



ISSUE BRIEF

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The R&D Gravy Train: Eleven reasons why Oregon should not further expand the corporate research and development tax credit in HB 3232 or HB 2542

Since 1989, corporations that increase eligible research and development (R&D) spending in Oregon over a certain base amount get a rebate of five percent of the increase. In other words, Oregon taxpayers will give a company five cents for every dollar that company spends on research and development over the base amount.

Today, the maximum credit a particular corporate taxpayer can take is \$500,000 annually. Under a tax break passed in the last legislative session, this will increase to \$750,000 in 2006.

The 2005 Legislative Assembly is again considering increasing the maximum annual R&D credit. The proposal to increase the credit to \$1 million, beginning in tax year 2008, is contained in the House-passed HB 3232. As the Legislature moves toward adjournment and final deals are struck on budgetary and substantive measures, the proposal may surface in another bill, such as HB 2542.

Increasing the R&D tax credit to \$1 million is bad public policy:

The R&D credit is already Oregon's most expensive corporate tax break.

According to the Tax Expenditure Report, the R&D credit is the most expensive tax break specifically designed for Oregon's corporate income taxpayers.¹ Under current law, the credit will cost Oregon an estimated \$21.6 million in the 2005-07 budget cycle. Increasing the maximum credit to \$1 million beginning in 2008 would add another \$2.8 million to the revenue loss in 2009-11, the first full budget cycle affected by the proposed increase.

A nickel is not an incentive to spend a buck; it is a small but expensive gift to profitable companies.

Proponents of the tax break argue that it provides an incentive to Oregon companies to engage in research and development. The credit, however, is tantamount to offering someone a nickel if they will spend one dollar. Instead of being an incentive, it's a small but expensive gift from Oregon taxpayers to profitable companies. Only profitable companies can actually use the credit, because it is a credit against income taxes on profits.

With a planned 50 percent increase next year, why boost it again?

The 2003 Legislative Assembly increased the maximum R&D credit by 50 percent, from \$500,000 to \$750,000, to take effect beginning in tax year 2006. It makes no sense to increase the credit again before that planned boost even takes effect.

The Oregon Center for Public Policy uses research and analysis to advance policies and practices that improve the economic and social opportunities of low- and moderate- income Oregonians, the majority of Oregonians.

The credit pays for activity that is already going to happen.

Research and development will occur and will increase even if the credit is not expanded. Some companies, particularly high-tech companies such as Intel, engage in aggressive research and development to maintain market share and expand. It makes no sense to pay a company to do activity that it has to undertake to remain competitive or to continue to exist.

The tax credit helps only a handful of Oregon corporations.

According to the Legislative Revenue Office, only 6 to 12 companies will claim the full \$250,000 increase to \$1 million.² A few additional companies will probably be able to claim a portion of the increase.³

The Ways and Means and Appropriations Committees would never fund this.

If the activity supported by a tax credit could not pass muster as a direct appropriation, or if the tax credit does not improve the progressivity of the tax system, it ought not be approved. Tax credits should be limited to (1) efficient mechanisms for funding activities that the Legislature could and would otherwise fund through the appropriations process, or (2) credits that increase the progressivity of Oregon's tax system (i.e. make it based more on taxpayers' ability to pay)⁴. It is doubtful, at best, that the Legislature would vote to give taxpayers' money to a few unnamed, profitable corporations' research efforts. The R&D credit does nothing to improve how the tax code treats taxpayers based on ability to pay.

The credit is not targeted to new industries or products.

Oregon may wish to encourage research into certain types of products. For instance, HB 3481 would create a new R&D credit to encourage the development of certain types of environmentally beneficial equipment with commercial applications. By contrast, the proposed increase in the existing R&D credit under HB 3232 rewards companies conducting a broad range of research. Economic development subsidies should be carefully targeted toward particular types of beneficial private investment as efficiently as possible.

HB 3232 is an end run around accountable decisions to cut public services and public investments.

Under House Bill 3232, the maximum R&D credit would not increase to \$1 million until 2008, delaying the revenue impact beyond the upcoming budget cycle. This approach allows the Legislative Assembly to avoid its responsibility to balance tax cuts against funding education, public safety, and human services. Future legislatures will need to reduce other public investments or services to pay for this additional corporate income tax break.

The R&D credit is unconstitutional.

In October 2004, a three-judge panel of the federal Sixth Circuit Court of Appeals ruled in *Cuno v. DaimlerChrysler* that the investment tax credit granted against Ohio's corporate income tax violates the Commerce Clause of the U.S. Constitution.⁵ *Cuno* was the latest in a line of court decisions holding that state tax laws that provide tax advantages to in-state business activity can illegally discriminate against interstate commerce. The Court agreed with the plaintiffs' argument that the credit unfairly "coerce[s] businesses already subject to the Ohio [corporate income] tax to expand

locally rather than out-of-state.” Although the decision voided only Ohio’s investment tax credit, its reasoning would apply to many other credits granted against state corporate income taxes, such as those aimed at rewarding corporations for conducting research and development in-state. The case has been appealed to the U.S. Supreme Court.

Oregon’s corporate income taxes are already very low.

Corporate income taxes in Oregon are already at an historically low level. As shown in OCPP’s recent report, Corporate Tax Dodge, Oregon corporate income taxes as a share of the economy have declined 71 percent since the late 1970s.⁶ Over the current decade, even without an additional expansion of the R&D credit, corporate income taxes will fall \$192 million, while personal income taxes will rise another \$4 billion. Studies by the Council of State Chambers of Commerce’s Council on State Taxation (COST) and the Utah State Tax Commission indicate that Oregon’s business taxes are low compared to other states.⁷

The major beneficiaries are already getting a massive break.

The primary beneficiaries of an increase in the maximum R&D credit are already likely to receive a massive reduction in their corporate income taxes under a tax break enacted in 2003. This separate break is a change in the formula multistate corporations use to calculate how much of their nationwide profits are taxable in Oregon. Currently, the formula is based on three factors, the share of a corporation’s payroll, property, and sales that are in Oregon. Under the new rules, fully phased-in in 2008, the formula will be based solely on the share of a company’s sales that are attributable to Oregon. Multistate corporations with large portions of their property and payroll in Oregon but a small share of their sales will reap a massive tax cut from this change. A hypothetical firm with 20 percent of its property and payroll in Oregon and one percent of their sales would see its annual taxes fall by more than 90 percent thanks to the formula change.

Endnotes:

¹ The 2005-07 Tax Expenditure Report is available at <http://egov.oregon.gov/DOR/STATS/exp05-07-toc.shtml>.

² Legislative Revenue Office revenue impact statement for HB3232, dated April 5, 2005. Available at <http://www.leg.state.or.us/comm/sms/ris05/rhb323204-06-2005.pdf>

³ Telephone conversation with Lizbeth Martin-Mahar, Legislative Revenue Office, on July 6, 2005.

⁴ ORS 316.003(2)(a).

⁵ *Cuno v. DaimlerChrysler*, 386 F.3d 738 (6th Cir. 2004), 2004 FED App. 0293P (6th Cir.), available online at <http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=6th&navby=case&no=013960>.

⁶ Available on the web at <http://www.ocpp.org/cgi-bin/display.cgi?page=es050520dodge>.

⁷ See “National Big Business Group Says Oregon’s Taxes Among Lowest in Nation,” Oregon Center for Public Policy, May 10, 2005, available at <http://www.ocpp.org/cgi-bin/display.cgi?page=nr050510>.

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