

0DEPARTMENT OF TAXATION

2011 Fiscal Impact Statement

1. **Patron** David A. Nutter

2. **Bill Number** HB 2400

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Corporate Income Tax; Subcontracts Tax
Credit.

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would create a corporate income tax credit for certain large businesses that enter into qualified subcontracts with small businesses equal to 6% of the value of new qualified subcontracts or the increase in the existing subcontracts.

The bill would be effective for taxable years beginning on and after January 1, 2011.

6. **Budget amendment necessary:**

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

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation considers implementation of this bill as "routine," and does not require additional funding. Virginia Economic Development Partnership and Department of Business Assistance would likely incur some costs depending on what their plans would require them to do.

Revenue Impact

The negative General Fund revenue impact of this bill is not known, but would be expected to be significant. The maximum negative revenue impact, however, could not exceed the \$10 million cap.

In addition, because the method for administering the \$10 million cap has not been specified, the first Fiscal Year in which the credit would impact General Fund revenue cannot be determined. If the cap is administered on a first come, first served basis, similar to the Land Preservation Tax Credit, the negative impact could start in Fiscal Year 2012. If the cap is administered by requiring all eligible large businesses to apply for a designated year and then prorated if the cap is exceeded, revenue may not be negatively impacted until Fiscal Year 2013 or Fiscal Year 2014.

9. Specific agency or political subdivisions affected:

Department of Taxation
Economic Development Partnership
Department of Business Assistance

10. Technical amendment necessary: Yes.

In order to clarify the purpose of this bill, an amendment in the nature of a substitute is recommended.

11. Other comments:

Federal Law

The Historically Underutilized Business Zones (HUBZone) program, administered by the Small Business Administration, helps small businesses in urban and rural communities gain preferential access to federal procurement opportunities. These preferences go to small businesses that maintain a principal office in a HUBZone and employ staff who live in a HUBZone. Small businesses that qualify for the program receive a HUBZone certification from the Small Business Administration.

Current Virginia Small Business Incentives

The Virginia Department of Business Assistance (VDBA) provides a one-stop-service for technical assistance related to business formation, access to capital, and workforce development. VDBA works with and mentors entrepreneurs from ideas to launching their first business venture. To accomplish its objectives, VDBA has provides workforce incentives, access to capital, business information, small business incubator counseling, and hosts entrepreneurial workshops statewide annually.

The Virginia Small Business Finance Authority (VSBFA) assists small businesses through a number of financing programs. VSBFA offers direct loans for fixed asset purchases to businesses, localities and Economic Development Authorities for projects of all sizes. VSBFA also offers loan guaranties and loan loss insurance programs to reduce risk to banks making it easier for financial institutions to make loans to small businesses. In addition, targeted financing programs are available for southern Virginia's tobacco region, minority-owned businesses, small manufacturers, non-profit organizations, licensed Child care and family home providers, and Virginia's tourism industry.

Under Virginia's Qualified Equity and Subordinated Debt Investments Tax Credit, an individual or corporation is allowed a tax credit for investments made in a qualified small business having annual gross revenues of no more than \$3 million engaged in the business of advanced computing, advanced materials, advanced manufacturing, agricultural technologies, biotechnology, electronic device technology, energy, environmental technology, medical device technology, nanotechnology, or any similar technology-related field.

The Virginia Enterprise Zone program, administered by the Department of Housing and Community Development, provides two grant programs available to eligible businesses that locate a facility within the zone. The Job Creation Grant program provides grants to eligible businesses for certain permanent full-time job creation exceeding a four job threshold. The Real Property Investment Grant program provides grants for qualified real property investments made in a designated Virginia Enterprise Zone by an eligible individual or business. Since the program was converted to a grant program in 2005, no new tax credits have been allowed. However, firms that had previously been allowed Enterprise Zone General Business Tax Credits are permitted to continue to claim them.

Proposal

Under this bill, a large business would be allowed a corporate income tax credit equal to 6% of the value of new qualified subcontracts or the amount of increase of existing subcontracts. The credit would not be refundable, and unused portions of the credit could not be carried forward to succeeding taxable years.

"Large business" would mean a corporation subject to income tax that has more than 250 full-time employees on its payroll at all times during which it is eligible for the corporate income tax credit provided in this section.

"Qualified subcontract" would mean a contract between a large business and a small business for new work and not an extension of an existing contract in an amount equal to at least \$1 million per year.

"Small business" would mean an independently owned and operated business commercially domiciled in Virginia that is located in (i) a HUBZone or (ii) an enterprise zone, or is a qualified small, women-owned, minority-owned, or veteran-owned business.

The Department of Business Assistance, the Virginia Economic Development Partnership Authority and the Virginia Economic Bridge, Inc. would be required to develop and publish a plan for implementing the provisions of the credit including, but not limited to, (i) sources for small business lending to help with capitalization, (ii) higher education workforce training, and (iii) small business certification and assistance to help small businesses qualify.

The bill would be effective for taxable years beginning on and after January 1, 2011. No credit would be permitted for incremental contract increases made prior to the 2011 taxable year.

The Department of Taxation would be required to develop and publish guidelines regarding the documentation necessary for large businesses to attach to their income tax returns. It is the understanding of the Department of Taxation that the intent of this bill is to provide a credit to large federal contractors for subcontracting work to designated small businesses in Virginia. Many of the terms used in the bill are intended to have the same meaning as the Federal Acquisition Regulations or terms used by the Small Business Administration.

The Small Business Administration establishes small business size standards on an industry-by-industry basis. In addition, the Small Business Administration considers a "minority-owned firm" to be a firm where the sole proprietor is African American, Hispanic, Asian, Pacific Islander, or American Indian/Alaska Native, or, in the case a firm with multiple owners, where 51% of the stock interest, claims or rights is held by African Americans, Hispanics, Asians, Pacific Islanders, or American Indians/Alaska Natives.

Under the Federal Acquisition Regulations, a "women-owned small business concern" means a small business concern that is at least 51% owned by one or more women, and whose management and daily business operations are controlled by one or more women. Further, a "veteran-owned small business concern" means a small business concern in which at least 51% is owned by one or more veterans (as defined at 38 U.S.C. 101(2)), and the management and daily business operations of which are controlled by one or more veterans.

The earliest the credit would be available to a large business would be 30 days after the first 12 months of the qualified subcontract. Under this provision, the large business would likely have to apply for the credit very shortly after the first 12 months of the qualified subcontract in order to get approval to take the credit after the 30 day period.

It is the Department's understanding, that the intent of the bill is to permit the large business to claim the credit in the taxable year the credit is approved, not the taxable year in which the subcontract was initiated.

The bill would establish cap of \$10 million per year on the total amount of credits allowed for qualified subcontracts. The bill does not specify what agency would administer the cap or how distributions would be made from the \$10 million pool.

The definition of a small business would include those small businesses located in an enterprise zone in which tax credit are provided. While a number of businesses continue to claim tax credits earned prior to 2006, the Virginia Enterprise Zone program was converted to a grant program in 2005. As such, there may be a question as to whether businesses located in Virginia Enterprise Zones would qualify as a small business under this credit.

cc : Secretary of Finance

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