DEPARTMENT OF TAXATION
2004 Fiscal Impact Statement

1. Patron Frank M. Ruff

2. Bill Number SB 411

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, 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, 2004, but before July 1, 2009.

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

   6a. Expenditure Impact:

Fiscal Year	***Dollars***	***Fund***
2003-04	$54,400	GF
2004-05	$259,650	GF
2005-06	$12,362	GF
2006-07	$12,731	GF
2007-08	$13,115	GF
2008-09	$13,507	GF
2009-10	$13,910	GF

7. **Budget amendment necessary:** Yes.
   Item(s): <u>284 and 286, Department of Taxation</u>

8. **Fiscal implications:**

   Administrative Costs

   The Department would incur significant administrative costs to implement this bill for systems modification, a new credit form and instructions, as well as additional effort to capture and process credit data.

   Revenue Impact

   The impact of this bill on General Fund revenues is unknown. About half of Virginia cities and counties would qualify as an economically distressed locality. 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. 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 differ 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. The Virginia Economic Development Partnership would be required to issue a report to the Governor and General Assembly no later than January 3, 2005, and every three years thereafter, outlining the impacts and measuring the effects of this bill.

A tiered tax credit was one of the recommendations of the Rural Virginia Prosperity Commission.

Economically Distressed Locality Tiers

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

Tier	Median household income as % of median Virginia household income	And	Unemployment rate as % of statewide average unemployment rate for the last 3 years	Or	Free lunch eligibility as % of state average
1	65% or less		At least 140%		At least 175%
2	65.1 to 75%		120% to 139.9%		150% to 174.9%
3	75% to 85%		100% to 119.9%		125% to 149.9%

A city or county would have to meet the median household income standard and one of the other two criteria (unemployment or school lunch) in order to qualify as an economically distressed locality. About half of 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 individual and corporate income tax credits as follows:

	Tier 1	Tier 2	Tier 3
New Jobs Credit for the creation of new jobs	$3,000 per new job up to 20 jobs	$2,500 per new job up to 15 jobs	$2,000 per new job up to 10 jobs
Tuition Credit for tuition paid by the employer to community colleges for worker training or retraining.	Up to $500 per employee	Up to $400 per employee	Up to $300 per employee
GED Credit for employees who obtain a GED	$2,500 per employee	$2,500 per employee	$2,500 per employee
Apprenticeship Credit for employees who successfully complete a state-approved apprenticeship program.	$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 guaranteeing 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 principal 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.

Other Legislation

House Bill 757 is identical to this bill except that it is effective for taxable years beginning on and after January 1, 2003, and the first report is due January 3, 2006.

House Bill 1089 is identical to this bill.

cc : Secretary of Finance

Date: 1/21/2004 JPJ