DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

1. Patron Richard P. Bell

2. Bill Number HB 1410

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

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

3. Committee House Finance

4. Title Income tax, corporate; small business reduced rate

5. Summary/Purpose:

This bill would reduce the corporate income tax rate by one-half of one percent for small businesses that increase the number of employees by a minimum of five percent over the number of employees in the immediately preceding year. This bill would also provide that the tax rate reduction would be allowed for no more than three taxable years.

The tax rate reduction would be effective for taxable years beginning on and after January 1, 2012.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

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

This bill would result in an unknown loss in General Fund revenue beginning in FY 2012. Based on data from the Quarterly Census of Employment and Wages, in the first quarter of 2009 there were 220,007 establishments in Virginia that had fewer that 250 employees.

However, it is not possible to identify how many of these establishments meet the other requirements in the definition of "small business" or the number that are subject to the Virginia corporate income tax. Businesses that are organized as S-corporations, LLCs, LLPs, partnerships, or sole proprietorships are not subject to the corporate income tax and would not qualify for the proposed reduced tax rate.

In order to qualify for the reduction, a business with 20 or fewer employees would need to add one employee in a given year. Employers with more than 200 employees would need to add ten to eleven employees to qualify. The bill does not specify any minimum employment level for the new employees.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

To correct the name of the fund established by *Va. Code* § 2.2-115, the following technical amendment is suggested:

Line 23, after Fund
Strike: for Economic Development

11. Other comments:

<u>Tax Incentives for Small Businesses in Other States</u>

Four states (California, Connecticut, Illinois, and West Virginia) currently provide job tax credits for small businesses.

California allows a new jobs tax credit equal to $3,000 for each net increase in qualified full-time employees. This credit is available to companies that, as of the last day of the preceding taxable year, employed a total of 20 or fewer employees.

Connecticut allows a small business job creation tax credit equal to $200 per month for each new employee hired. For purposes of this credit, a "qualified small business" is defined as an employer that employs less than 50 employees in Connecticut on the date of application for the credit.

Illinois allows a credit for a net increase in full-time Illinois employees that is maintained for at least 12 months. The amount of the credit may not exceed $2,500 per new employee hired. An applicant for the credit may have no more than 50 full-time employees, without regard to the location of employment, at the beginning of the incentive period.

West Virginia allows a credit for small businesses that create at least ten new jobs as a result of the taxpayer's qualified investment in a new or expanded business in-state. The credit is claimed over a period of ten years. For taxable years beginning on or after January 1, 2004, a "small business" is defined as a business with annual gross receipts of not more than $7 million, as adjusted for inflation. For the 2010 taxable year, a “small business” is a business with annual gross receipts of not more than $8.384 million.

Many states provide other tax incentives for small businesses. The most common tax incentives for small businesses are tax credits, which include investment credits (Alabama, Arizona, Colorado, and Vermont); a small business development credit (Kentucky); a tax credit for the creation or expansion of a “microbusiness” (Nebraska); and alternative tax credit structures for small businesses (Connecticut, Idaho, and Louisiana).

Proposed Legislation

This bill would reduce the corporate income tax rate from six percent to five and one-half percent for small businesses that increase the number of employees by a minimum of five percent over the number of employees in the immediately preceding year. This bill would also provide that the tax rate reduction would be allowed for no more than three taxable years.

This bill would use the definition of “small business” that is used for purposes of the Virginia Department of Business Assistance one-stop small business permitting program, defined as an independently owned and operated business that, together with affiliates, has 250 or fewer employees or average annual gross receipts of $10 million or less averaged over the previous three years.

This bill would require TAX to determine what information a small business would need to provide in order to receive the reduced tax rate.

Finally, this bill would require the Secretary of Finance and the Secretary of Commerce and Trade to determine how many employees are added each year to small businesses through assistance from the Governor’s Opportunity Fund for Economic Development.

The tax rate reduction would be effective for taxable years beginning on or after January 1, 2012.

cc : Secretary of Finance

Date: 1/25/2011 KLC
HB1410F161