

RESEARCH AND DEVELOPMENT TAX CREDIT

(ESTABLISHED UNDER A.R.S. §41-1507)

SUMMARY

The Research and Development (R&D) Tax Credit Program provides an Arizona income tax credit for increased research and development activities conducted in this state, including research conducted at a state university and funded by the taxpayer. The goal of the program is to encourage Arizona businesses to continue investing in research and development activities. The R&D program has nonrefundable components and a refundable component. The nonrefundable components are administered by the Arizona Department of Revenue (Revenue). The refundable component is administered by the Arizona Commerce Authority (ACA).

NONREFUNDABLE TAX CREDIT PROGRAM

The nonrefundable R&D program was enacted in 1992 for corporations (currently, A.R.S. § 43-1168) and in 1999 for individuals (A.R.S. § 43-1074.01). During 2009, the nonrefundable R&D program was modified by the Arizona legislature. For tax years 2011 through 2017, the R&D tax credit percentages are 24% of the first \$2.5 million in qualifying expenses plus 15% of the qualifying expenses in excess of \$2.5 million. For 2018 and thereafter, the R&D tax credit percentages will be 20% of the first \$2.5 million in qualifying expenses plus 11% of the qualifying expenses in excess of \$2.5 million.

The nonrefundable R&D program was further enhanced during the 2011 legislative session. An additional credit amount is allowed if the taxpayer made basic research payments during the tax year to a university under the jurisdiction of the Arizona Board of Regents. The additional university R&D tax credit for basic research payments is administered by Revenue for tax years beginning from and after December 31, 2011. The additional credit, when added to the R&D tax credit, could result in an Arizona tax credit of up to 34% of the excess of basic research payments over the base period amount, for some filers. It is not refundable.

REFUNDABLE TAX CREDIT PROGRAM

A taxpayer that otherwise qualifies for the nonrefundable R&D tax credit and who employs less than 150 full-time employees worldwide can apply to the ACA for approval of a refund. The refundable tax credit is equal to the lesser of either:

- 75% of the current year's tax credit minus the current year's tax liability; or
- The maximum refund amount on the Certificate of Qualification from the ACA.

APPLYING TO THE ACA FOR THE REFUND

The ACA may authorize up to \$5 million per calendar year in refundable tax credits to qualified taxpayers. The refundable tax credits will be authorized on a first-come, first-served basis, according to the date an application is submitted to the ACA.

A taxpayer seeking a refund must submit an application to the ACA prior to filing its tax return with Revenue. If the taxpayer is eligible, the ACA will issue a Certificate of Qualification. After a company has received a Certificate of Qualification from the ACA, it may claim the refund from Revenue. The refund must be claimed by the Applicant or its partners or S corporation shareholders on an original Arizona income tax return along with Revenue Form 308 (for corporations) or Arizona Form 308-I (for individuals) for the tax year identified on the Certificate.

The amount of tax credits not used to offset Arizona income tax liability will be paid to the taxpayer in the same manner as a cash refund. A.R.S. §§ 43-1074.01(C)(3) and 43-1168(D)(3). If Revenue determines that a refund is incorrect or invalid, the excess refund may be treated as a tax deficiency pursuant to A.R.S. § 42-1108.

