

THE GENERAL ASSEMBLY OF PENNSYLVANIA

HOUSE BILL

No. 2378 Session of  
1996

INTRODUCED BY BROWNE, NAILOR, BELARDI, HERMAN, EGOLF,  
M. N. WRIGHT, PISTELLA, TIGUE, L. I. COHEN, GEIST, DENT,  
MELIO, SCHRODER, E. Z. TAYLOR, YOUNGBLOOD, TULLI, J. TAYLOR  
AND TRELLO, FEBRUARY 6, 1996

REFERRED TO COMMITTEE ON FINANCE, FEBRUARY 6, 1996

AN ACT

1 Amending the act of March 4, 1971 (P.L.6, No.2), entitled "An  
2 act relating to tax reform and State taxation by codifying  
3 and enumerating certain subjects of taxation and imposing  
4 taxes thereon; providing procedures for the payment,  
5 collection, administration and enforcement thereof; providing  
6 for tax credits in certain cases; conferring powers and  
7 imposing duties upon the Department of Revenue, certain  
8 employers, fiduciaries, individuals, persons, corporations  
9 and other entities; prescribing crimes, offenses and  
10 penalties," providing for a research and orphan drug tax  
11 credit.

12 The General Assembly of the Commonwealth of Pennsylvania  
13 hereby enacts as follows:

14 Section 1. The act of March 4, 1971 (P.L.6, No.2), known as  
15 the Tax Reform Code of 1971, is amended by adding an article to  
16 read:

ARTICLE XVII-B

RESEARCH TAX AND ORPHAN DRUG CREDITS

19 Section 1701-B. Short Title.--This article shall be known  
20 and may be cited as the Pennsylvania Research Tax and Orphan  
21 Drug Credit Law.

1     Section 1702-B. Definitions.--The following words and  
2 phrases, when used in this article shall have the meanings  
3 ascribed to them in this section, except where the context  
4 clearly indicates a different meaning:

5     "Base period." The three consecutive taxable-year period  
6 ending with the taxable year immediately preceding the last  
7 taxable year beginning after December 31, 1994.

8     "Basic research." Any original investigation for the  
9 advancement of scientific knowledge not having a specific  
10 commercial objective.

11     "Clinical testing." Any human clinical testing which meets  
12 all of the following criteria:

13     (1) Testing which is carried out under an exemption for a  
14 drug being tested for a rare disease or condition under section  
15 505(I) of the Federal Food, Drug, and Cosmetic Act(52 Stat.  
16 1040, 21 U.S.C. § 301 et seq.) or any regulations promulgated  
17 thereunder.

18     (2) Testing which occurs:

19     (i) after the date such drug is designated under section 526  
20 of the Federal Food, Drug, and Cosmetic Act (52 Stat. 1040, 21  
21 U.S.C. § 301 et seq.);

22     (ii) before the date on which an application with respect to  
23 such drug is approved under section 505(b) or 507 of the Federal  
24 Food, Drug, and Cosmetic Act (52 Stat. 1040, 21 U.S.C. § 301 et  
25 seq.) or, if the drug is a biological product, before the date  
26 on which a license for that drug is issued under section 351 of  
27 the Public Health Service Act (58 Stat. 682, 42 U.S.C. § 201 et  
28 seq.); and

29     (iii) which is conducted by or on behalf of the taxpayer to  
30 whom the designation under section 526 of the Federal Food,

1 Drug, and Cosmetic Act (52 Stat. 1040, 21 U.S.C. § 301 et seq.)  
2 applies.

3 "Contract clinical testing expenses." One hundred per cent  
4 of any amount paid or incurred by the taxpayer to any person,  
5 other than an employe of the taxpayer, for qualified clinical  
6 testing. If any contract clinical testing expenses paid or  
7 incurred during any taxable year are attributable to qualified  
8 clinical testing conducted after the close of the taxable year,  
9 the amount so determined shall be treated as paid or incurred  
10 during the tax year in which the qualified clinical testing is  
11 conducted.

12 "Contract research expenses." Sixty-five per cent of any  
13 amount paid or incurred by the taxpayer to any person, other  
14 than an employe of the taxpayer, for qualified research. If any  
15 contract research expenses paid or incurred during any taxable  
16 year are attributable to qualified research conducted after the  
17 close of the taxable year, the amount so determined shall be  
18 treated as paid or incurred during the tax year in which the  
19 qualified research is conducted.

20 "Credit." The research tax credit made available under the  
21 provisions of this article.

22 "In-house clinical testing expenses." Any one of the  
23 following:

24 (1) Any wages paid or incurred to any employe for qualified  
25 services performed by that employe.

26 (2) Any amount paid or incurred for supplies used in the  
27 conduct of qualified clinical testing.

28 (3) Subject to regulations of the department, any amount  
29 paid or incurred to another person for the right to use  
30 computers in the conduct of qualified clinical testing, except

1 that this clause shall not apply to any amount to the extent  
2 that the taxpayer receives or accrues any amount from any other  
3 person for the right to use substantially identical personal  
4 property.

5 "In-house research expenses." Any one of the following:

6 (1) Any wages paid or incurred to any employe for qualified  
7 services performed by that employe.

8 (2) Any amount paid or incurred for supplies used in the  
9 conduct of qualified research.

10 (3) Subject to regulations of the department, any amount  
11 paid or incurred to another person for the right to use  
12 computers in the conduct of qualified research, except that this  
13 clause shall not apply to any amount to the extent that the  
14 taxpayer receives or accrues any amount from any other person  
15 for the right to use substantially identical personal property.

16 "Internal Revenue Code." The Internal Revenue Code of 1986  
17 (Public Law 99-514, 26 U.S.C. § 1 et seq.).

18 "Qualified clinical testing expenses." The sum of the in-  
19 house clinical testing expenses and the contract clinical  
20 testing expenses which are paid or incurred by the taxpayer  
21 during the taxable year for which the orphan drug credit is  
22 claimed.

23 "Qualified research expenses." The sum of the in-house  
24 research expenses and the contract research expenses which are  
25 paid or incurred by the taxpayer during the taxable year for  
26 which the research credit is claimed.

27 "Qualified services." Services consisting of engaging in  
28 qualified research, or engaging in the direct supervision or  
29 direct support of research activities which constitute qualified  
30 research.

1     "Supplies." Any tangible property, other land or improvement  
2     to land and any property of a character subject to depreciation.

3     "Wages." Compensation as defined in section 301.

4     Section 1703-B. Research Tax Credit.--(a) Any taxpayer  
5     subject to Articles IV, VI or XI shall be eligible for and may  
6     claim a research tax credit or orphan drug credit as provided in  
7     this article.

8     (b) (1) Subject to the overall limitation set forth in  
9     clause (2), the amount of the research tax credit under this  
10    article for any taxable year shall be equal to the sum of:

11    (i) five per cent of the excess, if any, of the qualified  
12    research expenses for the taxable over the base amount; plus

13    (ii) five per cent of the basic research payments determined  
14    under section 1707-B; plus

15    (iii) five per cent of the applicable percentage of qualified  
16    research and development property; plus

17    (iv) ten per cent of the applicable percentage of qualified  
18    wages paid to jobs created in research and development  
19    activities.

20    (2) The amount of the research tax credit under this article  
21    for any taxable year shall not exceed fifty per cent of the tax  
22    liability for that taxpayer in that tax year.

23    (3) The amount of any research tax credit otherwise  
24    allowable which cannot be taken because of the limitation under  
25    clause (2) may be carried forward to the next three succeeding  
26    tax years.

27    Section 1704-B. Orphan Drug Credit.--(a) There shall be  
28    allowed as a credit against tax imposed by Article IV, VI or IX  
29    for the taxable year an amount equal to 50 per cent of the  
30    qualified clinical testing expenses for the taxable year.

1     (b) The term "qualified clinical testing expenses" shall not  
2 include any amount to the extent such amount is funded by any  
3 grant, contract or otherwise by another person or any other  
4 governmental entity.

5     (c) Human clinical testing shall be taken into account under  
6 subsection (a) only to the extent such testing is related to the  
7 use of a drug for the rare disease or conditions for which it  
8 was designated under section 526 of the Federal Food, Drug, and  
9 Cosmetic Act (52 Stat. 1040, 21 U.S.C. § 301 et seq.).

10    (d) For purposes of this section, the term "rare disease or  
11 condition" means any disease or condition which:

12    (1) affects less than 200,000 persons in the United States;  
13 or

14    (2) affects more than 200,000 persons in the United States  
15 but which there is no reasonable expectation that the cost of  
16 developing and making available a drug for such disease or  
17 condition will be recovered from the worldwide sales of such a  
18 drug.

19 Determinations under the preceding sentence with respect to any  
20 drug shall be made on the basis of the facts and circumstances  
21 as of the date such drug is designated under section 526 of the  
22 Federal Food, Drug, and Cosmetic Act.

23    (e) No credit shall be allowed under this section with  
24 respect to any clinical testing conducted outside this  
25 Commonwealth.

26    (f) This section shall apply to any taxpayer for any taxable  
27 year only if such taxpayer elects to have this section apply for  
28 such taxable year in place of either section 1703-B(b)(1)(i) or  
29 section 1703-B(b)(1)(ii).

30    Section 1705-B. Base Amount.--(a) (1) The base amount is

equivalent to the product of the fixed-base percentage and the average annual gross receipts of the taxpayer for the four consecutive taxable years immediately preceding the tax year for which the research tax credit is claimed.

(2) In no event shall the base amount less than fifty per cent of the qualified research expenses for the taxable year for which the credit is claimed.

(b) (1) Except as otherwise provided in this subsection, the fixed-base percentage is the percentage which the aggregate research expenses of the taxpayer for the four consecutive taxable years immediately preceding the tax year for which the credit is claimed is to the aggregate gross receipts of the taxpayer for such four consecutive taxable years.

(2) The fixed-base percentage for a taxpayer who has less than four consecutive taxable years shall be determined in the same manner as set forth in clause (1) using the number of immediately preceding taxable years to arrive at the percentage.

(3) In no event shall the fixed-base percentage exceed sixteen per cent.

(c) For purposes of this section, gross receipts for any taxable year shall:

(i) be reduced by returns and allowances made during the taxable year; and

(ii) shall only consist of gross receipts which are effectively connected with the conduct of a trade or business within this Commonwealth.

Section 1706-B. Qualified Research.--(a) Qualified research is research which complies with all of the following criteria:

(1) Expenditures on the research may be treated as expenses under section 175 of the Internal Revenue Code.

1     (2) Research is undertaken for the purpose of discovering  
2 information which is technological in nature and the application  
3 of which information is intended to be useful in the development  
4 of a new or improved business component for the taxpayer.

5     (3) Substantially all of the activities constitute elements  
6 of a process of experimentation for a purpose described in  
7 subsection (b) of this section.

8     (b) (1) Research may qualify for a credit under this  
9 article if that research relates to any of the following:

10     (i) A new or improved function.

11     (ii) Performance.

12     (iii) Reliability or quality.

13     (2) A tax credit under this article shall not be allowed for  
14 any of the following types of research:

15     (i) Any research conducted after the beginning of commercial  
16 production of the business component.

17     (ii) Any research related to the adaptation of an existing  
18 business component to a particular customer's need.

19     (iii) Any research related to the reproduction of an  
20 existing business component from a physical examination of the  
21 business component itself or from plans, blueprints, detailed  
22 specifications or publicly available information with respect to  
23 the business component.

24     (iv) Any efficiency survey; activity related to management  
25 function or technique; market research, testing or development;  
26 routine data collection; or routine or ordinary testing or  
27 inspection for quality control.

28     (v) Any research with respect to computer software which is  
29 developed by or for the benefit of the taxpayer, other than  
30 computer software for use in an activity which constitutes



1 qualified research, or a production process which meets the  
2 requirements of subsection (a) of this section.

3 (vi) Any research conducted outside the Commonwealth. If the  
4 taxpayer has research within and without Pennsylvania and cannot  
5 determine the amount of Pennsylvania qualified research expenses  
6 for the period beginning after December 31, 1991, and before  
7 January 1, 1995, the amount to be used in the numerator for the  
8 fixed based percentage should be qualified research and  
9 development expenditures everywhere for the period multiplied by  
10 the average of the payroll and property factors used on the  
11 corporation's Corporate Tax Report for the Corporate Net Income  
12 Tax imposed under Article IV of this act for the corresponding  
13 years in question.

14 (vii) Any research in the social sciences, arts or the  
15 humanities.

16 (viii) Any research to the extent funded by a grant,  
17 contract or otherwise by another person or governmental entity.

18 Section 1707-B. Basic Research Payments.--(a) For purposes  
19 of section 1703-B of this article, the amount of any basic  
20 research payments shall be equal to the excess of such basic  
21 research payments over the qualified organization base period  
22 amount. The portion of the basic research payment which does not  
23 exceed the qualified organization base period amount shall be  
24 treated as contract research expenses.

25 (b) As used in this section, the term "basic research  
26 payment" means any amount paid in cash during the tax year for  
27 which credit is claimed by the taxpayer to a qualified  
28 organization for basic research if such payment is made under  
29 written agreement between that taxpayer and the qualified  
30 organization and the basic research is to be performed by that

1 qualified organization.

2 (c) (1) The qualified organization base period amount is an  
3 amount equal to the sum of the minimum basic research amount  
4 plus the maintenance-of-effort amount.

5 (2) Minimum basic research amount is an amount equal to the  
6 greater of:

7 (i) one per cent of the average of the sum of amount paid or  
8 incurred during the base period for in-house research expenses  
9 and any contract research expenses; or

10 (ii) the amounts treated as contract expenses during the  
11 base period by reason of subsection (a) of this section. The  
12 minimum basic research amount for any base period shall not be  
13 less than fifty per cent of the basic research payments for the  
14 tax year for which credit is claimed.

15 (3) Maintenance-of-effort amount is an amount equal to the  
16 excess, if any, of an amount equal to the average of the  
17 nondesignated higher education contributions paid by the  
18 taxpayer during the base period multiplied by the cost-of-living  
19 adjustment for the calendar year in which the tax year begins  
20 over the amount of nondesignated higher education contributions  
21 paid by the taxpayer during the tax year for which credit is  
22 claimed.

23 (4) Nondesignated higher education contribution is any  
24 amount paid by a taxpayer to a qualified institution of higher  
25 education for which a deduction is allowable under section 170  
26 of the Internal Revenue Code and which amount was not used to  
27 compute a credit under this article or as a basic research  
28 payment for purposes of this article.

29 (5) Cost-of-living adjustment for any calendar year is the  
30 cost-of-living adjustment for such calendar year calculated

1 under section 1(f)(3) of the Internal Revenue Code.

2 Section 1708-B. Qualified research and development  
3 property.--(a) The cost of land and depreciable property  
4 purchased for the conduct of research and development which is  
5 placed in service or used in this Commonwealth during the  
6 taxable year shall be the base from which the qualified research  
7 and development property factor is calculated.

8 (b) (1) For the purpose of subsection (a), the applicable  
9 percentage for land and depreciable property shall be determined  
10 under the following table:

<u>If useful life is:</u>	<u>The applicable percentage is:</u>
<u>Less than 6 years</u>	<u>33 1/3%</u>
<u>6 years or more but</u>	
<u>less than 8 years</u>	<u>66 2/3%</u>
<u>8 years or more</u>	<u>100%</u>

16 (2) The useful life of any property for purposes of this  
17 section shall be determined as of the date such property is  
18 first placed in service or use in this Commonwealth by the  
19 taxpayer.

20 (c) For purposes of subsection (a), the cost of each  
21 property purchased for the conduct of research and development  
22 shall be determined under the following rules:

23 (1) Cost shall not include the value of property given in  
24 trade or exchange for the property purchased for the conduct of  
25 research and development.

26 (2) For property damaged or destroyed by fire, flood, storm  
27 or other casualty, or stolen, the cost of replacement property  
28 shall not include any insurance proceeds received in  
29 compensation for the loss.

30 (3) The cost of property acquired by lease for a term of ten

1 years or longer shall be one hundred per cent of the rent  
2 reserved for the primary term of the lease, not to exceed twenty  
3 years.

4 (4) The cost of property purchased for multiple business use  
5 including direct use in the conduct of research and development,  
6 together with some other business or activity not eligible under  
7 this section, shall be apportioned between such activities. The  
8 amount apportioned to the conduct of research and development  
9 shall be considered to be eligible investment subject to the  
10 conditions and limitations of this section.

11 (5) In the case of self-constructed property, the cost  
12 thereof shall be the amount properly charged to the capital  
13 account for depreciation in accordance with the provisions of  
14 the Internal Revenue Code.

15 Section 1709-B. Applicable Percentage of Qualified Research  
16 and Development Wages.--(a) (1) For purposes of section 1703-  
17 B, the applicable percentage of qualified research and  
18 development wages for the taxable year shall be equal to the  
19 following:

20 (i) Forty per cent of the qualified first year wages for  
21 such year.

22 (ii) Twenty per cent of the qualified second year wages for  
23 such year.

24 (iii) Twenty per cent of the qualified third year wages for  
25 such year.

26 (iv) Twenty per cent of the qualified fourth year wages for  
27 such year.

28 (2) (i) The amount of qualified first, second, third or  
29 fourth year wages, which may be taken into account with respect  
30 to any individual, shall be the amount of wages which exceed the

1 base amount wages of ten thousand dollars (\$10,000).

2 (ii) The base amount wages will be adjusted on an annual  
3 basis by the Secretary of Revenue to account for any increase or  
4 decrease in the consumer price index (CPI) in the previous  
5 calendar year.

6 (b) As used in this section, the following words and phrases  
7 shall have the meanings given to them in this subsection:

8 "Qualified wages." The wages paid or incurred by the  
9 employer during the taxable year to individuals who are employed  
10 in research development activities.

11 "Yearly wages." The qualified wages attributable to service  
12 rendered during a yearly period beginning with the day the  
13 individual begins work with the employer.

14 Section 2. This act shall take effect January 1, 1997.