New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-M-99(2)C
Corporation Tax
March 15, 1999

Qualified Emerging Technology Company Tax Credits (Article 9-A Taxpayers Only)

On April 28, 1998, Governor George E. Pataki signed into law new legislation. This new legislation, in part, amended Article 9-A (Franchise Tax on Business Corporations) of the Tax Law to provide new tax credits to enhance emerging technology industries in New York State. For tax years beginning on or after January 1, 1999, two tax credits have been created: the Qualified Emerging Technology Company (QETC) Employment Credit and the Qualified Emerging Technology Company (QETC) Capital Tax Credit. The credits are available only to Article 9-A taxpayers (business corporations). Article 22 taxpayers, such as individuals, sole proprietors, partners in a partnership (including members of an LLC, if that LLC is treated as a partnership for federal tax purposes), or shareholders of a New York S corporation **cannot** claim these credits against the Article 22 personal income tax.

General Definitions

A *qualified emerging technology company* is, pursuant to section 3102-e of the Public Authorities Law (PAL), a company located in New York State that has total annual product sales of $10 million or less, and meets either of the following criteria:

(1) its primary products or services are classified as emerging technologies under section 3102-e(1)(b) of the PAL; or

(2) it has research and development activities in New York State and its ratio of research and development funds to net sales equals or exceeds the average ratio for all surveyed companies classified (as determined by the National Science Foundation (NSF) in the most recently published results from its Survey of Industry Research and Development, or a comparable successor survey as determined by the Tax Department).

There are two average ratios for all surveyed companies classified on the NSF's survey. One average ratio is for companies doing research and development funded by the federal government, and the other average ratio is for companies doing research and development without funding by the federal government. The average ratio for all surveyed companies classified is deemed to be the lesser of these ratios.

Currently, the average ratio is 3.5% (see Table A-17 of the advanced release of the NSF’s 1996 Survey of Industry Research and Development) for companies doing research and development funded by the Federal Government, and 3.0% (see Table A-18 of the advanced release of the NSF’s 1996 Survey of Industry Research and Development) for companies doing research and development without funding by the Federal Government. Single copies of the survey are available free of charge from the Division of Science Resources Studies, National Science Foundation, 4201 Wilson

Boulevard, Suite 965, Arlington, VA 22230. It is also available through their website (http://www.nsf.gov/sbe/srs/stats.htm).

Accordingly, the most recently published average ratio for all surveyed companies classified is determined to be 3.0%. Therefore, to qualify under item (2) above, a company must have a ratio of research and development funds to net sales of at least 3.0%.

A *company located in New York State* means a corporation, partnership or limited liability company, or any other entity that, during the taxable year that the credit is claimed, owns or rents real property used in its emerging technology primary products or services business, or in its research and development activities in New York State.

Emerging technologies under section 3102-e(1)(b) of the PAL means:

(1) advanced materials and processing technologies that involve the development, modification, or improvement of one or more materials or methods to produce devices and structures with improved performance characteristics or special functional attributes, or to activate, speed up, or otherwise alter chemical, biochemical, or medical processes. Such technologies shall include, but not be limited to, the following: metal alloys, metal matrix and ceramic composites, advanced polymers, thin films, membranes, superconductors, electronic and photonic materials, bioactive materials, bioprocessing, genetic engineering, catalysts, waste emissions reduction and waste processing technologies;

(2) engineering, production, and defense technologies that involve knowledge-based control systems and architectures, advanced fabrication and design processes, equipment, and tools, or propulsion, navigation, guidance, nautical, aeronautical and astronautical ground and airborne systems, instruments, and equipment. Such technologies shall include, but not be limited to, the following: computer-aided design and engineering, computer-integrated manufacturing, robotics and automated equipment, integrated circuit fabrication and test equipment, sensors, biosensors, signal and image processing, medical and scientific instruments, precision machining and forming, biological and genetic research equipment, environmental analysis, remediation, control, and prevention equipment, defense command and control equipment, avionics and controls, guided missile and space vehicle propulsion units, military aircraft, space vehicles, and surveillance, tracking, and defense warning systems;

(3) electronic and photonic devices and components for use in producing electronic, optoelectronic, mechanical equipment and products of electronic distribution with interactive media content. Such technologies shall include, but not be limited to, the following: microprocessors, logic chips, memory chips, lasers, printed circuit board technology, electroluminescent, liquid crystal, plasma, and vacuum fluorescent displays, optical fibers, magnetic and optical information storage, optical instruments, lenses, and filters, simplex and duplex data bases, and solar cells; and

(4) information and communication technologies, equipment and systems that involve advanced computer software and hardware, visualization technologies, and human interface technologies. Such technologies shall include, but not be limited to, the following: operating and applications software, artificial intelligence, computer modeling and simulation, high-level software languages, neural networks, processor architecture, animation and full-motion video, graphics hardware and software, speech and optical character recognition, high-volume information storage and retrieval, data compression, broadband switching, multiplexing, digital signal processing, and spectrum technologies.

Total annual product sales means the amount reported, or that should have been reported for federal income tax purposes, as gross receipts or sales from the sale of all products during the taxable year that the credit is claimed.

Net sales means total annual product sales less the amount reported, or that should have been reported for federal income tax purposes, as returns and allowances during the taxable year that the credit is claimed.

Primary products or services means that more than 50 percent of a taxpayer's receipts from products or services are derived from emerging technology products or services during the taxable year that the credit is claimed.

Research and development funds are the same as those used by the NSF in its most recent Survey of Industry Research and Development (see **Definitions from the Survey** below). These funds represent expenditures paid or incurred in the conduct of research and development activities during the taxable year that the credit is claimed.

Definitions from the Survey

The following definitions are from the NSF's 1996 Survey of Industry Research and Development:

Research and development activities include basic and applied research in the sciences and engineering, and the design and development of prototypes and processes, excluding quality control, routine product testing, market research, sales promotion, sales service, other nontechnological activities or routine technical services, and research in the social sciences or psychology. Activities to be **excluded** from research and development:

- Routine product testing
- Research in social sciences or psychology
- Geological and geophysical exploration activities
- Technical services such as:
    - Quality and quantity control

- Technical plant sanitation control
- Trouble-shooting in connection with breakdowns in full-scale production
- Advertising programs to promote or demonstrate new products or processes
- Assistance in preparation of speeches and publications for persons not engaged in research and development.

- Social Science research and development is **excluded**. Social Science research and development is defined to encompass those activities devoted to further understanding the behavior of groups of human beings or of individuals as members of groups. Some of the topics include the following:
  - Personal research and development
  - Economic research and development
  - Artificial intelligence and expert systems research and development
  - Consumer, market, and opinion research and development
  - Engineering psychology research and development
  - Management and organizational research and development
  - Actuarial and demographic research and development
  - Educational processes and applications research and development
  - Research and development in law.

Basic research means original investigations for the advancement of scientific knowledge not having specific immediate commercial objectives.

Applied research means investigations for the discovery of new scientific knowledge having specific commercial objectives with respect to products or processes.

Development means technical activities not routine in nature concerned with translating research findings or other scientific knowledge into products or processes.

Include as development:

- The design and operation of pilot plants and semiwork plants
- Engineering activity required to advance the design of a product or process so it meets specific functional and economic requirements
- Design, construction, and testing of prototypes and models
- Design for special manufacturing equipment and tools
- Preparation of reports, drawings, formulas, specifications, standard practice instructions, or operating manuals
- Software development.

Exclude as development:

- Routing technical services to customers
- Toolmaking and tool tryout
- Production of detailed construction drawings and manufacturing blueprints
- Pre-production planning.

QETC Employment Credit (Tax Law §210.12-E)

The QETC employment credit is designed to encourage the creation of jobs in emerging technology companies. This credit is effective for taxable years beginning on or after January 1, 1999. The credit can be claimed for three consecutive years.

Who is Eligible

A taxpayer must be a qualified emerging technology company, pursuant to section 3102-e of the PAL, and subject to tax under Article 9-A of the Tax Law. In addition, the average number of individuals employed full-time by the taxpayer in New York State during the taxable year must be at least 101% of the taxpayer's base year employment.

Definitions

Base year employment means the average number of individuals employed full-time by the taxpayer in the state during the three taxable years immediately preceding the first taxable year in which the credit is claimed. The base year employment, once computed, remains the same for each of the two subsequent tax years for which the credit is claimed. If the taxpayer provided full-time employment in the state for only part of the three taxable years immediately preceding the first taxable year in which the credit is claimed, then the base year employment will be computed using that part.

The average number of individuals (including general executive officers) employed full-time is computed by adding the number of such individuals employed by the taxpayer at the end of each quarter during each taxable year and dividing the sum by the number of such quarters occurring within such taxable year. However, in computing base year employment only, the taxpayer must exclude any employee for whom an economic development zone (EDZ) or zone equivalent area (ZEA) wage credit is claimed for the taxable year.

Full-time employment means a job consisting of at least 35 hours per week, or two or more jobs that together constitute the equivalent of a job of at least 35 hours per week. A seasonal job that meets these requirements constitutes full-time employment if the job is continuous for at least three months.

Amount of Credit

The amount of the credit is equal to:

(1) the average number of individuals (including general executive officers) employed full-time by the taxpayer in New York State for the current taxable year, minus

(2) the taxpayer's base year employment, multiplied by

(3) $1,000.

Application, Carryover, and Refund of Credit

Application

The credit is available for three consecutive tax years selected by the taxpayer and can be claimed for each of the three years that the credit eligibility requirements are met. However, if the taxpayer has provided full-time employment in the state for only part of the three-year base period, the credit cannot first be claimed until the tax year following the first full taxable year (a period of at least 12 calendar months) the taxpayer had some full-time employment in the state. The credit and carryover of the credit deducted for the tax year cannot reduce the tax to an amount less than the tax due on the minimum taxable income base or the fixed dollar minimum, whichever is higher. In addition, the credit is not allowed against the metropolitan transportation business tax surcharge (MTA surcharge) under Article 9-A.

Carryover

Any amount of the credit not deductible in the current tax year may be carried over for an unlimited number of taxable years.

Refund of Credit

In lieu of a carryover, a taxpayer that qualifies as a new QETC business may elect on its return to have the carryover refunded. The Tax Law does not allow for the payment of interest on the refund.

A *new QETC business* shall include any corporation, except a corporation which:

(1) over 50% of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned or controlled, either directly or indirectly, by a taxpayer subject to tax under Article 9-A; Article 9, sections 183, 184, 185, or 186; Article 32 or 33;

(2) is substantially similar in operation and in ownership to a business entity (or entities) taxable, or previously taxable, under Article 9-A; Article 9, sections 183, 184, 185, or 186; Article 32 or 33; Article 23 or which would have been subject to tax under such Article 23 (as such article was in effect on January 1, 1980) or the income (or losses) of which is (or was) includable under Article 22;

(3) has been subject to tax under Article 9-A for more than six taxable years (excluding short taxable years) prior to the taxable year in which the taxpayer first becomes eligible for the credit; or

(4) has been subject to tax under Article 9-A for more than eight taxable years (excluding short taxable years) if such taxpayer's primary business or product requires federal regulatory approval or involves the discovery and sale of substances requiring clinical trials as part of the U.S. Food and Drug Administration's required approval process for the use of such substances by humans.

(See: Tax Law, sections 210.12-E and 209-B(4); Public Authorities Law, section 3102-e.)

Example

Taxpayer A, a calendar year taxpayer, became subject to tax under Article 9-A of the Tax Law, on September 1, 1997. Taxpayer A is claiming the QETC employment credit for the calendar year 1999. During calendar year 1999, Taxpayer A conducted research and development activities in New York State, paid or incurred expenditures of $100,000 for those activities, and had net sales of $3,225,000. Its total annual product sales were $3,300,000. The most recently published average ratio of research and development funds to net sales published in the NSF's most recent survey for all surveyed companies classified is 3.0%. This ratio is the lesser of the average ratio for all surveyed companies classified both with and without federal funding.

For calendar year 1999, Taxpayer A's records show the following number of individuals employed full-time in New York State at the end of each quarter:

Employment in Current Taxable Year 1999					
Calendar Year 1999	Quarter 3/31	Quarter 6/30	Quarter 9/30	Quarter 12/31	TOTAL
Number of Full-time Employees in New York State	20	25	50	25	120

The average number of individuals employed full-time in New York State for the calendar year 1999 is 30 (the total number of employees divided by the total number of quarters occurring within the taxable year (120÷4)).

Taxpayer A's records show the following number of individuals employed full-time in New York State at the end of each quarter for the base year employment period (the three taxable years immediately preceding calendar year 1999):

Number of Employees in New York State for Three-Year Base Period					
Base Period Years	Quarter 3/31	Quarter 6/30	Quarter 9/30	Quarter 12/31	TOTAL
Number in 1st Preceding Year (1998)	15	15	15	20	65
Number in 2nd Preceding Year (1997)			10	15	25
Number in 3rd Preceding Year (1996)					

The average number of individuals employed full-time in New York State for the base year employment period is 15 (the total number of employees for the employment period divided by the total number of quarters occurring within that part of the employment period for which the taxpayer provided full-time employment (65+25=90÷6)).

Taxpayer A does not have products or services classified as emerging technologies. However, the taxpayer meets all of the eligibility requirements as explained in the following questions and answers and may claim the QETC employment credit:

Question 1: Is the taxpayer a company located in New York State that has research and development activities in New York State? *Answer:* Yes.

Question 2: Is the amount of total product sales for the current tax year $10,000,000 or less? *Answer:* Yes, product sales for calendar year 1999 totaled $3,300,000.

Question 3: Does the ratio of research and development funds to net sales for the current tax year equal or exceed the NSF's average ratio? *Answer:* Yes. Taxpayer A's ratio of research and development funds to net sales is 3.1% ($100,000÷$3,225,000), which exceeds the NSF's average ratio of 3.0%.

Question 4: Is there a full taxable year in which the taxpayer had some full-time employment, preceding the current tax year? *Answer:* Yes, Taxpayer A was subject to tax for the full calendar year 1998 and had some full-time employment during that year.

Question 5: Is the average number of full-time employees in New York State for the current tax year at least 101% of the taxpayer's base year employment? *Answer:* Yes, it is 200% (the average for the calendar 1999 (30) divided by the average for the base year employment period (15)).

The QETC employment credit is computed as follows:

Average number of individuals employed full-time in New York State for the calendar year 1999	30
Minus: average number of individuals employed full-time in New York State for the base year employment period	- 15
Number of individuals employed full-time in New York State eligible for the credit	15
Tax credit per full-time employee	x $1,000
QETC employment credit allowable for calendar year 1999	$15,000

QETC Capital Tax Credit (Tax Law §210.12-F)

The QETC capital tax credit is designed to encourage investment in emerging technology companies. This credit is effective for taxable years beginning on or after January 1, 1999.

Who is Eligible

A taxpayer subject to tax under Article 9-A of the Tax Law that makes a qualified investment in a certified qualified emerging technology company.

Definitions

Qualified investment means:

- the contribution of property to a corporation in exchange for original issue capital stock or other ownership interest;
- the contribution of property to a partnership in exchange for an interest in the partnership; and
- similar contributions to a business entity not in corporate or partnership form in exchange for an ownership interest in the entity.

Qualified investments **do not include** investments made by or on behalf of an owner of the qualified emerging technology company, including, but not limited to, a stockholder, partner, sole proprietor or any related person (as defined in section 465(b)(3)(C) of the Internal Revenue Code).

An *owner of the qualified emerging technology company* means an entity that owns more than a 10% interest in a qualified emerging technology company.

A *certified qualified emerging technology company* means a qualified emerging technology company (see page 1) that is certified by the Commissioner of Taxation and Finance.

Amount of Credit

The QETC capital tax credit is computed on each qualified investment made during the taxable year in a certified qualified emerging technology company and is equal to the sum of:

(1) 10% of qualified investments in certified qualified emerging technology companies, if the taxpayer certifies to the Commissioner of Taxation and Finance at the time the credit is claimed that the qualified investment will not be sold, transferred, traded, or disposed of within four years from the close of the tax year in which the QETC capital tax credit is first claimed; and

(2) 20% of qualified investments in certified qualified emerging technology companies, if the taxpayer certifies to the Commissioner of Taxation and Finance at the time the credit is claimed that the qualified investment will not be sold, transferred, traded, or disposed of within nine years from the close of the tax year in which the QETC capital tax credit is first claimed.

The total amount of credit allowable to a taxpayer for all years may not exceed $150,000 for a credit at the rate of 10% of qualified investments, and $300,000 for a credit at the rate of 20% of qualified investments.

Application, Carryover, and Refund of Credit

Application
Section 210.12-F imposes the following limitations on the QETC capital tax credit:

- the credit and carryover of the credit deducted for the tax year cannot exceed 50% of the tax imposed (not including the MTA surcharge), before the deduction of any tax credit; and

- the credit and carryover of the credit deducted for the tax year cannot reduce the tax to an amount less than the tax due on the minimum taxable income base or the fixed dollar minimum, whichever is higher.

In addition, the credit is not allowed against the MTA surcharge under Article 9-A.

Carryover
Any amount of the credit not deductible in the current tax year may be carried over for an unlimited number of taxable years.

Refund of Credit
The QETC capital tax credit is not refundable.

Recapture of Credit

If a taxpayer sells, transfers or otherwise disposes of corporate stock, a partnership interest or other ownership interest arising from the making of a qualified investment, or if an investment is recovered by the taxpayer that was the basis for the allowance of the QETC capital tax credit, and the disposal or recovery occurs during the tax year or within 48 months (for a credit at the rate of 10% of qualified investments) or 108 months (for a credit at the rate of 20% of qualified investments) from the close of the tax year when the credit was allowed, the taxpayer must add back to the tax in the taxable year of the disposition or recovery, the required portion of the credit originally allowed.

The portion of the credit originally allowed that is required to be added back is the portion of the credit attributable to the property disposed of or the payment recovered, multiplied by the following percentages:

If a credit at the rate of 10% of qualified investments was originally allowed:

- 100%, if the disposition or recovery occurs within the tax year in which the credit was allowed, or within 12 months of the end of that tax year;

- 75%, if the disposition or recovery occurs more than 12 months, but not more than 24 months, after the end of the tax year in which the credit was allowed;

- 50%, if the disposition or recovery occurs more than 24 months, but not more than 36 months, after the end of the tax year in which the credit was allowed; or

- 25%, if the disposition or recovery occurs more than 36 months, but not more than 48 months, after the end of the tax year in which the credit was allowed.

If a credit at the rate of 20% of qualified investments was originally allowed:

- 100%, if the disposition or recovery occurs within the tax year in which the credit was allowed, or within 12 months of the end of that tax year;

- 80%, if the disposition or recovery occurs more than 12 months, but not more than 48 months, after the end of the tax year in which the credit was allowed;

- 60%, if the disposition or recovery occurs more than 48 months, but not more than 72 months, after the end of the tax year in which the credit was allowed;

- 40%, if the disposition or recovery occurs more than 72 months, but not more than 96 months, after the end of the tax year in which the credit was allowed; or

- 20%, if the disposition or recovery occurs more than 96 months, but not more than 108 months, after the end of the tax year in which the credit was allowed.

(See: Tax Law, sections 210.12-F and 209-B(4); Public Authorities Law, section 3102-e.)

Example 1:

On January 1, 1999, Taxpayer A, a calendar year taxpayer, purchased 20,000 shares of common stock for $10 a share and 50,000 shares of preferred stock for $32 a share from the Oz Corporation, a corporation certified as a qualified emerging technology company. At the time this investment is made, Taxpayer A does not own more than 10% of Oz Corporation; accordingly, the investment in Oz is a qualified investment. The taxpayer certifies that the common stock will be held for four years and the preferred stock for nine years. For calendar year 1999, Taxpayer A's tax due, computed on the entire net income base, is $90,000 before the deduction of any credits and before the addition of the MTA surcharge. In addition, Taxpayer A's tax on the minimum taxable income base is $50,000.

The computation of the QETC capital tax credit and the recapture of the credit is computed as follows:

Computation of credit for qualified investments to be held four years-

Amount of qualified investments in certified QETC's (20,000 shares x $10)	$200,000	
Credit rate	10%	
Credit amount ($200,000 x 10%)		$ 20,000

Computation of credit for qualified investments to be held nine years-

Amount of qualified investments in certified QETC's (50,000 shares x $32)	$1,600,000	
Credit rate	20%	

Credit amount ($1,600,000 x 20%, limited to $300,000*)		$300,000
Total credit computed for calendar year 1999 ($20,000 + $300,000)		$320,000
Tax limitations-		
(a) 50% limitation ($90,000 x 50%)	$45,000	
(b) Tax on the minimum taxable income base or the fixed dollar minimum tax, whichever is larger, limitation ($90,000 - $50,000)	$40,000	
Credit allowed after limitation (enter limitation (a) or (b), whichever is less)		$ 40,000
Credit available as carry forward ($320,000 - $40,000)		$280,000

*The credit amount for qualified investments to be held nine years was limited, as the total amount of credit allowable for those investments for all years may not exceed $300,000.

Example 2:

Assume the same facts as in *Example 1*, and that for calendar year 2000, Taxpayer A claimed no additional tax credits. Taxpayer A has a $280,000 QETC capital tax credit carryover from calendar year 1999. On June 30, 2000, the taxpayer sold 10,000 shares of the Oz Corporation preferred stock. The recapture of the credit is computed as follows:

Credit available as carry forward ($320,000 - $40,000)	$280,000
Recapture of credit ($60,000** x 80%***)	$ 48,000
Credit available as carry forward after recapture	$232,000

**The recapture of credit was computed as follows:

Original credit		$300,000
Property disposed of	10,000 shares	
Property for which the credit was originally allowed	50,000 shares	
Disposal rate (10,000 shares/50,000 shares)		20%
Portion of the credit attributable to the property disposed of		$ 60,000

***Taxpayer A recaptured 80% of the portion of the credit attributable to the property disposed of, as the disposition occurred more than 12 months, but not more than 48 months, after the end of the tax year in which the credit was allowed.