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States Attracting Biotech by Extending NOL Carry Forward

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With a federal tax benefit that allows young companies to carry forward 20 years of net losses, more states are following in papa's footsteps in order to incentivize innovation and attract the high-wage biotech industry within its borders.

A total of eight states already are there, and 10 others offer a 15-year benefit. But two of the most populous states for the biotech industry - Massachusetts and California - offer only a five- and 10-year net operating loss (NOL) carry forward benefit, respectively. The lawmakers in both states, however, are working on a change.

Since it takes up to 15 years in research and development before most biotech companies reach profitability with a marketed product, those residing in biotech's western epicenter must absorb one-third of their losses.

"This is not only unfair, but it also makes the economic rationale for a lot of these projects very, very difficult," said Frank Karbe, executive vice president and chief financial officer of South San Francisco-based Exelixis Inc.

That is why California State Assemblywoman Sally Lieber introduced in 2007 Assembly Bill 1370, which proposes doubling the time biotech companies can carry forward their NOLs from 10 years to 20 years. The state is home to 2,000 life sciences companies that would benefit, including those developing therapeutics, diagnostics, research tools and medical technology.

"This legislation would literally help every single biotech company operating in California," said Matt Gardner, CEO of BayBio, Northern California's life sciences association.

The bill passed 79-0 in the Assembly and is awaiting action by the Senate Review and Tax Committee. It currently is at a standstill while state legislators grapple with budget deficit discussions, but Gardner hopes they will include the bill in an economic stimulus program, under which it "could move very quickly this summer," he told *BioWorld Financial Watch*.

In Massachusetts, the legislature is working on Gov. Deval Patrick's \$1 billion life sciences initiative that would not only extend the NOL carry forward from five to 15 years, but would earmark \$500 million for capital spending, \$250 million for grants and financings to encourage job growth, and \$250 million in tax credits and incentives. The bill was passed earlier this year by both the House and Senate, and a committee is working on a completed package with amendments

The initiative prompted Canton, Mass.-based Organogenesis Inc., which had once planned to move out of state, to expand its headquarters and its research and development and manufacturing facilities in Canton. The regenerative medicine company expressed concerns last year over tax inequalities between states and worked closely with the Massachusetts Office of Business Development to secure a \$12.9 million incentive package, as well as \$5 million in low-interest loans for job growth. The company has since increased its 200-employee workforce to 325 employees and it has 50 more positions to fill this year. Its first product, the living, allogeneic, cell-based Apligraf, was approved in 1998 for venous leg ulcers and in 2000 for diabetic foot ulcers.

With 11 compounds in the clinic, four of which could move into Phase III within the next year, California cancer company Exelixis still is two to three years away from having its first marketed product. After 12 years of research and development, it is now posting net losses of about \$100 million a year, money that under the current law it will never recover. Karbe is astounded that the state has not taken full advantage of investing in an industry that has brought it a high concentration of brainpower and well-paying jobs.

The current tax benefit "ultimately means less jobs, less money invested in R&D, less products coming to market, less solutions for patients," he said.

In total, it can take up to \$1 billion to bring just one product to market. Once that product reaches the market and revenues begin to roll in, according to the Biotechnology Industry Organization, companies in these states - Connecticut, Delaware, Florida, Hawaii, Idaho, Iowa, Kentucky and Pennsylvania - can offset their state taxes by applying 20 years of net losses, thereby maximizing their profits.

It's an attractive benefit not only for start-up companies deciding where to set up their headquarters, but for investors that are taking huge risks that don't always pay off.

"Attracting sufficient equity capital to fund critical research is often a challenging task for biotech innovators," said Jim Greenwood, president and CEO of Biotechnology Industry Organization (BIO). "From capital gains exemptions and net operating loss considerations to tax exemptions on equipment and investment credits for individuals, states are increasingly aware of the unique challenges facing bioscience companies."

Data tracked by BIO indicate that 31 states allow sales tax exemptions for equipment used in research and development activities, including biomanufacturing, and 39 states offer NOL carry forwards for anywhere from five years to 20 years. Puerto Rico offers the benefit for an unlimited number of years; and the benefit is transferable, meaning the company can sell the exemption credit to another entity, in the states of Kentucky, New Jersey, Ohio and Tennessee.

Resistance to the tax benefit change in California appears to be minimal, but critics do point to a handful of companies like Genentech Inc. and Gilead Sciences Inc. and ask whether biotech firms really need more tax incentives. For the first quarter, Genentech posted product sales of \$2.2 billion and a non-GAAP net income of \$895 million, while Gilead reported revenues of \$1.3 billion and a non-GAAP net income of \$522.1 million.

But the majority of the biotech industry is made up of smaller and mid-size companies, most of which will never see profits like Genentech and Gilead but still are conducting solid research on high-stakes money.

"We have such a wonderful accumulation of brain power in this state," Karbe said. "I think we need to be very careful that we create and maintain an environment here that . . . keeps this industry alive."