

# DEPARTMENT OF TAXATION

## 2023 Fiscal Impact Statement

1. **Patron** Jeremy S. McPike

3. **Committee** Senate Finance and Appropriations

4. **Title** Research and Development Tax Credits;  
Expenses

2. **Bill Number** SB 1048

**House of Origin:**

X **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

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

This bill would reduce the annual aggregate tax credit cap for the Major Research and Development Expense Tax Credit by \$8 million (from \$24 million to \$16 million) and increase the annual aggregate tax credit cap for the Research and Development Expenses Tax Credit by this same amount (from \$7.77 million to \$15.77 million). This bill would also introduce both a step-rate structure and a per taxpayer annual credit cap to the Major Research and Development Expenses Tax Credit.

This bill would be effective for taxable years beginning on or after January 1, 2023.

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

7. **No Fiscal Impact:** (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

Because the combined total credit cap for both of these programs would remain unchanged, this bill would have no impact on General Fund revenues.

Both of these credit programs are currently oversubscribed by a significant amount. For Taxable Year 2021, taxpayers requested \$19.7 million of Research and Development Expenses Tax Credits, which has a current \$7.77 million cap. Similarly, taxpayers requested \$152.0 million of Major Research and Development Expenses Tax Credits for Taxable Year 2021, which has a current \$24 million cap. Under both tax credit programs, the amount of the tax credits that may be claimed must be prorated to the extent that approved credits exceed the respective annual credit caps.

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

Department of Taxation

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

**11. Other comments:**

Research and Development Expenses Tax Credit

The Research and Development Expenses Tax Credit is a refundable tax credit for conducting qualified research and development in Virginia. This credit may be taken against the individual income tax or the corporate income tax for Taxable Years beginning on and after January 1, 2021. 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.

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, to \$7 million for Taxable Year 2016 through Taxable Year 2020, and to \$7.77 million for Taxable Year 2021 and thereafter.

No taxpayer may claim both the Research and Development Expenses Tax Credit and the Major Research and Development Expenses Tax Credit for the same taxable year.

The Research and Development Expenses Tax Credit has historically been oversubscribed. The table below shows the amount of credit requested compared to the amount granted each year:

**Research and Development Expenses Tax Credit**

<b>Taxable Year</b>	<b>Granted Amount</b>	<b>Requested Amount</b>	<b>Proration Factor</b>	<b>Count</b>
2012	\$4,545,634	\$2,750,734	100%	135
2013	\$4,999,960	\$3,912,218	100%	193
2014	\$5,965,844	\$6,158,692	97%	229
2015	\$5,999,900	\$7,146,924	84%	268
2016	\$6,999,718	\$13,935,573	50%	442
2017	\$6,999,683	\$15,033,028	47%	464
2018	\$7,000,000	\$16,402,425	43%	518
2019	\$7,000,000	\$20,828,700	34%	622
2020	\$7,000,000	\$20,826,430	34%	633
2021	\$7,700,000	\$19,688,637	39%	608
<b>Total</b>	<b>\$64,210,739</b>	<b>\$126,683,361</b>	<b>N/A</b>	<b>4,112</b>

**Major Research and Development Expenses Tax Credit**

Virginia allows a nonrefundable tax credit for incurring more than \$5 million of Virginia qualified research and development expenses during a taxable year. This credit may be taken against the individual income tax or the corporate income tax for Taxable Years beginning on and after January 1, 2021. 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 was subject to an annual credit cap of \$20 million for Taxable Year 2016 through Taxable Year 2020. The credit is subject to an annual cap of \$24 million for Taxable Year 2021 and thereafter.

As with the Research and Development Expenses Tax Credit, the Major Research and Development Expenses Tax Credit has historically been oversubscribed. The table below shows the amount of credit requested compared to the amount granted each year:

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

<b>Taxable Year</b>	<b>Granted Amount</b>	<b>Requested Amount</b>	<b>Proration Factor</b>	<b>Count</b>
2016	\$19,999,981	\$52,917,838	38%	38
2017	\$19,999,978	\$63,346,579	32%	46
2018	\$20,000,000	\$94,646,779	21%	72
2019	\$20,000,000	\$125,840,747	16%	79
2020	\$20,000,000	\$133,673,023	15%	91
2021	\$20,000,000	\$152,032,254	16%	81
<b>Total</b>	<b>\$119,999,959</b>	<b>\$622,457,220</b>	<b>N/A</b>	<b>407</b>

#### Proposed Legislation

This bill would reduce the annual aggregate tax credit cap for the Major Research and Development Expense Tax Credit by \$8 million (from \$24 million to \$16 million) and increase the annual aggregate tax credit cap for the Research and Development Expenses Tax Credit by this same amount (from \$7.77 million to \$15.77 million).

This bill would introduce a step-rate structure to the Major Research and Development Expenses Tax Credit. Under current law, the credit percentage is 10 percent. Under the new step-rate structure, the credit percentage would be 10 percent, up to the first \$1 million, and 5 percent for amounts in excess of \$1 million. As under current law, 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 would continue to equal to 5 percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the relevant taxable year.

This bill would also introduce a new per taxpayer cap to the Major Research and Development Expenses Tax Credit. Under current law, there is an aggregate cap applicable to all taxpayers, but there is no per taxpayer cap. Under this bill, each taxpayer would be limited to \$300,000, or \$400,000 in the case of qualified research conducted in conjunction with a public or private institution of higher education in the Commonwealth, in credits each year.

This bill would be effective for taxable years beginning on or after January 1, 2023.

### Similar Legislation

**House Bill 2043** would increase the aggregate annual credit cap for the Research and Development Expense Tax Credit from \$7.77 million to \$10 million for Taxable Year 2023 and after.

cc : Secretary of Finance

Date: 1/20/2023 RWC  
SB1048F161