DEPARTMENT OF TAXATION
2016 Fiscal Impact Statement

1. Patron Peter F. Farrell

2. Bill Number HB 28

House of Origin:

_____ **Introduced**

__X__ **Substitute**

_____ **Engrossed**

Second House:

_____ **In Committee**

_____ **Substitute**

_____ **Enrolled**

3. Committee House Finance

4. Title Income Tax; Sunset the Qualified Equity and Subordinated Debt Investments Tax Credit

5. Summary/Purpose:

This bill would reduce the amount of the Qualified Equity and Subordinated Debt Investments Tax Credit from 50 percent of a taxpayer's qualified investments to 30 percent of such investments. This bill would reduce the credit carryover period from 15 years to two years.

This bill would require that for an investment to be a qualified investment for purposes of the credit, such investment must be made in the initial issuance or offering of equity or subordinated debt by a qualified business, regardless of class or series of equity, type or term of subordinated debt, type of partnership interest or membership interest, or whether the business changes its name or business form.

This bill would be effective for taxable years beginning on or after January 1, 2017.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Unknown (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 General Fund revenue impact, beginning as early as Fiscal Year 2017. Without any additional modifications, reducing the amount of the Qualified Equity and Subordinated Debt Investments Tax Credit from 50 percent of a taxpayer's qualified investments to 30 percent of such investments would have no impact on General Fund revenue because the credit is currently oversubscribed.

However, this bill would also restrict qualifying investments to investments made in the initial issuance or offering of equity or subordinated debt by a qualified business. This could significantly reduce the number of investments that qualify for the credit, and would result in a positive General Fund revenue impact. However, because the number of otherwise qualified businesses that would make an initial issuance or offering of equity or subordinated debt is unknown, the extent of such positive revenue impact is unknown.

This bill would also reduce the credit carryover period from 15 years to 2 years. This provision would have a positive impact on General Fund revenue because credits claimed prior to Taxable Year 2017 could still be carried forward for up to 15 years. As a result, the full positive revenue impact of this provision would not be realized until after Taxable Year 2031.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

<u>The Qualified Equity and Subordinated Debt Investments Tax Credit</u>

Virginia currently allows Qualified Equity and Subordinated Debt Investments Tax Credits in an amount equal to 50 percent of a taxpayer's qualified investments. The credit may be claimed against the individual income tax or the income tax imposed on trusts and estates. For purposes of the credit, a "qualified investment" is defined as a cash investment in a qualified business in the form of equity or subordinated debt. A "qualified business" is a business which:

- Has no more than $3 million of gross revenues in the most recent fiscal year;
- Has its principal office or facility in Virginia;
- Is engaged in business primarily in or does substantially all of its production in Virginia;
- Has not during its existence more than $3 million in aggregate gross cash proceeds from the issuance of its equity or debt investments; and
- Is primarily engaged in or is primarily organized to engage in one or more of the following high technology-related fields:
    - Advanced computing;
    - Advanced materials;
    - Advanced manufacturing;
    - Agricultural technologies;
    - Biotechnology;

- o Electronic device technology;
- o Energy;
- o Environmental technology;
- o Information technology;
- o Medical device technology;
- o Nanotechnology; or
- o Any similar technology-related field as determined by regulations promulgated by the Department.

Credits cannot be claimed by any taxpayer that has committed capital under management in excess of $10 million and engages in the business of making debt or equity investments in private businesses, or by any taxpayer that is allocated a credit as a partner, shareholder, member or owner of an entity that engages in such business.

The credit is currently capped at $5 million per year. However, beginning with 2006, budget actions have imposed a lower credit cap for certain years. See the chart below for information about the annual credit cap imposed from 2006 through 2014.

Year	**Annual Credit Cap**
2006-2009	$3 million
2010	$5 million
2011	$3 million
2012	$4 million
2013	$4.5 million
2014 and after	$5 million

One-half of the amount of credits available each year must be allocated exclusively for credits for commercialization investments. For purposes of the credit, a “commercialization investment” is a qualified investment in a qualified business that was created to commercialize research developed at or in partnership with an institution of higher education. If the amount of credits requested for commercialization investments is less than one-half of the credit cap, the balance of credits remaining must be allocated for qualified investments in any qualified business.

No taxpayer is permitted to claim more than $50,000 in credits for a taxable year. Any credit not useable for the taxable year in which the credit was allowed may be, to the extent usable, carried over for the next 15 succeeding taxable years or until the total amount of the credit has been taken, whichever occurs first.

Credit applications have exceeded the credit cap, resulting in a reduction in the amount of credit each taxpayer is allocated. See the chart below for information regarding the amount of credits requested from 2011 through 2014.

Year	Number of Taxpayers	Number of Investments	Amount Approved	Annual Cap
2011	200	235	$8,089,740	$3,000,000
2012	65	83	$2,534,882	$4,000,000
2013	140	245	$7,291,256	$4,500,000
2014	127	228	$9,029,024	$5,000,000

Proposed Legislation

This bill would reduce the amount of the Qualified Equity and Subordinated Debt Investments Tax Credit from 50 percent of a taxpayer's qualified investments to 30 percent of such investments. This bill would reduce the credit carryover period from 15 years to 2 years.

This bill would require that for an investment to be a qualified investment for purposes of the credit, such investment must be made in the initial issuance or offering of equity or subordinated debt by a qualified business, regardless of class or series of equity, type or term of subordinated debt, type of partnership interest or membership interest, or whether the business changes its name or business form.

This bill would require the Department to develop and publish guidelines, exempt from the Administrative Process Act, implementing the provisions of this bill.

This bill would be effective for taxable years beginning on or after January 1, 2017.

Similar Bills

House Bill 660 and **Senate Bill 200** would increase the annual cap on the Qualified Equity and Subordinated Debt Investments Tax Credit from $5 million to $9 million and increase the maximum amount of credits each taxpayer may claim per taxable year from $50,000 to $100,000.

House Bill 799 would increase the annual cap on the Qualified Equity and Subordinated Debt Investments Tax Credit from $5 million to $7.5 million, reserve $2.5 million of the annual cap exclusively for investments in cybersecurity businesses, and allow a business with no more than 50 full-time employees to qualify even if it has more than $3 million of annual gross revenues.

Item 3-6.04 of the Introduced Executive Budget would allocate $2 million of the amount of Qualified Equity and Subordinated Debt Investments Tax Credits exclusively for investments in biotechnology companies.

cc : Secretary of Finance

Date: 1/26/2016 MTH
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