DEPARTMENT OF TAXATION
2002 Fiscal Impact Statement

1. Patron Ruff

2. Bill Number SB 339

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **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, or 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 the employer 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
- a tax credit against employees' state income tax withholding for a percentage of all capital investment above $250,000 per year in new, expanded or modernized plant and equipment certified by the Virginia Economic Development Partnership.

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.

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: No

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, businesses providing tuition reimbursement, and employers investing in excess of $250,000 are not readily available by locality. However, because so many localities would be classified as economically distressed, the revenue loss resulting from this bill would be significant.

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

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

Technical amendment necessary: Yes

Under proposed § 58.1-518 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 (i) medium household income of 65% or less of the median Virginia household income; and either (ii) an unemployment rate of at least 140% greater than the state wide average unemployment rate for the last three consecutive years; or (iii) free lunch eligibility of at least 175% greater of the state average.

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

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

An economically distressed locality would only have to meet one of the criteria in order to qualify for a tier. 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:

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

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

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

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

The Investment Credit - a tax credit against employees' state income tax withholding for a percentage of all capital investment in excess of $250,000 per year in new, expanded or modernized plant and equipment certified by the Virginia Economic Development Partnership.

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
Investment Credit	3% of excess investment	2% of excess investment	1% of excess investment

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.

The Virginia Economic Development Partnership would be responsible for certifying capital investments exceeding $250,000.

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 funds 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% the principle amounts of the loans.

This bill would require that loans made pursuant to the VCAP to businesses located within economically distressed localities to qualify for 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, or capital investment that qualifies for one of the economically distressed locality credits would not be able to used as the basis for claiming any other Virginia tax credit.

Virginia provides a number of tax credits based on creating jobs. Virginia’s job creation credits include the Major Business Facility Jobs Tax Credit, the Clean Fuel Vehicle Job Creation Tax Credit, the tax credit for certain employers hiring recipients of Temporary Assistance to Needy Families, or the Employees with Disabilities Tax Credit. In addition, two programs, the Virginia Targeted Jobs Grant Program and the Enterprise Zone Job Grant Program, provide grants for jobs that would qualify for the New Jobs Credit under this bill.

Virginia has also established numerous credits for investing in certain property or certain locations. The Historic Rehabilitation Tax Credit, the Day-Care Facility Tax Credit, The Recycling Machinery and Equipment Tax Credit, the Alternative Recycling Tax Credit, the Oil Burning Equipment Tax Credit provide credits for investing in designated real property, equipment, and/or machinery. The Enterprise Real Property Improvement Tax Credit, the Enterprise Zone Improvement Tax Credit, and the Tobacco-Dependent Localities Technology Investment Tax Credit provide credits for investments in real property, equipment, and/or machinery located within designated localities are areas within localities.

The Worker Retraining Tax Credit provides a tax credit for expenditures made by employers for noncredit courses at community colleges or private schools or apprenticeship programs for qualified employees.

Other Legislation

House Bill 1235 is identical to this bill.

cc: Secretary of Finance

Date: 01/25/02/dtm