

DEPARTMENT OF TAXATION

2008 Fiscal Impact Statement

1. **Patron** Mark D. Sickles

3. **Committee** House Finance

4. **Title** Corporate Income Tax: Virginia
Biotechnology Investment Tax Credit

2. **Bill Number** HB 1092

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would create an individual income tax and corporate income tax credit for biotechnology companies with fewer than 100 employees. The credit would equal 15% of the amount by which qualified research expenditures exceed the base amount and 15% of the basic research payments. The credit is limited to \$500,000 per company and may not exceed 50% of the company's tax liability. The credits may be carried forward for up to 10 years. The total amount of credits given is not to exceed \$5 million per year.

This bill would be effective for taxable years beginning on and after January 1, 2008.

6. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

7. **Budget amendment necessary:** Yes. (See Line 8.)

Page 1, Revenue Estimates

8. **Fiscal implications:**

Administrative Impact

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, TAX considers implementation of this bill as "routine," and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not "routine." Additionally, TAX will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, TAX will identify the costs at that time.

Revenue Impact

The negative revenue impact associated with this bill is unknown. The criteria for awarding credits under this legislation are very specific and restrictive. Only Virginia based companies with fewer than 100 employees in a limited range of fields are eligible for the credit and the credit is only available for costs incurred in Virginia. In addition, credits are awarded for 15% of the expenses in excess of the base amount, and for basic research expenditures. Given the restrictions, there is not sufficient data to produce a revenue estimate. The revenue impact may be as much as \$5 million annually.

9. Specific agency or political subdivisions affected:

Department of Taxation
Innovative Technology Authority

10. Technical amendment necessary: Yes.

In order to avoid a possible challenge regarding the Commerce Clause of the U.S. Constitution, an amendment is suggested to eliminate the restriction to Virginia companies.

Page 1, Line 25, after employees
Strike: the remainder of line 25 and line 26

11. Other comments:

Current Law

Federal Credit

The federal government offers an income tax credit for businesses that increase their research activities during the taxable year. 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.

Other States

Approximately forty states offer a research and development credit of some kind. Only Michigan and Louisiana condition the credit on the number of employees in the state, but neither of these states denies the credit based on the proportion of employees who are based in state.

Proposal

This bill would create a tax credit for biotechnology companies 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, or provides services or products necessary for such research, development and production in Virginia.

This bill would create a credit against the individual income tax and the corporate income tax for 15% of the qualified research expenditures by biotechnology companies. In general, expenditures that qualify for this credit would be the same as those that qualify for the federal research credit but the proposed credit could not be claimed with respect to expenditures for which the federal credit has been claimed.

The Biotechnology Investment Tax Credit would be limited to 50% of the tax liability or \$500,000. Unused credits could be carried forward for up to 10 years. The credit would be available to corporations subject to the corporate income tax as well as pass through entities. The 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.

The effective date for this bill is taxable years beginning on and after January 1, 2008.

Constitutional Issue

This credit may be subject to challenge under the Supreme Court's dormant commerce clause jurisprudence. The bill would deprive certain companies of beneficial tax treatment because less than 75% of their employees work in Virginia. This limitation may violate the Commerce Clause of the U.S. Constitution, which prohibits states from discriminating against out-of-state taxpayers. While a state can offer a direct subsidy to in-state firms of any size, the state cannot use its tax system to offer preferences that discriminate against out-of-state taxpayers. *New Energy v. Limbach*, 486 U.S. 269 (1988).

A technical amendment has been suggested to eliminate the restriction to Virginia companies.

cc : Secretary of Finance

Date: 1/24/2008 TG
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