

**DEPARTMENT OF TAXATION
2020 Fiscal Impact Statement**

1. **Patron** Kathy K.L. Tran
3. **Committee** Senate Finance and Appropriations
4. **Title** State Income Tax; Amended Return Notice and Interest Accrual Period

2. **Bill Number** HB 1220
House of Origin:
 _____ **Introduced**
 _____ **Substitute**
 _____ **Engrossed**
- Second House:**
X **In Committee**
 _____ **Substitute**
 _____ **Enrolled**

5. Summary/Purpose:

If the Department of Taxation (“the Department”) is made aware that a taxpayer is required to file an amended federal income tax return, this bill would require the Department to notify such taxpayer in writing regarding whether an amended Virginia income tax return is also required to be filed. This requirement would apply with respect to taxpayers subject to the individual income tax, corporate income tax, and the income tax imposed on estates and trusts.

This bill would give the Department the discretion to waive interest due on an underpayment of income taxes or the pass-through entity nonresident withholding tax if a return was submitted in good faith and the understatement of the amount in the return was not due to any fault of the taxpayer. Under current law, the Department is required to waive any applicable penalties in this situation, but does not have the authority to waive interest.

If enacted during the 2020 Regular Session of the General Assembly, this bill would become effective July 1, 2020.

6. **Budget amendment necessary:** Yes.
 Item(s): 282 and 284, Department of Taxation

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

7a. Expenditure Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2019-20	\$16,690	0	GF
2020-21	\$346,198	5	GF
2021-22	\$316,468	5	GF
2022-23	\$319,782	5	GF
2023-24	\$323,081	5	GF
2024-25	\$326,387	5	GF
2025-26	\$329,699	5	GF

8. Fiscal implications:

Administrative Costs

The Department estimates that it would incur administrative costs of \$16,690 in Fiscal Year 2020, \$346,198 in Fiscal Year 2021, \$316,468 in Fiscal Year 2022, \$319,782 in Fiscal Year 2023, \$323,081 in Fiscal Year 2024, \$326,387 in Fiscal Year 2025, and \$329,699 in Fiscal Year 2026. These costs would be incurred for purposes of making changes to the Department's systems for correspondence and hiring five additional full-time employees to handle the taxpayer notification requirement and interest waiver requests. The Department anticipates that this bill would result in the agency receiving a significant number of interest waiver requests.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2021. It is unknown to what extent the Department would waive interest that may apply to qualified taxpayers.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Report of Change in Federal Taxable Income

If the amount of federal taxable income reported on a taxpayer's federal income tax return for any taxable year is changed or corrected by the Internal Revenue Service, or as the result of a renegotiation of a contract or subcontract with the United States, the taxpayer is required to file an amended return reporting such change to the Department. Taxpayers are required to do so within one year after the final determination of such change, correction, or renegotiation, or as otherwise required by the Department, and are required to concede the accuracy of such determination or state wherein it is erroneous. If the Department has sufficient information from which to compute the proper additional tax and the taxpayer has already paid such tax, the taxpayer is not required to file an amended individual income tax return. Any taxpayer filing an amended federal income tax return is also required to file an amended Virginia return within one year of the filing of the federal return.

Assessment and Payment of Deficiencies

If a taxpayer understates their income tax liability, the Department is required to mail an assessment of additional taxes owed to the taxpayer. The taxpayer is required to pay such additional tax to the Department within 30 days after the assessment is mailed by the Department. If the underreporting was made in good faith and not due to any fault of the taxpayer, no penalty may be imposed. However, interest accrues from the due date of the relevant return until the tax owed is paid. The Department does not currently have the authority to waive interest in this scenario.

An individual who fails to file income tax returns with intent to evade tax is subject to a 100 percent penalty, with interest.

IRS Notice to Individuals of Potential State Tax Liability

Virginia generally conforms to the Internal Revenue Code for income tax purposes. Therefore, the starting point for determining a taxpayer's Virginia income tax liability is based on its federal adjusted gross income (for individuals) and federal taxable income (for corporations). Both of these amounts are included on a taxpayer's federal income tax return.

Because of the close relationship between federal income tax returns and determining Virginia income tax liability, the Department has an information sharing agreement with the Internal Revenue Service ("IRS"). This arrangement allows for the exchange of information regarding taxpayers when the agencies make findings that require taxpayers to file amended returns. For example, if the IRS determines that a taxpayer failed to report income correctly for federal income tax purposes and sends a notice regarding additional taxes owed to the taxpayer, it will share that information with the Department. This allows the Department to review the taxpayer's returns to determine whether they also failed to report income correctly for Virginia income tax purposes. All such IRS notifications contain the following statement:

"We send information about these changes to state and local tax agencies. If the changes we made to your federal tax return also impact your state or local tax return, file an amended state or local tax return as soon as possible."

The states successfully lobbied the IRS to include this statement on such notifications. This information is intended to inform taxpayers that they may be required to file an amended state or local tax return because of a federal tax deficiency revealed by the IRS.

If the taxpayer follows through and correctly files an amended return, they will receive no additional contact from the Department. If the individual fails to file an amended return as required, the Department will contact the taxpayer regarding the matter and potentially mail an assessment of additional taxes owed.

Proposed Legislation

If the Department is made aware that a taxpayer is required to file an amended federal income tax return, this bill would require the Department to notify such taxpayer in writing

regarding whether an amended Virginia income tax return is also required to be filed. This requirement would apply with respect to taxpayers subject to the individual income tax, corporate income tax, and the income tax imposed on estates and trusts.

Such notice would be required to detail:

- The additional tax owed to the Department, if any, that is assessed as a result of such amended federal income tax return and the amount of overpayment that is required to be refunded to the taxpayer; or
- Any information the Department may require from the taxpayer to compute the amount of additional tax owed or to be refunded.

This bill would give the Department the discretion to waive interest due on an underpayment of income taxes or the pass-through entity nonresident withholding tax if a return was submitted in good faith and the understatement of the amount in the return was not due to any fault of the taxpayer. Under current law, the Department is required to waive any applicable penalties in this situation, but does not have the authority to waive interest.

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cc : Secretary of Finance

Date: 2/14/2020 JLOF
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