DEPARTMENT OF TAXATION
2012 Fiscal Impact Statement

1. **Patron** Mark R. Herring

2. **Bill Number** SB 226
   House of Origin:
   _____ **Introduced**
   _____ **Substitute**
   _____ **Engrossed**

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

3. **Committee** House Finance

4. **Title** Income tax; capital gains subtraction

5. **Summary/Purpose:**

   This bill would extend the time before which investments may be made in order for the gain from such investments to qualify for the capital gain subtraction from June 30, 2013 to June 30, 2015.

   This is an Executive bill.

6. **Budget amendment necessary:** No.

7. **No Fiscal Impact**. (See Line 8.)

8. **Fiscal implications:**

   Administrative Impact

   The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

   Revenue Impact

   This bill would have no revenue impact because the extension is already assumed in the official revenue forecast.

9. **Specific agency or political subdivisions affected:**

   Department of Taxation

10. **Technical amendment necessary:** No.

11. Other comments:

Capital Gains

Almost everything owned and used for personal or investment purposes is a capital asset. Examples include homes, household furnishings, and stocks, bonds or other forms of investment. When a capital asset is sold, the difference between what the taxpayer paid for the asset (the “basis”) and the amount for which it is sold is a capital gain or a capital loss. A capital gain is realized if the asset sells for more than base amount, while a capital loss is realized if the asset sells for less than the base amount.

Capital gains and losses are classified as either long-term or short-term. If an asset is held for more than one year before it is sold, the capital gain or loss is long-term. A short-term capital gain is when the asset is held for one year or less.

If a net capital gain is realized, for federal income tax purposes, that gain may be taxed at a lower tax rate than the ordinary income tax rates. The "net capital gain" is the amount by which a net long-term capital gain for the year is more than the sum of the net short-term capital loss and any long-term capital loss carried over from the previous year. Currently, net capital gain is generally taxed at rates no higher than 15%, although, for 2008 through 2012, some or all net capital gain may be taxed at 0%, if it would otherwise be taxed at lower rates. Virginia does not currently have any preferential tax treatment for capital gains.

Investment Services Partnership Interest (“Carried Interest”)

Carried interest is a share in the profits of a partnership given to its general partner or other managers, such as managers of investment partnerships, hedge funds, or private equity funds, in exchange for their management services. When a share of a partnership is purchased, the purchaser receives a capital interest, which is the share of ownership that was purchased, and a profits interest, which is the share of the profits earned by the partnership. A carried interest, therefore, is generally a profits interest without the capital interests.

Because the manager or general partner is compensated with a profits interest, the bulk of this income is taxed not as a compensation for services, but as a return on an investment. As the types of funds involved in these cases typically invest on a longer time horizon, this income is often taxed as a long-term capital gain.

Qualified Equity and Subordinated Debt Credit

Under current law an individual or corporation is allowed a tax credit for investments made to a qualified business. The total amount of the tax credits that may be granted to taxpayers is capped at $3 million. The $3 million is bifurcated, with one-half of the $3 million reserved for qualified businesses created to commercialize research developed at or in partnership with an institution of higher education and the remaining portion available for all other qualified businesses.

A “qualified business” is one that has annual gross revenues of no more than $3 million in its most recent fiscal year; has its principal office or facility in the Commonwealth; is engaged in business primarily in or does substantially all of its production in the Commonwealth; and has not obtained during its existence more than $3 million in aggregate gross cash proceeds from the issuance of its equity or debt investments except for those from banking or savings and loan institutions.

Qualified businesses include those related to 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.

No investment qualifies for this credit if the otherwise qualified business performs research in Virginia on human cells or tissue derived from induced abortions or from stem cells obtained from human embryos. This restriction does not apply to qualified businesses that conduct research using stem cells other than embryonic stem cells.

Capital Gain Subtraction

Current law allows an individual and corporate income tax subtraction for income taxed for federal income tax purposes as a long-term capital gain or as investment services partnership interest income (otherwise known as investment partnership carried interest income). The gain must be related to investments in “qualified businesses” as defined for the purposes of the Qualified Equity and Subordinated Debt Credit (QESDC), or in any other technology business approved by the Secretary of Technology, provided its principal office or facility is in the Commonwealth and it has less than $3 million in annual revenues in the fiscal year prior to the investment. A taxpayer who claims a tax credit for investment in a qualified business under the QESDC would not be allowed to claim this subtraction relating to investments in the same business.

To qualify for the subtraction, the related investment must currently be made between April 1, 2010 and June 30, 2013.

Proposal

This bill would extend the time before which investments may be made in order for the gain from such investments to qualify for the capital gain subtraction from June 30, 2013 to June 30, 2015.

Similar Legislation

House Bill 1013 is identical to this bill.

House Bill 585 and Senate Bill 344 would allow an individual income tax credit for certain investments made to small businesses.

cc : Secretary of Finance

Date: 02/14/2012 KLC
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