DEPARTMENT OF TAXATION
2006 Fiscal Impact Statement

1. Patron Harry R. Purkey

2. Bill Number HB 159

House of Origin:
X Introduced
___ Substitute
___ Engrossed

3. Committee House Finance

4. Title Individual and Corporate Income Tax; Virginia Technology and Biotechnology Investment Act

Second House:
___ In Committee
___ Substitute
___ Enrolled

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 include:

- A tax credit equal to 15% of the qualified research and development expenditures made by technology and biotechnology corporations.
- A tax credit equal to 15% of a qualified investment in a technology or biotechnology corporation.
- The creation of a "Corporation Tax Benefit Certificate Program" that would allow technology and biotechnology corporations to transfer unused but otherwise allowable research and development tax credits or net operating loss (“NOL”) carryovers to another corporation taxpayer for a minimum of 75 cents on the dollar.

The total amount of credits that could be authorized under this bill would be limited to $10 million annually.

This bill would be effective for taxable years beginning on or after January 1, 2006.

6. No Fiscal Impact or Fiscal Impact Estimates are: Preliminary. (See Line 8.)

6a. Expenditure Impact: Department of Taxation

Fiscal Year	*Dollars*	*Positions*	*Fund*
2005-06	$0	0	GF
2006-07	$176,250	1	GF
2007-08	$45,000	1	GF
2008-09	$47,000	1	GF
2009-10	$47,000	1	GF
2010-11	$49,000	1	GF
2011-12	$49,000	1	GF

6a. Expenditure Impact: Innovative Technology Authority

Fiscal Year	*Dollars*	*Positions*	*Fund*
2005-06	$0	0	GF
2006-07	$400,000	4	GF
2007-08	$400,000	4	GF
2008-09	$400,000	4	GF
2009-10	$400,000	4	GF
2010-11	$400,000	4	GF
2011-12	$400,000	4	GF

7. Budget amendment necessary: Yes.
ITEM(S) 264 and 265, Department of Taxation
419, Innovative Technology Authority

8. Fiscal implications:

This bill cannot be implemented as part of the annual changes to our systems and forms. The Department would incur costs of $176,250 for FY 2007, $45,000 for FY 2008, $47,000 for FY 2009, $47,000 for FY 2010, $49,000 for FY 2011 and $49,000 for FY 2012 for forms development, systems modifications and the compensation of an additional full-time employee.

In addition, the Center for Innovative Technology has indicated that it will incur costs of $400,000 per year for the compensation of three additional full-time employees in order to administer the corporate tax benefit certificate program.

The negative revenue impact of this bill is unknown, but potentially significant. Although each of the proposed credits is capped at $5 million, the fact that the credits may be transferred or carried over suggests that the negative revenue impact 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 taxpayers from receiving a double benefit by utilizing the investment tax credit proposed in this bill as well as other investment tax credits, the following technical amendments are suggested:

Page 2, Line 111, after allowed under
Strike: Article 13 (§58.1-430 et seq.) of this chapter
Insert: the Code of Virginia

Page 3, Line 163, at the end of the line
Insert: F. A taxpayer who claims a credit pursuant to this section may not use the applicable qualified investment as the basis for claiming any other credit or grant provided under the Code of Virginia.

To encourage electronic filing (which cannot accommodate paper attachments), the following technical amendments are proposed:

Page 4, Line 188, after A.
Strike: Attachment of certificate to return
Insert: Certificate

Page 4, Line 190, after carryover deduction
Strike: sh shsh all attach that certificate to
Insert: may claim the specified net operating loss carryover deduction on

Page 4, Line 198, after B.
Strike: Attachment of certificate to return
Insert: Certificate

Page 4, Line 200, after credit carryover
Strike: s hall attach that certificate to
Insert: may claim the specified research and development tax credit on

11. Other comments:

Generally

The Virginia Technology and Biotechnology Investment Act would create a program of tax credits and benefits for technology and biotechnology companies, as well as individual and corporate taxpayers investing in those companies.

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

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

Biotechnology Research and Development Tax Credit

This bill would create a credit against the corporate income tax for 15% of the qualified research expenditures by technology and biotechnology companies. In general, expenditures that qualify for this credit would be the same as those that qualify for the federal research credit.

The Biotechnology Research and Development Tax Credit would be limited to 50% of the tax liability or $500,000. The technology or biotechnology company, however would be required to reduce its income tax liability by any other corporate income tax credit it had earned prior to determining the amount of this credit. Unused credits could be carried forward for up to 10 years.

The federal credit is based on (1) the excess of the qualified research expenses; and (2) basic research payments. Qualified research expenses include wages and salaries paid to individuals engaged in research, amounts paid for supplies used to conduct research, and 65% of fees paid to a research contractor. Basic research payments are amounts paid to educational institutions and nonprofit research organizations to conduct research pursuant to a written agreement.

Technology and biotechnology companies would not be able to claim the Biotechnology Research and Development Credit for otherwise qualifying research expenditures paid out of funds received from an investor claiming the Technology and Biotechnology Investment Tax Credit (see below). These corporations would also be prohibited from using such expenditures to claim both the Biotechnology Research and Development Credit and any other credit against the Virginia corporate income tax.

The Biotechnology Research and Development 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 that pass income through to their owners would not qualify for this credit.

The Biotechnology Research and Development Credit would be limited to $5 million annually. If credits exceeded 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.

Technology and Biotechnology Investment Tax Credit

This bill would also create a tax credit for individual, fiduciary, and corporate taxpayers equal to 15% of a qualified investment in a technology or biotechnology corporation. The maximum credit that could be earned for each qualified investment in any taxable year would be $500,000. Like the Biotechnology Research and Development Credit, this credit would be limited to 50% of the tax liability after the application of other corporate income tax credits or $500,000. Any unused portion of the credit could be carried forward for up to 10 years subject to the $500,000 annual limitation.

For the purposes of the Technology and Biotechnology Investment Tax Credit, a qualified investment would include traditional investments like stocks, warrants, options, partnership interests, and participation in joint ventures. In addition, a taxpayer could qualify for the Technology and Biotechnology Investment Credit by purchasing exclusive or nonexclusive licenses or rights to use technology, marketing rights or any similar items.

The Technology and Biotechnology Investment Credit would be limited to $5 million annually. If credits exceeded 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.

This credit would be available for the five taxable years beginning on or after January 1, 2006.

Corporation Tax Benefit Certificate Program

Finally, this bill would authorize the Innovative Technology Authority (“ITA”), with the assistance of the Department of Taxation, to establish a program to allow technology or biotechnology corporations to sell unused carryovers of the Biotechnology Research and Development Credit and net operating losses (“NOLs”) to other corporations. These purchasing corporations would be able to use the Biotechnology Research and Development Credit and NOLs to reduce their Virginia income tax.

The ITA would receive, review and approve applications from technology or biotechnology corporations wishing to sell unused credits and NOLs. Corporations wishing to purchase these tax benefits would also apply to the ITA. The ITA would then facilitate negotiations for the transfer of the tax benefits between the technology and biotechnology corporations and the 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 Biotechnology Research and Development Credit, the minimum that another corporation would have to pay for that credit would be $75.

Pursuant to the written agreement, the ITA 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.

Investments/Expenditures Qualifying for Multiple Credits

In 1998, the General Assembly established the Qualified Equity and Subordinated Debt Investments Tax Credit ("Qualified Equity Credit") for individual and fiduciary income taxpayers that invest in qualified Virginia small business ventures that have annual gross receipts of $5 million or less. It is possible that the technology and biotechnology companies targeted by the Technology and Biotechnology Investment Credit could also qualify for the Qualified Equity Credit. In order to qualify for the Technology and Biotechnology Investment Credit, the target business must have 100 employees or less. If a technology and biotechnology company had gross receipts of $5 million or less and 100 or fewer employees, it is possible that an investment made in such a company could meet the qualifications of both credits. This bill would not prohibit taxpayers from claiming both credits for the same investment. A technical amendment has been suggested so that an investment that qualifies for the Technology and Biotechnology Investment Credit would not be able to used as the basis for claiming any other investment tax credit or grant.

The General Assembly also enacted legislation during the 2000 session that established the Tobacco-Dependent Localities Technology Investment Tax Credit. That legislation, however, contained a provision that would prevent investments from being used for the Tobacco-Dependent Localities Technology Investment Credit and any other investment tax credit.

Along with the Tobacco-Dependent Localities Technology Investment Tax Credit, the General Assembly established the Tobacco-Dependent Localities Research and Development Tax Credit. Expenditures qualifying for that credit could also quality for the Biotechnology Research and Development Credit under this bill. The Tobacco-Dependent Localities Research and Development Tax Credit, however, includes a provision that would prevent expenditures that quality for that credit from being used to claim any other Virginia tax credit. This bill also includes such a provision for the Biotechnology Research and Development Credit.

cc : Secretary of Finance

Date: 01/26/2006 AMS
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