DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. **Patron** Stephen D. Newman

2. **Bill Number** SB 1739
   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, Taxpayer Relief Fund, 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 provide that any additional revenues generated by the TCJA in fiscal years beginning on and after July 1, 2018, but before July 2, 2026, beyond those revenues reasonably expected to be collected absent the federal policy changes, would be transferred to a special nonreverting fund established by this bill and to be known as the "Taxpayer Relief Fund." On September 1, 2019, and each September 1 annually through September 1, 2027, the Department of Taxation ("the Department") would be required to issue a refund to each individual taxpayer, including married persons filing a joint return, who filed a tax return in the immediately preceding taxable year.

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.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

8. **Fiscal implications:**

<u>Administrative Costs</u>

Due to uncertainty about the systems and processing changes that may be required for the 2018 and 2019 income tax filing seasons, the Department is unable to assign administrative costs to this bill at this time. During 2017, Congress enacted the Tax Cuts and Jobs Act, which made substantial changes to federal tax law. At this time, it is uncertain what Virginia tax policy changes will be adopted in reaction to the federal law.

If substantial changes are enacted or required in response to state/federal law, it is possible that the Department may not have the ability to implement the changes set forth in this bill by the proposed effective date. Accordingly, the Department will reevaluate its costs once action is taken and may request additional funding or an amendment to delay the effective date of this legislation.

Revenue Impact

The portion of this bill advancing Virginia's date of conformity 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.

This bill would also create a special nonreverting fund to be known as the Taxpayer Relief Fund, where any additional revenues generated by the TCJA in fiscal years beginning on and after July 1, 2018, but before July 2, 2026 would be required to be transferred. This portion of the bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2019.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

This bill requires that on September 1, 2019, and each September 1 annually through September 1, 2027, the Department must issue a refund to each taxpayer who filed a tax return in the immediately preceding taxable year. Under current law, the due date for most individual income taxpayers filing on a calendar year basis is May 1 of the year following the taxpayer's taxable year. However, Virginia law allows individual income taxpayers a six-month extension in the time allowed to file their returns. Therefore, individual income taxpayers filing on a calendar year basis could file as late as November 1 of the year following the taxpayer's taxable year. Since the refunds under this bill would be issued in September, it is unclear how this bill would treat additional revenues attributable to taxpayers filing on extension.

This bill would require that distributions from the Taxpayer Relief Fund be made on a pro rata basis based on the tax liability of each taxpayer after accounting for additions, deductions, subtractions, and credits claimed by the taxpayer. It is unclear whether the Department would calculate the amount of refund owed to each taxpayer based only on the tax liability reported on his or her return or whether the Department would be required to audit taxpayers to determine whether the tax liability reported on the return is correct.

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.

Tax Cuts and Jobs Act

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.

Bipartisan Budget Act of 2018

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.

History of Virginia's Response to Federal Tax Reform

During the 1987 Session, the General Assembly enacted legislation in response to the federal Tax Reform Act of 1986 that increased the:

- Amounts of the personal exemption and standard deduction;
- Threshold for the top individual income tax rate bracket; and
- Individual income tax filing threshold.

This legislation also required excess revenues from federal tax reform to be set aside in a special fund for purposes of providing future tax relief. During the 1989 Session, the General Assembly enacted legislation that utilized such revenue to provide a one-time, nonrefundable individual income tax credit in an amount equal to $35 per personal and dependent exemption claimed. Taxpayers with Virginia adjusted gross income of less than $17,000 for individuals and $34,000 for married persons filing joint returns received the full amount of the credit. The amount of the credit declined gradually based on a taxpayer's income in excess of such amounts so that a taxpayer with Virginia adjusted gross income greater than $34,000 for individuals and $68,000 for married persons filing joint returns received no credit.

During the 1989 Session, the General Assembly also enacted a smaller $22.50 tax credit for Taxable Year 1990 through Taxable Year 1993. However, this credit was repealed during the 1990 Session in order to instead eliminate the sales and use tax on nonprescription drugs.

Proposed Legislation

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.

The bill would delete obsolete language regarding Virginia's deconformity from the IRC § 199 domestic production activities deduction. Virginia partially deconformed from this deduction for Taxable Years 2010, 2011, and 2012. However, because Virginia fully conformed to this deduction beginning with Taxable Year 2013 and because the TCJA repealed the deduction beginning with Taxable Year 2018, this language is obsolete.

This bill would provide that any additional revenues generated by the TCJA in fiscal years beginning on and after July 1, 2018, but before July 2, 2026, beyond those revenues reasonably expected to be collected absent the federal policy changes, would be transferred to a special nonreverting fund established by this bill and to be known as the "Taxpayer Relief Fund." On September 1, 2019, and each September 1 annually through September 1, 2027, the Department would be required to issue a refund to each individual taxpayer, including married persons filing a joint return, who filed a tax return in the immediately preceding taxable year. The Department would be required to determine the amount of the refund due to each taxpayer based on the amount of revenues deposited into the Taxpayer Relief Fund during the prior fiscal year and would be required to ensure that such refunds are calculated and distributed on a pro rata basis based on the tax liability of each taxpayer after accounting for additions, deductions, subtractions, and credits claimed by the taxpayer.

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, **Senate Bill 1320**, and **Senate Bill 1732** would advance the date of conformity to the IRC from February 9, 2018 to December 31, 2018.

House Bill 1851, **House Bill 1980**, **House Bill 2086**, **House Bill 2110**, **House Bill 2673**, **House Bill 2765**, **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: 1/22/2019 JJS
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