



**JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION**  
**Fiscal Impact Review**  
**2011 Session**

**Bill Number:** SB 1440  
**Review Requested By:** Senator Colgan

**JLARC Staff Fiscal Estimates**

JLARC staff do not concur with the Fiscal Impact Statement (FIS) for SB 1440. Contrary to the FIS finding, implementing SB 1440 would reduce State general fund revenues. SB 1440 would divert certain individual income taxes from the State general fund to the Commonwealth Innovation Investment Fund, a non-reverting special fund established by the bill.

JLARC staff are in agreement with the Department of Taxation's preliminary estimate that approximately \$70 million in withheld employee income taxes would be deposited into the Commonwealth Innovation Investment Fund between FY 2013 and FY 2017. The fiscal impact could continue to increase after FY 2017. The FIS estimate appears to be based on reasonable assumptions concerning the share of total taxes withheld by science and innovation companies, as well as growth in total taxes withheld by Virginia businesses between FY 2012 and FY 2017. However, the fiscal impact of SB 1440 could be higher or lower than estimated if the amount of taxes withheld differs from the current forecast, or if the ultimate regulatory definition of science and innovation companies is different than the definition assumed in the FIS. Growth or contraction in the science and innovation sector could also affect the fiscal impact of the bill.

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

**Authorized for Release:**



Glen S. Tittermary  
Director

**Bill Summary:** SB 1440 would create the Commonwealth Innovation Investment Fund. The fund would be administered by the Innovation and Entrepreneurship Investment Authority to create, attract, retain, expand, and enhance technology research, innovation, and economic development in the Commonwealth. Beginning in 2013, the fund would receive a portion of the income taxes withheld by science and innovation companies on behalf of employees in the Commonwealth. The percentage of the withheld taxes allocated to the fund would be based on a percentage of the difference between the current year's withheld taxes and the amount withheld in 2012, the baseline year.

**Discussion of Fiscal Implications:** The Fiscal Impact Statement (FIS) for SB 1440 indicates that the bill will not impact general fund revenue. JLARC staff do not concur with this conclusion, because diverting withholding tax revenue to the Commonwealth Innovation Investment Fund, which is a special fund, would have a direct general fund impact. Total revenue to the State, however, will not be affected. The annual general fund revenue impact of SB 1440 is estimated to increase over time, from \$2.0 million in FY 2013 to approximately \$25.8 million in FY 2017. Table 1 shows the estimated amounts that would be transferred to the Commonwealth Innovation Investment Fund based on a percentage of taxes withheld by affected companies.

<b>Fiscal Year</b>	<b>Impact on General Fund (\$ in millions)</b>	<b>Impact on Commonwealth Innovation and Investment Fund (\$ in millions)</b>
2013	(\$2.0)	\$2.0
2014	(8.5)	8.5
2015	(14.0)	14.0
2016	(19.7)	19.7
2017	(25.8)	25.8
<b>Cumulative Total FY 2013-2017</b>	<b>(\$70.0)</b>	<b>\$70.0</b>

Neither the Department of Taxation (TAX) nor the Innovation Entrepreneurship Investment Authority anticipate the bill resulting in increased administrative expenses for either agency.

#### *Explanation of the TAX Methodology*

In order to estimate the fiscal impact of SB 1440, TAX first identified total individual State income taxes withheld by all companies in tax year 2008, approximately \$8.8 billion. TAX then estimated that science and innovation (S&I) companies withheld approximately \$85.6 million in income taxes in tax year 2008. Because the bill did not explicitly define S&I companies, and would direct TAX to do so through regulation if implemented, assumptions were made by TAX for the purposes of its analysis. Using the North American Industry Classification System (NAICS), TAX identified 18 types of businesses, a total of 828 firms, as S&I companies operating in Virginia. The 18 types of businesses identified appear to be a reasonable definition of S&I companies.

TAX then calculated the portion of total income taxes withheld by science and innovation companies. By dividing S&I withholding into total withholding, TAX estimated that S&I companies represented approximately 0.98 percent of total income tax withholding in tax year 2008. For the purposes of its analysis, TAX then assumed that S&I companies would remain a constant portion of total income taxes withheld. This estimate could be higher or lower if the final regulatory defini-

tion of qualifying S&I companies differs from the definition used by TAX for its analysis, or if S&I firms withhold a higher or lower share of all employee income taxes in future years.

In order to estimate the fiscal impact of SB 1440 in the FY 2013 to FY 2017 period, TAX used its forecasts of total revenue growth for the FY 2012 to FY 2017 period. For the period, total income taxes withheld are forecast to increase by four to five percent per year, rising from \$9.9 billion in FY 2012 to \$12.5 billion in FY 2017. The portion of withheld taxes attributable to S&I businesses was calculated by multiplying total withheld taxes by 0.98 percent, as seen in Table 2.

**Table 2: Estimates of Total and Science and Innovation Company Withholding Taxes, FYs 2012-2017 (\$ in millions)**

<b>Fiscal Year</b>	<b>Estimated Total Taxes Withheld</b>	<b>Estimated Science and Innovation Taxes Withheld</b>	<b>Estimated Change from Baseline in Taxes Withheld by Science and Innovation Companies</b>
2012	\$9,871	\$96.7	N/A
2013	10,279	100.7	4.0
2014	10,739	105.2	8.5
2015	11,294	110.1	13.9
2016	11,881	116.4	19.7
2017	12,495	122.5	25.7

The general fund impact of the bill was then calculated by finding the difference in S&I taxes withheld in each of the fiscal years between 2013 and 2017 and the base year, 2012 (Table 2). For FY 2013, this difference was halved, as SB 1440 would go into effect on January 1, 2013. Under SB 1440, this difference would be diverted from the State general fund to the Commonwealth Innovation Investment Fund.

**Budget Amendment Necessary:** Yes. SB 1440 would reduce State general fund revenues beginning with FY 2013. The bill would also require the creation and appropriations from the Commonwealth Innovation Investment Fund.

**Agencies Affected:** The Department of Taxation; the Innovation and Entrepreneurship Investment Authority

**Date Released, Prepared By:** 12/02/2011, David Reynolds.