

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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► SUBJECT

MASSACHUSETTS ENACTS AN ECONOMIC DEVELOPMENT BILL THAT REVISES THE REGULAR RESEARCH CREDIT, PROVIDES AN ALTERNATIVE SIMPLIFIED RESEARCH CREDIT, AND ESTABLISHES OTHER TAX INCENTIVES.

► SUMMARY

On August 13, 2014, Massachusetts Governor Deval Patrick signed into law House Bill No. 4377, 188th Gen. Court (Mass. 2014), entitled “An Act Promoting Economic Growth across the Commonwealth” (“H.B. 4377”), that revises the calculation of the corporate net income tax regular research credit and provides an elective alternative simplified approach to calculating the same credit. In addition, H.B. 4377 creates a new job creation project tax credit and an investment tax credit for individual income and corporate net income tax purposes, establishes a sales/use tax holiday, and expands the research and development (“R&D”) corporation sales/use tax exemption so that a limited partnership may qualify for the exemption as well.

► DETAILS

Regular Research Credit

For corporate net income tax purposes, subject to certain limitations, Massachusetts allows a taxpayer a credit for research expenses equal to ten percent of the excess of “qualified research expenses” incurred for research activity for the taxable year over the “base amount,” plus 15 percent of “basic research payments” incurred for research activity for the taxable year. Prior to the enactment of H.B. 4377, the definitions of “qualified research expenses,” “base amount” (which may not be less than 50 percent of qualified research expenses for the credit year), and “basic research payments” conformed to the federal income tax definitions under section 41

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of the Internal Revenue Code as amended and in effect on August 12, 1991, but only expenditures for research conducted in Massachusetts are considered for purposes of calculating the credit.

While the definitions of “qualified research expenses” and “basic research payments” remain the same under H.B. 4377, the definition of “base amount” is amended. Specifically, under H.B. 4377, a taxpayer’s “base amount” equals the product of the average annual gross receipts of the taxpayer for the four taxable years preceding the credit year and a “fixed-base ratio,” where the “fixed-base ratio” is calculated by dividing the average aggregate “qualified research expenses” for the third and fourth taxable years preceding the credit year by the average annual gross receipts for the same taxable years. The “fixed-based ratio” may not exceed 16 percent.

Prior to the enactment of H.B. 4377, and due to conformity with the federal section 41 definition, Massachusetts adopted the federal income tax definition of “start-up company” (and the related preferential three-percent “fixed-base ratio”) and calculated the “fixed-based ratio” (or “fixed-based percentage” as used in section 41) for a non-start-up company by dividing the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 1989, by the aggregate gross receipts of the taxpayer for such taxable years. The “fixed-based ratio” was subject to the same 16-percent maximum as under H.B. 4377.

Elective Alternative Simplified Research Credit

H.B. 4377 phases in an elective alternative simplified method for computing the research credit (similar to the federal income tax research credit) which, if elected, is computed as follows:

- For calendar years 2015, 2016, and 2017, five percent of the amount by which the taxpayer’s qualified research expenses for the taxable year exceeds 50 percent of the taxpayer’s average qualified research expenses for the three taxable years preceding the taxable year for which the credit is being determined;
- For calendar years 2018, 2019, and 2020, 7½ percent of the amount by which the taxpayer’s qualified research expenses for the taxable year exceeds 50 percent of the taxpayer’s average qualified research expenses for the three taxable years preceding the taxable year for which the credit is being determined; and
- Beginning with calendar year 2021, ten percent of the appropriate base.¹

However, if the taxpayer did not have qualified research expenses in any one of the three taxable years preceding the taxable year for which the credit is being determined, the amount of the credit is equal to five percent of the taxpayer’s qualified research expenses for the taxable year.

Other Tax Incentives

Job Creation Project Credit. H.B. 4377 establishes a credit under the individual income tax and corporate net income tax equal to \$1,000 per job created in connection with a job-creation project certified by the Massachusetts Economic Assistance Coordinating Council (the “EACC”). The credit is increased to \$5,000 for each job created in a Gateway Municipality.² At the option of the taxpayer, and to the extent authorized by the EACC, the credit may be refundable.

Investment Tax Credit. H.B. 4377 also establishes an investment credit under the individual income tax and the corporate net income tax equal to 20 percent of the “qualifying investment” made by a “qualifying investor” in a “qualifying business.” The credit is increased to 30 percent of the “qualifying investment” if the principal place of business of the “qualifying business” is in a Gateway Municipality. A “qualifying investor” may invest up to \$125,000 per “qualifying business” per year with a \$250,000 maximum for each “qualifying business,” but the total of all available credits may not exceed \$50,000 in any year. For these purposes, a qualifying investor is an accredited investor who is not the principal

¹ H.B. 4377 does not clearly identify the base to which the specified percentage applies. Taxpayers and tax practitioners may have to wait for a corrected bill or guidance from the Massachusetts Department of Revenue regarding calculation of the credit for calendar years after 2020.

² A “Gateway Municipality” is a municipality with a population greater than 35,000 and less than 250,000, a median household income below the commonwealth’s average, and a rate of educational attainment of a bachelor’s degree or above that is below the commonwealth’s average.

owner of the “qualifying business” who is involved as a full-time professional activity. A “qualifying investment” is an unsecured and non-guaranteed investment, which is not in the form of a venture capital fund, hedge funds, or commodity fund with institutional investors, or an investment in a business involved in retail, real estate, professional services, gaming, or financial services. Finally, a “qualifying business” is a business that has its principal place of business in Massachusetts where at least 50% of its employees are located, has a developed business plan, and has gross revenues equal to or less than \$500,000.

Sales/Use Tax. H.B. 4377 established a sales tax holiday for the days of August 16 and 17, 2014. In addition, under H.B. 4377, a limited partnership that is not classified as a corporation may qualify for the sales and use tax exemption available to R&D corporations. Previously, the exemption was limited to corporations.

► BDO INSIGHTS

- Other than the elective alternative simplified credit and the sales/use tax holiday, for which an effective date may be presumed, the effective dates for the tax incentives discussed above are not clear. For example, in the substantive portions of H.B. 4377, no effective date is provided for the provisions related to the regular research credit, the job creation project credit, the investment tax credit, or the sales/use tax exemption for limited partnerships. In addition, in the final sections of H.B. 4377 where many of the effective dates are provided, “XX” is used to reference the section number in H.B. 4377 in lieu of the actual section. Tax practitioners and taxpayers alike may have to wait for a corrected version of the bill to be released or guidance from the Massachusetts Department of Revenue regarding effective dates.
- Due to Massachusetts legislature’s adoption of its own definition of “base amount” under H.B. 4377 with no specific provision related to start-up companies, it appears that start-up companies and non-start-up companies will be treated the same for purposes of calculating the research credit under H.B. 4377. However, because Massachusetts adopts its own definition of “base amount” with no reference to a minimum amount, it appears that the “base amount” will not be subject to the minimum 50 percent of qualified research expenses for the credit year as it was prior to the enactment of H.B. 4377.
- The investment tax credit established under H.B. 4377 applies to a qualified taxpayer that invests in a business whereas the historical investment tax credit, which is still in effect, applies to a qualifying business that invests in certain depreciable tangible property that is used by the business in Massachusetts. Thus, H.B.4377 expands the scope of taxpayers that may qualify for some type of investment tax credit.
- Non-start-up companies should no longer have to maintain records related to taxable years beginning after December 31, 1983, and before January 1, 1989, for purposes of calculating the credit under H.B. 4377. This, along with the alternative simplified research credit option, should make calculating the credit easier.

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