DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

1. Patron L. Scott Lingamfelter

2. Bill Number HB 2325

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

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

3. Committee House Finance

4. Title Income Tax: Research and Development Expenses Tax Credit

5. Summary/Purpose:

This bill would allow an individual or corporate income tax credit for qualified research and development expenses paid or incurred during the taxable year. The credit amount would be equal to (i) three percent of the Virginia qualified research and development expenses, not to exceed the Virginia base amount for the taxpayer; or (ii) ten percent of the Virginia qualified research and development expenses that exceed the Virginia base amount for the taxpayer.

The total amount of tax credits available for all taxpayers who qualify would be limited to $6 million for each fiscal year, and would be allocated evenly between research and development expenses that do not exceed the Virginia base amount and research and development expenses that exceed the Virginia base amount. This bill would provide that if the total amount of tax credits applied for exceeded the $3 million limit for either, the credits would be prorated and allocated to the taxpayers on a pro rata basis.

This bill would allow any unused credits to be carried over for five taxable years or until the total amount of the credit is taken, whichever is sooner. Any taxpayer that is allowed a research and development expenses tax credit would not be allowed to use the same expenses as the basis for claiming any other Virginia tax credit.

This bill would be effective for taxable years beginning on or after January 1, 2012, but before January 1, 2017.

6. Budget amendment necessary: No.

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

7b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2010-11	$0	GF
2011-12	$0	GF
2012-13	($6 million)	GF
2013-14	($6 million)	GF
2014-15	($6 million)	GF
2015-16	($6 million)	GF
2016-17	($6 million)	GF

8. Fiscal implications:

Administrative Costs

TAX considers implementation of this bill as "routine," and does not require additional funding. The Virginia Economic Development Partnership may incur costs to administer the allocation of credits depending on the volume of applications.

Revenue Impact

This bill would have an annual revenue loss of $6 million in Fiscal Years 2013 through 2017. Based on data related to the federal research credit, a Virginia credit equal to 1 percent of the federal credit claimed would total an estimated $3.4 million in FY 2013. It is not known how much of the research and development for which corporations claimed a federal credit was conducted in Virginia. However, since the proposed Virginia credit would be 3% or 10% of the federal credit on qualifying Virginia-based research, it is likely that total credits claimed will be greater than $6 million. Therefore, the revenue loss would be limited to $6 million.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia Economic Development Partnership

10. Technical amendment necessary: No.

11. Other comments:

Federal Research Tax Credit

Under federal law, a taxpayer is allowed a research credit equal to twenty percent of (i) the qualified research expenses for a taxable year that exceed the taxpayer's base amount for that year; (ii) the basic research payments made to a qualified organization that conducts research; and (iii) the payments made to energy research consortiums, which include nonprofit organizations, other than private foundations, that are operated primarily to conduct energy research.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, extended the research and development tax credit for two years, through December 31, 2011.

Other States

Thirty-seven states provide income tax credits for research and development expenses. These credits vary not only in amount, but also in how they are structured. However, a majority of the credits are incremental, granting the credit for expenditures over a certain base or average amount.

Maryland allows a research and development tax credit that is similar to this bill. Under Maryland law, there are two types of credits available to taxpayers, a basic credit and a growth credit. The basic credit is a non-incremental individual or corporate income tax credit equal to three percent of Maryland qualified research and development expenses paid during the taxable year, not to exceed the Maryland base amount. The growth credit is an incremental credit equal to ten percent of Maryland qualified research and development expenses paid during the taxable year that exceed the Maryland base amount. Maryland's research and development tax credit is capped at $6 million annually.

Proposal

This bill would allow an individual or corporate income tax credit for qualified research and development expenses paid or incurred during the taxable year. The credit amount would be equal to (i) three percent of the Virginia qualified research and development expenses, not to exceed the Virginia base amount for the taxpayer; or (ii) ten percent of the Virginia qualified research and development expenses that exceed the Virginia base amount for the taxpayer.

The total amount of tax credits available for all taxpayers who qualify would be limited to $6 million for each fiscal year. Under this bill, the Partnership would allocate the total amount of tax credits available for all taxpayers evenly between research and development expenses that do not exceed the Virginia base amount and research and development expenses that exceed the Virginia base amount. This bill would provide that if the applications for the tax credits exceeded the $3 million limit for either, the credits would be prorated and allocated by the Partnership to the taxpayers on a pro rata basis.

This bill would allow any unused credits to be carried over for five taxable years or until the total amount of the credit is taken, whichever is sooner. Any taxpayer that is allowed a research and development expenses tax credit would not be allowed to use the same expenses as the basis for claiming any other Virginia tax credit.

Under this bill, "Virginia base amount" would mean the base amount as defined in § 41 (c) of the Internal Revenue Code (IRC), as amended, that is attributable to Virginia. Under § 41 (c) of the IRC, "base amount" is defined as the product of the fixed-base percentage and the average annual gross receipts of the taxpayer for the four taxable years preceding the taxable year in which the credit is being claimed. The "fixed-base percentage" is defined as the percentage of the aggregate gross receipts that were qualified research expenses during a specified time period.

In order to determine the Virginia base amount, however, this bill would substitute "Virginia qualified research and development expense" for "qualified research expense"; and "Virginia qualified research and development" for "qualified research". In addition, instead of "fixed base percentage," the Virginia base amount would be determined by using: (1) the percentage of the taxpayer's total gross receipts that is the Virginia qualified research and development expense for the four taxable years immediately preceding the taxable year in which the expense is incurred; or (2) the percentage of the taxpayer's total gross receipts that is the Virginia qualified research and development expense for at least one taxable year, but no more than three, immediately preceding the taxable year in which the expense is incurred.

"Virginia gross receipts" would mean the whole, entire, total receipts, without deduction.

"Virginia qualified research and development" would mean qualified research, as defined in § 41 (d) of the IRC, as amended, that is conducted in the Commonwealth in partnership with any Virginia nonprofit college or university. In general, this would be research that is undertaken for the purpose of discovering information that is technological in nature and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer.

"Virginia qualified research and development expenses" would mean qualified research expenses, as defined in § 41 (b) of the IRC, as amended, incurred for Virginia qualified research. In general, this would be the sum of the in-house research expenses and the contract research expenses.

Any credits granted to a partnership, limited liability company, or electing small business corporation (S corporation) would be allocated to the individual partners, members, or shareholders, respectively, in proportion to their ownership interests in such entities.

TAX would be required to promulgate regulations, which would be exempt from the Administrative Process Act, to establish procedures for applying for the tax credits and standards for determining when research and development is considered to have been conducted in the Commonwealth. In order to determine when research and development is conducted in the Commonwealth, TAX may consider (i) the location where the research and development are performed; (ii) the residence or business location of the taxpayer or taxpayers doing the research and development; (iii) the location where supplies used in the research and development are consumed; and (iv) any other factors that TAX deems to be relevant.

Finally, the Virginia Economic Development Partnership would be required to issue a report to the Governor and the chairmen of the House Committee on Appropriations, the House Committee on Finance, and Senate Committee on Finance that includes: (i) the total number of applicants approved for the tax credits during the applicable tax year, (ii) the total number of tax credit applications approved during the applicable tax year, and (iii) the total amount of credits authorized for all tax years.

This bill would be effective for taxable years beginning on or after January 1, 2012, but before January 1, 2017.

Similar Legislation

House Bill 1447 and Senate Bill 1326, as amended, would allow a refundable individual or corporate income tax credit for qualified research and development expenses paid or incurred during the taxable year. The credit amount would be equal to (i) fifteen percent of the first $167,000 in Virginia qualified research and development expenses; or (ii) twenty percent of the first $175,000 in Virginia qualified research and development expenses if the research was conducted in conjunction with a Virginia public college or university, not to exceed the Virginia base amount for the taxpayer. The total number of tax credits would be limited to $5 million for each fiscal year.

cc : Secretary of Finance

Date: 1/27/2011 TG
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