



State of Oklahoma

Incentive Evaluation Commission

Technology Transfer Income Tax Exemption Draft Evaluation

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Key Findings and Recommendations



Overview

The Technology Transfer Income Tax Exemption was created in 1987. For tax years starting on or after January 1, 1988, it allows corporations to exempt from income 10 percent of gross proceeds from the transfer of technology to an Oklahoma small business for 10 years. While not specified in statute, the goals of the program are likely to provide support for the transfer of technology to Oklahoma small businesses that do not have the resources to produce technology that may provide operational efficiencies or provide innovative products to the market.

Overall Recommendation: Reconfigure the program to capture data that would provide a basis for a rigorous cost benefit analysis.

Key Findings Related to Evaluation for Criteria

- **The Oklahoma Tax Commission (OTC) is unable to provide data on the use of the exemption.** Corporate tax exemptions are claimed through Form 512, as part of the calculation of Oklahoma taxable income for corporate income tax returns. The OTC collects this information through a “Miscellaneous Other” exemptions form box – the Technology Transfer program represents one of five possible exemptions that can be listed in that space. When combined with the practice of reporting only in the aggregate the level of corporate income tax exemptions taken, it is not currently possible to know the true cost of this program.
- **Despite many other states having similar goals, Oklahoma is the only example of this particular strategy to incentivize the relevant activities.** In Arkansas, the state offers grant funding to reduce technology transfer costs for businesses. Other states supplement federal programs, including the Small Business Technology Transfer (SBTT) program, by offering technical training, funding to complete the SBTT application process, or matching grants for federal funds received.

Recommendations

The Evaluators have considered the current period as well as previous rounds of evaluation and determined there are several approaches to reconfigure the program.

- **Enhance data collection through changes to current corporate tax forms.** In During incentive evaluation interviews, OTC staff expressed the opinion that the current tax forms are viewed as burdensome for taxpayers, and the OTC seeks to streamline and reduce the required data rather than increasing it. Their general perspective is that increased complexity leads to greater taxpayer reporting errors.

While this is an understandable perspective, there is also a public policy need for data and information associated with tax expenditures. Given that digital tax preparation software is widely used, and many of the impacted taxpayers are probably retaining tax preparation professionals, the OTC should consider targeted, high-value additions to these forms to improve data quality.

- **The State could shift administration of the program to a contract-based agreement with the Department of Commerce.** The authorizing statute could require that those wishing to take the exemption must be approved by the Department of Commerce. The Department of Commerce could then make data reporting an annual requirement for program approval.



- **Consider reconfiguring the program to incorporate best practices from benchmark programs.** This might include converting the income tax exemption to a grant, as has been successful in the Arkansas example. Specifically, the program could be altered to reduce costs for entities generating technology that can be transferred, as opposed to the corporations that acquire the technology. Funding can also be diverted to support services such as technical assistance for small businesses that are applying for STTR awards, or to connecting small businesses and entities such as colleges and universities that frequently develop these desirable technologies to generate additional opportunities to commercialize these products and services.



Introduction



Incentive Evaluation Commission Overview

The Oklahoma Incentive Evaluation Commission (Commission) was created by HB 2182 of 2015 to produce objective evaluations of the State of Oklahoma's wide array of economic incentives. The Commission is made up of five members appointed by the Governor, President Pro Tempore of the Senate and Speaker of the House of Representatives, along with representatives of the Department of Commerce, Office of Management and Enterprise Services and the Tax Commission.

Under the enabling legislation, each of the State's economic incentives must be evaluated once every four years according to a formal set of general criteria, including (but not limited to) economic output, fiscal impact, return on incentive and effectiveness of administration, as well as criteria specific to each incentive.

Since the Commission's inception, it has contracted with PFM Group Consulting LLC (PFM) to serve as the independent evaluator of each incentive scheduled for review in a given year. PFM issues a final draft report on each incentive with recommendations as to how Oklahoma can most effectively achieve the incentive's goals, including recommendations on whether the incentive should be retained, reconfigured or repealed. The evaluations also include, where appropriate, recommendations for any changes to State policy, rules or statutes that would allow the incentive to be more easily or conclusively evaluated in the future.

The Commission is charged with considering the independent evaluator's facts and findings – as well as all public comments – before voting to retain, repeal or reconfigure each incentive under review. It then submits a final report to the Governor and Legislature. This incentive was last evaluated in 2018:



2018 Evaluation: Key Findings and Recommendations

Evaluation Category	Significant Finding(s)
Overall Findings	Due to reporting limitations on corporate tax exemptions, this incentive is unable to be evaluated on its usage, cost, or ROI.
Fiscal and Economic Impact	Unable to be determined.
Future Fiscal Impact Protections	Unable to be determined.
Administrative Effectiveness	The exemption is not very effective administratively, as it is unclear how often is it being used.
Achievement of Goals	It is unclear due to the lack of data and reporting.
Retain, Reconfigure or Repeal	The project team recommends reconfiguring the exemption to properly collect data to report on its usage and potential impact.
Other Recommendations	None.



2022 Criteria for Evaluation

The provisions of HB 2182 require that criteria specific to each incentive be used for the evaluation. A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation.

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

1. Comparison of Oklahoma incentive to other states
2. Number and amount of technology transfers
3. Dollar value of the benefit
4. Employment and payroll associated with the technology transfer



Incentive Usage and Administration



Technology Transfer Income Tax Exemption Incentive Background

The Technology Transfer Income Tax Exemption was created in 1987. For tax years starting on or after January 1, 1988, it allows corporations to exempt from income 10 percent of gross proceeds from the transfer of technology to an Oklahoma small business for 10 years. While not specified in statute, the goals of the program are likely to provide support for the transfer of technology to Oklahoma small businesses that do not have the resources to produce technology that may provide operational efficiencies or provide innovative products to the market.

Research and development investments create new products and services, but large upfront costs are often too large for a small business to absorb. Research institutions, such as universities, generate large quantities of viable solutions, but they often lack the business acumen to launch a business. The transfer of technology from these research entities to a commercial entity, such as a small business, is one path to creating and marketing a new technology. This may then create jobs and tax revenue that are vital components of State economic development.

Program Administration

The Oklahoma Tax Commission (OTC) administers the Technology Transfer Income Tax Exemption. In order to claim the exemption, the OTC requires corporations to list the amount of exemption claimed on Form 512 in part 1 or 2, where Oklahoma taxable income is calculated.

The exemption allows corporations to exclude from taxable income a portion of royalty payments received as a result of a transfer of technology to a small business in Oklahoma. The corporation may exclude 10 percent of the gross proceeds from this transfer per year for up to 10 years.

To qualify for the exemption, the recipient of the transferred technology must be a business organized for profit in Oklahoma with capitalization of no more than \$250,000, and with at least 50 percent of its employees and assets located in the State. Oklahoma State Statute prohibits the use of this exemption by subsidiaries or affiliates of the corporation making the transfer. The qualifying transferred technology may be a proprietary process, formula, pattern, device, or compilation of scientific or technical information that is not in the public domain.

Use of the Program

The OTC did not provide data on corporate income tax exemptions related to the Technology Transfer Income Tax Exemption which prevents the Evaluators from determining the usage of the program. Without this data, it is unclear whether the program is being utilized (and to what degree), how much income is exempted in a given tax year, or if the incentive is achieving the goals outlined in the establishing statute.



Incentive Benchmarking



Benchmarking

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are ‘perfect peers’ – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.¹ These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentives typically begins with bordering states. This is generally the starting point, because proximity often leads states to compete for the same regional businesses or business/industry investments. Second, neighboring states often (but not always) have similar economic, demographic or political structures that lend themselves to comparison.

In the case of Oklahoma’s Technology Transfer Income Tax Exemption, only Arkansas was found to have a similar program. **Arkansas’ Technology Transfer Assistance Grant Program** was created in 1987 and offers grants of up to \$3,750 to finance the transfer of technology from a public or private enterprise, college, university or laboratory to an Arkansas based company. Funding can be used for engineering and support fees, database searches, travel, and to pursue further grant funding from federal sources. In calendar year 2020, the most recent year for which data was available, Arkansas made 22 matching grants to 16 entities totaling \$86,250.²

Arkansas’ program is similar in that it targets the costs of the transferor but differs in the chosen method of reducing costs. Instead of the tax exemption offered by Oklahoma, Arkansas offers a cash grant to fund the costs of the transfer. This is an important difference - while the overall amount of the grant is small, at \$3,750 per transfer, it may be more valuable than tax preferences for the transferors of technology. Technology is most commonly transferred by non-profit research institutions and colleges or universities that are tax-exempt. In this case, the transferor may not have the tax liability to benefit from a corporate income tax exemption. Arkansas’ method of reducing the transaction costs involved in the transfer of technology may be more impactful in promoting the transfer of technology to companies within its borders.

Other Methods of Supporting Small Business Technology Transfer

More states support the transfer of technology to small businesses by offering support to small businesses and research institutions in conjunction with the federal Small Business Technology Transfer (STTR) program. This program provides funding on competitive basis to small businesses who collaborate with research institutions to develop the scientific merit of a technology and then commercialize it. Arizona and Connecticut offer training and technical assistance programs to small businesses applying for these funds. Florida provides grant funding to fund the preparation of applications for STTR funding. Both Kentucky and Nebraska offer grant funding on a competitive basis that matches STTR funds. Hawaii and North Carolina provide 50 percent matching funds for Phase I and Phase I & II, respectively. Additional programs exist in Iowa, Maine, Montana, Rhode Island, South Carolina, Virginia, and Wisconsin.³

¹ The primary instances of exactly alike state incentive programs occur when states choose to ‘piggyback’ onto federal programs.

² “Act 1282 Annual Report,” Arkansas Economic Development Commission. 2020. Accessed via: https://www.arkansasedc.com/docs/default-source/data-and-reports/annual-reports/cy-2020-act-1282-report-final.pdf?sfvrsn=812c0188_2

³ National Institute on Drug Abuse. “State Matching Funds Program.” Accessed via: <https://nida.nih.gov/funding/small-business-innovation-research-sbir-technology-transfer-sttr-programs/resources/state-matching-funds>



A key difference between Oklahoma's program and the more commonly used programs that follow the STTR program is where the program benefit is targeted. The STTR program and the state programs that follow it are primarily focused on reducing costs for the small business that will commercialize the technology. Conversely, Oklahoma's program provides a benefit only for the corporation that transfers the developed technology to a small business.



Economic and Fiscal Impact



Economic and Fiscal Impact

There is insufficient data to perform an economic impact and tax revenue analysis of this program. To estimate the economic impact of the program, OTC and OCAST should collect and store the following information by company and year: (1) economic activity or sales in Oklahoma, (2) employment and payroll in Oklahoma, (3) growth rates associated with technology transfers. Without this information it is not possible to accurately estimate the program's economic impact or net fiscal impact for the State.

The current data collected by OCAST and OTC does not provide this level of detail in a time series per company. Tax forms for filers do not provide sufficient data to disaggregate the returns for this specific exemption. All of this information would contribute to an accurate assessment of economic impact.



Appendices



Appendix A: Incentive Statute 68 O.S. § 2358

C. 1. For taxable years beginning after December 31, 1987, the taxable income of any corporation shall be further adjusted to arrive at Oklahoma taxable income for transfers of technology to qualified small businesses located in Oklahoma. Such transferor corporation shall be allowed an exemption from taxable income of an amount equal to the amount of royalty payment received as a result of such transfer; provided, however, such amount shall not exceed ten percent (10%) of the amount of gross proceeds received by such transferor corporation as a result of the technology transfer. Such exemption shall be allowed for a period not to exceed ten (10) years from the date of receipt of the first royalty payment accruing from such transfer. No exemption may be claimed for transfers of technology to qualified small businesses made prior to January 1, 1988.

2. For purposes of this subsection:

a. "Qualified small business" means an entity, whether organized as a corporation, partnership, or proprietorship, organized for profit with its principal place of business located within this state and which meets the following criteria:

(1) Capitalization of not more than Two Hundred Fifty Thousand Dollars (\$250,000.00),

(2) Having at least fifty percent (50%) of its employees and assets located in Oklahoma at the time of the transfer, and

(3) Not a subsidiary or affiliate of the transferor corporation;

b. "Technology" means a proprietary process, formula, pattern, device or compilation of scientific or technical information which is not in the public domain;

c. "Transferor corporation" means a corporation which is the exclusive and undisputed owner of the technology at the time the transfer is made; and

d. "Gross proceeds" means the total amount of consideration for the transfer of technology, whether the consideration is in money or otherwise.