

DEPARTMENT OF TAXATION

2017 Fiscal Impact Statement

1. **Patron** Glen H. Sturtevant

3. **Committee** Senate Finance

4. **Title** Income Tax; Phase Out Certain Tax Credits

2. **Bill Number** SB 1540

House of Origin:

X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would extend the expiration date for the Major Research and Development Expenses Tax Credit and the Research and Development Expenses Tax Credit from January 1, 2022 to January 1, 2027. This bill would also impose a January 1, 2027 sunset date on the Historic Rehabilitation Tax Credit and the Land Preservation Tax Credit.

This bill would impose an annual credit cap of \$80 million on the Historic Rehabilitation Tax Credit for taxable years beginning on or after January 1, 2017, but before January 1, 2019.

This bill would phase out the Historic Rehabilitation Tax Credit, Land Preservation Tax Credit, Major Research and Development Expenses Tax Credit, and the Research and Development Expenses Tax Credit by gradually reducing the annual cap for each credit until such credits expire for taxable years beginning on or after January 1, 2027.

The effective date for this bill is not specified.

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"), the Department of Conservation and Recreation, the Virginia Land Conservation Foundation, and the Department of Historic Resources consider implementation of this bill as routine, and do not require additional funding. However, by reducing the Land Preservation Tax Credit and Historic Rehabilitation Tax Credit caps, this bill would decrease the amount of funding that such agencies receive from Land Preservation Tax Credit transfer fees and Historic Rehabilitation Tax Credit application fees.

Revenue Impact

This bill would have an unknown, potentially significant, positive revenue impact, beginning in Fiscal Year 2018. The provisions of this bill that would impose annual credit caps on the Historic Rehabilitation Tax Credit, Land Preservation Tax Credit, and Research and Development Expenses Tax Credit would have an estimated positive General Fund revenue impact of approximately \$9.8 million in Fiscal Year 2018, \$13.73 million in Fiscal Year 2019, \$27.73 million in Fiscal Year 2020, \$35.27 million in Fiscal Year 2021, \$50.98 million in Fiscal Year 2022, and \$58.87 million in Fiscal Year 2023. Such impact is as follows:

Fiscal Year	Historic Rehabilitation Tax Credit	Land Preservation Tax Credit	Research and Development Expenses Tax Credit	Total Revenue Impact
2018	\$7.77 million	\$2.03 million	-	\$9.8 million
2019	\$10.88 million	\$2.85 million	-	\$13.73 million
2020	\$21.89 million	\$5.84 million	-	\$27.73 million
2021	\$26.24 million	\$7.03 million	\$2.0 million	\$35.27 million
2022	\$38.40 million	\$10.58 million	\$2.0 million	\$50.98 million
2023	\$43.75 million	\$12.12 million	\$3.0 million	\$58.87 million

The full impact of imposing and reducing these annual credit caps would not be realized immediately due to outstanding Historic Rehabilitation Tax Credit and Land Preservation Tax Credit carryovers. Since the Research and Development Expenses Tax Credit is generally refundable and has no carryover period, the full impact of reducing the cap for this credit would be realized beginning in Taxable Year 2021, when taxpayers would first file returns claiming credits under the lower cap amounts.

During the 2016 Session, the General Assembly created the Major Research and Development Expenses Tax Credit, effective for taxable years beginning on or after January 1, 2016. Because the Department does not yet have data available regarding taxpayers claiming the Major Research and Development Expenses Tax Credit, the provisions regarding this credit would have an unknown positive General Fund revenue impact beginning in Fiscal Year 2018.

This bill would have an unknown negative impact on non-General Fund revenues beginning in Fiscal Year 2018. Reducing the annual credit cap for the Land Preservation Tax Credit would reduce the amount of collected credit transfer fees. Such fees are used to pay the costs of administering the Land Preservation Tax Credit program, as well as to provide funding to the Virginia Land Conservation Foundation. During Taxable Year 2016, approximately \$2.7 million was collected in Land Preservation Tax Credit transfer fees. By lowering the cap, this bill would reduce, and eventually eliminate, the amount collected.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Conservation and Recreation

10. Technical amendment necessary: Yes.

To remove redundant language, the Department recommends the following technical amendment:

Page 1, Line 33, beginning of line
Strike: Lines 33 through 43

11. Other comments:

Historic Rehabilitation Tax Credit

Virginia allows a credit in an amount equal to 25 percent of the eligible expenses incurred in the rehabilitation of a certified historic structure. Such credit may be claimed against the individual income tax, tax imposed on estates and trusts, corporation income tax, bank franchise tax, insurance premiums license tax, and tax imposed on certain public service corporations. The credit is not currently subject to an annual credit cap and has no sunset date. The chart below shows the amount of Historic Rehabilitation Tax Credits claimed since Fiscal Year 2008:

Fiscal Year	Income Tax	Bank Franchise Tax	Insurance Premiums License Tax	Total
2008	\$39.81 million	\$0.13 million	\$41.42 million	\$81.36 million
2009	\$62.77 million	\$0.15 million	\$45.25 million	\$108.17 million
2010	\$64.62 million	\$1.18 million	\$48.93 million	\$114.72 million
2011	\$46.80 million	\$1.53 million	\$34.84 million	\$83.17 million
2012	\$59.22 million	\$4.96 million	\$30.33 million	\$94.50 million
2013	\$23.53 million	\$1.66 million	\$42.38 million	\$67.57 million
2014	\$27.10 million	\$0.48 million	\$43.27 million	\$70.86 million
2015	\$43.80 million	\$2.77 million	\$51.42 million	\$98.00 million
2016 (preliminary)	\$47.98 million	\$4.66 million	\$45.43 million	\$98.07 million

Land Preservation Tax Credit

The Land Preservation Tax Credit is an individual income tax and corporate income tax credit equal to forty percent of the fair market value of land or an interest in land located in Virginia

which is conveyed for the purpose of agricultural and forestal use, open space, natural resource, and/or biodiversity conservation, or land, agricultural, watershed and/or historic preservation, as an unconditional donation by the taxpayer to a public or private conservation agency. The credit is not currently subject to a limitation on the amount of credits a taxpayer may earn per conveyance. The amount of credits that may be claimed by each taxpayer per taxable year is limited to \$20,000 for Taxable Year 2016, and \$50,000 for Taxable Year 2017 and thereafter. The credit is currently subject to an annual credit cap of \$75 million, but has no sunset date provision. The chart below shows the amount of Land Preservation Tax Credits allocated to taxpayers for Taxable Years 2013 through 2016:

Taxable Year	Number of Conveyances	Amount of Credits Allocated	Annual Credit Cap
2012	224	\$60,068,308	\$111,054,000
2013	234	\$78,882,596	\$100 million
2014	136	\$46,584,627	\$100 million
2015	182	\$48,625,672	\$75 million
2016 (preliminary)	146	\$55,318,175	\$75 million

Research and Development Expenses Tax Credit

The Research and Development Expenses Tax Credit is a refundable individual and corporate income tax credit for conducting qualified research and development in Virginia. The credit is comprised of a base credit and a supplemental credit that is available only to the extent that the total amount of base credits granted for a fiscal year is less than the annual credit cap. A taxpayer may compute the base credit using the primary method for determining the credit or elect to compute the base credit using the alternative simplified method ("simplified method") for determining the credit.

The base credit for a taxpayer using the primary method is equal to: (i) 15 percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the credit year (up to a \$45,000 credit), or (ii) 20 percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the credit year if the Virginia qualified research was conducted in conjunction with a Virginia public or private college or university (up to a \$60,000 credit), to the extent such expenses exceed the taxpayer's Virginia base amount.

The base credit for a taxpayer that elects to utilize the simplified method is equal to 10 percent of the difference between:

- 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 immediately preceding taxable years.

If a taxpayer did not pay or incur Virginia qualified research and development expenses in any one of the three preceding taxable years, the base 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 annual base credit amount allowed may not exceed (i) \$45,000 or (ii) \$60,000 if the Virginia qualified research was conducted in conjunction with a Virginia public or private college or university.

The credit is effective for taxable years beginning on or after January 1, 2011, but before January 1, 2022. When the credit was first enacted, it was subject to a \$5 million annual cap. The cap was increased to \$6 million for Taxable Years 2014 and 2015, and to \$7 million for Taxable Year 2016 and thereafter. No taxpayer may claim both this credit and the Major Research and Development Expenses Tax Credit for the same taxable year. For Taxable Years 2011 through 2015, 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
TY 2015	269	\$7,146,924	\$6,000,000

Major Research and Development Expenses Tax Credit

Virginia allows an individual and corporate income tax credit for incurring more than \$5 million of Virginia qualified research and development expenses during a taxable year. The amount of the credit is equal to 10 percent of the difference between:

- 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 years.

If a 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 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 Major Research and Development Expenses Tax Credit is subject to an annual cap of \$20 million. The credit is effective for taxable years beginning on or after January 1, 2016, but before January 1, 2022. The first applications requesting allocations of the Major Research and Development Expenses Tax Credit are due July 1, 2017.

Sunset Dates for Income Tax Credits and Sales Tax Exemptions

Section 3-5.14 of the 2016 Appropriations Act provides that the General Assembly may not advance the sunset date for any existing income tax credit or sales tax exemption beyond June 30, 2022. Any new income tax credit or sales tax exemption enacted by the General Assembly prior to the 2021 Session must have a sunset date not later than June 30, 2022. This requirement does not apply to sales tax exemptions related to nonprofit entities or to income tax credits or sales tax exemptions with sunset dates after June 30, 2022 that were enacted or advanced during the 2016 Session.

Further, during the 2012 Session, the General Assembly enacted House Bill 246, which prohibits legislation from adding a new credit or renewing an existing credit unless the legislation contains a sunset date of not longer than five years from the effective date of the new or renewed credit.

Proposed Legislation

This bill would extend the expiration date for the Major Research and Development Expenses Tax Credit and the Research and Development Expenses Tax Credit from January 1, 2022 to January 1, 2027. This bill would also impose a January 1, 2027 sunset date on the Historic Rehabilitation Tax Credit and the Land Preservation Tax Credit.

This bill would impose an annual credit cap of \$80 million on the Historic Rehabilitation Tax Credit for taxable years beginning on or after January 1, 2017, but before January 1, 2019. The Department of Historic Resources would be required to issue credits on a first-come/first-served basis, in the order that each completed credit application is approved.

This bill would phase out the Historic Rehabilitation Tax Credit, Land Preservation Tax Credit, Major Research and Development Expenses Tax Credit, and the Research and Development Expenses Tax Credit by gradually reducing the annual cap for each credit as follows:

Taxable Year	Historic Rehabilitation Tax Credit	Land Preservation Tax Credit	Major Research and Development Expenses Tax Credit	Research and Development Expenses Tax Credit
2016 (current law)	Uncapped	\$75 million	\$20 million	\$7 million
2017-2018	\$80 million	\$60 million	\$16 million	\$7 million
2019-2020	\$60 million	\$48 million	\$12 million	\$5 million
2021-2022	\$40 million	\$36 million	\$9 million	\$4 million
2023-2024	\$20 million	\$24 million	\$6 million	\$4 million
2025-2026	\$10 million	\$12 million	\$3 million	\$2 million
2027 and thereafter	\$0	\$0	\$0	\$0

The effective date for this bill is not specified.

Similar Bills

Senate Bill 1485 would impose a January 1, 2022 sunset date on certain income tax credits that are not currently subject to a sunset date.

cc: Secretary of Finance

Date: 1/30/2017 MTH
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