

**NOTICE OF ADOPTION**

**RULE NO. 18-05**

**1. Rule.**

Research and Development Refundable Tax Credit Program (the “Program”)

**2. Date of Posting Notice of Rule Making.**

November 21, 2018

**3. Public Comment Period.**

November 21, 2018 through December 31, 2018

**4. Hearing Date**

none

**5. The deadline for the Authority to file a Notice of Adoption.**

Not later than 180 days following November 21, 2018.

**6. Notice of Adoption Posting Date.**

December 31, 2018

**7. Preamble**

**An explanation of the agency’s action pertaining to the Rule**

The main substance of the update to the Rule places a cap of \$100,000 on the amount of funds awarded to each applicant. The purpose of the change was to allow more **small** businesses to take advantage of the benefits associated with the Program. This emphasis on small business is in keeping with the spirit of the Program reflected in statute. Informal comments were received by the Authority overwhelmingly in favor of the change; however, one comment was received that acknowledged a cap was appropriate but identified the cap would negatively impact an applicant whose R&D efforts would otherwise yield a benefit greater than the cap allowed. The comment indicated this would be especially problematic for an applicant who planned an increase in R&D expenses. The Authority acknowledges that such an effect is a natural consequence of a per-applicant cap, but notes that in setting the cap, various scenarios were contemplated based on historic performance of the Program and amounts claimed by all the Program’s applicants. A multi-year historical review of the amounts claimed by applicants indicates that the \$100,000 threshold best mitigates the loss to any single applicant while maximizing the additional number of applicants for whom credits will be made available. Additional variables such as the number



of applicants annually, amounts claimed by each applicant, timing of each submitted application, the time it takes to fully allocate the \$5 million aggregate cap, and other variables were all considered. In addition, the Authority considered feedback it received indicating that, in the past, an unknown number of applications were consciously withheld by applicants based on the knowledge that either the aggregate cap had already been allocated fully or the likelihood of actually receiving a certificate for refundable credits was extremely low. This difficulty in accessing funds is due to the \$5 million aggregate cap being allocated within minutes of the Program applications going live. Based on all these inputs, the Authority is confident that the \$100,000 cap referenced in the Rule will serve the purpose for which it is intended – to provide broader access to refundable tax credits to more small businesses engaged in R&D activities in the State.

## **8. Amendments**

The Arizona Commerce Authority hereby gives notice that Rule 18-05 has been adopted and governs the applications to be submitted on or after December 31, 2018. No amendments to the version of the Rule set forth in the Notice of Rule Making were made.



Michael Kellis  
Associate Counsel



**Arizona Commerce Authority**  
**REFUNDABLE RESEARCH AND DEVELOPMENT TAX CREDIT**

**Program Rules & Guidelines<sup>1</sup>**

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**Section 1. Overview**

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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 (the "Authority").

The nonrefundable R&D program was enacted in 1992 for corporations (A.R.S. § 43-1168) and in 1999 for individuals (A.R.S. § 43-1074.01). For tax years beginning on or before December 31, 2021, 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 taxable years beginning January 1, 2022 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 the Authority 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, the Authority may approve refunds under this program in an amount up to \$5 million in any calendar year. Refunds are approved by the Authority on a first come, first served basis, according to the date and time stamp on the Application submitted to the Authority. **Beginning in calendar year 2019, the maximum refund amount per taxpayer is \$100,000 in a single tax year.**

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 the Authority. Questions regarding the refundable tax credit may be directed to (602) 845-1200 or (800) 542-5684.

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**Section 2. Eligibility Requirements for Refundable Tax Credits**

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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 the Authority 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) (pertaining to enrollment in E-Verify); and
- Submits an Application to the Authority when sufficient cap is available under A.R.S. § 41-1507(E).

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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.

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### Section 3. Explanation of Refundable Tax Incentive

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

Refundable R&D Tax Credit. Pursuant to A.R.S. § 41-1507, for tax years beginning January 1, 2010 or later, 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 taxable years beginning on or before December 31, 2021, the credit is 24% of the qualifying expenses if qualifying expenses amount to a maximum of \$2.5 million. For taxable years beginning January 1, 2022 and thereafter, the credit is 20% of the qualifying expenses if qualifying expenses amount to a maximum of \$2.5 million.
- For taxable years beginning on or before December 31, 2021 the credit is \$600,000 plus 15% of the amount of qualifying expenses over \$2.5 million. For taxable years beginning January 1, 2022 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) \$100,000 (the remaining balance of the otherwise non-refundable portion is forfeited if a refund is issued); or
- c) The maximum refund amount on the Certificate of Qualification from the Authority.

After a company has received a Certificate of Qualification from the Authority, it may claim the refund with Revenue. The tax credit must be claimed by the taxpayer 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 the Authority 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.

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

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- A. **The Authority 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, the Authority 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 the Authority approves and allocates that calendar year's cap. The Authority 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 the Authority, the taxpayer will receive any remaining cap amount. The balance of the credit is irrevocably waived.
- D. The Authority 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. In order to maximize the number of taxpayers who may receive the refundable credit, the maximum amount for each award will be \$100,000 per taxpayer per tax year. The balance of the credit is irrevocably waived.
- F. Each taxpayer may submit only one Application per tax year.

- G. Once a Certificate of Qualification is issued by the Authority, the taxpayer cannot revise its Application for that tax year. The R&D refund amount approved by the Authority is based on the current year's excess credit, the \$100,000 limit, and the amount of cap remaining. When the taxpayer receives its Arizona tax return from Revenue, the actual refund amount may be less than the amount approved by the Authority, but never more than the amount approved by the Authority.
- H. If a taxpayer files its tax return with Revenue prior to applying for the refund with the Authority, 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.

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### **Section 5. Submittal of Applications for a Partial Refund**

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Taxpayers must submit all applications for refundable tax credits electronically through the Authority's Electronic Application System (also known as "EASY"). The Authority shall accept applications for refundable tax credits on or after the first business day following the close of the previous calendar year. The process described in this section will determine the order in which the Authority authorizes refundable tax credits to qualified taxpayers. The Authority, through the EASY system, will date and time stamp each application on the date of receipt.

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### **Section 6. Processing Applications for a Partial Refund**

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- 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 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 taxpayer's name, address, taxpayer identification number and NAICS Code
  2. Name and contact information of an individual who may be contacted with regard to the Application
  3. A general description of the business and research activities
  4. Number of full-time employees as of the last day of the taxpayer's taxable year (must be less than 150)
  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 taxpayer for the full-time employees
  7. The amount of the taxpayer'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 taxpayer'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 taxpayer during the taxable year in Arizona
  10. An affidavit signed by an officer of the taxpayer or its authorized representative. By signing the affidavit, the taxpayer 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 the Authority or Revenue on request
    - c. To allow site visits and audits to verify the taxpayer's continuing qualification and the accuracy of information submitted to the Authority
    - 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 the Authority to obtain confidential taxpayer information from Revenue
- C. During review of a Substantially Complete Application, the Authority may request additional information, conduct a site visit or discuss the Application with the taxpayer. If the taxpayer 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 taxpayer.
- D. The Authority will attempt to make a determination with regard to each Application within 30 calendar days after the date and time stamp of a Substantially Complete Application.

- E. If the Authority denies an Application, the taxpayer may appeal the decision in accordance with A.R.S. Title 41 Chapter 6, Article 10. A taxpayer may appeal this decision; however, the denial prohibits a taxpayer from receiving a refundable tax credit under this program unless the appeal is successful. In the event that an appeal is successful, the Authority 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, the Authority will use the next calendar year's cap.
- F. If the taxpayer is qualified for the tax credit refund, the Program Manager will request the taxpayer to remit a non-refundable processing fee equal to 1% of the maximum refundable credit amount. After the fee has been processed, the Authority shall issue a Certificate of Qualification to the taxpayer and transmit a copy to Revenue. A Certificate of Qualification includes, at a minimum, the taxpayer's name, the maximum refundable tax credit amount, the calendar year cap affected, and the tax year the refund is available.

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## **Section 7. Definitions of Program Terms**

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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 the Authority 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. "Application" means the electronic application system ("EASY") form and all required uploads a qualified taxpayer must submit to apply for a refundable tax credit.
2. "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 the Authority is authorized or obligated by law or executive order to be closed.
3. "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 the Authority is authorized or obligated by law or executive order to be closed.
4. "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.
5. "Certificate of Qualification" means a document issued by the Authority to an eligible taxpayer after review and approval of an Application. The Certificate of Qualification includes, at a minimum, the taxpayer's name, the maximum refundable tax credit amount, the calendar year cap affected, and the tax year the refund is available.
6. "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.
7. "Date and time stamp" means the day and time an Application is submitted electronically through EASY.
8. "Eligible" means a taxpayer for which an Application has been submitted and the Authority has issued a Certificate of Qualification.
9. "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 taxpayer.
10. "First come, first served" means the numerical order in which the Authority shall approve available calendar year cap. The order is established by the date and time stamp of an Application.
11. "Substantially Complete" means all questions in the Application are fully addressed by the taxpayer and all documents required by the Authority are attached or can be supplied within 14 calendar days after receipt of notification by the Authority 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 taxpayer. The date and time stamp on the withdrawn Application is void and the cap is authorized to the next eligible taxpayer.
12. "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.

13. "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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