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HOUSE BILL NO. 335

Offered January 11, 2012

Prefiled January 10, 2012

A BILL to amend and reenact §§ 58.1-322 and 58.1-402 of the Code of Virginia, relating to taxable income of investors in small businesses.

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Referred to Committee on Finance

Be it enacted by the General Assembly of Virginia:**1. That §§ 58.1-322 and 58.1-402 of the Code of Virginia are amended and reenacted as follows:**

§ 58.1-322. Virginia taxable income of residents.

A. The Virginia taxable income of a resident individual means his federal adjusted gross income for the taxable year, which excludes combat pay for certain members of the Armed Forces of the United States as provided in § 112 of the Internal Revenue Code, as amended, and with the modifications specified in this section.

B. To the extent excluded from federal adjusted gross income, there shall be added:

1. Interest, less related expenses to the extent not deducted in determining federal income, on obligations of any state other than Virginia, or of a political subdivision of any such other state unless created by compact or agreement to which Virginia is a party;

2. Interest or dividends, less related expenses to the extent not deducted in determining federal taxable income, on obligations or securities of any authority, commission or instrumentality of the United States, which the laws of the United States exempt from federal income tax but not from state income taxes;

3. Unrelated business taxable income as defined by § 512 of the Internal Revenue Code;

4. The amount of a lump sum distribution from a qualified retirement plan, less the minimum distribution allowance and any amount excludable for federal income tax purposes that is excluded from federal adjusted gross income solely by virtue of an individual's election to use the averaging provisions under § 402 of the Internal Revenue Code; and

5 through 8. [Repealed.]

9. The amount required to be included in income for the purpose of computing the partial tax on an accumulation distribution pursuant to § 667 of the Internal Revenue Code.

C. To the extent included in federal adjusted gross income, there shall be subtracted:

1. Income derived from obligations, or on the sale or exchange of obligations, of the United States and on obligations or securities of any authority, commission or instrumentality of the United States to the extent exempt from state income taxes under the laws of the United States including, but not limited to, stocks, bonds, treasury bills, and treasury notes, but not including interest on refunds of federal taxes, interest on equipment purchase contracts, or interest on other normal business transactions.

2. Income derived from obligations, or on the sale or exchange of obligations of this Commonwealth or of any political subdivision or instrumentality of the Commonwealth.

3. [Repealed.]

4. Benefits received under Title II of the Social Security Act and other benefits subject to federal income taxation solely pursuant to § 86 of the Internal Revenue Code.

4a. Through December 31, 2000, the same amount used in computing the federal credit allowed under § 22 of the Internal Revenue Code by a retiree under age 65 who qualified for such retirement on the basis of permanent and total disability and who is a qualified individual as defined in § 22(b)(2) of the Internal Revenue Code; however, any person who claims a deduction under subdivision 5 of subsection D of this section may not also claim a subtraction under this subdivision.

4b. For taxable years beginning on or after January 1, 2001, up to \$20,000 of disability income, as defined in § 22(c)(2)(B)(iii) of the Internal Revenue Code; however, any person who claims a deduction under subdivision 5 of subsection D of this section may not also claim a subtraction under this subdivision.

5. The amount of any refund or credit for overpayment of income taxes imposed by the Commonwealth or any other taxing jurisdiction.

6. The amount of wages or salaries eligible for the federal Targeted Jobs Credit which was not deducted for federal purposes on account of the provisions of § 280C(a) of the Internal Revenue Code.

7, 8. [Repealed.]

9. [Expired.]

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59 10. Any amount included therein less than \$600 from a prize awarded by the State Lottery
60 Department.

61 11. The wages or salaries received by any person for active and inactive service in the National
62 Guard of the Commonwealth of Virginia, not to exceed the amount of income derived from 39 calendar
63 days of such service or \$3,000, whichever amount is less; however, only those persons in the ranks of
64 O3 and below shall be entitled to the deductions specified herein.

65 12. Amounts received by an individual, not to exceed \$1,000 in any taxable year, as a reward for
66 information provided to a law-enforcement official or agency, or to a nonprofit corporation created
67 exclusively to assist such law-enforcement official or agency, in the apprehension and conviction of
68 perpetrators of crimes. This provision shall not apply to the following: an individual who is an employee
69 of, or under contract with, a law-enforcement agency, a victim or the perpetrator of the crime for which
70 the reward was paid, or any person who is compensated for the investigation of crimes or accidents.

71 13. [Repealed.]

72 14. [Expired.]

73 15, 16. [Repealed.]

74 17. For taxable years beginning on and after January 1, 1995, the amount of "qualified research
75 expenses" or "basic research expenses" eligible for deduction for federal purposes, but which were not
76 deducted, on account of the provisions of § 280C(c) of the Internal Revenue Code and which shall be
77 available to partners, shareholders of S corporations, and members of limited liability companies to the
78 extent and in the same manner as other deductions may pass through to such partners, shareholders, and
79 members.

80 18. [Repealed.]

81 19. For taxable years beginning on and after January 1, 1996, any income received during the taxable
82 year derived from a qualified pension, profit-sharing, or stock bonus plan as described by § 401 of the
83 Internal Revenue Code, an individual retirement account or annuity established under § 408 of the
84 Internal Revenue Code, a deferred compensation plan as defined by § 457 of the Internal Revenue Code,
85 or any federal government retirement program, the contributions to which were deductible from the
86 taxpayer's federal adjusted gross income, but only to the extent the contributions to such plan or
87 program were subject to taxation under the income tax in another state.

88 20. For taxable years beginning on and after January 1, 1997, any income attributable to a
89 distribution of benefits or a refund from a prepaid tuition contract or savings trust account with the
90 Virginia College Savings Plan, created pursuant to Chapter 4.9 (§ 23-38.75 et seq.) of Title 23. The
91 subtraction for any income attributable to a refund shall be limited to income attributable to a refund in
92 the event of a beneficiary's death, disability, or receipt of a scholarship.

93 21. For taxable years beginning on or after January 1, 1998, all military pay and allowances, to the
94 extent included in federal adjusted gross income and not otherwise subtracted, deducted or exempted
95 under this section, earned by military personnel while serving by order of the President of the United
96 States with the consent of Congress in a combat zone or qualified hazardous duty area which is treated
97 as a combat zone for federal tax purposes pursuant to § 112 of the Internal Revenue Code.

98 22. For taxable years beginning on or after January 1, 2000, the gain derived from the sale or
99 exchange of real property or the sale or exchange of an easement to real property which results in the
100 real property or the easement thereto being devoted to open-space use, as that term is defined in
101 § 58.1-3230, for a period of time not less than 30 years. To the extent a subtraction is taken in
102 accordance with this subdivision, no tax credit under this chapter for donating land for its preservation
103 shall be allowed for three years following the year in which the subtraction is taken.

104 23. Effective for all taxable years beginning on or after January 1, 2000, \$15,000 of military basic
105 pay for military service personnel on extended active duty for periods in excess of 90 days; however,
106 the subtraction amount shall be reduced dollar-for-dollar by the amount which the taxpayer's military
107 basic pay exceeds \$15,000 and shall be reduced to zero if such military basic pay amount is equal to or
108 exceeds \$30,000.

109 24. Effective for all taxable years beginning on and after January 1, 2000, the first \$15,000 of salary
110 for each federal and state employee whose total annual salary from all employment for the taxable year
111 is \$15,000 or less.

112 25. Unemployment benefits taxable pursuant to § 85 of the Internal Revenue Code.

113 26. For taxable years beginning on and after January 1, 2001, any amount received as military
114 retirement income by an individual awarded the Congressional Medal of Honor.

115 27. Effective for all taxable years beginning on and after January 1, 1999, income received as a
116 result of (i) the "Master Settlement Agreement," as defined in § 3.2-3100; and (ii) the National Tobacco
117 Grower Settlement Trust dated July 19, 1999, by (a) tobacco farmers; (b) any person holding a tobacco
118 marketing quota, or tobacco farm acreage allotment, under the Agricultural Adjustment Act of 1938; or
119 (c) any person having the right to grow tobacco pursuant to such a quota or allotment, but only to the
120 extent that such income has not been subtracted pursuant to subdivision C 18 of § 58.1-402.

28. For taxable years beginning on and after January 1, 2000, items of income attributable to, derived from or in any way related to (i) assets stolen from, hidden from or otherwise lost by an individual who was a victim or target of Nazi persecution or (ii) damages, reparations, or other consideration received by a victim or target of Nazi persecution to compensate such individual for performing labor against his will under the threat of death, during World War II and its prelude and direct aftermath. This subtraction shall not apply to assets acquired with such items of income or with the proceeds from the sale of assets stolen from, hidden from or otherwise lost to, during World War II and its prelude and direct aftermath, a victim or target of Nazi persecution. The provisions of this subdivision shall only apply to an individual who was the first recipient of such items of income and who was a victim or target of Nazi persecution, or a spouse, widow, widower, or child or stepchild of such victim.

"Victim or target of Nazi persecution" means any individual persecuted or targeted for persecution by the Nazi regime who had assets stolen from, hidden from or otherwise lost as a result of any act or omission in any way relating to (i) the Holocaust; (ii) World War II and its prelude and direct aftermath; (iii) transactions with or actions of the Nazi regime; (iv) treatment of refugees fleeing Nazi persecution; or (v) the holding of such assets by entities or persons in the Swiss Confederation during World War II and its prelude and aftermath. A victim or target of Nazi persecution shall also include any individual forced into labor against his will, under the threat of death, during World War II and its prelude and direct aftermath. As used in this subdivision, "Nazi regime" means the country of Nazi Germany, areas occupied by Nazi Germany, those European countries allied with Nazi Germany, or any other neutral European country or area in Europe under the influence or threat of Nazi invasion.

29, 30. [Repealed.]

31. Effective for all taxable years beginning on or after January 1, 2001, the military death gratuity payment made after September 11, 2001, to the survivor of deceased military personnel killed in the line of duty, pursuant to Chapter 75 of Title 10 of the United States Code; however, the subtraction amount shall be reduced dollar-for-dollar by the amount that the survivor may exclude from his federal gross income in accordance with § 134 of the Internal Revenue Code.

32. Effective for all taxable years beginning on or after January 1, 2007, the death benefit payments from an annuity contract that are received by a beneficiary of such contract and are subject to federal income taxation.

33. For taxable years beginning on and after January 1, 2009, any gain recognized from the sale of launch services to space flight participants, as defined in 49 U.S.C. § 70102, or launch services intended to provide individuals the training or experience of a launch, without performing an actual launch. To qualify for a deduction under this subdivision, launch services must be performed in Virginia or originate from an airport or spaceport in Virginia.

34. For taxable years beginning on and after January 1, 2009, any gain recognized as a result of resupply services contracts for delivering payload, as defined in 49 U.S.C. § 70102, entered into with the Commercial Orbital Transportation Services division of the National Aeronautics and Space Administration or other space flight entity, as defined in § 8.01-227.8, and launched from an airport or spaceport in Virginia.

35. (See Editor's note) For taxable years beginning on or after January 1, 2011, any income taxed as a long-term capital gain for federal income tax purposes, or any income taxed as investment services partnership interest income (otherwise known as investment partnership carried interest income) for federal income tax purposes. To qualify for a subtraction under this subdivision, such income shall be attributable to an investment in a "qualified business," as defined in § 58.1-339.4, or in any other technology business approved by the Secretary of Technology, provided the business has its principal office or facility in the Commonwealth and less than \$3 million in annual revenues in the fiscal year prior to the investment. To qualify for a subtraction under this subdivision, the investment shall be made between the dates of April 1, 2010, and June 30, 2013. No taxpayer who has claimed a tax credit for an investment in a "qualified business" under § 58.1-339.4 shall be eligible for the subtraction under this subdivision for an investment in the same business.

36. Any income taxed as (i) a gain for federal income tax purposes attributable to an investment in a small business made on or after January 1, 2012, held by the individual for at least five years or (ii) investment services partnership interest income (otherwise known as investment partnership carried interest income) for federal income tax purposes that is attributable to an investment in a small business made by the individual on or after January 1, 2012. For purposes of this subdivision, a "small business" means a business that (a) has its principal office or facility in the Commonwealth and (b) immediately after such investment and at all times prior to such investment, had aggregate assets that totaled less than \$50 million in cash plus the aggregate adjusted bases of all other property held by the business. The subtraction under this subdivision shall be limited to any gain or investment services partnership interest income attributable to the first \$500,000 invested by the individual in the respective small

182 *business, regardless of the taxable year or years in which the investment was made. No subtraction*
183 *shall be allowed under this subdivision to the extent of any gain or investment services partnership*
184 *interest income for which the individual has claimed a deduction or subtraction under another provision*
185 *of this section. No taxpayer who has claimed a tax credit for an investment in a "qualified business"*
186 *under § 58.1-339.4 shall be eligible for the subtraction under this subdivision for an investment in the*
187 *same business.*

188 D. In computing Virginia taxable income there shall be deducted from Virginia adjusted gross
189 income as defined in § 58.1-321:

190 1. a. The amount allowable for itemized deductions for federal income tax purposes where the
191 taxpayer has elected for the taxable year to itemize deductions on his federal return, but reduced by the
192 amount of income taxes imposed by the Commonwealth or any other taxing jurisdiction and deducted
193 on such federal return and increased by an amount which, when added to the amount deducted under
194 § 170 of the Internal Revenue Code for mileage, results in a mileage deduction at the state level for
195 such purposes at a rate of 18 cents per mile; or

196 b. Three thousand dollars for single individuals and \$6,000 for married persons (one-half of such
197 amounts in the case of a married individual filing a separate return) for taxable years beginning on and
198 after January 1, 2005; provided that the taxpayer has not itemized deductions for the taxable year on his
199 federal income tax return. For purposes of this section, any person who may be claimed as a dependent
200 on another taxpayer's return for the taxable year may compute the deduction only with respect to earned
201 income.

202 2. a. A deduction in the amount of \$900 for taxable years beginning on and after January 1, 2005,
203 but before January 1, 2008; and \$930 for taxable years beginning on and after January 1, 2008, for each
204 personal exemption allowable to the taxpayer for federal income tax purposes.

205 b. For taxable years beginning on and after January 1, 1987, each blind or aged taxpayer as defined
206 under § 63(f) of the Internal Revenue Code shall be entitled to an additional personal exemption in the
207 amount of \$800.

208 The additional deduction for blind or aged taxpayers allowed under this subdivision shall be
209 allowable regardless of whether the taxpayer itemizes deductions for the taxable year for federal income
210 tax purposes.

211 3. A deduction equal to the amount of employment-related expenses upon which the federal credit is
212 based under § 21 of the Internal Revenue Code for expenses for household and dependent care services
213 necessary for gainful employment.

214 4. An additional \$1,000 deduction for each child residing for the entire taxable year in a home under
215 permanent foster care placement as defined in § 63.2-908, provided the taxpayer can also claim the child
216 as a personal exemption under § 151 of the Internal Revenue Code.

217 5. For taxable years beginning on and after January 1, 2004, a deduction in the amount of \$12,000
218 for individuals born after January 1, 1939, who have attained the age of 65. This deduction shall be
219 reduced by \$1 for every \$1 that the taxpayer's adjusted federal adjusted gross income exceeds \$50,000
220 for single taxpayers or \$75,000 for married taxpayers. For married taxpayers filing separately, the
221 deduction will be reduced by \$1 for every \$1 the total combined adjusted federal adjusted gross income
222 of both spouses exceeds \$75,000.

223 For the purposes of this subdivision, "adjusted federal adjusted gross income" means federal adjusted
224 gross income minus any benefits received under Title II of the Social Security Act and other benefits
225 subject to federal income taxation solely pursuant to § 86 of the Internal Revenue Code, as amended.

226 6. For taxable years beginning on and after January 1, 1997, the amount an individual pays as a fee
227 for an initial screening to become a possible bone marrow donor, if (i) the individual is not reimbursed
228 for such fee or (ii) the individual has not claimed a deduction for the payment of such fee on his federal
229 income tax return.

230 7. a. A deduction shall be allowed to the purchaser or contributor for the amount paid or contributed
231 during the taxable year for a prepaid tuition contract or savings trust account entered into with the
232 Virginia College Savings Plan, pursuant to Chapter 4.9 (§ 23-38.75 et seq.) of Title 23. Except as
233 provided in subdivision 7 c, the amount deducted on any individual income tax return in any taxable
234 year shall be limited to \$4,000 per prepaid tuition contract or savings trust account. No deduction shall
235 be allowed pursuant to this section if such payments or contributions are deducted on the purchaser's or
236 contributor's federal income tax return. If the purchase price or annual contribution to a savings trust
237 account exceeds \$4,000, the remainder may be carried forward and subtracted in future taxable years
238 until the purchase price or savings trust contribution has been fully deducted; however, except as
239 provided in subdivision 7 c, in no event shall the amount deducted in any taxable year exceed \$4,000
240 per contract or savings trust account. Notwithstanding the statute of limitations on assessments contained
241 in § 58.1-312, any deduction taken hereunder shall be subject to recapture in the taxable year or years in
242 which distributions or refunds are made for any reason other than (i) to pay qualified higher education
243 expenses, as defined in § 529 of the Internal Revenue Code or (ii) the beneficiary's death, disability, or

receipt of a scholarship. For the purposes of this subdivision, the term "purchaser" or "contributor" means the person shown as such on the records of the Virginia College Savings Plan as of December 31 of the taxable year. In the case of a transfer of ownership of a prepaid tuition contract or savings trust account, the transferee shall succeed to the transferor's tax attributes associated with a prepaid tuition contract or savings trust account, including, but not limited to, carryover and recapture of deductions.

b. The amount paid for a prepaid tuition contract during taxable years beginning on or after January 1, 1996, but before January 1, 1998, shall be deducted in taxable years beginning on or after January 1, 1998, and shall be subject to the limitations set out in subdivision 7 a.

c. A purchaser of a prepaid tuition contract or contributor to a savings trust account who has attained age 70 shall not be subject to the limitation that the amount of the deduction not exceed \$4,000 per prepaid tuition contract or savings trust account in any taxable year. Such taxpayer shall be allowed a deduction for the full amount paid for the contract or contributed to a savings trust account, less any amounts previously deducted.

8. For taxable years beginning on and after January 1, 2000, the total amount an individual actually contributed in funds to the Virginia Public School Construction Grants Program and Fund, established in Chapter 11.1 (§ 22.1-175.1 et seq.) of Title 22.1, provided the individual has not claimed a deduction for such amount on his federal income tax return.

9. For taxable years beginning on and after January 1, 1999, an amount equal to 20 percent of the tuition costs incurred by an individual employed as a primary or secondary school teacher licensed pursuant to Chapter 15 (§ 22.1-289.1 et seq.) of Title 22.1 to attend continuing teacher education courses that are required as a condition of employment; however, the deduction provided by this subsection shall be available only if (i) the individual is not reimbursed for such tuition costs and (ii) the individual has not claimed a deduction for the payment of such tuition costs on his federal income tax return.

10. For taxable years beginning on and after January 1, 2000, the amount an individual pays annually in premiums for long-term health care insurance, provided the individual has not claimed a deduction for federal income tax purposes, or a credit under § 58.1-339.11.

11. For taxable years beginning on and after January 1, 2006, contract payments to a producer of quota tobacco or a tobacco quota holder, or their spouses, as provided under the American Jobs Creation Act of 2004 (P.L. 108-357), but only to the extent that such payments have not been subtracted pursuant to subsection D of § 58.1-402, as follows:

a. If the payment is received in installment payments, then the recognized gain, including any gain recognized in taxable year 2005, may be subtracted in the taxable year immediately following the year in which the installment payment is received.

b. If the payment is received in a single payment, then 10 percent of the recognized gain may be subtracted in the taxable year immediately following the year in which the single payment is received. The taxpayer may then deduct an equal amount in each of the nine succeeding taxable years.

12. For taxable years beginning on and after January 1, 2007, an amount equal to 20 percent of the sum paid by an individual pursuant to Chapter 6 (§ 58.1-600 et seq.), not to exceed \$500 in each taxable year, in purchasing for his own use the following items of tangible personal property: (i) any clothes washers, room air conditioners, dishwashers, and standard size refrigerators that meet or exceed the applicable energy star efficiency requirements developed by the United States Environmental Protection Agency and the United States Department of Energy; (ii) any fuel cell that (a) generates electricity using an electrochemical process, (b) has an electricity-only generation efficiency greater than 35 percent, and (c) has a generating capacity of at least two kilowatts; (iii) any gas heat pump that has a coefficient of performance of at least 1.25 for heating and at least 0.70 for cooling; (iv) any electric heat pump hot water heater that yields an energy factor of at least 1.7; (v) any electric heat pump that has a heating system performance factor of at least 8.0 and a cooling seasonal energy efficiency ratio of at least 13.0; (vi) any central air conditioner that has a cooling seasonal energy efficiency ratio of at least 13.5; (vii) any advanced gas or oil water heater that has an energy factor of at least 0.65; (viii) any advanced oil-fired boiler with a minimum annual fuel-utilization rating of 85; (ix) any advanced oil-fired furnace with a minimum annual fuel-utilization rating of 85; and (x) programmable thermostats.

13. For taxable years beginning on or after January 1, 2007, the lesser of \$5,000 or the amount actually paid by a living donor of an organ or other living tissue for unreimbursed out-of-pocket expenses directly related to the donation that arose within 12 months of such donation, provided the donor has not taken a medical deduction in accordance with the provisions of § 213 of the Internal Revenue Code for such expenses. The deduction may be taken in the taxable year in which the donation is made or the taxable year in which the 12-month period expires.

E. There shall be added to or subtracted from federal adjusted gross income, as the case may be, the individual's share, as beneficiary of an estate or trust, of the Virginia fiduciary adjustment determined under § 58.1-361.

F. There shall be added or subtracted, as the case may be, the amounts provided in § 58.1-315 as

305 transitional modifications.

306 G. Effective for all taxable years beginning on or after January 1, 2007, to the extent included in
307 federal adjusted gross income, there shall be (i) subtracted from federal adjusted gross income by a
308 shareholder of an electing small business corporation (S corporation) that is subject to the bank franchise
309 tax imposed under Chapter 12 (§ 58.1-1200 et seq.) for the calendar year in which such taxable year
310 begins, the shareholder's allocable share of the income or gain of such electing small business
311 corporation (S corporation), and (ii) added back to federal adjusted gross income such that, federal
312 adjusted gross income shall be increased, by a shareholder of an electing small business corporation (S
313 corporation) that is subject to the bank franchise tax imposed under Chapter 12 (§ 58.1-1200 et seq.) for
314 the calendar year in which such taxable year begins, the shareholder's allocable share of the losses or
315 deductions of such electing small business corporation (S corporation).

316 Effective for all taxable years beginning on or after January 1, 2007, to the extent excluded from
317 federal adjusted gross income, there shall be added to federal adjusted gross income by a shareholder of
318 an electing small business corporation (S corporation) that is subject to the bank franchise tax imposed
319 under Chapter 12 (§ 58.1-1200 et seq.) for the calendar year in which such taxable year begins, the
320 value of any distribution paid or distributed to the shareholder by such electing small business
321 corporation (S corporation).

322 H. Notwithstanding any other provision of law, the income from any disposition of real property
323 which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or
324 business, as defined in § 453(l) (1) (B) of the Internal Revenue Code, of property made on or after
325 January 1, 2009, may, at the election of the taxpayer, be recognized under the installment method
326 described under § 453 of the Internal Revenue Code, provided that (i) the election relating to the dealer
327 disposition of the property has been made on or before the due date prescribed by law (including
328 extensions) for filing the taxpayer's return of the tax imposed under this chapter for the taxable year in
329 which the disposition occurs, and (ii) the dealer disposition is in accordance with restrictions or
330 conditions established by the Department, which shall be set forth in guidelines developed by the
331 Department. Along with such restrictions or conditions, the guidelines shall also address the recapture of
332 such income under certain circumstances. The development of the guidelines shall be exempt from the
333 Administrative Process Act (§ 2.2-4000 et seq.).

334 § 58.1-402. Virginia taxable income.

335 A. For purposes of this article, Virginia taxable income for a taxable year means the federal taxable
336 income and any other income taxable to the corporation under federal law for such year of a corporation
337 adjusted as provided in subsections B, C, D, and E.

338 For a regulated investment company and a real estate investment trust, such term means the
339 "investment company taxable income" and "real estate investment trust taxable income," respectively, to
340 which shall be added in each case any amount of capital gains and any other income taxable to the
341 corporation under federal law which shall be further adjusted as provided in subsections B, C, D, and E.

342 B. There shall be added to the extent excluded from federal taxable income:

343 1. Interest, less related expenses to the extent not deducted in determining federal taxable income, on
344 obligations of any state other than Virginia, or of a political subdivision of any such other state unless
345 created by compact or agreement to which the Commonwealth is a party;

346 2. Interest or dividends, less related expenses to the extent not deducted in determining federal
347 taxable income, on obligations or securities of any authority, commission or instrumentality of the
348 United States, which the laws of the United States exempt from federal income tax but not from state
349 income taxes;

350 3. [Repealed.]

351 4. The amount of any net income taxes and other taxes, including franchise and excise taxes, which
352 are based on, measured by, or computed with reference to net income, imposed by the Commonwealth
353 or any other taxing jurisdiction, to the extent deducted in determining federal taxable income;

354 5. Unrelated business taxable income as defined by § 512 of the Internal Revenue Code;

355 6. [Repealed.]

356 7. The amount required to be included in income for the purpose of computing the partial tax on an
357 accumulation distribution pursuant to § 667 of the Internal Revenue Code;

358 8. a. For taxable years beginning on and after January 1, 2004, the amount of any intangible
359 expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or
360 indirectly with one or more direct or indirect transactions with one or more related members to the
361 extent such expenses and costs were deductible or deducted in computing federal taxable income for
362 Virginia purposes. This addition shall not be required for any portion of the intangible expenses and
363 costs if one of the following applies:

364 (1) The corresponding item of income received by the related member is subject to a tax based on or
365 measured by net income or capital imposed by Virginia, another state, or a foreign government that has
366 entered into a comprehensive tax treaty with the United States government;

(2) The related member derives at least one-third of its gross revenues from the licensing of intangible property to parties who are not related members, and the transaction giving rise to the expenses and costs between the corporation and the related member was made at rates and terms comparable to the rates and terms of agreements that the related member has entered into with parties who are not related members for the licensing of intangible property; or

(3) The corporation can establish to the satisfaction of the Tax Commissioner that the intangible expenses and costs meet both of the following: (i) the related member during the same taxable year directly or indirectly paid, accrued or incurred such portion to a person who is not a related member, and (ii) the transaction giving rise to the intangible expenses and costs between the corporation and the related member did not have as a principal purpose the avoidance of any portion of the tax due under this chapter.

b. A corporation required to add to its federal taxable income intangible expenses and costs pursuant to subdivision a may petition the Tax Commissioner, after filing the related income tax return for the taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under this article for such taxable year including tax upon any amount of intangible expenses and costs required to be added to federal taxable income pursuant to subdivision a, to consider evidence relating to the transaction or transactions between the corporation and a related member or members that resulted in the corporation's taxable income being increased, as required under subdivision a, for such intangible expenses and costs.

If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and convincing evidence, that the transaction or transactions between the corporation and a related member or members resulting in such increase in taxable income pursuant to subdivision a had a valid business purpose other than the avoidance or reduction of the tax due under this chapter, the Tax Commissioner shall permit the corporation to file an amended return. For purposes of such amended return, the requirements of subdivision a shall not apply to any transaction for which the Tax Commissioner is satisfied (and has identified) that the transaction had a valid business purpose other than the avoidance or reduction of the tax due under this chapter. Such amended return shall be filed by the corporation within one year of the written permission granted by the Tax Commissioner and any refund of the tax imposed under this article shall include interest at a rate equal to the rate of interest established under § 58.1-15 and such interest shall accrue as provided under § 58.1-1833. However, upon the filing of such amended return, any related member of the corporation that subtracted from taxable income amounts received pursuant to subdivision C 21 shall be subject to the tax imposed under this article on that portion of such amounts for which the corporation has filed an amended return pursuant to this subdivision. In addition, for such transactions identified by the Tax Commissioner herein by which he has been satisfied by clear and convincing evidence, the Tax Commissioner may permit the corporation in filing income tax returns for subsequent taxable years to deduct the related intangible expenses and costs without making the adjustment under subdivision a.

The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of any petition pursuant to this subdivision, to include costs necessary to secure outside experts in evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this subdivision upon payment of such fee.

No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision shall be maintained in any court of this Commonwealth.

c. Nothing in subdivision B 8 shall be construed to limit or negate the Department's authority under § 58.1-446;

9. a. For taxable years beginning on and after January 1, 2004, the amount of any interest expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with one or more related members to the extent such expenses and costs were deductible or deducted in computing federal taxable income for Virginia purposes. This addition shall not be required for any portion of the interest expenses and costs, if:

(1) The related member has substantial business operations relating to interest-generating activities, in which the related member pays expenses for at least five full-time employees who maintain, manage, defend or are otherwise responsible for operations or administration relating to the interest-generating activities; and

(2) The interest expenses and costs are not directly or indirectly for, related to or in connection with the direct or indirect acquisition, maintenance, management, sale, exchange, or disposition of intangible property; and

(3) The transaction giving rise to the expenses and costs between the corporation and the related member has a valid business purpose other than the avoidance or reduction of taxation and payments between the parties are made at arm's length rates and terms; and

(4) One of the following applies:

428 (i) The corresponding item of income received by the related member is subject to a tax based on or
429 measured by net income or capital imposed by Virginia, another state, or a foreign government that has
430 entered into a comprehensive tax treaty with the United States government;

431 (ii) Payments arise pursuant to a pre-existing contract entered into when the parties were not related
432 members provided the payments continue to be made at arm's length rates and terms;

433 (iii) The related member engages in transactions with parties other than related members that
434 generate revenue in excess of \$2 million annually; or

435 (iv) The transaction giving rise to the interest payments between the corporation and a related
436 member was done at arm's length rates and terms and meets any of the following: (a) the related
437 member uses funds that are borrowed from a party other than a related member or that are paid,
438 incurred or passed-through to a person who is not a related member; (b) the debt is part of a regular and
439 systematic funds management or portfolio investment activity conducted by the related member, whereby
440 the funds of two or more related members are aggregated for the purpose of achieving economies of
441 scale, the internal financing of the active business operations of members, or the benefit of centralized
442 management of funds; (c) financing the expansion of the business operations; or (d) restructuring the
443 debt of related members, or the pass-through of acquisition-related indebtedness to related members.

444 b. A corporation required to add to its federal taxable income interest expenses and costs pursuant to
445 subdivision a may petition the Tax Commissioner, after filing the related income tax return for the
446 taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under this
447 article for such taxable year including tax upon any amount of interest expenses and costs required to be
448 added to federal taxable income pursuant to subdivision a, to consider evidence relating to the
449 transaction or transactions between the corporation and a related member or members that resulted in the
450 corporation's taxable income being increased, as required under subdivision a, for such interest expenses
451 and costs.

452 If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and
453 convincing evidence, that the transaction or transactions between the corporation and a related member
454 or members resulting in such increase in taxable income pursuant to subdivision a had a valid business
455 purpose other than the avoidance or reduction of the tax due under this chapter and that the related
456 payments between the parties were made at arm's length rates and terms, the Tax Commissioner shall
457 permit the corporation to file an amended return. For purposes of such amended return, the requirements
458 of subdivision a shall not apply to any transaction for which the Tax Commissioner is satisfied (and has
459 identified) that the transaction had a valid business purpose other than the avoidance or reduction of the
460 tax due under this chapter and that the related payments between the parties were made at arm's length
461 rates and terms. Such amended return shall be filed by the corporation within one year of the written
462 permission granted by the Tax Commissioner and any refund of the tax imposed under this article shall
463 include interest at a rate equal to the rate of interest established under § 58.1-15 and such interest shall
464 accrue as provided under § 58.1-1833. However, upon the filing of such amended return, any related
465 member of the corporation that subtracted from taxable income amounts received pursuant to subdivision
466 C 21 shall be subject to the tax imposed under this article on that portion of such amounts for which the
467 corporation has filed an amended return pursuant to this subdivision. In addition, for such transactions
468 identified by the Tax Commissioner herein by which he has been satisfied by clear and convincing
469 evidence, the Tax Commissioner may permit the corporation in filing income tax returns for subsequent
470 taxable years to deduct the related interest expenses and costs without making the adjustment under
471 subdivision a.

472 The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of
473 any petition pursuant to this subdivision, to include costs necessary to secure outside experts in
474 evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this
475 subdivision upon payment of such fee.

476 No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision
477 shall be maintained in any court of this Commonwealth.

478 c. Nothing in subdivision B 9 shall be construed to limit or negate the Department's authority under
479 § 58.1-446.

480 d. For purposes of subdivision B 9:

481 "Arm's-length rates and terms" means that (i) two or more related members enter into a written
482 agreement for the transaction, (ii) such agreement is of a duration and contains payment terms
483 substantially similar to those that the related member would be able to obtain from an unrelated entity,
484 (iii) the interest is at or below the applicable federal rate compounded annually for debt instruments
485 under § 1274(d) of the Internal Revenue Code that was in effect at the time of the agreement, and (iv)
486 the borrower or payor adheres to the payment terms of the agreement governing the transaction or any
487 amendments thereto.

488 "Valid business purpose" means one or more business purposes that alone or in combination
489 constitute the motivation for some business activity or transaction, which activity or transaction

improves, apart from tax effects, the economic position of the taxpayer, as further defined by regulation.
 10. a. For taxable years beginning on and after January 1, 2009, the amount of dividends deductible under §§ 561 and 857 of the Internal Revenue Code by a Captive Real Estate Investment Trust (REIT).
 For purposes of this subdivision, a REIT is a Captive REIT if:

(1) It is not regularly traded on an established securities market;
 (2) More than 50 percent of the voting power or value of beneficial interests or shares of which, at any time during the last half of the taxable year, is owned or controlled, directly or indirectly, by a single entity that is (i) a corporation or an association taxable as a corporation under the Internal Revenue Code; and (ii) not exempt from federal income tax pursuant to § 501(a) of the Internal Revenue Code; and

(3) More than 25 percent of its income consists of rents from real property as defined in § 856(d) of the Internal Revenue Code.

b. For purposes of applying the ownership test of subdivision 10 a (2), the following entities shall not be considered a corporation or an association taxable as a corporation:

(1) Any REIT that is not treated as a Captive REIT;
 (2) Any REIT subsidiary under § 856 of the Internal Revenue Code other than a qualified REIT subsidiary of a Captive REIT;

(3) Any Listed Australian Property Trust, or an entity organized as a trust, provided that a Listed Australian Property Trust owns or controls, directly or indirectly, 75 percent or more of the voting or value of the beneficial interests or shares of such trust; and

(4) Any Qualified Foreign Entity.

c. For purposes of subdivision B 10, the constructive ownership rules prescribed under § 318(a) of the Internal Revenue Code, as modified by § 856(d)(5) of the Internal Revenue Code, shall apply in determining the ownership of stock, assets, or net profits of any person.

d. For purposes of subdivision B 10:

"Listed Australian Property Trust" means an Australian unit trust registered as a Management Investment Scheme, pursuant to the Australian Corporations Act, in which the principal class of units is listed on a recognized stock exchange in Australia and is regularly traded on an established securities market.

"Qualified Foreign Entity" means a corporation, trust, association or partnership organized outside the laws of the United States and that satisfies all of the following criteria:

(1) At least 75 percent of the entity's total asset value at the close of its taxable year is represented by real estate assets, as defined in § 856(c)(5)(B) of the Internal Revenue Code, thereby including shares or certificates of beneficial interest in any REIT, cash and cash equivalents, and U.S. Government securities;

(2) The entity is not subject to a tax on amounts distributed to its beneficial owners, or is exempt from entity level tax;

(3) The entity distributes, on an annual basis, at least 85 percent of its taxable income, as computed in the jurisdiction in which it is organized, to the holders of its shares or certificates of beneficial interest;

(4) The shares or certificates of beneficial interest of such entity are regularly traded on an established securities market or, if not so traded, not more than 10 percent of the voting power or value in such entity is held directly, indirectly, or constructively by a single entity or individual; and

(5) The entity is organized in a country that has a tax treaty with the United States.

C. There shall be subtracted to the extent included in and not otherwise subtracted from federal taxable income:

1. Income derived from obligations, or on the sale or exchange of obligations, of the United States and on obligations or securities of any authority, commission or instrumentality of the United States to the extent exempt from state income taxes under the laws of the United States including, but not limited to, stocks, bonds, treasury bills, and treasury notes, but not including interest on refunds of federal taxes, interest on equipment purchase contracts, or interest on other normal business transactions.

2. Income derived from obligations, or on the sale or exchange of obligations of this Commonwealth or of any political subdivision or instrumentality of this Commonwealth.

3. Dividends upon stock in any domestic international sales corporation, as defined by § 992 of the Internal Revenue Code, 50 percent or more of the income of which was assessable for the preceding year, or the last year in which such corporation has income, under the provisions of the income tax laws of the Commonwealth.

4. The amount of any refund or credit for overpayment of income taxes imposed by this Commonwealth or any other taxing jurisdiction.

5. Any amount included therein by the operation of the provisions of § 78 of the Internal Revenue Code (foreign dividend gross-up).

- 551 6. The amount of wages or salaries eligible for the federal Targeted Jobs Credit which was not
552 deducted for federal purposes on account of the provisions of § 280C(a) of the Internal Revenue Code.
- 553 7. Any amount included therein by the operation of § 951 of the Internal Revenue Code (subpart F
554 income).
- 555 8. Any amount included therein which is foreign source income as defined in § 58.1-302.
- 556 9. [Repealed.]
- 557 10. The amount of any dividends received from corporations in which the taxpaying corporation
558 owns 50 percent or more of the voting stock.
- 559 11. [Repealed.]
- 560 12, 13. [Expired.]
- 561 14. For taxable years beginning on or after January 1, 1995, the amount for "qualified research
562 expenses" or "basic research expenses" eligible for deduction for federal purposes, but which were not
563 deducted, on account of the provisions of § 280C(c) of the Internal Revenue Code.
- 564 15. For taxable years beginning on or after January 1, 2000, the total amount actually contributed in
565 funds to the Virginia Public School Construction Grants Program and Fund established in Chapter 11.1
566 (§ 22.1-175.1 et seq.) of Title 22.1.
- 567 16. For taxable years beginning on or after January 1, 2000, the gain derived from the sale or
568 exchange of real property or the sale or exchange of an easement to real property which results in the
569 real property or the easement thereto being devoted to open-space use, as that term is defined in
570 § 58.1-3230, for a period of time not less than 30 years. To the extent a subtraction is taken in
571 accordance with this subdivision, no tax credit under this chapter for donating land for its preservation
572 shall be allowed for three years following the year in which the subtraction is taken.
- 573 17. For taxable years beginning on and after January 1, 2001, any amount included therein with
574 respect to § 58.1-440.1.
- 575 18. For taxable years beginning on and after January 1, 1999, income received as a result of (i) the
576 "Master Settlement Agreement," as defined in § 3.2-3100; and (ii) the National Tobacco Grower
577 Settlement Trust dated July 19, 1999, by (a) tobacco farming businesses; (b) any business holding a
578 tobacco marketing quota, or tobacco farm acreage allotment, under the Agricultural Adjustment Act of
579 1938; or (c) any business having the right to grow tobacco pursuant to such a quota allotment.
- 580 19, 20. [Repealed.]
- 581 21. For taxable years beginning on and after January 1, 2004, any amount of intangible expenses and
582 costs or interest expenses and costs added to the federal taxable income of a corporation pursuant to
583 subdivision B 8 or B 9 shall be subtracted from the federal taxable income of the related member that
584 received such amount if such related member is subject to Virginia income tax on the same amount.
- 585 22. For taxable years beginning on and after January 1, 2009, any gain recognized from the sale of
586 launch services to space flight participants, as defined in 49 U.S.C. § 70102, or launch services intended
587 to provide individuals the training or experience of a launch, without performing an actual launch. To
588 qualify for a deduction under this subdivision, launch services must be performed in Virginia or
589 originate from an airport or spaceport in Virginia.
- 590 23. For taxable years beginning on and after January 1, 2009, any gain recognized as a result of
591 resupply services contracts for delivering payload, as defined in 49 U.S.C. § 70102, entered into with the
592 Commercial Orbital Transportation Services division of the National Aeronautics and Space
593 Administration or other space flight entity, as defined in § 8.01-227.8, and launched from an airport or
594 spaceport in Virginia.
- 595 24. For taxable years beginning on or after January 1, 2011, any income taxed as a long-term capital
596 gain for federal income tax purposes, or any income taxed as investment services partnership interest
597 income (otherwise known as investment partnership carried interest income) for federal income tax
598 purposes. To qualify for a subtraction under this subdivision, such income must be attributable to an
599 investment in a "qualified business," as defined in § 58.1-339.4, or in any other technology business
600 approved by the Secretary of Technology, provided the business has its principal office or facility in the
601 Commonwealth and less than \$3 million in annual revenues in the fiscal year prior to the investment. To
602 qualify for a subtraction under this subdivision, the investment must be made between the dates of April
603 1, 2010, and June 30, 2013. No taxpayer who has claimed a tax credit for an investment in a "qualified
604 business" under § 58.1-339.4 shall be eligible for the subtraction under this subdivision for an
605 investment in the same business.
- 606 25. *Any income taxed as (i) a gain for federal income tax purposes attributable to an investment in a*
607 *small business made on or after January 1, 2012, held by the corporation for at least five years or (ii)*
608 *investment services partnership interest income (otherwise known as investment partnership carried*
609 *interest income) for federal income tax purposes that is attributable to an investment in a small business*
610 *made by the corporation on or after January 1, 2012. For purposes of this subdivision, a "small*
611 *business" means a business that (a) has its principal office or facility in the Commonwealth and (b)*
612 *immediately after such investment and at all times prior to such investment, had aggregate assets that*

613 totaled less than \$50 million in cash plus the aggregate adjusted bases of all other property held by the
614 business. The subtraction under this subdivision shall be limited to any gain or investment services
615 partnership interest income attributable to the first \$500,000 invested by the corporation in the
616 respective small business, regardless of the taxable year or years in which the investment was made. No
617 subtraction shall be allowed under this subdivision to the extent of any gain or investment services
618 partnership interest income for which the corporation has claimed a deduction or subtraction under
619 another provision of this section. No taxpayer who has claimed a tax credit for an investment in a
620 "qualified business" under § 58.1-339.4 shall be eligible for the subtraction under this subdivision for an
621 investment in the same business.

622 D. For taxable years beginning on and after January 1, 2006, there shall be subtracted from federal
623 taxable income contract payments to a producer of quota tobacco or a tobacco quota holder as provided
624 under the American Jobs Creation Act of 2004 (P.L. 108-357) as follows:

625 1. If the payment is received in installment payments, then the recognized gain, including any gain
626 recognized in taxable year 2005, may be subtracted in the taxable year immediately following the year
627 in which the installment payment is received.

628 2. If the payment is received in a single payment, then 10 percent of the recognized gain may be
629 subtracted in the taxable year immediately following the year in which the single payment is received.
630 The taxpayer may then deduct an equal amount in each of the nine succeeding taxable years.

631 E. Adjustments to federal taxable income shall be made to reflect the transitional modifications
632 provided in § 58.1-315.

633 F. Notwithstanding any other provision of law, the income from any disposition of real property
634 which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or
635 business, as defined in § 453(l)(1)(B) of the Internal Revenue Code, of property made on or after
636 January 1, 2009, may, at the election of the taxpayer, be recognized under the installment method
637 described under § 453 of the Internal Revenue Code, provided that (i) the election relating to the dealer
638 disposition of the property has been made on or before the due date prescribed by law (including
639 extensions) for filing the taxpayer's return of the tax imposed under this chapter for the taxable year in
640 which the disposition occurs, and (ii) the dealer disposition is in accordance with restrictions or
641 conditions established by the Department, which shall be set forth in guidelines developed by the
642 Department. Along with such restrictions or conditions, the guidelines shall also address the recapture of
643 such income under certain circumstances. The development of the guidelines shall be exempt from the
644 Administrative Process Act (§ 2.2-4000 et seq.).