

DEPARTMENT OF TAXATION

2018 Fiscal Impact Statement

1. **Patron** R. Lee Ware, Jr.

2. **Bill Number** HB 154

3. **Committee** Passed House and Senate

House of Origin:

 Introduced

 Substitute

 Engrossed

4. **Title** Commonwealth's Tax System; Conformity
with Federal Law, Emergency

Second House:

 In Committee

 Substitute

 X **Enrolled**

5. **Summary/Purpose:**

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from December 31, 2016 to December 31, 2017. This would allow Virginia to conform to the Disaster Tax Relief and Airport and Airway Extension Act of 2017 ("the Disaster Relief Act").

This bill would generally conform only to those provisions of Public Law 115-97, known as the "Tax Cuts and Jobs Act" ("the TCJA") that affect the computation of federal adjusted gross income of individuals or federal taxable income of corporations for Taxable Year 2017. This bill would deconform from all other provisions of the TCJA. This bill would specifically deconform from the temporary reduction in the medical expense deduction threshold.

Because some taxpayers will be preparing their 2017 Virginia returns while the General Assembly is in session, **this bill contains an emergency clause** which states that it would be in force from its passage.

This is a Department of Taxation bill.

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

This bill would have a negative General Fund revenue impact of \$2.5 million for Fiscal Year 2018 and \$3.3 million for Fiscal Year 2019. This bill would have a positive General Fund revenue impact of \$700,000 for Fiscal Year 2020; \$1.4 million in Fiscal Year 2021, \$900,000 in Fiscal Year 2022, \$550,000 in Fiscal Year 2023, and \$120,000 in Fiscal Year 2024. The

revenue impact of this bill is attributable to conforming to the Disaster Relief Act. No budget amendment is needed because the General Fund revenue impact of conforming to the Disaster Relief Act is assumed in the Introduced Executive Budget.

Only one provision of this Act is expected to have a greater than minimal General Fund revenue impact on Virginia. This provision provides an incentive to taxpayers to make contributions to 2017 hurricane relief efforts by temporarily suspending the annual limitations imposed on charitable contribution deductions for certain contributions made for such efforts before December 31, 2017. This allows taxpayers to immediately deduct the full amount of their contributions for 2017 hurricane relief efforts, even if such taxpayers would otherwise be required to carryforward a portion of their contributions and deduct them in future taxable years.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Virginia's date of conformity to the IRC is currently fixed to the IRC as it existed on December 31, 2016. Virginia law currently deconforms from the following IRC provisions:

- **Bonus depreciation allowed for certain assets under federal income taxation.** Taxpayers who claim bonus depreciation on their federal returns upon purchasing an asset must make adjustments on their Virginia returns for the taxable year in which they purchased such asset and in each subsequent year until the asset has been fully depreciated for federal and Virginia purposes.
- **The five-year carry-back of net operating losses ("NOLs") generated in certain taxable years.** Although no longer available, taxpayers who benefited from the use of a five-year carry-back on their federal returns for losses generated during 2008 and 2009 must make adjustments on their Virginia returns for the taxable year in which such losses were generated and in each subsequent year until all such losses have been fully absorbed for both federal and Virginia purposes.
- **Tax exclusions related to cancellation of debt income.** Although no longer available, taxpayers who benefited from a deferral of income realized upon the reacquisition of certain business debt during 2009 and 2010 on their federal returns must make adjustments on their Virginia returns for the taxable year in which they deferred such income and in each subsequent year until such income is fully reported for both federal and Virginia purposes. However, for transactions completed on or before April 21, 2010, taxpayers were permitted to partially defer such income by reporting the income over three taxable years.
- **Tax deductions related to the application of the applicable high yield debt obligation rules.** Although no longer available, taxpayers who benefited from the suspension of the application of the applicable high yield debt obligation rules for

certain debts issued between September 30, 2008, and December 31, 2009 on their federal returns must make adjustments on their Virginia returns for the taxable year in which they claimed a deduction and in each subsequent year until such deductions are fully claimed for both federal and Virginia purposes.

Disaster Relief Act

On September 29, 2017, the President signed into law the Disaster Relief Act. This federal legislation provides temporary tax relief to individuals and businesses affected by Hurricanes Harvey, Irma, and Maria. Some of the key tax provisions of the Disaster Relief Act include:

- Suspension of the annual limitations imposed on charitable contribution deductions if certain contributions are made for hurricane relief;
- Waiver of the 10 percent additional tax on early distributions from retirement plans for up to \$100,000 in distributions made by certain individuals in hurricane disaster areas;
- Modification of the method by which earned income is determined for purposes of computing the earned income tax credit and the child tax credit for taxpayers in hurricane disaster areas; and
- Modification of the deduction for personal casualty losses in the hurricane disaster areas to eliminate the requirement that casualty losses must exceed 10 percent of adjusted gross income to qualify for the deduction and to allow the deduction for taxpayers who do not elect to itemize.

Tax Cuts and Jobs Act

On December 22, 2017, the TCJA was signed into law. This legislation substantially changes the federal income taxation of individuals and businesses. A limited number of the TCJA's provisions are effective for Taxable Year 2017. These include:

- Temporarily reducing the medical expense deduction threshold from 10 percent to 7.5 percent of adjusted gross income;
- Providing tax relief for specified 2016 disaster areas;
- Providing tax relief for certain individuals performing services in the Sinai Peninsula of Egypt; and
- Repealing the substantiation exception for charitable contributions reported by a donee organization.

The TCJA also included various provisions that were effective for transactions occurring after the date of enactment, including the following provisions:

- Rollovers from 529 accounts to Achieving a Better Life Experience ("ABLE") accounts;
- Modification of the treatment of S corporation conversions into C corporations;
- Expensing of certain costs of replacing citrus plants lost by reason of a casualty;
- Creating qualified opportunity zones;
- Denial of a deduction for settlements subject to a nondisclosure agreement paid in connection with sexual harassment;
- Expansion of the provision relating to the non-deductibility of fines and penalties;
- Repeal of the deduction for local lobbying expense; and
- Revision of the treatment of contributions to capital.

Proposed Legislation

This bill would advance Virginia's date of conformity to the IRC from December 31, 2016 to December 31, 2017. This bill would allow Virginia to conform to the Disaster Relief Act.

This bill would conform to the following provisions of the TCJA that may affect the computation of federal adjusted gross income of individuals or federal taxable income of corporations for Taxable Year 2017:

- Treatment of certain individuals performing services in the Sinai Peninsula of Egypt;
- Relief for 2016 disaster areas; and
- Repeal of substantiation exception in case of contributions reported by a donee.

In addition to the provisions above, this bill would provide that Virginia would generally conform to any other provision of the TCJA that affects the computation of federal adjusted gross income of individuals or federal taxable income of corporations for Taxable Year 2017.

However, this bill would deconform from the TCJA's temporary reduction in the medical expense deduction threshold from 10 percent to 7.5 percent of adjusted gross income. Because the reduction in the medical expense deduction threshold was effective for Taxable Year 2017, taxpayers currently preparing and filing their 2017 Virginia income tax returns would be impacted, and taxpayers would be required to make adjustments on their 2017 Virginia income tax returns to account for differences between Virginia's 10 percent medical expense deduction threshold and the 7.5 percent threshold under federal law.

This bill would deconform from all other provisions of the TCJA. Because the majority of the TCJA's provisions are effective for Taxable Year 2018 or thereafter, the TCJA would not generally impact Virginia taxpayers currently preparing and filing their 2017 Virginia returns.

Virginia would continue to deconform from the following IRC provisions:

- Bonus depreciation allowed for certain assets under federal income taxation;
- The five-year NOLs generated in certain taxable years;
- Tax exclusions related to cancellation of debt income; and
- Tax deductions related to the application of the applicable high yield debt obligation rules.

Because some taxpayers will be preparing their Virginia returns while the General Assembly is in session, **this bill contains an emergency clause** which states that it would be in force from its passage.

Similar Legislation

Senate Bill 230 is identical to this bill.

cc : Secretary of Finance

Date: 2/13/2018 JJS
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