

DEPARTMENT OF TAXATION

2011 Fiscal Impact Statement

1. **Patron** Mark R. Herring

3. **Committee** Senate Finance

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

2. **Bill Number** SB 1326

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

TAX understands that the patron will offer a substitute for this bill. This fiscal impact statement is applicable to that substitute version.

This bill 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 amount of tax credits available for all taxpayers who qualify would be limited to \$5 million for each fiscal year. This bill would provide that if the total amount of tax credits applied for exceeded the \$5 million limit, TAX would be required to prorate the credits and allocate them to the taxpayers on a pro rata basis.

This bill would also provide that if the total amount of approved tax credits is less than the \$5 million limit, TAX would be required to allocate the remaining amount to the taxpayers already approved for the tax credits for the taxable year for fifteen percent of the second \$167,000 in Virginia qualified research expenses or 20 percent of the second \$175,000 in Virginia qualified research expenses if the research was conducted in conjunction with a Virginia public college or university, not to exceed the Virginia base amount, on a pro rata basis.

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, 2011, but before January 1, 2016.

This is an Executive bill.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

TAX considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would reduce General Fund revenue by \$5 million annually for FY 2012 through FY 2016. However, the revenue impact is included in the introduced Executive Budget.

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 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 amount of tax credits available for all taxpayers who qualify would be limited to \$5 million for each fiscal year. This bill would provide that if the total amount of tax credits applied for or exceeded the \$5 million limit, TAX would be required to prorate the credits and allocate them to the taxpayers on a pro rata basis.

This bill would also provide that if the total amount of approved tax credits is less than the \$5 million limit, TAX would be required to allocate the remaining amount to the taxpayers already approved for the tax credits for the taxable year for fifteen percent of the second \$167,000 in Virginia qualified research expenses or 20 percent of the second \$175,000 in Virginia qualified research expenses if the research was conducted in conjunction with a Virginia public college or university, not to exceed the Virginia base amount, on a pro rata basis.

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" 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 three 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 the one or two taxable years 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" would mean qualified research, as defined in § 41 (d) of the IRC, as amended, that is conducted in the Commonwealth. 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 the entities or in accordance with a written agreement entered into by the individual partners, members, or shareholders.

TAX would be required to promulgate guidelines, 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 include in the Annual Report on Business Incentives, compiled by the Secretary of Commerce and Trade, (i) the total number of applicants approved for research and development expenses tax credits during the applicable tax year, and (ii) the total number of research and development expenses tax credits approved during the applicable tax year.

This bill would be effective for taxable years beginning on or after January 1, 2011, but before January 1, 2016.

Similar Legislation

House Bill 1447, as amended, is identical to this bill.

House Bill 2325 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. This bill would allow any unused tax credits to be carried over for five taxable years.

cc : Secretary of Finance

Date: 1/24/2011 TG
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