Life Science Tax Incentive Background

On June 16th, 2008, Massachusetts enacted legislation that created both the Life Sciences Investment Program, and the Life Sciences Tax Incentive program. The Massachusetts Life Science Center (MLSC) acts as an agent for the commonwealth for purposes of administering who qualifies for any incentives under the Life Science Investment Program and the Life Sciences Tax Incentive Program, as well as who can have their certification revoked. The standards used by the MLSC to determine who should qualify for a credit has been subject to significant modification over the past few years, without any legislative changes. This has presented a challenge for companies attempting to conform to the standards set by the MLSC, in addition to the statutory rules imposed on life science companies.

This article explains how a company today can qualify for the various Life Science credits, and maintain its certification by staying in conformance with the current policy of the MLSC.

<u>What is a Life Science Company?</u>

In order to simplify the process of determining what qualifies as a life science company, Massachusetts has defined the term "Life Sciences" as "advanced and applied sciences that expand the understanding of human physiology and have the potential to lead to medical advances or therapeutic applications"[1]. The statute also provides a list of examples of companies that would qualify, though it is important to note that this list only provides examples of companies that can qualify, and is by no means exhaustive. The credit is also available to entities regardless of whether it is a corporation, partnership, or unincorporated association, so long as they are involved in life science research, development, manufacturing, or commercialization in Massachusetts. [2]

However, simply because a company engages in the activities above does not make them a certified life science company. In order for a company to take advantage of any of the funding or tax incentives offered to life science companies, they must apply for certification through the Massachusetts Life Sciences Center Board (MLSC). Rather than receiving certification through the Department of Revenue, the MLSC board has the authority to certify companies through a majority vote, in conjunction with cost approval by the DOR.[3] The cost

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[1] (Ch. 62, Sec. 6(m)(1), G.L. Ch.63, Sec. 31M(a), G.L. ; Ch.63, Sec. 38U(a), G.L.)

[2] GENERAL LAWS OF THE COMMONWEALTH OF MASSACHUSETTS, 1932, CHAPTER 23I THE MASSACHUSETTS LIFE SCIENCES CENTER Sec. 2

[3] GENERAL LAWS OF THE COMMONWEALTH OF MASSACHUSETTS, 1932, CHAPTER 23I THE MASSACHUSETTS LIFE SCIENCES CENTER Sec. 5(d)

approval, or “tax cost”, is based on the Massachusetts Department of Revenue’s calculation of the amount of tax revenue the project is projected to make through the creation of jobs within the commonwealth. This is weighed against the negative impact created by providing the tax credit to the company. Therefore, the board is more likely to approve of profitable companies that provide high salaries to their employees, in relation to the credit they are applying for.

On the MLSC website, the board states that its primary focus in determining what companies will qualify for the program is the number of full time (35 hrs per week or more) jobs the company plans to either create, or move to the commonwealth. The MLSC also considers the company’s ability to meet employment projections, and retain said employees. However, the definition of what qualifies as a full time employee (FTE) has expanded significantly since the inception of the program. In 2011, FTEs only included permanent FTEs in the recipient’s Massachusetts Facilities. In the 2015 tax year, the MLSC included FTEs from subsidiaries in their calculation. Additionally, FTEs of parent companies could qualify when 75% or more of global consolidated annual revenue was derived from life sciences.

How to Apply For Certification

While details regarding the application can be found on the MLSC website, the requirements of the application are detailed in the statute. This certification must be filled out and signed by an individual expressly authorized to contract on behalf of the company applying. Section 5(b) of the statue requires the application to include the following information:

A. An estimate of the projected new state revenue the company expects to generate during the period they are seeking certification. This must include a plan detailing precise goals and objectives that the company will use to reach the revenue objectives, including for each tax year the company is seeking certification:
    1. An estimate of the number of permanent full time employees expected to be hired or retained, as well as the year they expect to hire or retain the employees.
    2. An estimate of the projected average salaries of the employees
    3. An estimate of projected taxable income under chapter 62 or 63 generated by the employees
    4. An estimate of the methods used to obtain new employees and pursue a diverse workforce
- Documentation of a loan agreement (if any) between the company and a bank under the small business capital access program (Section 57 of Chapter 23A)
- Documentation that the company has received approval for a certified project under the economic development incentive program, if appropriate.

The Economic Development Incentive Program is another job based tax program available to projects in Massachusetts. Due to the fact that many projects that will qualify for a life science tax credit will also qualify for this incentive, this credit is discussed in more detail in the incentives a company can qualify for section of this report.

- They are also subject to reports by the board, including findings by the center that the company has sufficient contacts in the state, and ability to generate resources for the commonwealth as well as the ability to create and meet employment projections.[4]

Before a company receives certification, the board must submit an estimate of the total tax cost (detailed above) of extending these benefits to the department of revenue. Certification of a company is subject to the approval of this estimate by the DOR. The maximum amount of credit permitted to be distributed to all companies in total per year is limited to 25 million dollars.[5] The vast majority of companies who qualified in 2015 received a tax credit of $15,000 per employee hired or relocated. However, the amount of credit awarded to companies has varied significantly on a year to year basis, so this number may not reflect the amount a company can expect to receive in later tax years.

Once a company is granted certification by the board, the company will have a valid certificate for five years. Retaining this certification will be subject to an annual review by the center. The company is required to issue a report detailing whether or not the company was able to meet the target figures detailed under section 5(b).[6] The board puts priority on emphasizing job creation. More information on their process is in the policy requirements section of this report.

The MLSC requires that the annual report is filed within 30 days of the end of each year, in each year after the company originally received their certification.[7]

Benefits a Certified Company Can Qualify For

- For IRC 167 property that meets 179(d) standards, there is a credit available equal to 10% of the investment cost of the property so long as it has a useful life of more than 4 years.[8]
- 100% of user fees necessary in the year where a life science company applies for approval of a drug by the FDA can be claimed as a credit. This is also the only credit that

[4] GENERAL LAWS OF THE COMMONWEALTH OF MASSACHUSETTS, 1932, CHAPTER 23I THE MASSACHUSETTS LIFE SCIENCES CENTER Sec. 5 (b)

[5] Sec. 5 (d)
[6] Sec. 5 (e)(1)
[7] MLSC Job Creation Tax Incentive Program Annual Report and Multiple Awards Policy (Page 3)

[8] Chapter 62 Section 6(m)(2)

allows for out of state expenses to be included in the credit, so long as they are required expenses for the certification of the drug.[9]

- Any life science company can also qualify for status as a research and development company for purposes of exemptions under Chapters 64H and 64I.[10]
- To the extent the board approves, purchase of tangible personal property that is used "in connection with the construction, alteration, remodeling, repair or remediation of research, development or manufacturing facilities and utility support systems" can be exempt from sales taxation.[11]
- The IRC typically allows companies to take a 50% credit for qualified clinical testing expenses a company generates throughout the year. However, IRC 280 typically disallows a company from taking a deduction that is equal to the credit available for the year. This rule allows a deduction equal to the amount of credit allowed under IRC section 45C.[12]
- This credit allows a deduction for 10% of qualified research expenses and 15% of basic research payments in excess of the base amount, as defined under IRC section 41 (R&D Credit).[13]
- This section offers a credit to companies who commit to creating at least 50 full time positions within the commonwealth.[14]

Carry forwards:

- To the extent approved by the board under the program, losses incurred by the life sciences company can be carried forward up to 15 years.[15]
- Unused life science credits can be carried forward up to 10 Years.[16]

<u>Refundable Credits:</u>

One of the valuable properties of these credits are their ability to be refunded rather than being carried forward. The following credits are refundable.

- 90% of unused life science credit can be refunded instead of being carried forward under Ch. 38 Sec. 38U(h)
- 90% of a FDA user fee credit, or
- 90% of a 38CC life science job credit

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[9] Chapter 63 Sec. 31M (b)
[10] Chapter 63 Sec. 42B(c)
[11] Chapter 64H Sec. 6 (xx)
[12] IRC 280(b), IRC 45C, Chapter 63 Section 38V
[13] Chapter 63 Sec. 38W
[14] Ch. 63 Section 38CC
[15] Chapter 63 Section 30.17
[16] Chapter 63 Section 38U (e)

Exclusivity Provisions and Alternative Options

For some of the credits and opportunities under this program, taking a credit will come at the cost of being unable to take advantage of another opportunity in the tax code. For example, if someone wished to take advantage of the 10% credit available on qualifying property, they would be unable to qualify for a low income housing credit or a Massachusetts investment tax credit on the same property.[17]

Economic Development Incentive Program Credit

This credit is outside the Mass Life Science tax incentives, but since they offer credits for very similar activities, the vast amount of overlap between the programs made the legislature dictate specific provisions for companies that wished to receive benefits under both programs.

The credit offered through this program is equal to 10% of the cost of qualifying property used for an expansion project, or a project designed to create at least 100 full time jobs. However, for a manufacturing retention project, the credit is equal to 40% of the cost of qualifying property. Additionally, there is a credit of $1,000 for each new hire under the job creation project, or 5,000 if the job was created in a gateway municipality. This $5,000 credit for new hires can also be utilized in areas where seasonally adjusted unemployment rate is higher than the average of the commonwealth.

If the property in question also qualifies for the life science tax credit, the EDIPC credit is limited to 2% of the cost of the property. If you are eligible for both credits, an analysis should be done on a property by property basis by your accountant to determine whether you should apply for one of the credits, or both.

MassTAG Program

If a company does not qualify for the credit due to a lack of existing contacts within the state, but still wishes to receive funding from the Massachusetts life science center and would otherwise qualify for certification, they should apply to the MassTAG program. The Transition and Growth Program is a non-tax based grant program through the MLSC that provides funding to organizations intending to hire or relocate between 10 and 49 full time employees during the company’s first 12 months in Massachusetts. Because it is not a tax based incentive, it is not

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[17] Chapter 63 Section 38U(b)

covered in as much detail as the other tax credits in this report, but applicants can expect to receive a similar level of funding to that they would receive under the tax incentive program run through the life science center. If a company intends to move or hire more than 49 employees in Massachusetts, they should apply for the tax credit instead of this option.

Policy Requirements to Qualify For Additional Awards

The MLSC makes it abundantly clear on its website that regardless of the tax award provided, they put the highest level of scrutiny on whether or not the life science company was able to meet its job creation targets set for the year.[18] Depending on how successful the company is in reaching their target projections, the company may either be eligible for additional tax incentives through the program, or they may have their certification revoked, and be subject to a return of some of the benefits they received. If a company does not reach 100% of its job projections for the year, they may still qualify for additional credits in future years. The MLSC has provided a very detailed table on its policy with regard to these circumstances, and can be viewed on their website.

Any company that has a material variance with regard to any employment or other commitments made within their proposal will be subject to review by the MLSC. If this occurs 2 years in a row Chapter 23I requires the company's certification to be revoked. The policy statements made on the board's website indicate that they include a 70% baseline for employment growth as a basis for deeming a company to be in material variance. The board chooses to focus on employment growth results primarily when determining if a company can qualify for extra incentives under the program as well. For companies that fail to reach this goal in one year, the MLSC will conduct an investigation to determine whether or not they should revoke the company's certification based primarily on the probability the company will meet target employment growth in future years.

Penalties of Revocation Ch. 23I Sec. 5 (e)

If a company has its certification as a life science company removed for not reaching target employment forecasts or otherwise having a material variance causing revocation, the company may have significant portions of its tax credit subject to recapture. Recapture calculations start from the first day of the taxable year in which the revocation occurs. A good example of these claw back provisions exists under chapter 63 section 38U, where property

[18] MLSC Job Creation Tax Incentive Program Annual Report and Multiple Awards Policy

that is no longer in qualified use will have its credit due as a tax to the extent the credit issued exceeds the amount that was allowed for actual use.

Disclaimer: The purpose of this article is to detail the general provisions of the tax code and policy for the Life Sciences tax program as of January, 2017. Please talk to your accountant for specific inquiries about how this credit would apply to your business or industry.