DEPARTMENT OF TAXATION
2017 Fiscal Impact Statement

1. Patron Nick Rush

2. Bill Number HB 2074

House of Origin:
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. Committee Senate Finance

4. Title Individual and Corporate Income Tax; Subtraction for Investments in Virginia Venture Capital Accounts

5. Summary/Purpose:

This bill would allow an individual and corporate income tax subtraction for certain income attributable to an investment in a Virginia venture capital account made on or after January 1, 2018. A "Virginia venture capital account" would be defined as an investment fund that (i) invests at least 50 percent of its funds invested during the year in which the taxpayer claims a subtraction, or any of the previous five years, in qualified portfolio companies and (ii) employs at least one investor who has either at least four years of professional experience in venture capital investment or substantially equivalent experience.

This bill would be effective for taxable years beginning on and after January 1, 2018.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Not available. (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 negative General Fund revenue impact beginning in Fiscal Year 2019. According to the Virginia Economic Development Partnership, there were 75 venture capital deals in Virginia in 2014. However, it is unknown how many venture capital investments will be made through Virginia venture capital accounts on or after January 1, 2018, and the amount income attributable to such investments that would qualify for the subtraction proposed by this bill. Additionally, no subtraction would be allowed for an investment that was used as the basis to claim the subtraction for certain long-term capital gains or the Qualified Equity and Subordinated Debt Investments Tax Credit.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

The Qualified Equity and Subordinated Debt Investments Tax Credit

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;
  - Electronic device technology;
  - Energy;
  - Environmental technology;
  - Information technology;
  - Medical device technology;
  - Nanotechnology; or
  - 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 imposed a lower credit cap for certain years. See the chart below for information about the annual credit cap imposed from 2006 through 2016.

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 2015.

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
2015	191	268	$7,369,520	$5,000,000

Virginia's Subtraction for Certain Long-Term Capital Gains

Virginia allows an individual and corporate income tax subtraction for any income attributable to an investment in certain high technology businesses that is taxed as long-term capital gain or investment services partnership interest income for federal income tax purposes. For purposes of the subtraction, "qualified business" means a business that:

- Has annual gross revenues of no more than $3 million in its 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 obtained 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, or is primarily organized to engage, in certain technology-related fields.

"Qualified business" also includes any other technology business approved by the Secretary of Technology provided that the business has its principal office or facility in Virginia and less than $3 million in annual revenues in the fiscal year prior to the investment.

For an investment to qualify for the subtraction, it must be made between April 1, 2010 and June 30, 2020.

No taxpayer that has claimed the Qualified Equity and Subordinated Debt Investments Tax Credit for an investment in a qualified business may claim the subtraction for income taxed as long-term capital gain for federal income tax purposes for an investment in the same business.

Proposed Legislation

This bill would allow an individual and corporate income tax subtraction for certain income attributable to an investment in a Virginia venture capital account made on or after January 1, 2018. No subtraction would be allowed to an individual taxpayer:

- For an investment in a company that (i) is owned or operated by a family member or affiliate of the taxpayer, or (ii) within one year before the investment provided compensation to the taxpayer for services as an employee, officer, director, manager, or independent contractor;
- Who has claimed the subtraction for certain long-term capital gains for the same investment; or
- Who claimed the Qualified Equity and Subordinated Debt Investments Tax Credit for the same investment.

No subtraction would be allowed to a corporate taxpayer for an investment in a company that is owned or operated by an affiliate of the taxpayer, or that was used as the basis to claim the subtraction for certain long-term capital gains.

"Virginia venture capital account" would be defined as an investment fund that (i) invests at least 50 percent of its funds invested during the year in which the taxpayer claims a subtraction, or any of the previous five years, in qualified portfolio companies and (ii) employs at least one investor who has either at least four years of professional experience in venture capital investment or substantially equivalent experience.

"Qualified portfolio company" would be defined as a company that (i) has its principal place of business in the Commonwealth; (ii) has a primary purpose of production, sale, research, or development of a product or service other than the management or investment of capital; and (iii) provides equity in the company to the Virginia venture capital account in exchange for a capital investment. "Qualified portfolio company" would not include a company that is an individual or sole proprietorship.

"Substantially equivalent experience" would include, but would not be limited to, an undergraduate degree from an accredited college or university in economics, finance, or a similar field of study. The Department would be allowed to require a Virginia venture capital account to provide documentation of the investor's training, education, or experience as deemed necessary by the Department to determine substantial equivalency.

This bill would be effective for taxable years beginning on and after January 1, 2018.

cc : Secretary of Finance

Date: 2/9/2017 MTH
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