DEPARTMENT OF TAXATION
2015 Fiscal Impact Statement

1. Patron Ryan T. McDougle

2. Bill Number SB 1447

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

3. Committee House Finance

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

4. Title Corporate Income Tax; Subtraction For Previously Inverted Corporation

5. Summary/Purpose:

This bill would provide a corporate income tax subtraction for the first $5,000,000 of profits per year of any previously-inverted corporation that makes a capital investment of at least $5 million to open a facility or business operation in the Commonwealth. Such subtraction would be allowed for the first five years of the operation of the qualifying facility or business operation.

The bill would be effective for taxable years beginning on or after January 1, 2016.

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 result in an unknown General Fund revenue loss. For each qualifying company, exempting the first $5 million of income would reduce Corporate Income Tax revenue by up to $1.5 million ($300,000 for five years), depending on its income and apportionment factor.

The number of corporations that would qualify is unknown, but there could be several corporations making qualifying investments each year. Based on announced plans of new or expanding companies tracked by the Virginia Economic Development and Partnership, there were 727 projects announced over the last 10 years with investments of $5 million or more, of which 173 had a foreign affiliation. It is not known how many of the 173 corporations were the result of an inversion.

According to the Committee on Ways and Means, there were approximately 40 corporate inversions between 2004 and 2014. The Department is not aware of any corporate inversions that have occurred since 2014, nor is the Department aware of any such transactions that have impacted businesses that are currently subject to Virginia income taxation.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Taxation of Foreign Income and Foreign Corporations

The United States generally taxes U.S. corporations on their worldwide income, regardless of its geographic origin. However, corporations are permitted to claim a federal tax credit for income taxes paid to foreign countries. Additionally, the United States has entered into a number of income tax treaties with other countries that limit taxation to the source country, which may impact the taxation of certain foreign source income.

Foreign corporations, on the other hand, are only taxed by the United States on income originating in the United States. Income generated by a trade or business in the United States is taxed at the regular federal income tax rates if such income is effectively connected with the U.S. business. Income that is not effectively connected with a U.S. business (either because the person has no business or business the income is not related to the business) is generally subject to a 30 percent gross income tax (with no deductions allowed), unless a lower rate is imposed by an applicable income tax treaty.

For corporate income tax purposes, Virginia generally conforms to federal definition of federal taxable income. However, Virginia law specifically excludes any foreign source income from taxation in Virginia. Accordingly, even if such income is subject to taxation under federal law, it is not subject to Virginia taxation.

Corporate Inversions

A corporate inversion occurs when a corporation with its headquarters in the United States, and owned by U.S. shareholders, shifts its headquarters to a foreign country so that the U.S. corporation becomes a subsidiary of a foreign parent corporation. The foreign parent owns all of the foreign operations, while the U.S. corporation owns only U.S. operations. There are several ways to accomplish such a move (mergers are usually involved), but the result is that income earned abroad is no longer subject to U.S. income tax. In addition to removing foreign income from the United States tax base, such transactions would also often enable the corporation to reduce the tax on U.S. source income through various earnings stripping transactions, such as making deductible payments of interest, royalties, or management service fees to the new foreign parent or other foreign affiliates.

Prior to 2004, it was relatively easy for corporations to structure inversion transactions. In 2004, Congress enacted the American Jobs Creation Act of 2004, which established rules intended to limit the benefits of inversion transactions. For example, if at least 80 percent of the foreign parent corporation is owned by former shareholders of the inverted domestic corporation following an inversion, the parent corporation is treated as a domestic corporation for U.S. tax purposes and it becomes subject to tax on its worldwide income, rather than only on income originating in the United States. As a result, the rate of corporate inversions has decreased since the 2004 legislation was enacted.

Proposal

This bill would provide a corporate income tax subtraction for the first $5,000,000 of profits per year of any previously-inverted corporation that makes a capital investment of at least $5 million to open a facility or business operation in the Commonwealth. Such subtraction would be allowed for the first five years of the operation of the qualifying facility or business operation.

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cc : Secretary of Finance

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