

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

**Program 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 company. The goal of the program is to encourage Arizona businesses to continue investing in research and development activities.

Enacted in 1992 for corporations (currently, A.R.S. § 43-1168) and 1999 for individuals (A.R.S. § 43-1074.01), the R&D program has been administered by the Arizona Department of Revenue (Revenue). Through 2009, the R&D tax credit was equal to 20% of the first \$2.5 million in qualifying expenses plus 11% of the qualifying expenses in excess of \$2.5 million.

The R&D program was modified by the Arizona legislature during 2009. The 2010 R&D tax credit is equal to 22% of the first \$2.5 million in qualifying expenses plus 13% of the qualifying expenses in excess of \$2.5 million. The 2011 through 2017 R&D tax credit will be equal to 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 tax credit rates will return to 20% of the first \$2.5 million in qualifying expenses plus 11% of the qualifying expenses in excess of \$2.5 million.

Starting in 2010, a qualifying company may be eligible to claim a partial refund of its current year excess R & D credit. For tax years beginning on or after December 31, 2009, a company that is otherwise qualified for the R&D tax credit who employs less than 150 full-time employees can apply to the Arizona Commerce Authority (Commerce) for a refund of 75% of the excess credit amount. (A.R.S. § 41-1507) Commerce has been given the authority to approve refunds under this program not to exceed \$5 million in any calendar year. Therefore, refunds are approved by Commerce on a first come, first served basis, according to the date and time an application is filed with Commerce.

Beginning in 2011 an additional credit amount is allowed if the taxpayer made basic research payments during the tax year to an Arizona state university, 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.

A company seeking a partial refund of the R&D tax credit must submit an application to Commerce prior to filing its tax return with the Revenue. Since applications must be based on actual numbers, and not estimated ones, applications to Commerce may not be filed earlier than the first business day after the close of the taxpayer's taxable year. After determining eligibility for a refund, Commerce will issue a "Certificate of Qualification" to eligible companies. To obtain the refund, the company must then file its Arizona tax return with Revenue and attach a copy of the Certificate of Qualification to its return.

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**Section 2. Eligibility Requirements**

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A business 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 company's current year's Arizona R&D tax credit exceeds its 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 less than 150 full-time employees company-wide as of December 31st of the taxable year
- Remits a non-refundable processing fee equal to 1% of the company's tax credit being refunded
- Does not exceed the tax year refund limitations under A.R.S. § 41-1507 (E)
- Complies with the employer and business sanctions set forth in A.R.S. § 23-214 (B) and A.R.S. § 35-393

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These Guidelines 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 & 43-1168.

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### Section 3. Explanation of Tax Incentives

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The R&D Tax Credit offers the following Arizona tax incentive to companies that are approved by Commerce.

Refundable R&D Tax Credits. Under A.R.S. § 41-1507, for years beginning from and after December 31, 2009, a partial refund is allowed for a company with eligible R&D tax credits.

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

- For tax year 2010, if the qualifying expenses are \$2.5 million or less the tax credit is 22% of the qualifying expenses. For tax years 2011 thru 2017, the credit is 24% and for tax year 2018 and thereafter the credit is 20% of the qualifying expenses.
- For tax year 2010, if the qualifying expenses exceed \$2.5 million, the credit is \$550,000 plus 13% of the amount of qualifying expenses over \$2.5 million. For tax year 2011 thru 2017 the credit is \$600,000 plus 15% and for tax year 2018 and thereafter, the credit is \$500,000 plus 11% of the amount of qualifying expenses over \$2.5 million.

Up to 75% of the excess credit could be refunded to qualified taxpayers. The excess credit is the current year's credit amount less the current year's tax liability.

The tax credit must be claimed by an eligible company 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)). The taxpayer must attach a copy of the Certificate of Qualification from Commerce for the tax year.

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

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- A. Applications can be accepted by Commerce beginning the first business day of January for the previous calendar year. For calendar year 2010 taxpayers, applications will be accepted by Commerce on or after January 3, 2011. Fiscal year taxpayers may file applications on the first business day following the close of the previous fiscal year. Commerce shall not accept applications for or approve tax credit refunds from a calendar year's cap until the first business day of that calendar year.
- B. Commerce may not approve refunds exceeding a total of \$5 million per calendar year. A.R.S. § 41-1507 (E)
- C. If in any year there is an unused tax credit amount, Commerce shall allocate the balance to the following year's cap. A.R.S. § 41-1507 (E)
- D. R&D tax credit refunds are approved on a first come, first served basis according to the date of receipt of the company's application. A.R.S. § 41-1507 (E)
- E. When application is made, if sufficient cap is not available the company will receive any remaining cap amount. The balance of the credit is irrevocably waived.
- F. Commerce cannot approve a tax refund in an amount more than 75% of the amount by which the current year's credit exceeds the business'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)
- G. A taxpayer that claims a credit for increased R&D activity under section 43-1074.01 or section 43-1168 shall not claim a credit under section 43-1085.01 or section 43-1164.02 for the same expenses. A.R.S. §§ 43-1074.01 (D) & 43-1168 (E)
- H. Once a Certificate of Qualification is issued by Commerce, the taxpayer 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.
- I. If a taxpayer files its tax return with Revenue prior to applying for the refund with Commerce, it cannot elect 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 under this program.

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## Section 5. Submittal of Applications

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Commerce will date and time stamp each application on the date of receipt. The date of receipt determines the order in which Commerce approves and allocates that calendar year's cap.

Commerce shall 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.

Applications must be based on actual numbers, not estimates. Calendar year taxpayers may file applications on or after the first business day following the close of the previous fiscal year. Fiscal year taxpayers may file applications on or after the first business day after the end of the fiscal year.

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## Section 6. Processing Applications

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- A. Application for a refund can be made by submitting the Commerce form: "Application for Certification of Qualification". The Application shall include:
1. Name, address, federal 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 Dec 31<sup>st</sup> of the taxable year
  5. Average hourly wage of the full-time employees for the previous fiscal year and gross payroll as of Dec 31<sup>st</sup> of the taxable year
  6. Percentage of health insurance covered by the business for the full-time employees
  7. The amount of the business'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 business'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 company for the taxable year
  10. The company must submit to Commerce an affidavit signed by an officer of the applicant company. By signing the affidavit the company agrees, but is not limited, to the following:
    - a. That the information contained in the initial 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. A non-refundable processing fee equal to 1% of the business's tax credit being refunded (Acceptable methods of payment include: check, cashier check or wire transfer. No other form of payment will be accepted by Commerce.)
  12. Revenue's [Form 285B](#) authorizing Commerce to obtain confidential taxpayer information from Revenue
- B. During review of the substantially complete application, Commerce may request additional information, conduct a site visit or discuss the application with the company. The company will have 14 calendar days to supply any additional information requested by Commerce. If the information provided does not complete the application the company can be given one extension of an additional 14 calendar days to supply the requested information. If the company does not satisfy the request within the allotted timeframe, the application will be considered withdrawn by the company and the application will be returned.
- C. Commerce shall make a determination with regard to each application within 30 calendar days after the date of receipt of a complete application.
- D. If Commerce denies an application, the company may appeal the decision in accordance with A.R.S. Title 41 Chapter 6, Article 10. A company may appeal this decision; however, the denial prohibits a company from receiving a refundable tax credit under this program, unless the appeal is successful.
- E. If the company is qualified for the tax credit refund, Commerce shall issue a "Certificate of Qualification" to the company and transmit a copy to Revenue. A certificate of qualification letter includes the company 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. Claiming Tax Credit Refund

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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. 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 from Revenue. The refund must be claimed by the certified company on an Arizona income tax return along with Revenue Form 308 (for corporations) or Arizona Form 308-I (for individuals) for the tax year identified on the certificate.

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) & 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 8. 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 Commerce or defined in A.R.S. § 41-1507. If a term is not defined, the most commonly accepted meaning applies. For purposes of this program:

1. "Application" means the Commerce form "Application for Certificate of Qualification" and all required attachments to apply for the refundable R&D 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 department 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 department 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 Commerce to an eligible company after review and approval of an Application. The "Certificate of Qualification" includes the company 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 the Clean Elections tax reduction and 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 of receipt" means the day and time an Application is 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.
8. "Eligible" means a company for which an Application has been submitted and Commerce 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 or state withholding tax, whether or not withholding tax is actually remitted. The full-time employee limitation applies company-wide for the taxpayer, the unitary group, or the consolidated filer, as appropriate.
10. "First come, first served" means the numerical order in which Commerce shall approve available calendar year cap OR refundable tax credits, which is established by the date of receipt of an Application.
11. "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 day 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 substantially complete will be considered withdrawn by the company and returned to the applicant.

12. "Tax credit" means the portion of the incentive provided under A.R.S. §§ 41-1507, 43-1074.01 & 43-1168 that may be refunded to Eligible companies.
13. "Qualifying expense" means an amount determined pursuant to section 41 of the internal revenue code and only for research conducted in Arizona including research conducted at a university in Arizona and paid for by the taxpayer.

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