

Arizona Commerce Authority
REFUNDABLE RESEARCH AND DEVELOPMENT TAX CREDIT

Program Rules & Guidelines¹

Section 1. Overview

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 (Commerce).

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). 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 Arizona legislature in 2010 created the refundable component of the R&D program. A taxpayer that is otherwise qualified for the nonrefundable R&D tax credit and who employs fewer than 150 full-time employees worldwide can apply to Commerce for approval of a refund of 75% of the current year's excess credit amount. (A.R.S. § 41-1507) For tax years beginning after December 31, 2009, Commerce has authority to approve refunds under this program in an amount up to \$5 million in any calendar year. Refunds are approved by Commerce on a first come, first served basis, according to the date and time stamp on the Application submitted to Commerce.

The nonrefundable R&D program was 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 credit amount is equal to 10% of the basic research payments that constitute excess expenses for the tax year over the base amount. The increased university R&D tax credit is administered by Revenue for tax years beginning from and after December 31, 2010. The additional credit is not refundable.

Application materials and instructions for the non-refundable tax credit are available on Revenue's website (<http://www.azdor.gov/Forms/Credits.aspx>) Questions regarding the non-refundable tax credit may be directed to (602) 255-3381 or (800) 352-4090.

The contents of these Rules & Guidelines pertain to the refundable R&D tax credit program that is administered by Commerce. Questions regarding the refundable tax credit may be directed to (602) 845-1200 or (800) 542-5684.

Section 2. Eligibility Requirements for Refundable Tax Credits

A taxpayer may be eligible for a partial refund of its R&D tax credit, if it:

- Meets the eligibility requirements of A.R.S. §§ 41-1507 and 43-1074.01 or 43-1168 and the taxpayer's current year Arizona R&D tax credit exceeds the taxpayer's current year's tax liability;
- Submits an Application to Commerce and receives a Certificate of Qualification prior to filing a tax return with Revenue;
- Employs fewer than 150 full-time employees worldwide on the last day of the taxpayer's taxable year;
- Remits a nonrefundable processing fee equal to 1% of the tax credit being refunded;
- Complies with the employer requirement set forth in A.R.S. § 23-214(B); and
- Submits an Application to Commerce when sufficient cap is available under A.R.S. § 41-1507(E).

Section 3. Explanation of Refundable Tax Incentive

The following Arizona tax incentive is available to taxpayers approved by Commerce.

These rules are provided to assist applicants. In case of conflict between what is presented here and in the Arizona Revised Statutes, the statutes shall prevail. See A.R.S. §§ 41-1507, 43-1074.01 and 43-1168.

Refundable R&D Tax Credit. Pursuant to A.R.S. § 41-1507, for years beginning from and after December 31, 2009, a partial refund is allowed for a taxpayer that is otherwise eligible to receive non-refundable R&D tax credits under A.R.S. §§ 43-1074.01 or 43-1168.

The specific percentage used to calculate the refundable tax credit depends on the tax year in which the R&D activity is conducted and the amount of the qualifying expenses are incurred, as outlined below:

- For tax years 2011 thru 2017, the credit is 24% of the qualifying expenses and for tax year 2018 and thereafter, the credit is 20% of the qualifying expenses.
- For tax year 2011 thru 2017 the credit is \$600,000 plus 15% of the amount of qualifying expenses over \$2.5 million and for tax year 2018 and thereafter, the credit is \$500,000 plus 11% of the amount of qualifying expenses over \$2.5 million.

The R&D tax credit refund is the lesser of:

- a) 75% of the excess credit (the excess credit is the current year's R&D credit for increased research activities less the current year's tax liability). The remaining 25% is forfeited if a refund is issued; or
- b) The maximum refund amount on the Certificate of Qualification from Commerce.

After a company has received a Certificate of Qualification from Commerce, it may claim the refund with Revenue. The tax credit must be claimed by the Applicant or its partners or S corporation shareholders on an original Arizona tax return along with the form prescribed by Revenue (Arizona Form 308 (for corporations) or Arizona Form 308-I (for individuals)) for the tax year identified on the Certificate of Qualification. The taxpayer must attach a copy of the Certificate of Qualification from Commerce to its tax return for the tax year to receive the partial refund.

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.

Section 4. Refundable Tax Incentive Limitations and Calendar Year Cap Management

- A. **Commerce may not approve Applications exceeding a total of \$5 million per calendar year.** Unused tax credit amounts roll forward to the succeeding consecutive calendar year and then expire, to ensure full utilization of the cap, Commerce will authorize refunds from the unused cap from the previous year before it begins authorizing refunds from the current calendar year's cap.
- B. R&D tax credit refunds are approved on a first come, first served basis. The date and time stamp on an Application determines the order in which Commerce approves and allocates that calendar year's cap. Commerce will not accept Applications for tax credit refunds from a calendar year's cap until the first business day of that calendar year.
- C. If sufficient cap is unavailable when an Application is submitted to Commerce, the Applicant will receive any remaining cap amount. The balance of the credit is irrevocably waived.
- D. Commerce cannot approve an Application in an amount greater than 75% of the amount by which the current year's credit exceeds the current year's tax liability for the taxable year. The balance of the credit is irrevocably waived. A.R.S. §§ 43-1074.01(C)(2) & 43-1168(D)(2).
- E. A taxpayer that claims a credit for increased R&D activity under A.R.S. §§ 43-1074.01 or 43-1168 shall not claim a credit under A.R.S. §§ 43-1085.01 or 43-1164.02 for the same expenses. A.R.S. §§ 43-1074.01(D) & 43-1168(E)
- F. Once a Certificate of Qualification is issued by Commerce, the Applicant cannot revise its Application for that tax year. The R&D refund amount approved by Commerce is based on the current year's excess credit. When the taxpayer files its Arizona tax return with Revenue, the refund amount may be less than the amount approved by Commerce, but never more than the amount approved by Commerce.
- G. If a taxpayer files its tax return with Revenue prior to applying for the refund with Commerce, the taxpayer is not eligible to receive a refundable R&D tax credit for that tax year. Further, if a taxpayer elects to carry forward its R&D tax credit for the tax year, it is no longer eligible for a refund for that tax year. A taxpayer that files a return with Revenue without claiming a refund of the R&D tax credit is electing to carry the unused R&D credit forward for the tax year.

Section 5. Submittal of Applications for a Partial Refund

In an effort to streamline and expedite applications for incentives, Commerce is pleased to offer a new service that enables taxpayers to apply for incentives electronically. All materials submitted through the Electronic Application

System (EASY), including, without limitation, applications for refundable R&D tax credits, are subject to the [EASY terms and conditions](#). The EASY being utilized by Commerce will date and time stamp each Application on the date of receipt.

If a taxpayer insists on submitting a written Application, Commerce will only accept original Applications delivered via private delivery service or hand delivery. Any other form of delivery for an Application, including mailed, emailed or faxed copies, will not be accepted by Commerce. When a written Application is submitted, Commerce will date and time stamp each Application on the date of receipt.

In the situation in which an Application submitted via the EASY bears the same date and time stamp as a written Application, the Application submitted through EASY will take precedence.

Section 6. Processing Applications for a Partial Refund

- A. Applications must be based on actual numbers, not estimates. Therefore, a calendar year taxpayer may file an Application on or after the first business day following the close of the previous calendar year. A fiscal year taxpayer may file an Application on or after the first business day following the close of the fiscal year. For example, a taxpayer with a June 30, 2013 fiscal year end could apply for a partial refund of R&D credits as early as July 1, 2013, if cap is still available. If, however the 2013 cap has been exhausted, the fiscal year end taxpayer may submit an Application on or after the first business day of 2014, provided said taxpayer has NOT filed its tax return with Revenue for the tax year in which the R&D credit was generated.
- B. The Application for a refund must include:
1. The Applicant's name, address, taxpayer identification number and NAICS Code
 2. Name and contact information of an individual who can be contacted with regard to the Application
 3. A detailed description of the business and research activities
 4. Number of full-time employees as of the last day of the taxpayer's taxable year
 5. Average hourly wage of the full-time employees for the previous taxable year and gross payroll for the taxable year
 6. Percentage of health insurance covered by the Applicant for the full-time employees
 7. The amount of the Applicant's R&D income tax credit for the taxable year calculated on Arizona Form 308 (for corporations) or Arizona Form 308-I (for individuals)
 8. The amount of the Applicant's income tax liability for the taxable year (exclusive of the R&D credit or any carryover of the R&D credit from prior years)
 9. Amount of capital investment made by the Applicant during the taxable year
 10. An affidavit signed by an officer of the Applicant or its authorized representative. By signing the affidavit the Applicant agrees, but is not limited, to the following:
 - a. That the information contained in the Application is true and correct under penalty of perjury
 - b. To furnish records of expenditures to Commerce or Revenue on request
 - c. To allow site visits and audits to verify the Applicant's continuing qualification and the accuracy of information submitted to Commerce
 - d. If Revenue determines that a credit refunded is incorrect or invalid, the excess credit issued may be treated as a tax deficiency pursuant to A.R.S. § 42-1108.
 11. Revenue's [Form 285B](#) authorizing Commerce to obtain confidential taxpayer information from Revenue
- B. During review of a Substantially Complete Application, Commerce may request additional information, conduct a site visit or discuss the Application with the Applicant. If the Applicant does not satisfy the request within the allotted timeframe (maximum of 28 calendar days as per the definition of Substantially Complete), the Application will be considered inactive and withdrawn by the Applicant.
- C. Commerce will make a determination with regard to each Application within 30 calendar days after the date and time stamp of a Substantially Complete Application.
- H. If Commerce denies an Application, the Applicant may appeal the decision in accordance with A.R.S. Title 41 Chapter 6, Article 10. An Applicant may appeal this decision; however, the denial prohibits an Applicant from receiving a refundable tax credit under this program unless the appeal is successful. In the event that an appeal is successful, Commerce will allocate cap, as follows:
- a. Utilize the remaining cap from the current calendar year, and

- b. If additional funds are required to satisfy the appealed amount, Commerce will use the next calendar year's cap.
- D. If the Applicant is qualified for the tax credit refund, the Program Manager will request the Applicant to remit a non-refundable processing fee equal to 1% of the maximum refundable credit amount. Acceptable methods of payment include: check, cashier check or wire transfer. No other form of payment will be accepted by Commerce. After the fee has been processed, Commerce shall issue a Certificate of Qualification to the Applicant and transmit a copy to Revenue. A Certificate of Qualification includes, at a minimum, the Applicant's name, the maximum refundable tax credit amount, the calendar year cap affected, and the tax year the refund is available.

Section 7. Definitions of Program Terms

For purposes of applying for and maintaining eligibility for a partial refund of the R&D Tax Credit, the following terms are either defined by Commerce or defined in A.R.S. § 41-1507. If a term is not defined, the most commonly accepted meaning of the term applies. For purposes of this program:

1. "Applicant" means a C corporation, a unitary group of corporations, an Arizona affiliated group as defined in A.R.S. § 43-947(I)(2), a limited liability company, an S corporation, a sole proprietorship, or a partnership.
2. "Application" means either 1) the Commerce written form "Application for Certificate of Qualification" and all required attachments to apply for the refundable R&D tax credit or 2) the EASY form "R&D Refundable Tax Credit Application" and all required uploads to apply for the refundable R&D tax credit.
3. "Business day" means a day other than Saturday, Sunday, a legal holiday or the day the State of Arizona observes a legal holiday or a day on which Commerce is authorized or obligated by law or executive order to be closed.
4. "Calendar day" means a day of the week and includes Saturday, Sunday, a legal holiday, the day the State of Arizona observes a legal holiday or a day on which Commerce is authorized or obligated by law or executive order to be closed.
5. "Calendar year cap" or "cap" means the refundable tax credit amount prescribed by A.R.S. § 41-1507 for allocation in a specific calendar year.
6. "Certificate of Qualification" means a document issued by Commerce to an eligible Applicant after review and approval of an Application. The Certificate of Qualification includes, at a minimum, the Applicant's name, the maximum refundable tax credit amount, the calendar year cap affected, and the tax year the refund is available.
7. "Current year's tax liability" is the calculated tax plus any recapture less any other nonrefundable credits and carryovers from Arizona Form 300 for corporations or Arizona Form 301 for individuals, but not including the Arizona R&D credit or prior year carryovers. The current year's tax liability cannot be less than zero.
8. "Date and time stamp" means the day and time an Application is submitted via EASY or delivered to and accepted by Commerce via private delivery service or hand delivery. Any other form of delivery for an Application, including mailed, emailed or faxed copies, will not be accepted by Commerce.
9. "Eligible" means an Applicant for which an Application has been submitted and Commerce has issued a Certificate of Qualification.
10. "Full-time employee" means an individual who works at least 35 hours a week and for whom a company is required to remit Federal Insurance Contributions Act (FICA) tax, whether or not FICA is actually remitted. The full-time employee limitation applies worldwide for the Applicant.
11. "First come, first served" means the numerical order in which Commerce shall approve available calendar year cap. The order is established by the date and time stamp of an Application.
12. "Substantially Complete" means all questions in the Application are fully addressed by the Applicant and all documents required by Commerce are attached or can be supplied within 14 calendar days after receipt of notification by Commerce of any deficiencies. One extension of an additional 14 calendar days may be requested and granted by the program manager. Applications that are not made Substantially Complete within the stated timeframe will be considered inactive and withdrawn by the Applicant. The date and time stamp on the withdrawn Application is void and the cap is authorized to the next eligible Applicant.
13. "Qualifying expenses" means the excess of "qualified research expenses" over the "base amount", determined pursuant to section 41 of the Internal Revenue Code, as applicable, and only for research conducted in Arizona including research conducted at a university in Arizona and paid for by the taxpayer.

14. "Taxpayer" means an individual, a corporation, an S corporation, a partnership or a limited liability company. A unitary group required to file a combined return shall be treated as a single taxpayer. An Arizona affiliated group required to file a consolidated return shall be treated as a single taxpayer.

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