Fiscal Note & Local Impact Statement

125 th General Assembly of Ohio

Ohio Legislative Service Commission
77 South High Street, 9th Floor, Columbus, OH 43215-6136 ✧ Phone: (614) 466-3615
✧ *Internet Web Site:* http://www.lsc.state.oh.us/

BILL: **Am. Sub. H.B. 1** DATE: **June 25, 2003**

STATUS: **As Enacted – Effective July 9, 2003** SPONSOR: **Rep. Patton**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Establishes the Research and Development Loan Fund program, creates nonrefundable and transferable tax credits for payments made on loans from the Program, makes changes to laws governing various programs in the Department of Development, and makes appropriations for the Innovation Ohio Loan Fund in FY 2003, and for the Research and Development Loan Fund in FY 2004 and 2005**

State Fiscal Highlights

STATE FUND	FY 2003	FY 2004	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Loss of up to $5.5 million from decreased liquor profit transfers depending on the size and interest rate of future obligations Loss of up to $2.4 million from expanded technology tax credits Potential loss from R&D tax credit	Loss of up to $5.5 million from decreased liquor profit transfers depending on the size and interest rate of future obligations Loss of up to $2.4 million from expanded technology tax credits Potential loss from R&D tax credit
Expenditures	- 0 -	Potential increase	Potential increase
Research and Development Loan Fund			
Revenues	- 0 -	$50,000,000	$55,000,000
Expenditures	- 0 -	$50,000,000	$55,000,000
Innovation Ohio Loan Fund			
Revenues	$50,000,000	Potential gain	Potential gain
Expenditures	$50,000,000	Potential increase	Potential increase

Note: The state fiscal year is July 1 through June 30. For example, FY 2003 is July 1, 2002 – June 30, 2003.

- The bill establishes the Research and Development Loan Fund Program to finance eligible research and development projects. Because liquor profits are used to support the obligations issued to finance this program, the amount of liquor profits that are transferred to the General Revenue Fund will decrease. Substitute House Bill 1 creates a $50,000,000 appropriation in FY 2004 and a $55,000,000 appropriation in FY 2005 for the Research and Development Loan Fund.
- The bill creates the Ohio Research Commercialization Grant Program to provide commercialization grants, awarded by the Third Frontier Commission, to businesses that receive federal research and development funding.
- The bill creates nonrefundable and transferable corporate franchise and income tax credits for qualified payments on loans issued by the Director of Development. The amount of the credit per taxpayer cannot exceed $150,000 per year.
- The bill will decrease revenues to the General Revenue Fund from the tax credits. The amount of revenue loss will depend upon the amounts of tax credits issued under the program.
- The bill modifies certain technology investment tax credit criteria for investments made in EDGE businesses or in investments in businesses located in distressed areas of the state. (See the section on "The Technology Investment Tax Credit" for a description.)
- The bill potentially limits the corporate franchise tax liability of certain corporations providing telecommunications and billing services to clients through the use of "call-centers." This provision potentially reduces GRF revenues if a new law is adopted in the future.
- The bill moves the Innovation Ohio Loan Fund into the state treasury and makes an appropriation of $50 million in FY 2003 for loans and loan guarantees. Approximately $5.5 million per year for 15 years is needed to pay debt service on these obligations, resulting in a $5.5 million decrease in liquor profits transferred to the General Revenue Fund. The decrease in liquor profits depends on the amount of the bond sale, the interest rate, and other variables involved in the sale of bonds.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2003	FY 2004	FUTURE YEARS
Counties			
Revenues	- 0 -	Potential loss	Potential loss
Expenditures	- 0 -	- 0 -	- 0 -
Other Local Governments			
Revenues	- 0 -	Potential loss	Potential loss
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- The bill decreases revenues to various local government funds from the corporate franchise and personal income tax credits. Corporate franchise tax revenues are distributed to the GRF (95.2%), the LGF (4.2%) and the LGRAF (0.6%). Personal income tax revenues are distributed to the GRF (89.5%), the LGF (4.2%), the LGRAF (0.6%), and the LLGSF (5.7%).
- The amount of revenue loss will depend upon the amounts of tax credits issued and claimed under the R&D loan program tax credit, and credits claimed under the expanded technology investment tax credit Program.

Detailed Fiscal Analysis

Research and Development Loan Fund

The bill establishes the Research and Development Loan Fund Program to finance eligible research and development projects. Assistance is available for any research and development project involving the discovery of information that is technological in nature and used to develop new or improved products or processes. Any loan provided through the R&D Loan Fund cannot exceed 75% of the total eligible costs of the project. The Controlling Board must approve assistance provided through this program. Repayment of loans made from the fund will be repaid to the fund. Reimbursements of the Director of Development's expenses that are incurred in administering economic development programs can be paid from moneys in this fund.

The program will be financed through moneys from the proceeds of bond or note sales that are repaid with liquor profits and also loan repayments made by entities that borrow from the R&D Loan Fund Program. The bill creates a special revenue fund in the custody of the Treasurer of State for making withdrawals and deposits for the Program. The fund does not consist of any moneys raised by taxation, nor are tax revenues used to pay the principal or interest due on the obligations. Since this is a non-GRF revenue stream, it should not affect the state's bond rating or the 5% limit on debt service.

Substitute House Bill 1 appropriates $50,000,000 in FY 2004 and $55,000,000 in FY 2005 in appropriation item 195-665, Research and Development, (Fund 010) for research and development purposes including loans under Chapter 166 of the Revised Code. The bill designates that the unencumbered balance of the appropriation at the end of FY 2004 be transferred to FY 2005 by the Director of Budget and Management. Substitute House Bill 1 does not contain any appropriations for debt service.[1]

The bill requires the Director of Development to determine whether research and development financial assistance conforms with requirements of the programs in the Revised Code and shall submit that determination to both the Controlling Board and the Development Financing Advisory Council. Whenever a project applies for assistance and requests to relocate the project to another county, municipal corporation, or township within the state, the Director of Development must provide written notification to the appropriate local governmental bodies, including the affected boards of county commissioners, legislative authorities of special districts, legislative authorities of municipal corporations or the boards of township trustees, and state officials, including state representatives and state senators of affected districts. This provision creates a minimal cost to the Department of Development.

Liquor Profits

The bill increases the ceiling on the aggregate principal amount of obligations that may be issued to fund economic development programs from $300 million to $500 million, excluding those financing obligations for which bond service charges are not paid from liquor profits. Under current law, the following amounts are not included in the ceiling calculation: the principal amount of any obligations retired by payment, amounts held or obligations pledged for the payment of the principal of any outstanding obligations, amounts held in special funds as reserves to meet bond service charges and amounts of obligations issued to meet payments from either the Loan Guarantee Fund or the Innovation Ohio Loan Guarantee Fund. If the unpaid principal amount of loan repayments guarantees exceeds the actual amount in the Loan Guarantee Fund by more than 4%, then the amount of the loan repayment guarantees over the 4% cap is subtracted from those amounts not included in the ceiling calculation; Sub. H.B. 1 removes the 4% requirement, thereby effectively raising the ceiling on the aggregate principal amount of obligations that can be issued. The bill also adds the R&D Loan Fund to the list of funds whose obligations are supported by liquor profits; the list of other programs includes the

Facilities Establishment Fund, Loan Guarantee Fund, Innovation Ohio Loan Guarantee Fund, and Innovation Ohio Loan Fund. The $25 million limit for the aggregate amount of liquor profits that may be used to back the obligations issued for economic development is raised to $45 million by the bill. The bill excludes from the $45 million limit on the use of liquor profits, those obligations issued to meet loan guarantees that cannot be satisfied by amounts held in the Innovation Ohio Loan Guarantee Fund. Finally, the limit on the aggregate amount of loan guarantees made under the Loan Guarantee Fund and the Innovation Ohio Loan Guarantee Fund and the unpaid principal of loans made from the Facilities Establishment Fund and the Innovation Ohio Loan Fund is raised to $800 million, up from $700 million; loans made under the R&D Loan Fund are placed under this ceiling.

Innovation Ohio Loan Program

Originally created in H.B. 675 of the 124th General Assembly, the program was established in the Department of Development to provide financial assistance to eligible innovation projects in the state to maintain and enhance the competitiveness of the Ohio economy and to improve the economic welfare of all the people of the state, to ensure that "high-value" jobs based on research, technology, and innovation are available to the people of the state. Current law dictates that the program is financed through revenues from the proceeds of bond or note sales that are repaid with liquor profits and also loan repayments made by entities that borrow from the Innovation Ohio Loan Program. Approximately $5.5 million per year for 15 years is needed for debt service on these obligations. This amount may vary depending on the size and interest rate of future obligations and other variables involved in the sale of bonds. The Innovation Ohio Loan Fund does not consist of any moneys raised by taxation, nor are tax revenues used to pay the principal or interest due on the obligations. Since this is a non-GRF revenue stream, it should not affect the state's bond rating or the 5% limit on debt service. Substitute House Bill 1 moves the Innovation Ohio Loan Fund into the state treasury and makes a $50 million appropriation in FY 2003 for the program.[2]

Ohio Research Commercialization Grant Program

The bill also creates the Ohio Research Commercialization Grant Program to assist with the commercialization of research projects that have received assistance through the federal Small Business Innovation Research (SBIR) program, the federal Small Business Technology Transfer program, or other similar federal programs designated by the Director as making the applicant eligible for assistance. *State assistance under this program is only available if federal assistance has been awarded.* The state assistance must be specifically used for commercialization of core competency technology, including advanced materials, instruments, controls, electronics, biosciences, power and propulsion, and information technology, or for other business activities related to the commercialization of core competency technology. The bill does not include any appropriations for this program.

Tax Credits

The bill also makes various changes to laws governing technology investment tax credits, and allows the Director of Development to lend money in the R&D Loan Fund to persons for paying the allowable costs of an eligible research and development project.

The R&D Loan Fund Tax Credits

The bill creates a new nonrefundable and transferable credit against the corporation franchise and income taxes for qualified payments made on loans issued by the Director of Development. The amount of the credit cannot exceed $150,000 per year and per taxpayer. The tax credits could be carried forward until fully utilized. The bill established criteria for transferability of the credits. Borrowers in the R&D Loan Fund Program can assign their tax credits to other persons that may use these credits against a tax different from the one the borrower pays. However, borrowers must notify the Department of Development and the Department of Taxation of the transfer of the credits before such credits are used. Taxpayers who are partners in a partnership or members of a Limited Liability Corporation (LLC) may claim their proportionate share of the tax credits awarded to the partnership or the LLC. The amount of revenue loss from tax credits authorized in the R&D Loan Fund Program will depend upon the total issuance of tax credits by the Department of Development and credits claimed by the various investors in the program or by entities that received credits from those investors.

The Technology Investment Tax Credit

The bill increases the amount of technology investment tax credits that may be issued from $10 million to $20 million. The bill also increases the amount of investments by one person, for which a technology tax credit can be claimed from $150,000 to $250,000, raising the tax credit per person to $62,500, up from $37,500. Also, the maximum amount of investments that an investor can make in one business increases from $150,000 to $250,000. The bill expands the eligibility of the technology investment tax credit by increasing the maximum revenue of eligible firms or their net book value to $2.5 million, up from $1.0 million. Finally, the bill increases the maximum investments eligible for the technology investment tax credit for each firm to $1.5 million up from $1.0 million, thus increasing the potential maximum credit authorized per eligible firm to $375,000, up from $250,000.

The bill modifies the technology investment tax credit as it applies to EDGE businesses[3] and to business entities located in a "distressed area"[4] in several ways: the amount of investments by one person for which a technology tax credit can be claimed is increased to $300,000 for an EDGE business or for a business located in a distressed area. Also, the maximum amount of investments that an investor can make in one business is increased to $300,000 if such business is an EDGE business or if the business is located in a distressed area. The tax credit, which is 25% of the amount invested, is increased to 30%. These changes to the technology investment tax credit increase the amount of tax credits per person up to $90,000 for investments in an EDGE business or investments in a business located in a distressed area. Also, the maximum tax

credits that could be authorized for each firm may potentially be up to $450,000, instead of the maximum tax credits of $375,000 for other eligible firms under the technology investment tax credit program.

Based on data from the Ohio Department of Development on the current technology investment tax credit, the proposed modifications to this tax credit may decrease state revenues by up to $2.5 million per year.

The tax credits will decrease revenues to the General Revenue Fund (GRF), the Local Government Fund (LGF), the Local Government Revenue Assistance Fund (LGRAF), and the Library and Local Government Support Fund (LLGSF). Corporate franchise tax revenues are distributed to the GRF (95.2%), the LGF (4.2%) and the LGRAF (0.6%). Personal income tax revenues are distributed to the GRF (89.5%), the LGF (4.2%) the LGRAF (0.6%) and the LLGSF (5.7%). ***The amount of GRF and local government funds revenue loss will depend upon the total issuance of tax credits under the Research and Development Loan Program and credits claimed under the expanded Technology Investment Tax Credit Program.***

The bill also makes changes to the job retention tax credit. Under current law, the Ohio tax credit authority may grant to an eligible firm a nonrefundable corporate franchise or personal income job retention tax credit for a period of up to ten taxable years. The bill lengthens this period to 15 years. This provision has a minimal fiscal effect, if any.

Call-Center Tax liability

The bill limits any additional tax liability for "call-centers" if their tax liability would be increased under the corporate franchise taxation of telecommunications services under H.B. 95 (the proposed budget bill) or any future changes in corporation franchise tax laws regarding modifications to the add-back of inter-company expenses in the calculation of the franchise income tax liability for certain corporations and their related entities. This provision applies to a corporation (including its related members) that develops software applications to provide telecommunications and billing services, with revenue from sales and licensing of software of at least $600 million per taxable year. Such corporations (and their related members) provide a certain volume of customer and technical support for their clients through call-centers located in Ohio and outside this state.

The bill requires that, in computing the net income of such a corporation and its affiliates for purposes of the treatment of the add-back of inter-company expenses for the corporate franchise income tax, the corporation's franchise tax liability (for such corporation and its related entities) for any taxable year would be the lower of the tax liability calculated applying the corporate franchise law in effect that future year or the corporate franchise income tax liability calculated under current law. This implies that any future change to the treatment of the add-back of inter-company expenses in corporate franchise tax law would not increase the tax liability of certain corporations and affiliates. This provision may result in potential revenue loss. The bill also allows the Ohio tax credit authority to include companies with "call centers" in the job retention tax credit agreements.

LSC fiscal staff: Jean J. Botomogno, Economist
Allison Thomas, Economist

HB0001EN/lb

---

[1] The proposed budget bill, Am. Sub. H.B. 95 – As Reported by the Conference Committee, contains appropriations for debt service on bonds issued for this program. Contained within the Department of Commerce's operating budget, appropriation item 800-633, Development Assistance Debt Service, pays for the debt service on these obligations with liquor profits. In FY 2004 and FY 2005, $23.3 million and $29.0 million, respectively, are appropriated for debt service of all of the programs funded with economic development bonds, including the Facilities Establishment Fund, the Innovation Ohio Loan Fund, and the Research and Development Loan Fund.

[2] The proposed budget bill, Am. Sub. H.B. 95 – As Reported by the Conference Committee, contains FY 2004 and FY 2005 appropriations of $50.0 million and $55.0 million, respectively, for this program. Debt service for the program is also contained in the proposed budget bill in the Department of Commerce's appropriation item 800-633, Development Assistance Debt Service, which pays for the debt service on these obligations with liquor profits. In FY 2004 and FY 2005, $23.3 million and $29.0 million, respectively, are appropriated for debt service of all of the programs funded with economic development bonds, including the Facilities Establishment Fund, the Innovation Ohio Loan Fund, and the Research and Development Loan Fund.

[3] The EDGE program is a small business assistance program created by the Ohio Governor in December 2002 that applies to state procurements of supplies and services, information technology services, construction and professional design services. The Ohio Department of Administrative Services and the Ohio Department of Development jointly administer the EDGE program, and certify which businesses would qualify as EDGE businesses.

[4] A "distressed area" is defined in ORC Section 122.23 as a county with a population of less than 125,000 that meets at least two of the following criteria of economic distress; Its average rate of unemployment, during the most recent five-year period for which data are available, is equal to at least 125% of the average rate of unemployment for the United States for the same period; It has a per capita income equal to or below 80% of the median county per capita income of the United States as determined by the most recently available figures from the United States Census Bureau; or the county has a ratio of transfer payment income to total county income equal to or greater than 25%.