DEPARTMENT OF TAXATION
2017 Fiscal Impact Statement

1. Patron A. Benton Chafin, Jr.

2. Bill Number SB 1106

House of Origin:

X **Introduced**

_____ **Substitute**

_____ **Engrossed**

3. Committee Senate Finance

4. Title Made in Appalachia Tax Credits

Second House:

_____ **In Committee**

_____ **Substitute**

_____ **Enrolled**

5. Summary/Purpose:

This bill would allow a tax credit for certain capital investments, certain jobs created, and sales tax paid on certain items purchased in the Appalachian region of Virginia. The amount of the credit would be equal to any combination of the following:

- 10 percent of any capital investment that directly results in the creation of at least one eligible job.
- $6,000 per eligible job at or above local median income and, in addition, either $1,000 per eligible job at or above 150 percent of local median income or $2,000 per eligible job at or above 200 percent of local median income.
- The amount of sales tax paid by a taxpayer in purchasing materials or products that are used directly in the manufacture of products in the Appalachian region.

The Department would not be allowed to issue more than $40 million in credits during any taxable year. Any amount in excess of a taxpayer's tax liability for the taxable year would be refunded to the taxpayer, subject to the limitations set forth in the guidelines developed by the Department. In lieu of a refund, any taxpayer may elect to carry over any unused credits earned for the next three succeeding taxable years or until the credit is fully taken, whichever is sooner.

Any taxpayer who earns credits may transfer unused credits for use by another taxpayer. A fee of one percent of the dollar amount of the credit would be imposed on any transfer arising from the sale by any taxpayer of credits. To the extent included in and not otherwise subtracted from federal adjusted gross income or federal taxable income, this bill would allow an income tax subtraction for any amount of gain or income recognized by the taxpayer on the application of the credit against Virginia income tax liability. The transfer of the credit and its application against tax liability would not create gain or loss for the transferor or the transferee of the credit.

This bill would be effective for taxable years beginning on or after January 1, 2017, but before January 1, 2022.

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

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

8. **Fiscal implications:**

<u>Administrative Costs</u>

The Department of Taxation ("the Department") has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, the Department considers implementation of this bill as "routine," and does not require additional funding.

The Department will provide specific administrative costs on any legislation that is not "routine." Additionally, the Department will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, the Department will identify the costs at that time.

<u>Revenue Impact</u>

Because the amount of capital investments, jobs created, and sales tax paid that would qualify for this credit is uncertain, this bill would have an unknown, but potentially significant, annual negative General Fund revenue impact, beginning in Fiscal Year 2018. Because the credit is subject to an annual credit cap, the impact of this legislation would not exceed $40 million.

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

Department of Taxation
Counties of Bland, Buchanan, Carroll, Dickenson, Grayson, Lee, Russell, Scott, Smyth, Tazewell, Washington, Wise, and Wythe
Cities of Bristol, Galax, and Norton

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

This bill would allow credits for any capital investment that directly results in the creation of at least one eligible job. It is uncertain how a taxpayer would demonstrate the correlation between a capital investment and the creation of a job. As currently drafted, this bill would require the Department to determine how to make such correlation through its guidelines regarding the credit. The Department recommends that this bill be amended to provide more specific criteria for determining whether a capital investment results in the creation of a job.

In the event that applications for credits exceed the $40 million annual credit cap for the taxable year, the Department would be required to first allocate credits for eligible jobs at or above local median income. The remainder of the annual credit cap would then be required to be allocated equitably among credits earned for certain capital investments and for sales tax paid for certain purchases. The meaning of "equitably" in this context is unclear. The Department recommends that this bill be amended to utilize either a "prorated" or a "first-come/first-served" standard. In addition, as currently drafted, this bill would not provide a mechanism for allocating credits for eligible jobs at or above local median income if such credits alone exceed the $40 million annual credit cap. The Department recommends that this bill be amended to include either a "prorated" or a "first-come/first-served" standard for allocating such credits if they alone exceed the annual credit cap.

This bill would allow taxpayers the option to have unused credits refunded or to carry over such credits for use in another taxable year. Taxpayers would also be permitted to transfer unused credits, but such credits would no longer be refundable. Once taxpayers begin transferring unused credits, it would become administratively difficult for the Department to distinguish between unused credits that are refundable, and unused credits that have been transferred and, thereby, refundable. Therefore, the Department recommends that this bill be amended to make the credit refundable or transferable, but not both.

11. Other comments:

<u>Credits Primarily for the Appalachia Region of Virginia</u>

Virginia Coal Employment and Production Incentive Tax Credit

The Virginia Coal Employment and Production Incentive Tax Credit is a credit allowed to electricity generators in Virginia against the corporation income tax and the tax that applies to electric suppliers, pipeline distribution companies, gas utilities, and gas suppliers. The amount of the credit is equal to $3 for each ton of coal purchased and consumed by an electricity generator, provided such coal was mined in Virginia. To the extent an electricity generator purchased coal qualifying for the credit from a person with an economic interest in coal, the credit may be allocated between the electricity generator and such person with an economic interest in coal. Any person with an economic interest in coal that receives an allocation of credits is required to redeem such credits in a taxable year ending before July 1, 2016.

Any credit not allocated to a person with an economic interest in coal that is not usable for the taxable year for which the credit was issued may be carried over for up to ten taxable years. To the extent credit allocated to a person with an economic interest in coal exceeds such person's Virginia tax liability, such taxpayer is entitled to redeem the excess credits in an amount equal to 85 percent of the face value of such excess. The remaining 15 percent is to be deposited in a regional economic development fund administered by the Coalfield Economics Development Authority.

Coalfield Employment Enhancement Tax Credit

Persons with an economic interest in coal mined in Virginia are permitted to claim the Coalfield Employment Enhancement Tax Credit against any tax imposed by Virginia. For coal mined underground, the credit amount varies according to the seam thickness of the coal that is being mined. The credit is equal to $2.00 per ton for a seam thickness of 36 inches or less and $1.00 per ton for a seam thickness greater than 36 inches. For coal mined by surface mining methods, the credit is equal to $0.40 per ton of coal sold. Coalbed methane gas producers may claim a credit equal to $0.01 per million BTU's of gas produced.

The credit may be claimed in the third taxable year following the taxable year in which the credit was earned and allowed. To the extent the credit exceeds a taxpayer's Virginia tax liability, the taxpayer is entitled to redeem the excess credits in an amount equal to 85 percent of the face value of such excess. The remaining 15 percent is to be deposited in a regional economic development fund administered by the Coalfield Economics Development Authority.

The Coalfield Employment Enhancement Tax Credit expired for taxable years beginning on or after January 1, 2017.

Proposed Legislation

This bill would allow a tax credit for certain capital investments, certain jobs created, and sales tax paid on certain items purchased in the Appalachian region of Virginia. Taxpayers would be able to claim this credit against the individual income tax, corporate income tax, bank franchise tax, insurance premiums license tax, and the tax on public service corporations. The amount of the credit would be equal to any combination of the following:

- 10 percent of any capital investment that directly results in the creation of at least one eligible job. A taxpayer would be allowed to claim such credits in the year they make a capital investment or place the property in service.

- $6,000 per eligible job at or above local median income and, in addition, either $1,000 per eligible job at or above 150 percent of local median income or $2,000 per eligible job at or above 200 percent of local median income. Credits earned under such provision would be subject to the following restrictions:

    - The amount of credits earned would be multiplied by the local unemployment factor to calculate the total amount of credits for which the taxpayer is eligible. However, if the locality unemployment factor is one or less, the taxpayer would not be eligible to claim any credits. According to Virginia Employment Commission ("VEC") data for November 2016, unemployment rates ranged from 4.5 percent (Washington County) to 9.5 percent (Buchanan), while the state unemployment rate was 4 percent. Therefore, the local unemployment factors would have range from 1.125 to 2.375 for jobs created during November 2016.

    - Any credit earned would be subject to recapture if the eligible job fails to continue for at least three years. Recapture would be prorated based on the portion of the three-year period for which the eligible job continued.

A taxpayer would be allowed to claim such credits in the year they create an eligible job.

- The amount of sales tax paid by a taxpayer in purchasing materials or products that are used directly in the manufacture of products in the Appalachian region. However, no credit would be allowed for products not used directly in manufacturing, including but not limited to, office supplies and products used in administration, transportation, or marketing. A taxpayer would be allowed to claim such credits in the year they make a purchase resulting in sales tax liability.

"Appalachian region" would be defined as the localities that comprise the Cumberland Plateau, LENOWISCO, and Mount Rogers planning districts. Such region includes the Counties of Bland, Buchanan, Carroll, Dickenson, Grayson, Lee, Russell, Scott, Smyth, Tazewell, Washington, Wise, and Wythe, and the Cities of Bristol, Galax, and Norton.

"Capital investment" would be defined as an expenditure for (i) the construction or improvement of a facility in the Appalachian region or (ii) the purchase and placement into service or improvement of tangible personal property in the Appalachian region that has a useful life of not less than three years.

"Eligible job" would be defined as a new, permanent, full-time job or full-time equivalent in the Appalachian region. "Eligible job" does not include seasonal positions, temporary positions, or positions created by shifting an employee's location from elsewhere in the Commonwealth to the Appalachian region.

"Local median income" would be defined as the locality's median wage at the time of job creation as reported by the VEC.

"Local unemployment factor" would be defined as a fraction, the numerator of which is the locality's unemployment rate and the denominator of which is the unemployment rate of the Commonwealth. The fraction shall be calculated using the local area unemployment statistics at the time of job creation as reported by the VEC.

The Department would not be allowed to issue more than $40 million in credits during any taxable year. In the event that applications for credits exceed $40 million for the taxable year, the Department would be required to allocate credits according to the following priority:

- First, the full amount of credits earned for eligible jobs at or above local median income; and

- The remainder of the annual credit cap would be allocated equitably among credits earned for capital investments that directly result in the creation of at least one eligible job, and the amount of sales tax paid for purchasing materials or products that are used directly in the manufacture of products in the Appalachian region.

Any amount in excess of a taxpayer’s tax liability for the taxable year would be refunded to the taxpayer, subject to the limitations set forth in the guidelines developed by the Department. In lieu of a refund, any taxpayer may elect to carry over any unused credits earned for the next three succeeding taxable years or until the credit is fully taken, whichever is sooner. No credit would be allowed to be carried back to a preceding taxable year.

Any taxpayer who earns credits may transfer unused credits for use by another taxpayer. If a taxpayer transfers any amount of credits, they would be required to file a notification of the transfer with the Department in accordance with procedures and forms prescribed by the Tax Commissioner. A fee of 1 percent of the dollar amount of the credit would be imposed on any transfer arising from the sale by any taxpayer of credits. Any transferred credits would be subject to the three year limitation on claiming unused credits. No credits that have been transferred would be refundable.

To the extent included in and not otherwise subtracted from federal adjusted gross income or federal taxable income, this bill would allow an income tax subtraction for any amount of gain or income recognized by the taxpayer on the application of the credit against Virginia income tax liability. The transfer of the credit and its application against tax liability would not create gain or loss for the transferor or the transferee of the credit.

The Department would be required to develop and publish guidelines, exempt from the provisions of the Administrative Process Act, implementing the provisions of this bill.

This bill would be effective for taxable years beginning on or after January 1, 2017, but before January 1, 2022.

Similar Legislation

House Bill 1672 would allow a credit equal to 65 percent of the value of a monetary donation made to any school district in the coalfield region of Virginia.

House Bill 1917 would allow a credit for a capital investment in an energy production facility located in the coalfield region of Virginia.

House Bill 2198 and **Senate Bill 1470** would reduce the annual credit cap on the Virginia Coal Employment and Production Incentive Tax Credit, and would extend the sunset date for the Coalfield Employment Enhancement Tax Credit.

cc : Secretary of Finance

Date: 1/21/2017 MTH
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