JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION
Fiscal Impact Review
2011 Session

Bill Number: SB 1365 as Introduced
Review Requested By: Senator Colgan

JLARC Staff Fiscal Estimates

JLARC staff concur with the estimated revenue impact provided in the Fiscal Impact Statement (FIS) for SB 1365. SB 1365 would offer insurance companies a State license tax credit equal to 80 percent of their investment in Virginia small business investment companies. If implemented, SB 1365 is estimated to reduce general fund revenue by $11.1 million and Transportation Trust fund revenue by $5.6 million per year. Over the life of the program, the total revenue impact should be no higher than $100 million, as estimated in the FIS, due to the cap on total credits allowed. The annual revenue impact could vary by year depending on credit utilization.

The FIS estimate appears to be based on reasonable assumptions concerning insurance companies' interest in and ability to use the proposed tax credit. It appears that insurance companies have sufficient Virginia license tax liability that they could use the proposed credits. Similar credit programs in other states have been popular, often resulting in all of the credits being allocated. However, it is unclear whether the proposed Virginia tax credit would be as attractive because SB 1365 offers an 80 percent credit, rather than the 100 percent credit available in other states with similar programs. Other states have also found that insurance companies typically have sufficiently large annual tax liability to be able to claim the full the amount of credits each year. The State would likely have a similar experience given the size of the insurance market in the State, stability of State license tax liability, and transferability of the proposed credit.

To date, ten states and Washington, D.C. have adopted programs similar to that proposed in SB 1365, nine of which have audited or reviewed their programs. These audits indicate that the investments by insurance companies helped to create or retain more than 8,800 jobs. However, several states found that this type of program may not be an efficient economic development tool. For example, according to the state audits and reports, the average credit per job created or retained may be as much as $241,000.

An explanation of the JLARC staff review is included on the following pages.

Authorized for Release:

Glen S. Tittermary

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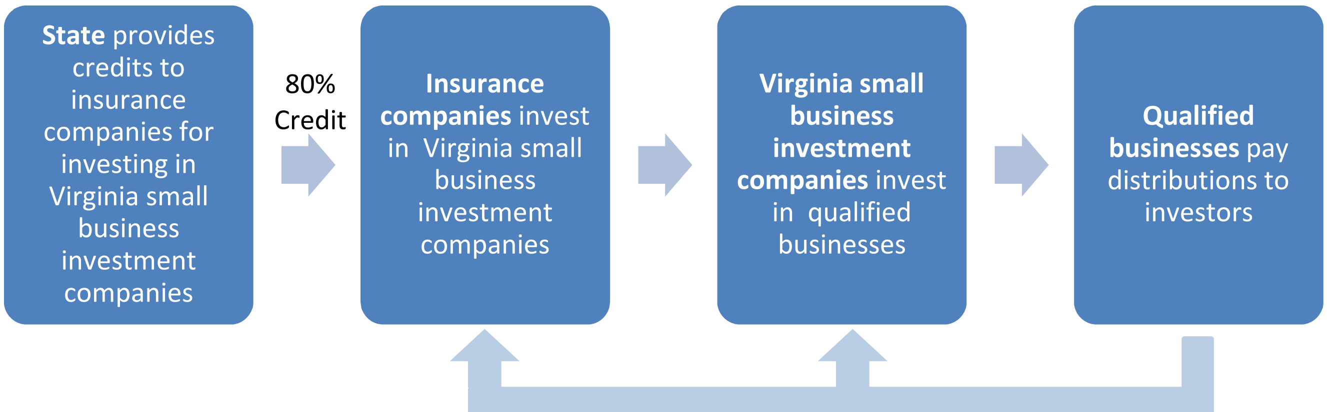
Director

JLARC offers Fiscal Impact Reviews in accordance with Item 30D of Chapter 874 (2010 Acts of Assembly). JLARC Fiscal Impact Reviews do not comment on the merits of the bill under review.

Bill Summary: SB 1365 would authorize a State license tax credit for insurance companies that invest in Virginia small business investment companies that would, in turn, be required to invest in Virginia qualified businesses (see figure below).The credit is intended to stimulate Virginia's venture capital market for qualified businesses by incentivizing insurance companies to invest. The amount of the credit would equal 80 percent of the investment made by the insurance companies, with a combined maximum of $100 million in credits over the life of the program. Insurance companies would be allowed to claim one-sixth of the credit in any taxable year beginning on or after January 1, 2013. The credit would not be refundable, meaning taxpayers' use of credits is limited by their tax liability, but the credit could carry forward indefinitely and would be transferrable.



Discussion of Fiscal Implications: The Fiscal Impact Statement (FIS) for SB 1365 estimates the following general fund and Transportation Trust fund revenue decreases for SB 1365:

	General Fund ($M)	*Transportation Trust Fund ($M)*
FY 2013	$11.1	$5.6
FY 2014	11.1	5.6
FY 2015	11.1	5.6
FY 2016	11.1	5.6
FY 2017	11.1	5.6
FY 2018	11.1	5.6

The fiscal impact of $100 million, developed by staff at the Department of Taxation (TAX), appears to be based upon the reasonable assumptions that insurance companies will make investments of sufficient magnitude and will have sufficient tax liability to fully claim allocated credits. However, it is possible that the fiscal impact could be lower if insurance companies do not fully utilize the program. Although this has not occurred in other states, their programs consistently offer a 100 percent tax credit, as opposed to the proposed 80 percent credit through SB 1365. In addition to the foregone revenue associated with the proposed credit, the FIS indicates that the Department of Business Assistance (DBA) would need one additional full time equivalent (FTE) position to process applications for small business investment companies and requests to allocate credits. While the cost of the position may be partially funded by the proposed application and renewal fees for small business investment companies, the fees may be insufficient to cover the full burdened cost of the position. Finally, ten other states and Washington, D.C. have enacted programs similar to the proposed credit. Reviews in nine of these states have indicated that the programs have encouraged investment in small businesses and created jobs. However, several states have questioned whether the program is the most efficient way for these states to create or retain jobs, given their high cost.

Fiscal Impact Estimate Appears Reasonable
The estimates provided by TAX appear reasonable, based on the State license tax liability of insurance companies and the experiences of other states. The FIS assumes that all $100 million in tax credits will be allocated prior to or during fiscal year 2013 and one-sixth of the total will be claimed each year for six years beginning in FY 2013. Because the credit is equal to 80 percent of the investments, insurance companies would need to invest $125 million in Virginia small business investment companies prior to FY 2014. Given that State license tax collections exceeded $390 million in FY2010, Virginia insurance companies appear to have sufficient tax liability to be interested in and able to claim the proposed tax credit. Insurance companies would be allowed under the proposed legislation to claim the credit beginning January 1, 2013, which would include returns from the previous year that are due March 1, 2013.

Similar programs in other states experienced rapid investment by insurance companies, resulting in the credits being quickly allocated. However, the proposed tax credit's value is 80 percent of the investment, whereas all other states have offered a 100 percent credit. This could make Virginia's program less attractive to insurance companies, but it is not possible to determine to what extent that may reduce the bill's fiscal impact. In addition to rapid take-up, evidence from other states indicates that insurance companies are typically able to claim the full the amount of credits each year. For example, Wisconsin's report indicates that on average 97 percent of allowable credits were claimed under their program. The State would likely experience similar claim rates given the stability of State license tax liability and transferability of the proposed credit.

Appropriations May Be Necessary to Fund Position at DBA
According to the FIS, the Department of Business Assistance will need an additional FTE position to process applications for small business investment companies and requests to allocate credits. It is anticipated that the cost of the position could be at least partially funded by the proposed $7,500 application fee and $5,000 renewal fee for small business investment companies. However, depending on the number of small business investment companies that apply to participate in the program, the fees may be insufficient to cover the full burdened cost of the position. Among the nine states that have reviewed their programs, the median number of participating investment companies is six. Some states, such as Louisiana that has issued more than $600 million in credits since 1983, have had many more participating investment companies. States that have had programs more comparable to the proposed Virginia credit have typically had between three and five certified investment companies participating in the program. Under the proposed structure, five participating small business investment companies would generate $37,500 the first year of the program and $25,000 for years after that, which may be insufficient to fully fund an FTE position, and may require general fund appropriations to offset the shortfall.

Similar Programs in Other States Encourage Investments in Small Businesses and Jobs Creation, but Their Efficiency Has Been Questioned
Ten other states and Washington, D.C. have enacted programs similar to the credit proposed in SB 1365 to promote investment in small businesses. Reviews in nine of these states have indicated that in most cases the programs have successfully encouraged investment in small businesses and created jobs. The table below summarizes results in the nine states that have published audits or reviews of their small business investment programs. In total, over $2.1 billion in credits have been allocated in the nine states, creating or retaining more than 8,800 jobs across the nine programs. Moreover, the National Coalition for Capital reports that the programs may have encour-

aged other investors to provide up to $6.9 billion in follow-on capital for investment in small businesses.

State	*Credits Allocated ($Million)*	*Jobs Created or Retained*	*Average Credit Per Job*
Louisiana	$638	3,296	$193,568
New York	400	524	763,359
Texas	400	1,648	242,718
Alabama	200	2,460	81,301
Florida	150	(162)	N/A
Missouri	140	552	253,623
Colorado	100	157	636,943
Wisconsin	50	316	158,228
Washington, D.C.	$50	31	$1,612,903
Total	**$2,128**	**8,822**	**$241,215**

Despite popularity among insurers and small business investment companies, several state audits, including Colorado, Louisiana, Missouri, and Wisconsin, questioned the efficiency of their programs. While an academic review of Alabama's program suggested that its state program resulted in net revenue gains for the state, formal audits in most states have found the programs will not produce enough state revenue to offset the costs of credits. The average cost to those states of retaining or creating jobs under programs similar to the proposed credit is $241,000. In contrast, Virginia's Major Business Facility Jobs Tax Credit provides $1,000 for each job created. According to Missouri's state auditor, "Each of the 293 jobs [created on average] will cost the state $31,854 per year in tax credits, and those jobs will yield additional state revenue (net of increased state expenditures) of $5,370 per year from income and sales taxes making the net cost to the state, $26,484 per year for 15 years." A report by Florida's Auditor General indicates that qualified businesses receiving investments under their program experienced a net decline of 162 jobs, while the state issued $150 million in credits. It is important to note that states employed a variety of methodologies to derive the estimated effects on investment and employment, and several audits have been criticized by proponents of the programs as underestimating the economic and revenue impacts of the programs. According to proponents of the program, the average cost per job created is approximately $63,500.

Budget Amendment Necessary: Yes. SB 1365 would affect State general fund and Transportation Trust Fund revenue in FY 2013 and 2014. Specifically, the two funds would need to be lowered by $11.1 and $5.6 million, respectively. Additionally, adjustments may need to be made to the Department of Business Assistance's appropriations and staffing levels.

Agencies Affected: Department of Taxation, Department of Business Assistance.

Date Released, Prepared By: 12/05/2011, Massey Whorley