

DEPARTMENT OF TAXATION

2015 Fiscal Impact Statement

1. **Patron** Timothy D. Hugo

3. **Committee** House Finance

4. **Title** Income Tax; Reform the Research and Development Expenses Tax Credit

2. **Bill Number** HB 1743

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would change the amount of the Research and Development Expenses Tax Credit to 10 percent of the difference between:

- The Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year; and
- 50 percent of the average Virginia qualified research and development expenses paid or incurred by the taxpayer for the three taxable years immediately preceding the taxable year for which the credit is being determined.

If a taxpayer did not pay or incur Virginia qualified research and development expenses in one or more of the three taxable years immediately preceding the taxable year for which the credit is being determined, the amount of the credit would be equal to 7 percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year.

This bill would also remove the credit cap for the Research and Development Expenses Tax Credit.

This bill would be effective for taxable years beginning on or after January 1, 2015, but before January 1, 2019.

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

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

8. **Fiscal implications:**

Administrative Costs

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 an unknown, but potentially significant, negative General Fund revenue impact beginning in Fiscal Year 2016. This bill would remove the annual credit cap and the provision limiting the amount of credits each taxpayer could claim. These changes would significantly increase the overall amount of credits claimed.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Virginia currently allows Research and Development Expenses Tax Credits in an amount equal to 15 percent of the first \$234,000 in Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year or 20 percent of the first \$234,000 of such expenses if the Virginia qualified research was conducted in conjunction with a Virginia public or private college or university, to the extent the expenses exceed the Virginia base amount for the taxpayer. The Virginia base amount is equal to the lesser of:

- The product of the taxpayer's average gross receipts for the four taxable years preceding the credit year and the taxpayer's fixed-base percentage; or
- 50 percent of the taxpayer's Virginia qualified research and development expenses for the credit year.

The fixed-base percentage is a complex computation based on federal law, calculated by dividing the amount of Virginia qualified research and development expenses for the three taxable years preceding the credit year by the amount of gross receipts for the three taxable years preceding the credit year.

The credit is capped at \$6 million per fiscal year. If the total eligible credit requests exceeds \$6 million for any taxable year, each taxpayer will be granted a pro rata amount of credits as determined by the Department. If the total amount of approved credits is less than \$6 million for any taxable year, the Department is required to allocate credits of up to \$6 million, on a pro rata basis, to taxpayers that are already approved for the credit in an amount equal to 15 percent of the second \$234,000 in Virginia qualified research and development expenses paid or incurred by the taxpayer or 20 percent of the second \$234,000 in such expenses if the Virginia qualified research was conducted in conjunction with a Virginia public or private college or university.

Proposed Legislation

This bill would change the amount of the Research and Development Expenses Tax Credit to 10 percent of the difference between:

- The Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year; and
- 50 percent of the average Virginia qualified research and development expenses paid or incurred by the taxpayer for the three taxable years immediately preceding the taxable year for which the credit is being determined.

If a taxpayer did not pay or incur Virginia qualified research and development expenses in one or more of the three taxable years immediately preceding the taxable year for which the credit is being determined, the amount of the credit would be equal to 7 percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year.

These changes would simplify the credit computation by eliminating the existing requirement that taxpayers calculate the Virginia fixed-base percentage and Virginia base amount. Instead of these complex calculations, taxpayers would compute the credit based on the difference between the amount of Virginia qualified research and development expenses paid or incurred during the taxable year and 50 percent of the average amount of such expenses incurred during the prior three taxable years. These changes would also eliminate the per-taxpayer limitation on the amount of credit earned, the rate differential based on whether research is conducted in conjunction with a Virginia public or private college or university, and the existing two-step proration for purposes of allocating the annual credit cap.

This bill would also remove the credit cap for the Research and Development Expenses Tax Credit. Under current law, the annual amount of credit that may be issued is capped at \$6 million.

This bill would be effective for taxable years beginning on or after January 1, 2015, but before January 1, 2019.

cc : Secretary of Finance

Date: 1/26/2015 MTH
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