DEPARTMENT OF TAXATION
2002 Fiscal Impact Statement

1. Patron Purkey

2. Bill Number HB 56

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

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

3. Committee House Finance

4. Title Income Tax Credit: Virginia Technology and Biotechnology Investment Act

5. Summary/Purpose:

This bill would create a number of tax incentives aimed at encouraging the establishment and expansion of small technology and biotechnology corporations. These incentives are:

- A tax credit equal to 50% of the qualified research and development expenses incurred by technology and biotechnology corporations within the Commonwealth.
- A tax credit equal to 50% of basic research payments for research and development done in the Commonwealth.
- The creation of a "Corporation Tax Benefit Certificate Program" which would allow technology and biotechnology corporations to transfer unused but otherwise allowable research and development tax credits to another corporation for a minimum of 75 cents on the dollar.
- Each of the credits would be subject to a $5 million annual cap. However, unused portions of an annual cap could be carried forward and added to the next taxable year's caps.

This bill is 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	$0	0	GF
2003-04 *****	$74,485	1	GF

*** Does not include systems costs. (See line 8.)**

7. Budget amendment necessary: No.

8. Fiscal implications:

Administrative Cost

While this bill does have costs associated with systems development, these cannot be ascertained at this time. The cost for implementing a **single** piece of legislation cannot be calculated precisely due to economies of scale. The actual cost to implement **all** legislation enacted during a given session will more than likely be less than the sum of the costs attributed to individual bills. Further, the ability to accurately predict costs is complicated because the department is replacing its current database system. As a result, legislative changes may need to be made to both the current and the future system, depending on the effective date. Therefore, the department is not providing specific systems costs for this bill, but will calculate the total for all tax bills once they have been acted upon favorably in both houses and prior to the conference committee report. The department would incur administrative costs of $74,485 for FY 2004 for form development and revisions, and one full-time position. Continuing costs would be $59,485 for FY 2005 and thereafter.

Revenue Estimate

The General Fund revenue impact of this bill is unknown. While each credit is capped at $5 million, unused portions of the caps could be carried over and added to the caps in subsequent years. As such, because taxpayers earning and purchasing these credits would be able to carry forward unused credits and unused portions of the $5 million caps carry forward to subsequent caps, the negative revenue impact of this bill could exceed $10 million in a given fiscal year.

9. Specific agency or political subdivisions affected:

Department of Taxation
Innovative Technology Authority

10. Technical amendment necessary: Yes.

In order to prevent a taxpayer from receiving a double benefit from qualified research expenses that qualify for the Qualified Research and Development Expenses tax credit in this bill and the Tax Credits for Technology Industries in Tobacco-Dependent Localities, the following technical amendment is suggested:

Page 2, Line 89, After B.
Strike: No credit shall be allowed under Article 13 (§ 58.1-430 et seq.) of Chapter 3 of this title or §§ 63.1-323 and 63.1-324 for property or expenditures for which a credit is allowed, or which are includable in the calculation of a credit allowed, under this section.
Insert: A taxpayer who claims the credit pursuant to this section may not use such qualified research expenses as the basis for claiming any other credit or grant provided under the Code of Virginia.

In order to prevent a taxpayer from receiving a double benefit from basic research payments that qualify for the Basic Research Payment tax credit in this bill and the Tax Credits for Technology Industries in Tobacco-Dependent Localities, the following technical amendment is suggested:

Page 3, Line 139, At the end of the line
Insert: E. A taxpayer who claims the credit pursuant to this section may not use such basic research payments as the basis for claiming any other credit or grant provided under the Code of Virginia.

To correct a reference error, the following technical amendments are suggested

Page 4, Line 164, After: §58.1-
Strike: 424
Insert: 425

Page 4, Line 171, After: §58.1-
Strike: 424
Insert: 425

11. Other comments:

<u>Generally</u>

The Virginia Technology and Biotechnology Investment Act would create a program of tax credits and benefits for technology and biotechnology companies.

A "Technology Company" would be a corporation having less than 100 employees (75% of whom work in Virginia) that performs research and development for specific commercial or public purposes, conducts pilot scale manufacturing, and/or provides services or products necessary for such research, development and production in Virginia.

A "Biotechnology Company" would be a corporation having less than 100 employees (75% of whom work in Virginia) that performs research and development for medical, pharmaceutical, nutritional, agricultural, or environmental purposes, conducts pilot scale manufacturing; and/or provides services or products necessary for such research, development and production in Virginia.

<u>Technology and Biotechnology Research and Development Tax Credit</u>

This bill would create a credit against the corporate income tax for 50% of "qualified research expenses" incurred by technology and biotechnology companies. In general, qualified research expenses that qualify for this credit would be the same as those that qualify for the federal research credit. For federal purposes, qualified research expenses include wages and salaries paid to individuals engaged in research; supplies, tools and equipment used to conduct research and 65% of fees paid to a research contractor.

The Technology and Biotechnology Research and Development Tax Credit ("TBRDTC") would be limited to 50% of the tax liability after being reduced by any other tax credit to which the corporation is entitled or $500,000. In other words, a technology or biotechnology company would reduce its income tax liability by any other corporate income tax credit it had earned. This reduced amount would be multiplied by 50% to determine if the limitation for this credit for the taxable year would be less than $500,000. Unused credits can be carried forward for up to 10 taxable years.

Technology and biotechnology corporations would be prohibited from using expenses for claiming both the TBRDTC and any other credit against the Virginia corporate income tax.

The credit would only be available to corporations subject to the corporate income tax. Technological and biotechnological research companies that are S corporations, limited liability companies, partnerships, or sole proprietorships and pass income through to their owners would not qualify for this credit.

This credit would be limited to $5 million annually. If credits exceed the $5 million annual cap in a taxable year, the Department of Taxation would be responsible for allocating the credits on a pro rata basis. If for any taxable year the amount of approved credits is less than $5 million annual cap, the unused portion would be carried over and added to the succeeding taxable year's cap.

Basic Research Payment Tax Credit

This bill would also create a tax credit for individual, fiduciary, and corporate taxpayers equal to 50% of "basic research payments" for research and development conducted in Virginia. In general, basic research payments that qualify for this credit would be the same as those that qualify for the federal research credit. For federal purposes, basic research payments are amounts paid to educational institutions and nonprofit research organizations to conduct research pursuant to a written agreement.

Like the TBRDTC, the Basic Research Payment Tax Credit ("BRPTC") would be limited to the greater of 50% of the tax liability after being reduced by any other tax credit to which the taxpayer is entitled or $500,000. In other words, a taxpayer would reduce its income tax liability by any other corporate income tax credit it had earned. This reduced amount would be multiplied by 50% to determine if the limitation for this credit for the taxable year would be less than $500,000. Unused credits can be carried forward for up to 10 taxable years.

This credit would be limited to $5 million annually. If credits exceed the $5 million annual cap in a taxable year, the Department of Taxation would be responsible for allocating the credits on a pro rata basis. If for any taxable year the amount of approved credits is less than $5 million annual cap, the unused portion would be carried over and added to the succeeding taxable years cap.

Corporation Tax Benefit Certificate Program

The bill would authorize the Department of Taxation, with the assistance of the Innovative Technology Authority ("ITA"), to establish a program to allow technology or biotechnology corporations to sell unused carryovers of the TBRDTC to other corporations. These purchasing corporations would be able to use the TBRDTC to reduce their Virginia income tax.

The Department of Taxation would receive, review and approve applications from technology or biotechnology corporations wishing to sell unused TBRDTC. Corporations wishing to purchase the tax benefits would also apply to the department. The Department of Taxation would facilitate negotiations for the transfer of the tax benefits between the technology and biotechnology corporations and purchasing corporations. No transfer would be made without a written agreement stipulating the sales price of the transfer and any other terms the parties may deem necessary. The minimum sales price of such transfers would be 75% of the value of the tax benefit. In other words, if a technology corporation earned a $100 credit, the minimum another corporation would have to pay for the credit is $75.

Pursuant to the written agreement, the Department of Taxation would issue a Corporation Tax Benefit Certificate to a purchasing corporation displaying the amount of the tax benefit. Purchasing corporations would have to attach a copy of the certificate to their income tax returns in order to redeem the tax benefit.

Expenditures Qualifying for Multiple Credits

The General Assembly enacted legislation in the 2000 session that established the Tobacco-Dependent Localities Research and Development Tax Credit ("TDLRDTC"). Expenditures qualifying for the TDLRDTC could also quality for the TBRDTC or the BRPTC under this bill. Two technical amendments have been suggested to prevent expenditures qualifying for the BRPTC or the TBRDTC from being used for the TDLRDTC or any other tax credit.

cc: Secretary of Finance

Date: 1/15/02/CT
Document: S:\2002leg\WorkInProcess\OTPwork\House Bills\HB56F161.doc