

# DEPARTMENT OF TAXATION

## 2004 Fiscal Impact Statement

1. **Patron** Harry J. Parrish

3. **Committee** House Finance

4. **Title** Income Tax: Conformity of Terms to the  
Internal Revenue Code

2. **Bill Number** HB 107

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

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

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from December 31, 2002 to December 31, 2003. Virginia would continue to disallow any bonus depreciation allowed for certain assets under federal income taxation and any 5 year carry-back of net operating losses ("NOL") allowed for NOLs generated in either taxable year 2001 or 2002.

This is an Executive Bill.

This bill contains an emergency clause. The effective date of this bill is not specified.

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

#### 6b. **Revenue Impact:**

| <i><b>Fiscal Year</b></i> | <i><b>Dollars</b></i> | <i><b>Fund</b></i> |
|---------------------------|-----------------------|--------------------|
| 2003-04                   | <\$15.3 million>      | GF                 |
| 2004-05                   | <\$17.2 million>      | GF                 |
| 2005-06                   | <\$11.2 million>      | GF                 |
| 2006-07                   | \$0.5 million         | GF                 |
| 2007-08                   | \$1.3 million         | GF                 |
| 2008-09                   | <\$1.1 million>       | GF                 |
| 2009-10                   | <\$2.7 million>       | GF                 |

7. **Budget amendment necessary:** Yes.

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## 8. Fiscal implications:

The Department's costs to administer this bill would be minimal.

Compared to current law, the Department estimates that this bill would result in decreased General Fund revenues of \$15.3 million in Fiscal Year 2004, \$17.2 million in Fiscal Year 2005, \$11.2 million in Fiscal Year 2006, increased revenues of \$510,000 in Fiscal Year 2007, increased revenues of \$1.3 million in Fiscal Year 2008, decreased revenues of \$1.1 million in Fiscal Year 2009, and decreased revenues of \$2.7 million in Fiscal Year 2010.

The Executive Budget has assumed a decrease in General Fund revenues of \$14.3 million in FY 2004, \$13.6 million in FY 2005, and \$7.6 million in FY 2006.

**Medical Savings Plans** After the revenue reforecast was finalized, the Executive budget was submitted, and the deadline for executive amendments expired, a comprehensive analysis of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 indicated that the bill contained some federal tax provisions that would affect Virginia.

The Act primarily creates a new Medicare prescription drug benefit program for seniors and the disabled as well as providing for a major overhaul of the current Medicare system. While the focus of this Act was not related to taxation, the Act nevertheless included three tax provisions providing tax benefits for health care savings. It is the effect of these three provisions that is the difference between the full impact of this bill and the impact included in the Executive Budget. The following table shows the difference.

| <b>Fiscal Year</b> | <b>Effect of HB 107 on General Fund Revenue</b> | <b>General Fund revenue effect of similar provisions in the Governor's tax reform proposal</b> | <b>Difference between HB 107 and similar provisions in the Governor's tax reform proposal</b> |
|--------------------|---|--|---|
| 2004               | (\$15.3 million)                                | (\$14.3 million)   | (\$1.0 million)   |
| 2005               | (\$17.2 million)                                | (\$13.6 million)   | (\$3.6 million)   |
| 2006               | (\$11.2 million)                                | (\$7.6 million)  | (\$3.6 million)   |
| 2007               | \$0.5 million                                   | \$3.9 million  | (\$3.4 million)   |
| 2008               | \$1.3 million                                   | \$4.8 million  | (\$3.5 million)   |
| 2009               | (\$1.1 million)                                 | \$2.6 million  | (\$3.7 million)   |
| 2010               | (\$2.7 million)                                 | \$1.1 million  | (\$3.8 million)   |

## 9. Specific agency or political subdivisions affected:

Department of Taxation

## 10. Technical amendment necessary: None.

## 11. Other comments:

### Current Law

Virginia's conformity to the IRC is currently fixed to the IRC as it existed on December 31, 2002. Since that date, Congress has enacted three measures that would affect income taxation in Virginia, the Jobs and Growth Tax Relief and Reconciliation Act, the Military Family Tax Relief Act, and the Medicare Prescription Drug, Improvement and Modernization Act. These acts have made considerable changes to the IRC that Virginia does not currently recognize.

### Jobs and Growth Tax Relief and Reconciliation Act

The Jobs and Growth Tax Relief Reconciliation Act of 2003 was enacted in May of 2003. The primary purpose of this act was to grant income tax relief to a variety of taxpayers. Only one provision of this act would have a flow-through effect on Virginia. The provision that would flow-through to Virginia income taxes is the increase in the § 179 expensing. This provision increases the amount that can be expensed from \$25,000 to \$100,000 for qualifying property placed into service in tax years beginning after 2002 and before 2006. The amount used to compute the phase-out of the deduction is increased from \$200,000 to \$400,000. This provision also includes software as property that may be expensed under § 179. In addition, this bill includes a provision for indexing both the deduction limit and the phase-out threshold after 2003 until 2005.

This bill also includes a provision to increase the bonus depreciation to 50% and extend the bonus depreciation through December 31, 2004. Virginia does not allow the bonus depreciation for certain assets under federal income taxation to flow through to the Virginia income tax.

### Military Family Tax Relief Act

The Military Family Tax Relief Act of 2003 was enacted in November of 2003. The primary purpose of this act was to provide income tax relief to members of the armed forces and their families. One of the more notable provisions is the exclusion of the gain from the sale of a principal residence by a member of the uniformed and foreign services. This provision is effective for sales after May 6, 1997. Another provision is an above-the-line deduction of up to \$1,500 for overnight travel expenses of National Guard and reserve members. The deduction of expenses is allowed when members are traveling more than 100 miles from home in connection with National Guard or reserve duties. This provision is effective for expenses incurred after December 31, 2002. This Act also included an expansion of the income tax exclusion for military death benefits.

## Medicare Prescription Drug, Improvement and Modernization Act

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was enacted in December 2003. The primary purpose of this act was to reform the federal Medicare system. This act contains three tax provisions. The most notable provision is the deduction for contributions made to Health Savings Accounts, HSAs. HSAs are an expanded version of Archer Medical Savings Accounts. This bill would provide a deduction for the amount paid during a taxable year by or on behalf of an individual to a health savings account.

### Proposal

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from December 31, 2002 to December 31, 2003. Virginia would continue to disallow any bonus depreciation allowed for certain assets under federal income taxation and any 5 year carry-back of net operating losses ("NOL") allowed for NOLs generated in either taxable year 2001 or 2002.

This bill would allow the increased amount for section 179 expensing to flow through to Virginia taxpayers. In addition, this bill would allow income tax provisions, which would provide income tax relief to members of the armed forces and their families to flow through to Virginia income taxes. Finally, this bill would allow the provisions relating to the income tax deduction for Health Savings Accounts to flow through to Virginia taxpayers.

### Other Legislation

**Senate Bill 466** and **Senate Bill 526** are identical to this bill.

cc : Secretary of Finance