

DEPARTMENT OF TAXATION

2016 Fiscal Impact Statement

1. **Patron** Peter F. Farrell

2. **Bill Number** HB 1355

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Income Tax; Modify the Refundability of the Research and Development Expenses Tax Credit

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would modify the Research and Development Expenses Tax Credit by making such credit nonrefundable. Any credit not usable for the taxable year for which the credit was issued would be permitted to be carried over to the extent useable for the next seven taxable years or until the total amount of the credit has been taken, whichever occurs sooner.

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

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 General Fund revenue impact, beginning as early as Fiscal Year 2017. Such revenue impact would be positive to the extent that taxpayers would be unable to claim refundable tax credits in excess of their tax liability. However, such credits would likely be claimed in later taxable years to the extent taxpayers have sufficient tax liability. The extent to which taxpayers would carry over unused credits, and the taxable years within which taxpayers would utilize such carryover credits is unknown.

9. **Specific agency or political subdivisions affected:**

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Research and Development Expenses Tax Credit

Virginia currently allows Research and Development Expenses Tax Credits in an amount equal to 15 percent of the first \$234,000 (up to a maximum of \$35,100) in Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year or 20 percent of the first \$234,000 (up to a maximum of \$46,800) of such expenses if the Virginia qualified research was conducted in conjunction with a Virginia public or private college or university, to the extent the expenses exceed the Virginia base amount for the taxpayer. The Virginia base amount is equal to the lesser of:

- The product of the taxpayer's average gross receipts for the four taxable years preceding the credit year and the taxpayer's fixed-base percentage; or
- 50 percent of the taxpayer's Virginia qualified research and development expenses for the credit year.

The fixed-base percentage is a complex computation based on federal law, calculated by dividing the amount of Virginia qualified research and development expenses for the three taxable years preceding the credit year by the amount of gross receipts for the three taxable years preceding the credit year.

The credit is capped at \$6 million per fiscal year. If the total eligible credit requests exceed \$6 million for any taxable year, each taxpayer is granted a pro rata amount of credits as determined by the Department. If the total amount of approved credits is less than \$6 million for any taxable year, the Department is required to allocate credits of up to \$6 million, on a pro rata basis, to taxpayers that are already approved for the credit in an amount equal to 15 percent of the second \$234,000 in Virginia qualified research and development expenses paid or incurred by the taxpayer or 20 percent of the second \$234,000 in such expenses if the Virginia qualified research was conducted in conjunction with a Virginia public or private college or university.

The Research and Development Expenses Tax Credit is generally a refundable credit. Therefore, if the amount of credit that a taxpayer is allowed to claim exceeds the taxpayer's tax liability for the taxable year, then the excess amount of credit will be refunded to the taxpayer. Research and development expenses that are paid or incurred for research conducted in Virginia on human cells or tissue derived from induced abortions or from stem cells obtained from embryos do not qualify for the credit. However, if a taxpayer engages in research in Virginia on human cells or tissue derived from induced abortions or from stem cells obtained from human embryos, it may receive a nonrefundable credit for other Virginia qualified research and development expenses. If the amount of nonrefundable credit that a taxpayer is allowed to claim exceeds the taxpayer's tax liability for the taxable year, then the excess amount of credit will not be refunded to the taxpayer and cannot be carried over to future taxable years.

For Taxable Years 2011 through 2014, the Department approved applications for Research and Development Expenses Tax Credits as follows:

Taxable Year	Number of Applications Approved	Total Amount Approved	Annual Cap
TY 2011	64	\$2,139,944	\$5,000,000
TY 2012	135	\$4,545,634	\$5,000,000
TY 2013	193	\$4,999,958	\$5,000,000
TY 2014	230	\$6,193,792	\$6,000,000

Refundable Tax Credits

Virginia currently allows 32 income tax credits. Of these credits, five are refundable:

- Agricultural Best Management Practices Tax Credit for individuals;
- Virginia Coal Employment and Production Incentive Tax Credit;
- Coalfield Employment Enhancement Tax Credit;
- Motion Picture Production Tax Credit; and
- Research and Development Expenses Tax Credit.

Federal Research Credit

For federal tax purposes, a taxpayer may claim a research credit equal to 20 percent of the excess of the qualified research expenses for the taxable year over the base amount. The federal base amount is equal to the lesser of:

- The product of the taxpayer's average gross receipts for the four taxable years preceding the credit year and the taxpayer's fixed-base percentage; or
- 50 percent of the taxpayer's Virginia qualified research and development expenses for the credit year.

The fixed-base percentage is a complex computation that is determined by dividing the aggregate amount of qualified research expenses of the taxpayer for certain taxable years by the aggregate gross receipts of the taxpayer for such taxable years.

Proposed Legislation

This bill would modify the Research and Development Expenses Tax Credit by making such credit nonrefundable. Any credit not usable for the taxable year for which the credit was issued would be permitted to be carried over to the extent useable for the next seven taxable years or until the total amount of the credit has been taken, whichever occurs sooner.

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

Similar Bills

House Bill 1100 and **Senate Bill 161** would modify the existing Research and Development Expenses Tax Credit, and create a new research and development tax credit with a \$15 million annual credit cap for certain large research companies.

House Bill 884 and **Senate Bill 58** would modify the existing Research and Development Expenses Tax Credit, and create a new research and development tax credit with a \$25 million annual credit cap for certain large research companies.

House Bill 590 would eliminate the requirement that the Virginia Economic Development Partnership annually report certain data regarding Research and Development Expenses Tax Credit.

cc : Secretary of Finance

Date: 2/1/2016 MTH
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