# DEPARTMENT OF TAXATION
# 2002 Fiscal Impact Statement

**1. Patron** Nutter

**2. Bill Number** HB 1235
**House of Origin:**
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

**Second House:**
X **In Committee**
_____ **Substitute**
_____ **Enrolled**

**3. Committee** Senate Finance

**4. Title** Income Tax: Tiered Credits for Economically Distressed Localities

**5. Summary/Purpose:**

This bill would create a tiered system of tax credits for businesses in economically distressed localities. The bill would establish three tiers of economically distressed localities based on median household income, free lunch eligibility of school children, and rates of unemployment. The system of credits would include:

- an individual and corporate income tax credit for the creation of new jobs;
- an individual and corporate income tax credit for tuition paid by employers to community colleges for worker training or retraining;
- an individual and corporate income tax credit for employers for employees who obtain a GED;
- an individual and corporate income tax credit for employees who successfully complete a state-approved apprenticeship program; and

The value of the credits would be determined based on the tier of the economically distressed locality in which the business is located. The bill would also require that loans made to eligible businesses located within economically distressed localities qualify for maximum portfolio reserve fund matching of 14% of the loan principal from the Virginia Small Business Growth Fund.

The bill would be effective for taxable years beginning on or after January 1, 2003 but before July 1, 2009.

**6. Fiscal Impact Estimates are:** Not Available. (See Line 8.)

**6a. Expenditure Impact:**

| *Fiscal Year* | *Dollars* | *Positions* | *Fund* |
|---|---|---|---|
| 2001-02 | $0 | 0 | GF |
| 2002-03 | $126,400 | 2 | GF |
| 2003-04 | $820,535 | 2 | GF |

7. **Budget amendment necessary:** Yes.
Item(s): 283 and 285, Department of Taxation

8. **Fiscal implications:**

**Administrative Costs**

There are costs associated with modifying the system to implement this legislation. The Department of Taxation is currently in the process of replacing its automated systems as part of a partnership with AMS. As a result, the Department of Taxation will be maintaining two systems - the current STARS system and the new IRMS system - for a period of time as a contingency. The contract with AMS generally provides for the costs of implementing routine legislation. However, changes attributable to major legislation are not within the scope of the contract.

Because the scope of this legislation is significant, systems changes will not be paid through the AMS contract. In Fiscal Year 2004, the Department of Taxation would incur $708,710 in costs for changes to its existing system the new IRMS system. Systems costs would be minimal for Fiscal Year 2005 and thereafter. The Department of Taxation would also incur other administrative costs with respect to this legislation of $126,400 in Fiscal Year 2003 and $111,825 in Fiscal Year 2004 and thereafter for forms development and two full time positions to administer the program this bill would create.

**Revenue Impact**

Based on the most current data, 63 of 135 Virginia cities and counties would qualify as an economically distressed locality. The following table shows a breakdown of the 63 economically distressed localities.

| Tier | Localities |
|---|---|
| 1 | 10 |
| 2 | 29 |
| 3 | 24 |
| Total | 63 |

The impact of this bill on General Fund revenues is unknown. Information on job creation, employees receiving GEDs, employees completing state-approved apprenticeship programs, and businesses providing tuition reimbursement are not readily available by locality.

In 1996, the North Carolina General Assembly passed a tiered credit program, administered by the North Carolina Department of Commerce, with larger credits available in more economically distressed areas. Taxpayers can earn credits for creating jobs, investing in machinery and equipment, providing worker training, engaging in research and development, and/or establishing a headquarters or central administrative office. Credits are limited to 50% of a corporations income tax liability.
The credits are available to businesses engaged in manufacturing-processing,

warehousing, wholesale trade, air courier services, central administrative offices, electronic mail order, and data processing.

A study of the North Carolina tiered credit program for 1998 and 1999 found companies had earned $213.8 million in credits and claimed $62.4 million of the earned credits over the two-year period. Although the North Carolina tiered credit program does differs from the program proposed in this bill, the annual total of credits claimed, which is in excess of $30 million annually, suggests that a Virginia tiered credit program could result in a large revenue loss.

**9. Specific agency or political subdivisions affected:**

Virginia Economic Development Partnership
Virginia Small Business Financing Authority
Virginia Department of Business Assistance
Department of Taxation

**10. Technical amendment necessary:** Yes

Under the proposed § 58.1-518 this bill would create, the Tax Commissioner would be required to promulgate regulations for the administration of the credit including the carryover, redemption, and transfer of the tiered tax credits. If it is the intent of this bill to allow the proposed tax credits to be carried forward, redeemed, or transferred, the bill would need to be amended to include provisions that would set forth a carryover period and conditions under which the credits could be redeemed or transferred.

**11. Other comments:**

**General**

This bill would create a three tiered system of economically distressed localities. Businesses located in the economically distressed localities would be eligible for a number of tax credits. The value of the credits would be determined based on the tier of the economically distressed locality.

**Economically Distressed Locality Tiers**

The designation of an economically distressed locality would be based on the following criteria:

Tier 1 - A locality in which the median household income is 65% or less of the median Virginia household income; and either (i) has an unemployment rate of at least 140% greater than the state wide average unemployment rate for the last three consecutive years; or (ii) has a free lunch eligibility of at least 175% greater of the state average.

Tier 2 - A locality in which the median household income is between 65.1% and 75% of the median Virginia household income; and either (i) has an unemployment rate of between 120% and 139.9% greater than the state wide average unemployment rate for the last three consecutive years; or (ii) has a free lunch eligibility of between 150% and 174.9% greater of the state average.

Tier 3 - A locality in which the median household income is between 75.1% and 85% of the median Virginia household income; and either (i) has an unemployment rate of between 100% and 119.9% greater than the state wide average unemployment rate for the last three consecutive years; or (ii) has a free lunch eligibility of between 125% and 149.9% greater of the state average.

A city or county would have to meet the medium household income standard and one of the other two criteria (unemployment or school lunch) in order to qualify as an economically distressed locality. Based on the most current data available, 63 of 135 Virginia cities and counties would qualify as an economically distressed locality under this bill.

**Economically Distressed Locality Credits**

The annual credits for businesses located within an economically distressed locality would include:

New Jobs Credit - an individual and corporate income tax credit for the creation of new jobs.

Tuition Credit - an individual and corporate income tax credit for tuition paid by the employer to community colleges for worker training or retraining.

GED Credit - an individual and corporate income tax credit for employers for employees who obtain a GED.

Apprenticeship Credit - an individual and corporate income tax credit for employees who successfully complete a state-approved apprenticeship program.

The following table shows the amount of each credit available in each tier.

| | **Tier 1** | **Tier 2** | **Tier 3** |
|---|---|---|---|
| **New Jobs Credit** | $3,000 per new jobs up to 20 jobs | $2,500 per new jobs up to 15 jobs | $2,000 per new jobs up to 10 jobs |
| **Tuition Credit** | Up to $500 per employee | Up to $400 per employee | Up to $300 per employee |
| **GED Credit** | $2,500 per employee | $2,500 per employee | $2,500 per employee |
| **Apprenticeship Credit** | $2,000 per employee | $2,000 per employee | $2,000 per employee |

**Administration of Credit System**

The Tax Commissioner would be responsible for developing a program for the carryover, redemption or transfer of the credits, and guidelines for determining which localities qualify as economically distressed localities, including a schedule for regularly updating the statistics used for making such determinations. The Tax Commissioner would also be required to issue regulations concerning the computation, carryover, and rollover of the credits.

**Economically Distressed Locality Loans**

The Virginia Small Business Financing Authority ("VSBFA") was created in 1984 with passage of the Virginia Small Business Financing Act and is the financial services division of the Virginia Department of Business Assistance.

The Virginia Small Business Growth Fund (the "Fund") is used by the VSBFA to fund the Virginia Capital Access Program (VCAP). The VCAP provides access to capital for Virginia businesses by encouraging banks in Virginia to make loans to borrowers with a high-risk profile. In lieu of guarantying specific loans, the VCAP utilizes an insurance concept to provide a reserve fund for portfolios of loans held by participating lending institutions. The VSBFA is allowed to match reserve fund deposits by lending institutions and borrowers up to 14% of the principle amounts of the loans.

This bill would require that loans made pursuant to the VCAP to businesses located within economically distressed localities qualify for the maximum portfolio reserve fund matching from the Virginia Small Business Growth Fund.

**Investments/Expenditures Qualifying for Multiple Credits**

This bill includes a provision that would prohibit a job, employee, tuition payment, or capital investment that qualifies for one of the economically distressed locality credits from being used as the basis for claiming any other Virginia tax credit.

cc: Secretary of Finance

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