DEPARTMENT OF TAXATION
2010 Fiscal Impact Statement

1. Patron Mark L. Keam

2. Bill Number HB 1359

House of Origin:
X **Introduced**
____ **Substitute**
____ **Engrossed**

3. Committee House Finance

4. Title Income Tax: Machinery and Equipment Incremental Investment Tax Credit

Second House:
____ **In Committee**
____ **Substitute**
____ **Enrolled**

5. Summary/Purpose:

This bill would provide an individual and corporate income tax credit to a small business that makes a "new investment" in machinery and equipment. The credit would be equal to 20% of the small business's new investment for the taxable year, not to exceed $10,000 in a taxable year. This credit would be allowed to be carried forward for up to five taxable years or until the credit has been taken, whichever is sooner. The amount of tax credit would not be allowed to exceed the total amount of tax imposed for the taxable year in which the investment was made.

Under this bill, "small business" would mean an independently owned and operated business that, together with affiliates, has 250 or fewer employees or average annual gross receipts of $10 million or less averaged over the previous three years.

This bill would be effective for taxable years beginning on or after January 1, 2010, but before January 1, 2013.

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

7. Budget amendment necessary: No.

8. Fiscal implications:

Administrative Costs

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, TAX considers implementation of this bill as "routine," and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not "routine." Additionally, TAX will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, TAX will identify the costs at that time.

Revenue Impact

This bill would have an unknown, but potentially significant, negative impact on General Fund revenue. The earliest loss in revenue would most likely fall in FY 2011 as taxpayers are filing their TY 2010 returns. Because this bill would provide a carry forward provision, the credit could be claimed as late as TY 2017, with the revenue impact from those returns falling in either FY 2018 or FY 2019.

In order to illustrate the amount of investments that small business might make in a given year, TAX looked at data from the U.S. Census as well as the Internal Revenue Service ("IRS"). According to the most recent U.S. Census data, it is estimated that Virginia manufacturers spent approximately $2.21 billion on equipment and machinery in 2006. This statistic, however, represents only one sector in Virginia's economy, and does not reflect investments by firm size.

Data from the IRS offers more information regarding investments by certain types of small businesses. Based on IRS data for Taxable Year 2007, sole proprietorships and partnerships in Virginia claimed an estimated $1.0 to $1.3 billion in deductions for investment in a wide variety of property, including machinery and equipment. Other property eligible for the deduction includes light trucks, computer software, and fixtures attached to real property.

It is, however, impossible to determine the revenue impact of the credit allowed under this bill.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

This bill would provide an individual and corporate income tax credit to a small business that makes a "new investment" in machinery and equipment. The credit would be equal to 20% of the small business's new investment for the taxable year, not to exceed $10,000 in a taxable year. This credit would be allowed to be carried forward for up to five taxable years or until the credit has been taken, whichever is sooner. The amount of tax credit would not be allowed to exceed the total amount of tax imposed for the taxable year in which the investment was made.

"New investment" would mean the purchase price paid or the lease payments made by a small business in the taxable year to acquire machinery or equipment that is used in the Commonwealth in the taxpayer's trade or business. The term would not apply to any machinery or equipment (i) that is rented under a short-term rental agreement, (ii) that is purchased or leased pursuant to a sale and leaseback transaction, (iii) that is acquired by merger with another entity or by the acquisition of all or a portion of the assets of another entity or that is included as part of the spin-off of an entity, or (iv) that is purchased by the small business for resale or for lease to another person.

"Small business" would mean an independently owned and operated business that, together with affiliates, has 250 or fewer employees or average annual gross receipts of $10 million or less averaged over the previous three years.

This bill would require a small business to apply to TAX for tax credits and provide supporting documentation such as sales receipts, contracts, and other evidence of new investments. TAX would be required to develop guidelines exempt from the Administrative Process Act that include procedures for claiming the tax credit.

Finally, this bill would provide that credits granted to a partnership, limited liability company, or electing small business corporation (S corporation) shall be allocated to the individual partners, members, or shareholders, respectively, in proportion to their ownership or interest in such business entity.

This bill would be effective for taxable years beginning on or after January 1, 2010, but before January 1, 2013.

Similar Legislation

House Bill 2 would provide a tax credit for small businesses that make eligible investments of at least $10,000. The investments would be required to be for the purposes of (i) acquiring personal property for use only by the business, and (ii) constructing, improving, or upgrading, real estate used by the business. The credit would be equal to 10% of the taxpayer's eligible investments made on or after July 1, 2010, but before July 1, 2011.

cc : Secretary of Finance

Date: 2/4/2010 TLG
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