

# DEPARTMENT OF TAXATION

## 2017 Fiscal Impact Statement

1. **Patron** David E. Yancey

2. **Bill Number** HB 1830

3. **Committee** House Finance

**House of Origin:**

  X   **Introduced**

      **Substitute**

      **Engrossed**

4. **Title** Individual and Corporate Income Tax;  
Artificial Intelligence Industry Tax Deductions  
and Subtractions

**Second House:**

      **In Committee**

      **Substitute**

      **Enrolled**

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

This bill would create individual and corporate income tax deductions for certain amounts paid or reimbursed during the taxable year by qualified employers in the artificial intelligence industry. Such amounts would be equal to 20 percent of the compensation paid to a qualified employee or independent contractor during the taxable year for the first through fifth years of employment if the employee or independent contractor graduated from an Accreditation Board for Engineering and Technology ("ABET") accredited program located in Virginia or 10 percent of the compensation paid for the first through fifth years of employment if the qualified employee or independent contractor graduated from an ABET-accredited program located outside Virginia. Such amount would be limited to \$4,000 each year of employment for each employee or independent contractor.

This bill would also allow individual and corporate income tax deductions for the amount paid or reimbursed during the taxable year by a qualified employer for tuition paid or incurred by a qualified employee earning an undergraduate or graduate degree in a qualified program while employed by, or performing services under a contract with, the qualified employer. The subtraction would be allowed for the employee's first through four years of employment with the qualified employer. Such amount would not to be permitted to exceed 50 percent of the average annual amount for enrollment and instruction in an ABET-accredited program at a public institution of higher education in the Commonwealth.

"Qualified employee" would mean any individual, regardless of the date of hire, who (i) is employed in the Commonwealth by, or has contracted to perform services in the Commonwealth related to the artificial intelligence industry with, a qualified employer; (ii) has been awarded an undergraduate or graduate degree from a qualified program by an institution; and (iii) was not employed or engaging in business in the artificial intelligence industry in the Commonwealth immediately preceding employment or contracting to perform services with a qualified employer.

"Artificial intelligence" would be defined as computer systems able to perform tasks that normally require human intelligence, such as visual perception, speech recognition, learning, planning, decision making, and translation between languages.

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 a negative, unknown General Fund impact beginning in Fiscal Year 2018. Artificial intelligence impacts many different industries and it is unknown how many of those industries employ employees or contractors who are enrolled in ABET programs that would qualify for this deduction. According to Virginia Labor Market Information, 6,182 job openings currently exist in Virginia, with a majority of those jobs related to engineering and computer science. If all the jobs were to and qualify for the maximum per employee \$4,000 per employee corporate income tax subtraction proposed by this bill, the negative General Fund revenue impact would be \$1.5 million annually. However, not all of these jobs would likely qualify. Additionally, this amount does not take into account amounts claimed for qualified tuition payments. Because deductions would be claimed for the first through fifth years of employment, regardless of the date of hire, the impact of this bill could be even greater. Such deduction would not be limited to newly hired employees, but to compensation paid for all qualifying employees who are within their first four years of employment, as well as tuition paid for qualified employees within their first four year of employment.

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

Department of Taxation

**10. Technical amendment necessary:** Yes.

To avoid potential conflicts with provisions of the U.S. Constitution, the Department recommends that the bill be amended to eliminate the different deduction rates that discriminate against graduates of programs outside the Commonwealth (10 percent) compared to graduates of programs located in the Commonwealth (20 percent).

Because the proposed deductions would be in addition to deductions for the same expenses already used in the computation of federal and Virginia taxable income, and some of the expenses may also qualify for one or more Virginia tax preferences related to jobs, it may also be advisable to include a provision that prohibits using tuition or compensation to qualify for this proposed deduction if it has or will also be used to qualify for any other Virginia tax credit, subtraction, or deduction.

## 11. Other comments:

### Federal Research Tax Credit

Under the federal research and development tax credit, 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. Small businesses, with gross receipts of \$50 million or less, are allowed to take the research and development credit against payroll taxes.

The research and development credit was made permanent on December 18, 2015 by the Protecting Americans from Tax Hikes Act.

### Virginia

#### *Research and Development Expenses Tax Credit*

Virginia currently allows a refundable Research and Development Expenses Tax Credits in an amount equal to 15 percent of the first \$300,000 (up to a maximum of \$45,000) in Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year or 20 percent of the first \$300,000 (up to a maximum of \$60,000) 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.

An alternative simplified method to this credit was enacted in 2016. Under this method, a taxpayer claiming the Research and Development Expenses Tax Credit computes the credit using a simplified method in lieu of the current statutory method. Under such method, the credit would be equal to 10 percent of the difference of:

- The Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year; and

- 50 percent of the average Virginia qualified research and development expenses paid or incurred by the taxpayer for the three taxable years immediately preceding the taxable year for which the credit is being determined.

If a taxpayer electing to use the simplified method did not pay or incur Virginia qualified research and development expenses in any one of the three taxable years immediately preceding the taxable year for which the credit is being determined, the credit would be equal to five percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year.

The credit is capped at \$7 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.

#### *Major Research and Development Expenses Tax Credit*

For taxable years beginning on or after January 1, 2016, but before January 1, 2022, a taxpayer with Virginia qualified research and development expenses for the taxable year in excess of \$5 million may claim the non-refundable Major Research and Development Expenses Tax Credit against the tax levied pursuant to individual or corporation income tax levels in an amount equal to 10 percent of the difference between (i) the Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year and (ii) 50 percent of the average Virginia qualified research and development expenses paid or incurred by the taxpayer for the three taxable years immediately preceding the taxable year for which the credit is being determined. If the taxpayer did not pay or incur Virginia qualified research and development expenses in any one of the three taxable years immediately preceding the taxable year for which the credit is being determined, the tax credit is equal to 5 percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the relevant taxable year.

The credit is capped at \$20 million per fiscal year. If approved applications for the tax credit exceed \$20 million for any taxable year, the Department must apportion the credits by dividing \$20 million by the total amount of tax credits approved, to determine the percentage of allowed tax credits for each taxpayer.

The amount of the credit claimed for the taxable year cannot exceed 75 percent of the Taxpayer's total amount of individual or corporate income tax. Any credit not usable for the taxable year for which the credit was first allowed may be carried over for credit against the income taxes of the taxpayer in the next 10 succeeding taxable years or until the total amount of the tax credit has been taken, whichever is sooner.

Taxpayers cannot claim both the Major Research and Development Expenses Tax Credit and the Research and Development Expenses Tax Credit for the same expenses.

### *Major Business Facility Job Tax Credit*

A taxpayer may claim the Major Business Facility Job Tax Credit if the taxpayer creates at least 50 new full-time jobs in connection with the establishment or expansion of a major business facility and the company is engaged in a qualifying industry in Virginia. If a taxpayer is located in an enterprise zone or in an economically distressed area (as defined by the Virginia Economic Development Partnership), the threshold is reduced from 50 jobs to 25. The credit is equal to \$1,000 for each qualifying new job in excess of 50 jobs (25 jobs for a taxpayer located in an enterprise zone or economically distressed area). A "major business facility" is a company that is engaged in any business in the Commonwealth, except a retail trade business if such trade is the principal activity of an individual facility in the Commonwealth.

The Major Business Facility Job Tax Credit must generally be claimed ratably over two taxable years, beginning with the taxable year following the year in which the facility is established or expanded, or the new qualifying jobs are added. The amount of credit allowed cannot exceed the tax imposed for such taxable year. Any credit not usable for the taxable year the credit was allowed may be, to the extent usable, carried over for the next 10 succeeding taxable years. This credit is set to expire on January 1, 2020.

In cases where the number of qualified full-time employees in any of the five years succeeding the credit year decreases below the average number of employees during the credit year, the taxpayer is required to recapture part or all of the credit by increasing the tax in the relevant tax years in which the number of qualified full-time employees decreases below the average number of qualified full-time employees employed during the credit year. Such tax increase amount is determined by (i) recomputing the credit which would have been earned for the original credit year, using the decreased number of qualified full-time employees and (ii) subtracting such recomputed credit from the amount of credit previously earned. In the event that the average number of qualifying full-time employees employed at a major business facility falls below the threshold amount in any of the five taxable years succeeding the credit year, all credits earned with respect to such major business facility must be recaptured.

A taxpayer cannot claim the Major Business Facility Job Tax Credit if it claims the Coalfield Employment Enhancement Tax Credit or receives Enterprise Zone Job Creation Grant funding. Additionally, taxpayers are prohibited from claiming the Major Business Facility Job Tax Credit and certain other job-related tax credits, including the Green Job Creation Tax Credit and the International Trade Facility Tax Credit, for the same jobs.

### Proposed Legislation

This bill would create individual and corporate income tax deductions for certain amounts paid or reimbursed during the taxable year by qualified employers in the artificial intelligence industry. Such amounts would be equal to 20 percent of the compensation paid to a qualified employee or independent contractor during the taxable year for the first through fifth years of employment if the employee or independent contractor graduated from an Accreditation Board for Engineering and Technology ("ABET") accredited program located in Virginia or 10 percent of the compensation paid for the first through fifth years of employment if the qualified employee or independent contractor graduated

from an ABET-accredited program located outside Virginia. Such amount would be limited to \$4,000 each year of employment for each employee or independent contractor.

This bill would also allow individual and corporate income tax deductions for the amount paid or reimbursed during the taxable year by a qualified employer during the taxable year for tuition paid or incurred by a qualified employee earning an undergraduate or graduate degree in a qualified program while employed by, or performing services under a contract with, the qualified employer. The subtraction would be allowed for the employee's first through four years of employment with the qualified employer. Such amount would not to be permitted to exceed 50 percent of the average annual amount for enrollment and instruction in an ABET-accredited program at a public institution of higher education in the Commonwealth.

This bill would allow individual corporate income tax deductions even if the taxpayer has already benefitted from a federal deduction for the same expenditures. There is no prohibition on claiming another Virginia tax credit, deduction, or subtraction for the same expenses. As a result, a taxpayer would be permitted to claim the proposed deduction in addition to a Virginia income tax deduction for the amount of compensation paid to the same employee and any job-related or research tax credits for which it otherwise qualifies, including the Major Business Facility Job Tax Credit, the Green Job Creation Tax Credit, the International Trade Facility Tax Credit, the Research and Development Expenses Tax Credit, and the Major Research and Development Expenses Tax Credit.

"Qualified employer" would mean a sole proprietor or other business entity whose principal business activity involves the artificial intelligence industry.

"Qualified employee" would mean any individual, regardless of the date of hire, who (i) is employed in the Commonwealth by, or has contracted to perform services in the Commonwealth related to the artificial intelligence industry with, a qualified employer; (ii) has been awarded an undergraduate or graduate degree from a qualified program by an institution; and (iii) was not employed or engaging in business in the artificial intelligence industry in the Commonwealth immediately preceding employment or contracting to perform services with a qualified employer. "Qualified employee" would not be interpreted to exclude any individual who (a) was employed in the artificial intelligence industry prior to being awarded an undergraduate or graduate degree from a qualified program by an institution or (b) has been awarded an undergraduate or graduate degree from a qualified program by an institution and is employed by a professional staffing company and assigned to work in the artificial intelligence industry in the Commonwealth.

"Artificial intelligence" would be defined as computer systems able to perform tasks that normally require human intelligence, such as visual perception, speech recognition, learning, planning, decision making, and translation between languages.

"Artificial intelligence industry" would be defined as (i) the manufacture or development of artificial intelligence hardware or software, (ii) the provision of services and support relating to artificial intelligence, (iii) research and development of artificial intelligence technology and systems, or (iv) the education and training of artificial intelligence personnel.

"Compensation" would mean (i) payments in the form of contract labor for which the payor is required to provide a federal Form 1099 to the person paid, (ii) wages subject to federal or state withholding tax paid to a part-time or full-time employee, or (iii) salary or other remuneration paid to a part-time or full-time employee. "Compensation" would not include employer-provided retirement, medical or health care benefits, flexible reimbursement accounts, or reimbursement for travel, meals, lodging, or similar expenses.

"Qualified program" would mean a program that has been accredited by the Accreditation Board for Engineering and Technology (ABET) and that awards an undergraduate or graduate degree.

"Institution" would be defined as a public institution of higher education, a private institution of higher education, or any other public or private college or university as accredited by a national accrediting body.

"Private institution of higher education" would include each nonprofit private institution of higher education and proprietary private institution of higher education in the Commonwealth.

"Public institution of higher education" would include the Virginia Community College System as a whole and each associate-degree-granting and baccalaureate public institution of higher education in the Commonwealth.

"Tuition" would mean the amount paid or incurred by a qualified employee for enrollment and instruction in a qualified program on or after January 1, 2017. "Tuition" would not include the cost of books, fees, or room and board.

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

#### Similar Bills

**House Bill 1439** would create an individual and corporate income tax credit in the amount of \$1,500 for each job created by a small business.

cc : Secretary of Finance

Date: 1/24/2017 NM  
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