DEPARTMENT OF TAXATION
2012 Fiscal Impact Statement

1. Patron Ryan T. McDougle

2. Bill Number SB 344

House of Origin:
X Introduced
____ Substitute
____ Engrossed

3. Committee Senate Finance

4. Title Income Tax: Small Business Investment Tax Credit

Second House:
____ In Committee
____ Substitute
____ Enrolled

5. Summary/Purpose:

This bill would allow a refundable individual income tax credit to an eligible investor for each qualified investment during the taxable year in one or more small businesses that have been certified by the Department of Taxation (the "Department"). The credit would be equal to 10 percent of the qualified investment.

The total amount of tax credits available for all taxpayers who qualify would be limited to $1.5 million for each fiscal year. The tax credits would be allocated in the order that each completed application is received by the Department.

An eligible investor would not be allowed to claim this credit and the Qualified Equity and Subordinated Debt Investments Tax Credit for same investment.

This bill would be effective for taxable years beginning on or after January 1, 2012, but before January 1, 2015.

This is an Executive Bill.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

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

Revenue Impact

This bill would reduce General Fund revenue by $1.5 million annually for FY 2013 and FY 2014. However, no budget amendment is necessary because the revenue impact is assumed in the introduced Executive Budget.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

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.

Proposal

This bill would allow a refundable individual income tax credit to an eligible investor for each qualified investment during the taxable year in one or more small businesses that have been certified by the Department of Taxation (the “Department”). The credit would be equal to 10 percent of the qualified investment.

This bill would require a small business to apply each year with the Department to become certified and eligible to receive qualified investments. This bill would not allow any credit to be allocated to an eligible investor until the small business is first certified by the Department.

An eligible investor would be required to apply to the Department in order to claim the credit. However, a small business would be allowed to apply to the Department on behalf of an eligible investor. The Department would be required to determine the amount of the credit allocated to the eligible investor for the taxable year, and provide the eligible investor with written certification of the approved amount, which would be required to be attached to the eligible investor's income tax return.

The eligible investor would be required to hold the investment for two years, unless the qualified investment is transferred as a result of (i) the liquidation of the small business issuing such equity, (ii) the merger, consolidation, or other acquisition of such business with or by a party not affiliated with such business, or (iii) the death of the eligible investor. If the eligible investor fails to hold the equity for at least two years, then both used and unused tax credits will be forfeited and interest will be assessed in the amount of one percent per month, compounded monthly, from the date the tax credits were allocated to the eligible investor. Any amount of forfeiture and interest would be deposited into the general fund of the Commonwealth.

The total amount of tax credits available for all taxpayers who qualify would be limited to $1.5 million for each fiscal year. The tax credits would be allocated in the order that each completed application is received by the Department.

"Eligible investor" would mean an individual subject to the tax imposed by § 58.1-320. The term shall not include an individual who engages in the business of making debt or equity investments in private businesses, or to any taxpayer who is allocated a credit as a partner, shareholder, member, or owner of an entity that engages in such business.

"Pass-through entity" would mean the same as that term is defined in § 58.1-390.1, which means any entity, including a limited partnership, a limited liability partnership, a general partnership, a limited liability company, a professional limited liability company, a business trust or a Subchapter S corporation, that is recognized as a separate entity for federal income tax purposes, in which the partners, members or shareholders report their share of the income, gains, losses, deductions and credits from the entity on their federal income tax returns.

"Qualified investment" would mean a cash investment in a qualified business in the form of equity or subordinated debt. However, an investment shall not be qualified if the taxpayer who holds such investment, or any of the taxpayer's family members, or any entity affiliated with such taxpayer, receives or has received compensation from the qualified business in exchange for services provided to such business as an employee, officer, director, manager, independent contractor, or otherwise in connection with or within one year before or after the date of such investment. For the purposes hereof, reimbursement of reasonable expenses incurred shall not be deemed to be compensation.

"Small business" would mean a corporation, pass-through entity, or other entity that (i) has annual gross revenues of no more than $3 million in its most recent fiscal year, (ii) has its principal office or facility in the Commonwealth, (iii) is engaged in business primarily in or does substantially all of its production in the Commonwealth, (iv) has not obtained during its existence more than $3 million in aggregate gross cash proceeds from the issuance of its equity or debt investments, not including commercial loans from national or state-chartered banking or savings and loan institutions, (v) has no more than 50 employees who are employed within the Commonwealth, and (vi) has been designated as such by the Department pursuant to the provisions of this section.

"Subordinated debt" would mean indebtedness of a corporation, general or limited partnership, or limited liability company that (i) by its terms required no repayment of principal for the first three years after issuance, (ii) is not guaranteed by any other person or secured by any assets of the issuer or any other person, and (iii) is subordinated to all indebtedness and obligations of the issuer to national or state-chartered banking or savings and loan institutions.

An eligible investor would not be allowed to claim this credit and the Qualified Equity and Subordinated Debt Investments Tax Credit for same investment.

Any credit attributable to a partnership, electing small business corporation (S corporation), or limited liability company would be allocated to the individual partners, shareholders, or members, respectively, in proportion to their ownership or interest in such business or entity.

The bill would require the Department to establish policies and procedure, exempt from the Administrative Process Act, regarding (i) the certification of small businesses, (ii) the application for tax credits, (iii) the recapture of credits and the assessment of interest in the event the qualified investment is not held for at least two years, and (iv) the method for allocating credits based on the order in which applications are received. The policies and procedures may also include provisions for allowing an application that is received after all of the credits allowable for the year have been allocated, to be carried over to a subsequent taxable year, up to the maximum amount of credits allowable for the subsequent taxable year.

This bill would be effective for taxable years beginning on or after January 1, 2012, but before January 1, 2015.

<u>Similar Bills</u>

Executive bills:

House Bill 585 is identical to this bill.

House Bill 714 and **Senate Bill 368** would extend the time during which the major business facility job tax credit may be taken over a two-year period through 2014.

House Bill 1013 and **Senate Bill 226** would extend the subtraction from individual and corporate income tax for capital gains to apply to investments in qualified businesses made through June 30, 2015.

Other bills:

House Bill 111 would grant an individual or corporate income tax credit, equal to $1,000, for each new full-time job, up to 50, that a small business creates in Virginia.

House Bill 149 and **Senate Bill 61** would reduce the corporate income tax rate to 3% for 3 years for corporations that locate satellite offices in certain localities.

House Bill 191 would allow a corporate or individual income tax credit, equal to $2,500, to a small business for each new job it creates in Virginia and fills with a graduate of a Virginia college or university.

House Bill 228 would create a corporate income tax credit for certain large federal government contractors equal to five percent of the value of new qualified subcontracts or the increase in the existing subcontracts with small businesses located in HUB zones or Enterprise Zones or are minority-owned, women-owned, or veteran-owned business.

House Bill 335 would allow an individual and corporate income tax deduction for any income taxed as a capital gain or investment services partnership interest income for federal income tax purposes attributable to an investment in a small business held for a period of at least five years.

cc : Secretary of Finance

Date: 2/2/2012 tlg
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