

Research & Development Tax Credit Workgroup Memo

To: The Joint Committee on Semiconductors

From: R&D Tax Credit Workgroup, Revenue Co-Chairs

Workplan

This workgroup was given a specific scope of work. The parameters of discussion were to create a Research & Development Tax Credit available to companies operating within the semiconductor industry. The tax credit should be scalable, have a cap, and have sufficient sideboards such that the use of the tax credit is limited to the semiconductor industry.

We met four times between March 24th and April 3rd. In broad terms, there was significant agreement on several specific features of the structure of a tax credit. However, there was a lack of agreement on the size and scope of a proposed program. Having said that, the text that follows outlines the various features of a tax credit that we feel meet the directive we were given and fit into the confines of SB 5. We believe there is sufficient detail for the Joint Committee on Semiconductors to restructure SB 5 and we are willing to provide additional support if requested.

In summary, the proposed tax credit is structured with two key features. First, the proposed design leverages CHIPS Act awards received by Oregon companies. By leveraging the tax credit with federal awards, we feel this creates the greatest likelihood of success for all stakeholders. Second, with state competition in mind, the tax credit is intended be competitive with other states, such as Arizona, while not being overly generous at a time when public resources are at a premium.

Framework and Purpose Statement

The structural, economic context for the policy is one that is focused on business retention and expansion. While business recruitment is certainly acceptable, building on Oregon's comparative advantage in the field of semiconductors with a targeted incentive is the most efficient use of public dollars. Consequently, the purpose of this tax credit is to expand semiconductor research and development activities within Oregon to ultimately increase Oregon's job base and to expand this economic ecosystem.

Eligibility

- **BUSINESS TYPE.** The tax credit should be available to every type of business: C-corporations, S-corporations, partnerships, LLCs, and sole proprietors.

- **INDUSTRY.** The credit should be limited to Oregon companies operating in an area that is essential to the semiconductor industry and receiving a CHIPS Act award. There was significant discussion about using the North American Industrial Classification Systems (NAICS) to statutorily define eligible businesses. However, by limiting the credit to businesses receiving a CHIPS Act award there is no need for further describing the industries by name or NAICS code. As an aside, there are both advantages and disadvantages to using NAICS codes. One advantage is the definitional clarity of using an established system. One disadvantage is that a given business may operate in multiple sectors, possibly negating the intended clarity. If the committee chooses to rely on this system, we encourage the use of both a NAICS code (or codes) and additional detail to make legislative intent clear.
- **LOCATION.** A key requirement is that the R&D be conducted in Oregon by individuals located in Oregon. The qualifying activities may be performed by the taxpayer themselves or contracted out to another Oregon business or to an Oregon college or university. The requirement for individuals to be located in Oregon is an important consideration for reaching the desired return on investment (ROI).

Tax Credit Structure

- **TAX CREDIT BASE.** Federal tax law currently includes a research tax credit. Oregon’s new tax credit should connect as much as possible to federal law to minimize confusion across taxpayers and administrators. In simplest terms, the federal credit is a certain percentage of a company’s qualified research expenses above a base amount. The base amount is the taxpayer’s historical R&D activity; the intent of the credit is to encourage additional R&D in Oregon, not just sustain current levels. For the sake of efficiency, Oregon should tie to the federal definitions of “qualified research expenses” and “base amount”. In short, the tax credit base (TCB) is qualified research expenses (QRE) minus the base amount (BA). Conceptually, this means the tax credit is a function only of *increased* R&D above historical norms. In formula form it is: $TCB = QRE - BA$.
- **FORMULA.** The TCB (tax credit base) as explained above is the increased - also known as the “excess” - R&D. The tax credit should be based on this new (or additional) research activity in Oregon by companies that operate in a field that is essential to the semiconductor industry. The tax credit should be 25 percent of the tax credit base. This formula applies to all qualified companies regardless of size or investment amount.
- **CAP.** To minimize the risk to public resources and availability of the credit for smaller companies working on the frontiers of technological research, there should be an annual taxpayer cap and a biennial program cap. For the former, we suggest a two-tiered taxpayer cap: a maximum credit of \$5M for taxpayers with no more than 150 Oregon employees; and a maximum credit of \$10M for taxpayers with more than 150 Oregon employees. With a tax credit rate of 25 percent, the \$5M cap translates to \$20M of “excess” R&D while the \$10M cap corresponds to \$40M of “excess” R&D. The program cap should be dependent upon available resources and be decided by the Presiding Officers and the Co-Chairs of the Joint Committee on Ways & Means.

- **REFUNDABILITY AND CARRYFORWARD.** The credit should be refundable only for smaller companies. We have identified refundability as a key factor for success and a reason for the disappointing performance of Oregon’s prior R&D tax credit. Refundability simply means that businesses would be allowed to use the tax credit to reduce their tax liability and, if their tax liability were reduced to zero, they would receive a refund for any remaining amount of unused tax credit. Larger companies would be allowed to carryforward unused amounts to use against future tax liabilities, for up to five years - which is a common length of time for tax credits. We suggest the following schedule.
 - 100% of the credit is refundable for taxpayers with up to 150 Oregon employees
 - 50% of the credit is refundable for taxpayers with 151 to 500 Oregon employees
 - 0% of the credit is refundable for taxpayers with more than 500 Oregon employees
- **TRANSFERABILITY.** Another consideration was to allow companies to sell any tax credit they were awarded. We do not recommend a transferable tax credit. For a successful tax credit program, we believe the full amount of credit should be available to those taxpayers associated with the research activities. Creating a transferable credit would likely result in a financial cottage industry whereby public dollars are distributed to taxpayers with little to no connection to the semiconductor industry.
- **DURATION.** The credit should be initially effective for tax years 2024 through 2029. This is our standard six-year length of time for the tax credit review process.

Other Points

- **APPRENTICESHIPS.** Incentives could be tied to apprenticeships or internships. For example, qualification for the tax credit could be dependent on a certain number of apprenticeships or internships offered each year. There may need to be allowances for start-ups or ‘young’ companies. Proximity to Oregon colleges, universities, or trade schools should also be a relevant consideration. A separate tax incentive or tier of R&D tax credit could be designed for investments in apprenticeships or internships.
- **OTHER SECTORS.** We discussed the topic of “Advanced Manufacturing” and feel it could encompass a broad range of industries, increasing exposure of public funds to an unachievable or unacceptable level. The work group discussed other industry sectors that seem to have the capacity for additional attention and support through R&D investment. If additional incentive funds are available, they could be targeted to, for example, bioscience, medicine, medical devices; energy; or timber products.
- **STARTUPS.** There was also a notable discussion about structuring an incentive that appeals to both established companies and start-ups. This would include the possibility of attracting start-up capital to Oregon. The refundability of the tax credit certainly helps with start-ups that are unlikely to have significant, if any, income tax liability. The group was uncertain, however, if limiting the tax credit to recipients of CHIPS Act awards would limit the appeal to start-ups. A potential solution would extend the tax credit eligibility to companies that are conducting qualifying research on contract with a company that receives a CHIPS Act award.