DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. Patron Emmett W. Hanger, Jr.

2. Bill Number SB 1320

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee Senate Finance

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

5. Summary/Purpose:

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from February 9, 2018 to December 31, 2018. This bill would also repeal language currently deconforming Virginia from most of the provisions of the Tax Cuts and Jobs Act ("the TCJA") and the Bipartisan Budget Act of 2018 ("the BBA") that affect Taxable Year 2018 and after. This would allow Virginia to fully conform to the TCJA.

This bill would be effective for taxable years beginning on and after January 1, 2018. Because some taxpayers will be preparing their 2018 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 an Executive Bill.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Available. (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 an estimated positive revenue impact of $594.2 million in Fiscal Year 2019; $611.1 million in Fiscal Year 2020; $653.7 million in Fiscal Year 2021; $798.7 million in Fiscal Year 2022; $943.2 million in Fiscal Year 2023; $950.6 million in Fiscal Year 2024; and $943.1 million in Fiscal Year 2025. No budget amendment would be necessary for this bill because the General Fund revenue impact of advancing Virginia's date of conformity is assumed in the Introduced Executive Budget.

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 February 9, 2018. 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 are required to 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 are required to 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 utilized 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 are required to 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, are required to 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.

In addition to these IRC provisions from which Virginia has historically deconformed, the General Assembly enacted legislation during the 2018 Session that deconformed Virginia from:

- The provision of the TCJA that temporarily increased the medical expenses deduction for Taxable Years 2017 and 2018; and
- All of the provisions of the TCJA and the Bipartisan Budget Act of 2018 that affect Taxable Year 2018 and after other than the provision of the TCJA providing tax relief for specified 2016 disaster areas and the provision extending combat zone benefits to members of the armed forces performing services in the Sinai Peninsula of Egypt.

<u>Tax Cuts and Jobs Act</u>

On December 22, 2017, the TCJA was signed into law. This federal tax reform legislation substantially changes the federal income taxation of individuals and businesses. The provisions that affect individual taxpayers include, but are not limited to:

- Increasing the standard deduction amount to $24,000 for joint filers and $12,000 for individual filers;
- Repealing the "Pease Limitation" that reduced the otherwise allowable amount of itemized deductions by 3 percent of the amount by which federal adjusted gross income exceeded a threshold amount (up to an 80 percent reduction);
- Expanding the charitable contribution deduction by increasing the percentage limitation on the amount of cash contributions that may be made to public charities;
- Imposing a $10,000 limitation on the state and local tax (“SALT”) deduction;
- Limiting the home mortgage interest deduction to interest expenses attributable to mortgage balances no greater than $750,000 (for mortgages incurred December 15, 2017 or later);
- Repealing the home mortgage interest deduction for all home equity loan interest expenses;
- Repealing certain miscellaneous deductions subject to 2 percent floor, such as the deduction for unreimbursed employee expenses (including travel and home office expenses) and the deduction for tax preparation fees; and
- Repealing the deduction for casualty losses other than for losses incurred in a federally-declared disaster area.

Most of the provisions of the TCJA impacting individual taxpayers are currently scheduled to sunset after December 31, 2025. Future legislation would be required to make the provisions effective beyond Taxable Year 2025.

The provisions that impact businesses include, but are not limited to:

- Expanding IRC § 179 small business expensing by raising the annual dollar limitation from $500,000 to $1 million of qualifying property and raising the threshold for reducing the deduction amount from $2 million to $2.5 million of qualifying purchases;

- Increasing first-year bonus deprecation from 50 percent to 100 percent of the purchase price of qualified property;
- Expanding the universe of taxpayers that can use the cash method of accounting by increasing the threshold for the cash method from $5 million in gross receipts (generally $1 million for those businesses that are required to use the inventory method) to $25 million;
- Imposing a 30 percent of adjusted income limit on the deduction for interest expenses for most businesses with gross receipts of over $25 million;
- Imposing an 80 percent of taxable income limitation on the net operating loss deduction, generally repealing the ability to carry back losses, and providing the ability to indefinitely carry forward losses;
- Repealing the IRC § 199 domestic production activities deduction; and
- Eliminating the ability of taxpayers to immediately deduct certain research and experimentation expenditures and requiring them to be amortized.

Most of the provisions of the TCJA impacting business taxpayers are effective beginning in Taxable Year 2018 and are permanent. However, the provision providing 100 percent bonus depreciation is currently scheduled to sunset after Taxable Year 2022.

The TCJA makes fundamental changes to the United States' international tax structure. In general, the TCJA shifts from the prior system of worldwide taxation with deferral to a participation exemption regime with current taxation of certain foreign income.

<u>Bipartisan Budget Act of 2018</u>

On February 9, 2018, the BBA was signed into law by Congress. In addition to providing a continuing resolution to fund the federal government, the BBA extends more than 30 tax provisions, commonly known as "extenders," which had expired at the end of 2016, so that they apply to Taxable Year 2017. The law expands the tax relief previously provided to victims of Hurricanes Harvey, Irma, and Maria so that it applies to victims of the 2017 California wildfires, clarifies the definition of “disaster areas” for Hurricanes Irma and Harvey, and makes other changes.

<u>Proposed Legislation</u>

This bill would advance Virginia's date of conformity to the IRC from February 9, 2018 to December 31, 2018. This bill would also repeal language currently deconforming Virginia from most of the provisions of the TCJA and the BBA that affect Taxable Year 2018 and after. This would allow Virginia to fully conform to the TCJA.

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.

This bill would be effective for taxable years beginning on and after January 1, 2018. 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

House Bill 2355 is identical to this bill.

Senate Bill 1372 is substantially similar to this bill.

House Bill 1851, **House Bill 1980**, **House Bill 2086**, **House Bill 2110**, **Senate Bill 1211**, **Senate Bill 1225**, **Senate Bill 1443**, and **Senate Bill 1631** would advance Virginia's date of conformity to the IRC from February 9, 2018 to December 31, 2018, and would also make various tax policy changes.

cc : Secretary of Finance

Date: 1/14/2019 JJS
SB1320F161