

# DEPARTMENT OF TAXATION

## 2016 Fiscal Impact Statement

1. **Patron** John J. Bell

3. **Committee** House Finance

4. **Title** Income Tax; Modify the Qualified Equity and Subordinated Debt Investments Tax Credit and the Subtraction for Certain Long-Term Capital Gains

2. **Bill Number** HB 799

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would increase the annual cap on the Qualified Equity and Subordinated Debt Investments Tax Credit from \$5 million to \$7.5 million. This bill would require that one-third of the amount of available credits be allocated exclusively for qualified investments in cybersecurity businesses, and one-third of the amount of available credits be allocated exclusively for commercialization investments. This bill would allow a business with more than \$3 million of annual gross revenues to be eligible for the credit if it has no more than 50 full-time employees. These provisions would be effective for taxable years beginning on or after January 1, 2017.

This bill would allow an investment in a technology business that is approved by the Secretary of Technology to qualify for the subtraction for certain long-term capital gains if it has no more than 50 full-time employees in the fiscal year prior to such investment, even if it has more than \$3 million in annual gross revenues. This provision would be effective for taxable years beginning on or after January 1, 2016.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Preliminary. (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

The provision of this bill that would increase the annual cap on the Qualified Equity and Subordinated Debt Investments Tax Credit would have a negative General Fund revenue impact of \$2.5 million beginning in Fiscal Year 2018. However, such provision would not require a budget amendment because a \$4 million increase in the annual cap on the

Qualified Equity and Subordinated Debt Investments Tax Credit is assumed in the Introduced Executive Budget.

The provision of this bill that would modify Virginia's subtraction for certain long-term capital gains would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2017.

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

Department of Taxation

**10. Technical amendment necessary: No.**

**11. Other Comments:**

The Qualified Equity and Subordinated Debt Investments Tax Credit

Virginia currently allows Qualified Equity and Subordinated Debt Investments Tax Credits in an amount equal to 50 percent of a taxpayer's qualified investments. The credit may be claimed against the individual income tax or the income tax imposed on trusts and estates. For purposes of the credit, a "qualified investment" is defined as a cash investment in a qualified business in the form of equity or subordinated debt. A "qualified business" is a business which:

- Has no more than \$3 million of gross revenues in the most recent fiscal year;
- Has its principal office or facility in Virginia;
- Is engaged in business primarily in or does substantially all of its production in Virginia;
- Has not during its existence more than \$3 million in aggregate gross cash proceeds from the issuance of its equity or debt investments; and
- Is primarily engaged in or is primarily organized to engage in one or more of the following high technology-related fields:
  - Advanced computing;
  - Advanced materials;
  - Advanced manufacturing;
  - Agricultural technologies;
  - Biotechnology;
  - Electronic device technology;
  - Energy;
  - Environmental technology;
  - Information technology;
  - Medical device technology;
  - Nanotechnology; or
  - Any similar technology-related field as determined by regulations promulgated by the Department.

Credits cannot be claimed by any taxpayer that has committed capital under management in excess of \$10 million and engages in the business of making debt or equity investments in private businesses, or by any taxpayer that is allocated a credit as a partner, shareholder, member or owner of an entity that engages in such business.

The credit is currently capped at \$5 million per year. However, beginning with 2006, budget actions imposed a lower credit cap for certain years. See the chart below for information about the annual credit cap imposed from 2006 through 2014.

<b>Year</b>	<b>Annual Credit Cap</b>
2006-2009	\$3 million
2010	\$5 million
2011	\$3 million
2012	\$4 million
2013	\$4.5 million
2014 and after	\$5 million

One-half of the amount of credits available each year must be allocated exclusively for credits for commercialization investments. For purposes of the credit, a “commercialization investment” is a qualified investment in a qualified business that was created to commercialize research developed at or in partnership with an institution of higher education. If the amount of credits requested for commercialization investments is less than one-half of the credit cap, the balance of credits remaining must be allocated for qualified investments in any qualified business.

No taxpayer is permitted to claim more than \$50,000 in credits for a taxable year. Any credit not useable for the taxable year in which the credit was allowed may be, to the extent usable, carried over for the next 15 succeeding taxable years or until the total amount of the credit has been taken, whichever occurs first.

Credit applications have exceeded the credit cap, resulting in a reduction in the amount of credit each taxpayer is allocated. See the chart below for information regarding the amount of credits requested from 2011 through 2014.

<b>Year</b>	<b>Number of Taxpayers</b>	<b>Number of Investments</b>	<b>Amount Approved</b>	<b>Annual Cap</b>
2011	200	235	\$8,089,740	\$3,000,000
2012	65	83	\$2,534,882	\$4,000,000
2013	140	245	\$7,291,256	\$4,500,000
2014	127	228	\$9,029,024	\$5,000,000

## Virginia's Subtraction for Certain Long-Term Capital Gains

Virginia allows an individual and corporate income tax subtraction for any income attributable to an investment in certain high technology businesses that is taxed as long-term capital gain or investment services partnership interest income for federal income tax purposes. For purposes of the subtraction, "qualified business" means a business that:

- Has annual gross revenues of no more than \$3 million in its most recent fiscal year;
- Has its principal office or facility in Virginia;
- Is engaged in business primarily in or does substantially all of its production in Virginia;
- Has not obtained during its existence more than \$3 million in aggregate gross cash proceeds from the issuance of its equity or debt investments; and
- Is primarily engaged, or is primarily organized to engage, in certain technology-related fields.

"Qualified business" also includes any other technology business approved by the Secretary of Technology provided that the business has its principal office or facility in Virginia and less than \$3 million in annual revenues in the fiscal year prior to the investment.

For an investment to qualify for the subtraction, it must be made between April 1, 2010 and June 30, 2020.

No taxpayer that has claimed the Qualified Equity and Subordinated Debt Investments Tax Credit for an investment in a qualified business may claim the subtraction for income taxed as long-term capital gain for federal income tax purposes for an investment in the same business.

## Proposed Legislation

### *Qualified Equity and Subordinated Debt Investments Tax Credit*

This bill would increase the annual cap on the Qualified Equity and Subordinated Debt Investments Tax Credit from \$5 million to \$7.5 million. This bill would require that one-third of the amount of available credits be allocated exclusively for qualified investments in cybersecurity businesses, and one-third of the amount of available credits be allocated exclusively for commercialization investments. This bill would require that any unused portion of the credit for investments in cybersecurity businesses or commercialization investments be allocated to other qualified investments.

"Cybersecurity business" would mean a business that is engaged primarily in the development of innovative and proprietary cybersecurity technology.

"Cybersecurity technology" would be defined as products or goods intended to detect or prevent activity intended to result in unauthorized access to, exfiltration of, manipulation of, or impairment to the integrity, confidentiality, or availability of an information system or information stored on or transiting an information system.

This bill would allow a business with more than \$3 million of annual gross revenues to be eligible for the credit if it has no more than 50 full-time employees. "Full-time employee" would be defined as an employee in an employment position of an indefinite duration requiring a minimum of 35 hours of the employee's time a week for the entire normal year of the qualified business's operations, which "normal year" would consist of at least 48 weeks, or an employment position of indefinite duration that requires a minimum of 35 hours of the employee's time a week for the portion of the year in which the employee was initially hired by, or transferred to, the qualified business. A full-time employee would not include an employee in a temporary position.

The portion of this bill that would modify the Qualified Equity and Subordinated Debt Investments Tax Credit would be effective for taxable years beginning on or after January 1, 2017.

#### *Virginia Income Tax Subtraction for Certain Long-Term Capital Gains*

This bill would allow an investment in a technology business that is approved by the Secretary of Technology and has less than fifty full-time employees in the fiscal year prior to such investment to qualify for the Virginia individual and corporate income tax subtraction for certain long-term capital gains. For purposes of the subtraction, "full-time employee" would be defined the same as the term is for purposes of the Qualified Equity and Subordinated Debt Investments Tax Credit.

The portion of this bill that would modify the Virginia income tax subtraction for certain long-term capital gains would be effective for taxable years beginning on or after January 1, 2016.

#### Similar Bills

**House Bill 660** and **Senate Bill 200** would increase the annual cap on the Qualified Equity and Subordinated Debt Investments Tax Credit from \$5 million to \$9 million.

**House Bill 28** would impose a January 1, 2017 sunset date on the Qualified Equity and Subordinated Debt Investments Tax Credit.

**Item 3-6.04 of the Introduced Executive Budget** would require that, for taxable years beginning on or after January 1, 2016, \$2 million of the amount of Qualified Equity and Subordinated Debt Investments Tax Credits available be allocated exclusively for investments in biotechnology companies.

cc: Secretary of Finance

Date: 1/23/2016 MTH  
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