

May 10, 2010

## ENHANCED RESEARCH TAX CREDITS

### Issues:

LB 555 (2009) amended the Nebraska Advantage Research and Development Act (Act) to provide enhanced research tax credits if the research or experimental activity takes place “on the campus of a college or university in this state or at a facility owned by a college or university in this state.” If the research activity meets this standard, the business firm is eligible to receive a research tax credit equal to 35 percent of the federal credit allowed by Internal Revenue Code (IRC) § 41, instead of 15 percent of the federal credit which is applicable if the research activity is not for on-campus activity.

Advice has been requested on the enhanced research tax credit. This ruling provides guidance to taxpayers that may qualify for enhanced research tax credits under [Neb. Rev. Stat. § 77-5803\(2\)](#). The issues addressed by this ruling are:

1. What is a “college or university” for purposes of enhanced research tax credits?
2. Does the phrase “in this state” refer to the campus, the college or university, or the facility?
3. Do the enhanced research tax credits only apply to research taking place on the campus or facility, or does the fact that some research occurs on the campus mean that **all** research carried on by that business firm in Nebraska qualifies for enhanced research tax credits?
4. If research is taking place both on- and off-campus, and both inside and outside this state, how are the regular and enhanced research tax credits calculated?
5. If the regular and enhanced research tax credits are separate credits, is there one five-year period for claiming the credits, or separate five-year periods?
6. If the tax year 2008 regular research tax credit included on-campus activities, does the firm have a five-year period for the enhanced research tax credits beginning in tax year 2009?

### Conclusions:

1. “College or university,” for purposes of enhanced research tax credits, means an institution of higher learning that offers a course or courses of study; resulting in a bachelor’s, vocational, associate, technical, or professional degree, or higher.
2. The phrase “in this state” refers to the campus or facility, not the college or university. It is the location of the research or experimental activities “in this state” that qualifies the business firm for enhanced research tax credits under the Act, not the home or primary location of the college or university.
3. Business firms qualify for enhanced research tax credits related to only on-campus activities. Business firms may qualify for both enhanced and regular research tax credits in the same year, provided the research and experimental activities are conducted in separate locations.
4. Dividing research and experimental activities between on- and off-campus and inside and outside this state may be done either by calculating the ratio of the actual amount of expenses

incurred at each location to the total expenses, or by apportionment based on the average of the business firm's property and payroll factors for each location. The same method must be used to calculate both the regular and enhanced research tax credits.

5. Separate qualification for enhanced and regular research tax credits start separate five-year earning periods. The five-year period for enhanced research tax credits applies even if some of the on-campus activity occurred before 2009.
6. The five-year period for claiming enhanced research tax credits applies beginning with the first year the enhanced credit is claimed, but no sooner than tax year 2009, even if some of the on-campus activity occurred before tax year 2009.

### **Definitions:**

**Enhanced research tax credits.** Enhanced research tax credits are the credits business firms may earn under [Neb. Rev. Stat. §77-5803\(1\)\(b\)](#), for on-campus research and experimental activities.

**Off-campus activities.** Off-campus activities are research and experimental expenditures that take place in this state, that are not on-campus activities.

**On-campus activities.** On-campus activities are research and experimental expenditures that take place on the campus of a college or university in this state or at a college- or university-owned facility in this state.

**Regular research tax credits.** Regular research tax credits are the credits business firms may earn under [Neb. Rev. Stat. §77-5803\(1\)\(a\)](#), for research and experimental activities taking place anywhere in this state.

### **Analysis:**

#### **(1) What is a “college or university” for purposes of enhanced research tax credits?**

There is no general definition of “college” or “university” found in the Nebraska Revised Statutes, even though those terms are used extensively throughout the statutes dealing with higher education. Chapter 85, Article 11 of the Nebraska Statutes, which deals with establishment of new private colleges and registration of out-of-state colleges, defines “out-of-state institutions of higher education” to include “any college, university, community college, technical institute, junior college or the equivalent that offers college courses or awards an associate or higher degree” ([Neb. Rev. Stat. §85-1101](#)). The approval process for new private colleges governs applications to “establish new two-year, four-year, graduate, or professional private colleges” ([Neb. Rev. Stat. §85-1105](#)). The property tax exemption for private colleges extends to “an institution operated exclusively for the purpose of offering regular courses with systematic instruction in academic, vocational, or technical subjects” ([Neb. Rev. Stat. §77-202\(1\)\(d\)\(iii\)\(A\)](#)).

The Merriam-Webster online dictionary defines “university” as “an institution of higher learning providing facilities for teaching and research and authorized to grant academic degrees; specifically bachelor’s degrees, graduate degrees, and professional schools which may confer master’s degrees and doctorates.” “College” is defined as “an independent institution of higher learning offering a course of general studies leading to a bachelor’s degree; also a university division offering this.” A secondary definition is “an institution offering instruction usually in a professional, vocational, or technical field.” Common to all of these sources are institutions of higher learning, offering postsecondary courses that grant or lead to a degree.

*Consistent with Nebraska law and the common and ordinary meaning of these terms, “college or university” for purposes of enhanced research tax credits, means “an institution of higher learning that offers a course or courses of study; resulting in a bachelor’s, vocational, associate, technical, or professional degree or higher.”*

**(2) Does the phrase “in this state” refer to the campus, the college or university, or the facility?**

[Neb. Rev. Stat. §77-5803\(1\)\(b\)](#) states as follows:

Any business firm which makes expenditures in research and experimental activities as defined in section 174 of the Internal Revenue Code of 1986, as amended, **on the campus of a college or university in this state or at a facility owned by a college or university in this state** shall be allowed a research tax credit. . . . [emphasis added]

This language allows two possible interpretations: first, “in this state” refers to the campus or facility; or second, it refers to a college or university.

Because the location of the research and experimental expenditures is critical to determining the amount of the credit, the reference to “in this state” must also refer to the location of the research, not the location of the college or university. Also, this legislation amended the Nebraska Advantage Research and Development Act, part of a series of acts designed to stimulate investment and employment in Nebraska. It seems only natural that this Act, like the Nebraska Advantage Act itself, should be construed to encourage research activities that take place in Nebraska.

*Therefore, the Department of Revenue (Department) has determined that “in this state” refers to the campus or facility; not the college or university.*

**(3) Do the enhanced research tax credits apply to only the research taking place on the campus or facility, or does the fact that some research occurs on the campus mean that *all* research carried on by that business firm in Nebraska qualifies for enhanced research tax credits?**

The entire text of subsection 77-5803(1) reads as follows:

(1)(a) Except as provided in subdivision (1)(b) of this section, any business firm which makes expenditures in research and experimental activities as defined in section 174 of the Internal Revenue Code of 1986, as amended, in this state shall be allowed a research tax credit as provided in the Nebraska Advantage Research and Development Act. The credit amount under this subdivision shall equal fifteen percent of the federal credit allowed under section 41 of the Internal Revenue Code of 1986, as amended, or as apportioned to this state under subsection (2) of this section. The credit shall be allowed for the first tax year it is claimed and for the four tax years immediately following.

(b) Any business firm which makes expenditures in research and experimental activities as defined in section 174 of the Internal Revenue Code of 1986, as amended, on the campus of a college or university in this state or at a facility owned by a college or university in this state shall be allowed a research tax credit as provided in the Nebraska Advantage Research and Development Act. The credit amount under this subdivision shall equal thirty-five percent of the federal credit allowed under section 41 of the Internal Revenue Code of 1986, as amended, or as apportioned to this state under subsection (2) of this section. The credit shall be allowed for the first tax year it is claimed and for the four tax years immediately following.

Answering this question requires determining if subdivisions (a) and (b) are alternative calculations of a single credit, or two separate credits. If there is only one credit, then (a) and (b) merely determine the amount of the credit. If, however, (a) and (b) are two separate credits, then business firms may qualify for them separately. In that event, a credit could be calculated for on-campus research, and a separate credit for off-campus research.

The two statutory subdivisions are not drafted so that each is connected to or dependent on the other. Either subdivision could be repealed, and the remaining subdivision would describe completely the remaining credit. While it is possible to interpret “Except as provided in subdivision (1)(b) of this section” to refer to business firms (meaning firms qualify for one or the other), the more logical interpretation is that the clause refers to “research and experimental activities.”

*Therefore, the Department has determined that subdivisions (a) and (b) authorize separate credits, with separate calculations, and business firms qualify for enhanced research tax credits related to only on-campus activities. Furthermore, the statutory language allows a single business firm to qualify for both the credit under subdivision (a) and the credit under subdivision (b). However, the subdivision precludes the **same** increased research and experimental activities from qualifying for both credits.*

This determination is supported by the conclusions with respect to the second issue, holding that the **location** of the research and experimental activities is crucial in determining the amount of credit and the applicability of each subdivision. Holding otherwise would allow a business firm with in-house research and experimental expenditures to qualify for the enhanced research tax credit for all of its activities by contracting for a relatively small amount of research to be conducted on a campus. “We must assume the Legislature intended a sensible rather than absurd result in enacting the statute.” *Concrete Industries v. Department of Revenue*, 277 Neb. 897, \_\_\_ N.W.2d \_\_\_ (2009), 277 Neb. at 904-905.

**(4) If research is taking place both on- and off-campus, and both inside and outside this state, how are the regular and enhanced research tax credits calculated?**

For research that is conducted both in Nebraska and in another state, [Neb. Rev. Stat. §77-5803\(2\)](#) provides the answer:

(2) For any business firm doing business both within and without this state, the amount of the federal credit may be determined either by dividing the amount expended in research and experimental activities in this state in any tax year by the total amount expended in research and experimental activities or by apportioning the amount of the credit on the federal income tax return to the state based on the average of the property factor as determined in section 77-2734.12 and the payroll factor as determined in section 77-2734.13.

There is nothing in the statute or legislative history suggesting that a different method should be used for dividing in-state research credits between on-campus and off-campus activities.

*The Department has determined that the provisions of [Neb. Rev. Stat. §77-5803\(2\)](#) also govern the allocation of the federal research credit between on-campus and off-campus activities.*

**Example 1: Actual Expenditures Method**

Assume that the business firm qualifies for a \$20,000 federal research credit. The firm's actual total research expenditures for that year occur 50% in Nebraska and 50% in another state; and the Nebraska research expenditures were also divided equally between on-campus research contracts and off-campus expenditures.

In this example, the actual expense ratios are 25% for the Nebraska on-campus expenditures, 25% for Nebraska off-campus expenditures, and 50% for out-of-state expenditures.

Off-campus activities regular research tax credit: . . . . .	\$	20,000.00
% off-campus	x	0.25
% credit	x	0.15
Regular credit amount	\$	750.00
Enhanced research tax credit: . . . . .	\$	20,000.00
% on-campus	x	0.25
% credit	x	0.35
Enhanced credit amount	\$	<u>1,750.00</u>
Total research tax credits for both	\$	2,500.00

**Example 2: Apportionment Method**

This same business firm could also determine the Nebraska credit using the apportionment method. Assume that the property and payroll factors would apportion 60% of the federal credit to Nebraska activities, and 40% to out-of-state activities. Because the on-campus research is under contract, there are no on-campus payroll or property factors, so all of the apportionment to Nebraska would be off-campus.

Both the regular and the enhanced research tax credit would be calculated by multiplying the federal research credit amount times the apportionment factor that reflects the share of the federal research credit that is attributable to on-campus or off-campus activities, times the appropriate credit percentage.

Off-campus activities regular research tax credit: . . . . .	\$	20,000.00
% off-campus	x	0.60
% credit	x	0.15
Regular credit amount	\$	1,800.00
Enhanced research tax credit: . . . . .	\$	20,000.00
% on-campus	x	0.00
% credit	x	0.35
Enhanced credit amount	\$	<u>0.00</u>
Total research tax credits for both	\$	1,800.00

The maximum total credits for the business firm are \$2,500 using the actual expenditures method. The business firm cannot use the apportionment method to apportion 60% of the federal credit to Nebraska for the regular research tax credit and then use actual expenses to calculate the enhanced research tax credit, because doing so would allow part of the on-campus expenditures to qualify for both credits.

- (5) **If the regular and enhanced research tax credits are separate credits, is there one five-year period for claiming the credits, or separate five-year periods?**

*Because the Department has determined in conclusion (3) that [Neb. Rev. Stat. §77-5803\(1\)\(a\) and \(b\)](#) grant two separate credits, business firms may benefit from two separate five-year periods.*

**Example 3: Determining the Five-year Period**

If a business firm first qualified for the regular research tax credit in tax year 2008, the credit may be taken for five years (through tax year 2012), so long as the business firm qualifies for the federal research credit in one or more of those years, and had research and experimental expenditures in those years in Nebraska. If, in tax year 2009, that same business firm had research or experimental expenditures on a campus site, the business firm could qualify for the enhanced research tax credit under subdivision (b) in tax year 2009. The enhanced research tax credit may also be taken for any of the succeeding four tax years, through tax year 2013, in which the business firm qualifies for the federal research credit and has research and experimental expenditures at an on-campus site in that year.

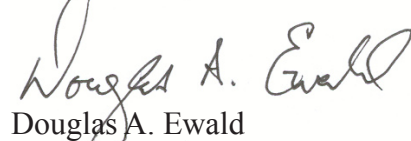
In tax year 2013, the business firm may only qualify for the enhanced research tax credits for on-campus research and experimental activities. Beginning in tax year 2014, the firm may no longer qualify for either regular or enhanced research tax credits, regardless of the amount or location of research or experimental activity.

- (6) **If the tax year 2008 regular research credit included on-campus activities, does the firm have a five-year period for the enhanced research tax credits beginning in tax year 2009?**

Nothing in [Neb. Rev. Stat. § 77-5803](#), as amended by LB 555, requires the on-campus activities to be new activities. Therefore, a five-year period for enhanced research tax credits could begin in tax year 2009, even if the on-campus activity has been taking place in prior years.

*The Department has determined that even if there were on-campus activities in 2008 that qualified for the regular research tax credit for tax year 2008, continuing on-campus activities could be claimed for the enhanced research tax credits in tax year 2009, and a new five-year period would start for the enhanced credits.*

APPROVED:



Douglas A. Ewald  
Tax Commissioner

May 10, 2010