	105	198
2004.....	123	224
2005.....	145	242
2006.....	197	252
2007.....	224	294
2008.....	240	314

Source: Data provided by the Pennsylvania Department of Revenue.

Preliminary Findings

1. The Department of Revenue does little to verify that the R&D tax credits are only awarded to businesses with qualified R&D expenses. Act 1997-7 stipulates that tax credits can only be awarded for “qualified research and development expense.” This term is defined by reference to Section 41 (d)(4) of the Internal Revenue Code. To assess whether a business has incurred qualified research and development expenses, the Pennsylvania Department of Revenue requires businesses to submit a copy of their Federal Form 6765 (Credit for Increasing Research Activities) or a “pro-forma 6765.” The Department of Revenue, however, never verifies with the IRS that the Form 6765 was actually used to claim the federal tax credit, or even that it was submitted with the business’ federal tax return. The Department stated that it cannot request this information unless the taxpayer grants specific permission for the IRS to release the information. The Department of Revenue also does not take steps to verify the information reported by the business if it decides to submit a pro-forma Form 6765.

In addition, the Department of Revenue does not audit the businesses receiving the research and development tax credit, unless a business’ tax return is being audited for other purposes. In contrast, the federal government does have specialized staff that audit the federal research tax credit. IRS personnel review the nature of the expenditures that businesses report on their application to determine if those expenses can be substantiated as qualifying research. According to the IRS’

Audit Techniques Guide: Credit for Increasing Research Activities, these determinations are based on factors such as whether the activity or project meets the definition of a qualified research expense, the amount and nature of expenses reported, job titles within the scope of research activities, contract research costs, and accounting records.

Program participants in Pennsylvania's research and development tax credit program who have been audited by the Internal Revenue Service told us that IRS auditors conduct site-visits of participant's research and development facilities to determine if the reported expenses meet the definition of a qualified research expense. These participants told us that the IRS personnel that conduct these investigations appear to have the necessary technical skills and expertise to review a wide range of research and development activities.

Tentative recommendation: As a condition of receiving a tax credit, businesses should be required to permit the Department to obtain the business' federal tax return as a means to verify the information provided on Form 6765. This could be done through a simple check-off on the tax credit application. The Department of Revenue should then match the information businesses report to the IRS to the information reported on the Pennsylvania Research and Development tax credit application to provide reasonable assurance that most businesses applying for the Pennsylvania tax credit have incurred legitimate research expenses and that the amounts claimed coincide.⁵ This, together with additional steps to provide assurance that the research expenses are incurred in Pennsylvania (see below), will help ensure that tax credits are only awarded for qualified research expenses, as provided in Pennsylvania statute.

2. We found it difficult to verify that the applicable research expenses were incurred in Pennsylvania, which is a requirement of the act. Act 1997-7 specifies that only research expenses incurred in Pennsylvania qualify for the tax credit. We reviewed 39 R&D tax credit applications, and in six instances we noted that the only business address on the application was not a Pennsylvania address. The application also does not require that the business list where the research was conducted or otherwise require the business to attest that the research was conducted in Pennsylvania.

While it is quite possible that a non-Pennsylvania business could incur qualified research expenses in Pennsylvania, neither we nor the Department of Revenue had any ready way to verify where the expenses were incurred.⁶ Even for those ap-

⁵In our telephone survey of 39 Pennsylvania businesses applying for the R&D tax credit, 70 percent reported that they applied for both the federal and Pennsylvania credits. Those that applied only for the Pennsylvania credit were generally firms that did not incur a tax liability but planned to sell their credits to another business, an option not available in the federal program.

⁶The phone numbers listed on the application appeared to be the telephone numbers of the corporate business office, not the research office.

plicants that do list a Pennsylvania-based address, it is unclear if the address provided is the corporate address or the address where the research took place.

Tentative recommendation: The Department of Revenue should revise its Research and Development tax credit application to require businesses to (1) provide the address and telephone number and other contact information where the research is taking place and (2) attest that the research expenses were incurred in Pennsylvania.

3. Although called the Research and Development Tax Credit, due to the adoption of federal program definitions, credits can only be awarded for research, not development. Act 1997-7 which created the Research and Development tax credit does not define the terms “research and development,” but rather refers to Section 41 (d)(4) of the Internal Revenue Code, which pertains to the federal research tax credit. The federal definition of “qualified research” is quite lengthy, but, in general, refers to research which is undertaken for the purpose of discovering information:

- (i) which is technological in nature, and
- (ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and
- (iii) substantially all of the activities of which constitute elements of a process of experimentation for the purpose of a new or improved function or improving performance, reliability or quality. The act specifically excludes activities such as research after commercial production, adaptation or duplication of existing business components, marketing studies, routine data collection, and computer software developed for internal use by the business.

Because businesses are only to obtain tax credits for activities which meet the federal definition of qualified research, the use of the term “development” in the Pennsylvania statute is confusing and implies that the credit is available for activities other than research.

Tentative recommendation: If the General Assembly chooses to reauthorize this program before it expires in 2015, it should consider renaming it the Research Tax Credit to more accurately reflect the definition of qualified research expenses as contained in the federal statute.

III. Appendices

APPENDIX A

THE GENERAL ASSEMBLY OF PENNSYLVANIA

SENATE RESOLUTION

No. 20

Session of
2009

INTRODUCED BY PIPPY, FERLO, FONTANA, WOZNIAK, ALLOWAY, STOUT,
FOLMER, ORIE, RAFFERTY, LEACH, BROWNE, O'PAKE, WAUGH,
SCARNATI AND EARLL, FEBRUARY 6, 2009

SENATOR BROWNE, FINANCE, AS AMENDED, FEBRUARY 10, 2009

A RESOLUTION

Directing the Legislative Budget and Finance Committee to determine the impact of Pennsylvania's tax credit programs on the Commonwealth's economy, job market and State and local tax revenues.

WHEREAS, The Commonwealth of Pennsylvania has enacted at least 18 different tax credit programs that apply to businesses and other taxpayers; and

WHEREAS, These tax credit programs vary in size, scope and purpose; and

WHEREAS, Taken together, the Commonwealth's tax credit programs total approximately \$350 million annually; and

WHEREAS, Information on the effectiveness of the Commonwealth's tax credit programs in achieving their respective goals and objectives is important information for the General Assembly to consider; therefore be it

RESOLVED, That the Legislative Budget and Finance Committee conduct a study to determine the effect of the Commonwealth's tax credit programs on the Commonwealth's economy, job market and State and local tax revenues; and be it further

Appendix A (Continued)

RESOLVED, That the Legislative Budget and Finance Committee study include an assessment of the:

- (1) neighborhood assistance programs (Article XIX-A of the Tax Reform Code of 1971);
- (2) employment incentive payments (Article XIX-A of the Tax Reform Code of 1971);
- (3) Homeowner's Emergency Mortgage Assistance Fund (Article IV-C of the Housing Finance Agency Law);
- (4) job creation tax credit (Article XVIII-B of the Tax Reform Code of 1971);
- (5) research and development tax credit (Article XVII-B of the Tax Reform Code of 1971);
- (6) keystone opportunity zone (Act 92 of October 6, 1998);
- (7) coal waste removal and ultraclean fuels tax credit (Article XVIII-A of the Tax Reform Code of 1971);
- (8) educational improvement tax credit (Article XX-B of the Public School Code of 1949, as amended);
- (9) keystone innovation zone (Act 12 of February 12, 2004);
- (10) FILM PRODUCTION TAX CREDIT (ARTICLE XVII-C OF THE TAX REFORM CODE OF 1971, AS AMENDED);
- (11) first class cities economic development district (Act 226 of December 1, 2004);
- (12) organ and bone marrow donor tax credit (Act 65 of July 2, 2006);

Appendix A (Continued)

(13) strategic development areas (Act 151 of November 20, 2006);

(14) resource enhancement and protection tax credit (Article XVII-E of the Tax Reform Code of 1971);

(15) life and health insurance guaranty association credit (Article XVII of the Insurance Company Law of 1921);

(16) property and causality guaranty association tax credit (Article IX of the Tax Reform Code of 1971);

(17) emergency tax credit (Article XX of the Tax Reform Code of 1971);

(18) call center credit (Article II of the Tax Reform Code of 1971);

and be it further

RESOLVED, That the Legislative Budget and Finance Committee determine the extent to which each of the above-listed programs have clearly defined goals and objectives and whether the Commonwealth collects the information necessary to assess whether those goals and objectives are being achieved; and be it further

RESOLVED, That the Legislative Budget and Finance Committee report all findings to the Senate no later than one year from the passage of this resolution.

APPENDIX B

REV-545CT(5-08)PC

PA DEPARTMENT OF REVENUE
 BUREAU OF CORPORATION TAXES
 TAXING DIVISION R&D UNIT
 PO BOX 280703
 HARRISBURG PA 17128-0703

PENNSYLVANIA RESEARCH AND DEVELOPMENT TAX CREDIT 2008 APPLICATION



ENTITY INFORMATION - (PLEASE PRINT OR TYPE)	Account ID (Box Number/SSN)	Entity ID (EIN)
Entity Name	DUE DATE: September 15, 2008	
Street Address	Department Use Only POST MARK DATE:	
City or Town, State, and ZIP Code	SEE INSTRUCTIONS ON REVERSE SIDE BEFORE COMPLETING	

CHECK BOX IF A "SMALL BUSINESS"
 IF CLAIM IS AS A "SMALL BUSINESS" WITH TOTAL ASSETS OF LESS THAN \$5,000,000 AT THE BEGINNING OR END OF THE YEAR, SUBMIT A BALANCE SHEET REFLECTING TOTAL ASSETS.
 ENTER ENTITY TYPE (SEE INSTRUCTIONS ON BACK) _____ KOZ - (SEE INSTRUCTIONS ON BACK)

COMPUTATION OF CREDIT

1. Pennsylvania qualified Research and Development Expenditures:

Tax Year Beginning MM/DD/YYYY	Tax Year Ending MM/DD/YYYY	Actual	Use Whole Dollars Annualized
____/____/____	____/____/____	\$ _____	1. \$ _____
2. 50% of Line (1)			2. \$ _____

3. Prior years' Pennsylvania Research and Development Expenditures:

Tax Year Beginning MM/DD/YYYY	Tax Year Ending MM/DD/YYYY	Actual	Annualized
____/____/____	____/____/____	\$ _____	3A. \$ _____
____/____/____	____/____/____	\$ _____	3B. \$ _____
____/____/____	____/____/____	\$ _____	3C. \$ _____
____/____/____	____/____/____	\$ _____	3D. \$ _____

4. Total of prior years' Annualized Pennsylvania Research and Development Expenditures

(Sum of Annualized 3A, 3B, 3C, & 3D) 4. \$ _____

5. Average of prior years' Pennsylvania Research & Development Expenditures

[Line (4) divided by number of base years in Line (3) with R&D Expenditures]..... 5. \$ _____

6. Line (1) Annualized minus the greater of Line (2) or Line (5)..... 6. \$ _____

7. Tentative Pennsylvania R&D Credit [Line (6) x 10% large company or 20% small company]..... 7. \$ _____

SIGNATURE AND VERIFICATION

Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. THIS FORM MUST BE SIGNED BY A CORPORATE OFFICER.

SIGNATURE OF OFFICER OF COMPANY		FAX NUMBER ()	DATE
PRINT OFFICER'S NAME	TITLE	TELEPHONE NUMBER ()	E-MAIL ADDRESS
NAME OF PREPARER		PREPARER'S ADDRESS	
TELEPHONE NUMBER ()	PREPARER'S EIN OR SSN	DATE	CITY STATE ZIP CODE

Appendix B (Continued)

PENNSYLVANIA RESEARCH AND DEVELOPMENT TAX CREDIT APPLICATION INSTRUCTIONS

PER ACT 7 of 1997, ACT 46 of 2003, and ACT 116 of 2006

To claim the PA Research and Development (R&D) Tax Credit, it is necessary for a taxpayer to have qualified Pennsylvania R&D expenses in the current tax year (Line 1) and in at least one preceding tax year (Line 3). NOTE: If PA R&D expenditures were incurred in a Keystone Opportunity Zone (KOZ), the taxpayer is not entitled to an R&D credit. If the PA R&D expenditures were not incurred in a KOZ, the taxpayer must include a statement to that effect in order to be considered for the credit.

For purposes of the PA R&D Tax Credit, a taxpayer is an entity subject to PA Personal Income Tax, PA Corporate Net Income Tax or PA Capital Stock/Franchise Tax. The term taxpayer also includes the shareholder of a PA S corporation that receives a PA R&D Tax Credit. The PA R&D Tax Credit applicable to a partnership may be claimed by each partner on a pass-through basis with each partner (taxpayer) computing the credit on a pro-rata basis.

PA qualified R&D expenses are qualified research expenses as defined in Section 41 (B) of the Internal Revenue Code of 1986, incurred for PA qualified research and development conducted within the Commonwealth of Pennsylvania.

A taxpayer must apply for the PA R&D Tax Credit by September 15 for PA R&D expenses incurred in the taxable year that ended in the prior calendar year. Thus, an application for PA R&D Tax Credit must be submitted by September 15, 2008 for all PA R&D expenses incurred in the tax year ending in 2007. Fifty two/fifty three-week filers whose year ends in the first week of January will be considered calendar year (12-31) filers.

The Department will notify all taxpayers by December 15, in the year in which an application is submitted, of the approved amount of PA R&D Tax Credit. The taxpayer may apply the approved credit against their PA Personal Income Tax, PA Corporate Net Income Tax, or PA Capital Stock/Franchise Tax for the current taxable year (the tax year in which the credit is approved). The amount of credit applied to any tax liability cannot exceed 50 percent of such liability for that taxable year (the 50 percent limitation is eliminated for tax years beginning in 2005 and after). Any unused credit may be carried over to no more than the 15 succeeding taxable years. A taxpayer is not entitled to carry back, to obtain a refund of, or to assign unused PA R&D Tax Credits (for awards made Dec. 15, 2002 and prior).

Effective for awards made Dec. 15, 2003, and after, the taxpayer can apply to the PA Department of Community and Economic Development (DCEd) to sell or assign a PA R&D credit if there has been no claim of allowance filed within one year from the date that the Department of Revenue approved the credit. Contact DCEd at 400 North St., 4th Fl., Keystone Building, Harrisburg PA 17120-0225; call 717-787-7120 or 1-800-379-7448; or visit www.newpa.com. The purchaser or assignee must use the credit in the taxable year in which the purchase or assignment is made and the credit cannot exceed 75 percent of the tax liability for the taxable year. The purchaser or assignee may not carry over, carry forward, carry back or obtain a refund of the credit.

Effective for awards made Dec. 15, 2006, and after, pass-through entities include limited liability companies and partnerships, thus the credit can be transferred (passed-through) in writing to shareholders, members or partners in their proportionate share. The shareholder, member or partner must use the credit in the taxable year in which the transfer is made. R&D credits cannot be used against Employer Withholding Taxes. Also effective for awards made Dec. 15, 2006, and after, the tentative credit on Line 7 is equal to 10 percent for large companies and 20 percent for small companies.

If any tax years on Line 1 or Lines 3A, 3B, 3C or 3D of the application form represents a period of less than a full year, (other than for full year 52/53 week filers), the amount(s) of PA R&D expenses must be annualized.

Example: Tax year beginning 01-01-06 and ending 07-31-06

Annualized amount = $\$1,000,000 \times \frac{365}{212} = \$1,721,698$

*Use 366 for periods that include February 29.

If the taxpayer has two or more consecutive short periods that equal one full tax year, the short periods shall be combined as a single tax year on Line 3 of the application.

PLEASE NOTE: ATTACH ALL ADDITIONAL INFORMATION USED TO DETERMINE THE CREDIT SUCH AS, FEDERAL FORM 6765, BALANCE SHEETS FOR A "SMALL BUSINESS" AND ANY APPLICABLE PARTNERSHIP INFORMATION (PERCENTAGE OWNED, ETC.).

ENTITY TYPE: Complete the Entity Type on the front of this form by selecting one of the following categories:

Individual, LLC, LLP, S Corporation, C Corporation, Sole Proprietorship

Please check our Web site and future editions of the Pennsylvania Tax Update e-newsletter for any changes that may affect this program. Any questions concerning completion of the application and the calculation of the credit should be directed to the PA Department of Revenue, Specialty Tax Unit at 717-783-6031, Option 3.

Send completed applications (including signature) to:

Bureau of Corporation Taxes
Taxing Division - R&D Unit
PO Box 280703
Harrisburg, PA 17128-0703

APPENDIX C

Response to This Report



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE
HARRISBURG, PENNSYLVANIA
17128-1100

THE SECRETARY

June 22, 2009

Philip R. Durgin, Executive Director
Legislative Budget and Finance Committee
400 Finance Building
613 North Street
Harrisburg, PA 17105-8737

Dear Mr. Durgin:

Thank you for giving us an opportunity to review the draft report prepared by the Legislative Budget and Finance Committee in response to SR 20 and HR 127 of 2009 on the Research and Development (R&D) Tax Credit. As these resolutions charge your Committee with reviewing 18 tax credits, I want to congratulate you on completing the first of several reports. I look forward to working with you on the reports to come.

This letter is in response to your letter dated June 9, 2009, in which you indicate that the Department of Revenue is invited to provide written comments to your reports, *Preliminary Report on Pennsylvania's Educational Improvement and Research and Development Tax Credit programs*.

On Page 14, the reports states, "The Department of Revenue never verifies with the IRS that Form 6765 was actually used to claim the federal tax credit, or even that it was submitted with the business' federal tax return." However, Footnote 10, at the bottom of Page 14, reads, "The Department stated that it cannot request this information unless the taxpayer grants specific permission for the IRS to release the information." I respectfully ask the committee to consider moving this footnote into the main body of text, so as to clarify the Department's obstacle in clarifying Form 6765.* I would further point out that the Department's R&D Tax Credit application requires a corporate officer to sign a declaration, attesting under penalties of perjury, that all items accompanying the application are true, correct and complete.

*LB&FC note: We moved this footnote to the main body of the text.

Philip R. Durgin, Executive Director
June 22, 2009
Page 2

On Page 15 of the draft report, the Committee recommends as a condition of receiving the tax credits, a business should be required to permit the Department to obtain their federal tax return as a means to verify Form 6765. On that recommendation, I would point out that the Department has the authority to request federal tax return information for verification purposes. However, we note that applications for the R&D Tax Credit are required to be filed on September 15 of the year following the tax year in which the expenditures are made. The R&D Tax Credit is awarded on the following December 15. The federal return date for calendar-year filers on extension is September 15, the same day that the R&D application is due. Given the IRS' normal return processing time, the Department does not have access to the data in a manner timely enough to assist in verifying the expenditures prior to the statutory award date of December 15.

On Page 16, in the second tentative recommendation, the report suggests that the Department should revise the R&D Tax Credit application to require businesses to provide the address and telephone number and other contact information for where the research is taking place. Indeed, it is very difficult to verify that the applicable research expenses were incurred in the commonwealth, and I agree with your recommendation. Moreover, the Department will explore asking for a percentage breakdown of the location in which the qualified federal expenses were incurred.

In addition, the tentative recommendation on Page 16 suggests that the Department require businesses to "attest that the research expenses were incurred in Pennsylvania" on the R&D Tax Credit application. Again, I would point to the declaration already included on the R&D Tax Credit application that requires corporate officers to attest, under the penalties of perjury, that all information submitted with the application is true, correct and complete. I believe our current practice satisfies this recommendation.

Again, I would like to thank you for the opportunity to comment on this draft report. I look forward to working with you and your staff as you continues to study Pennsylvania's tax credits. If you have any further questions, please feel free to call me at (717) 783-3680.

Sincerely,



Stephen H. Stetler
Secretary of Revenue