DEPARTMENT OF TAXATION
2020 Fiscal Impact Statement

1. **Patron** Janet D. Howell

2. **Bill Number** SB 582
   House of Origin:
   ____ **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

   Second House:
   ____ **In Committee**
   ____ **Substitute**
   X **Enrolled**

3. **Committee** House 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 December 31, 2018 to December 31, 2019. This would allow Virginia to generally conform to the Further Consolidated Appropriations Act, 2020 ("the federal extenders bill"). However, this bill would specifically deconform Virginia from the provision that temporarily reduces the medical expense deduction threshold.

This bill would allow Virginia to conform to the Virginia Beach Strong Act.

This bill would be effective for taxable years beginning on and after January 1, 2018. Because some taxpayers will be preparing their 2019 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 bill would be effective for taxable years beginning on and after January 1, 2018.

This is a Secretary of Finance bill.

6. **Budget amendment necessary:** Yes.

7. **Fiscal Impact Estimates are:** Available. (See Line 8.)
   7b. Revenue Impact:

Fiscal Year	*Dollars*	*Fund*
2019-20	($17.5 million)	GF
2020-21	($4.7 million)	GF
2021-22	$2.4 million	GF
2022-23	$0.9 million	GF
2023-24	$0.3 million	GF
2024-25	($0.6 million)	GF
2025-26	($1.0 million)	GF

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 negative General Fund revenue impact of $17.5 million in Fiscal Year 2020 and $4.7 million in Fiscal Year 2021. This bill would have an estimated positive General Fund revenue impact of $2.4 million in Fiscal Year 2022, $0.9 million in Fiscal Year 2023, and $0.3 million in Fiscal Year 2024, and an estimated negative impact of $0.6 million in Fiscal Year 2025, and $1.0 million in Fiscal Year 2026. A budget amendment is necessary because the federal legislation was not enacted until December 20, 2019, after the Governor's Executive Budget was introduced.

The revenue impact of this bill is attributable to two provisions within the federal extenders bill: disaster relief provisions, and the repeal of the unrelated business tax ("UBTI") on certain fringe benefits. The other provisions of this federal legislation that affect Virginia tax returns either have a minimal impact on Virginia revenues or have no impact because their extension is already assumed in the official General Fund revenue forecast. Conformity to the Virginia Beach Strong Act would have no impact on General Fund revenue. The revenue impact of conformity to the disaster relief and UBTI provisions is as follows:

FY	Disaster Relief	UBTI
2020	($16.9 million)	($0.6 million)
2021	($3.9 million)	($0.8 million)
2022	$3.2 million	($0.8 million)
2023	$1.7 million	($0.8 million)
2024	$1.3 million	($0.9 million)
2025	$0.3 million	($0.9 million)
2026	-	($1.0 million)

Deconforming from the temporary reduction in the medical expense deduction threshold would preserve revenues of $39.7 million in Fiscal Year 2020 and $14.0 million in Fiscal Year 2021.

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, 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.

- **Suspension of the federal overall limitation on itemized deductions.** During the 2019 Session, Virginia deconformed from the federal suspension of the overall limitation on itemized deductions (the "Pease Limitation"). This has the effect of reinstating the Pease Limitation for Virginia income tax purposes only beginning with Taxable Year 2019.

Further Consolidated Appropriations Act

On December 20, 2019, the Further Consolidated Appropriations Act, 2020 (H.R.1865) ("the federal extenders bill") was signed into law. The federal legislation extends for three years over 30 tax provisions, commonly known as "extenders," which generally expired at the end of 2017. The legislation also provides tax relief to victims of certain 2018 and 2019 disasters, makes significant changes to several retirement tax provisions, and makes other miscellaneous changes. To conform to these federal tax provisions, Virginia would be required to enact legislation advancing its date of conformity.

Federal Extenders

A number of the federal tax provisions that were extended would have an impact on taxpayers preparing and filing their Virginia income tax returns during the 2020 tax filing season. These extender provisions include, but are not limited to, the following:

- The temporary extension of the 7.5 percent of adjusted gross income limitation on the medical expense deduction;
- The above-the-line deduction for qualified tuition and related expenses for higher education;
- Exclusion from gross income of a discharge of qualified principal residence indebtedness; and
- Treatment of qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction.

Federal Disaster Relief

A number of disaster tax relief provisions relating to persons affected by certain disasters in 2018 and 2019 would have an impact on taxpayers preparing and filing their Virginia income tax returns during the 2020 tax filing season. These provisions include:

- Suspension of the annual limitations imposed on charitable contribution deductions for disaster 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 qualified disaster areas;
- Modification of the method by which earned income is determined for purposes of computing the earned income tax credit for taxpayers in disaster areas; and
- Modification of the deduction for personal casualty losses in qualified disaster areas to eliminate the requirement that casualty losses exceed 10 percent of adjusted gross income to qualify for the deduction.

Retirement Tax Provisions

H.R.1865 makes significant changes to the way that retirement plans work. The four retirement tax provisions with a greater than minimal Virginia revenue impact are:

- Reducing the minimum age for allowable in-service distributions from age 62 to age 59 ½;
- Modifying multiple employer plans and pooled employer plans;
- Raising the minimum age for required minimum distributions from 70 1/2 years of age to 72 years of age; and

- Eliminating so-called stretch IRA by requiring non-spouse beneficiaries of inherited IRAs to withdraw and pay taxes on all distributions from inherited accounts within 10 years.

Miscellaneous Tax Provisions

The federal legislation also makes a number of miscellaneous tax law changes, including the:

- Modification of income for purposes of determining tax-exempt status of certain mutual or cooperative telephone or electric companies;
- Repeal of UBTI on certain fringe benefits;
- Repeal of several Affordable Care Act excise taxes; and
- Correcting of technical drafting errors within the Tax Cuts and Jobs Act.

<u>Virginia Beach Strong Act</u>

On December 20, 2019, the Virginia Beach Strong Act (H. R. 4566) was signed into law. This legislation clarifies that the Virginia Beach Tragedy Fund is entitled to federal tax-exempt status. This legislation provides that certain payments made by a tax-exempt organization to the spouse or dependent of the dead or wounded victims of the Virginia Beach tragedy will be treated as related to such organization's tax-exempt purpose and not for the benefit of any private individual. This protects the tax-exempt status of such entities. In addition, this legislation ensures that cash contributions made specifically for the relief of families of the dead or wounded victims of the Virginia Beach tragedy qualify for the charitable contributions deduction. To conform to these federal tax provisions, Virginia would be required to enact legislation advancing its date of conformity.

<u>Proposed Legislation</u>

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from December 31, 2018 to December 31, 2019. This would allow Virginia to generally conform to the Further Consolidated Appropriations Act, 2020 ("the federal extenders bill").

This bill would allow Virginia to conform to the Virginia Beach Strong Act.

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;
- Tax deductions related to the application of the applicable high yield debt obligation rules; and
- The suspension of the overall limitation on itemized deductions.

In addition, Virginia would now also deconform from the provision of the federal Further Consolidated Appropriations Act related to the reduction of the adjusted gross income limitation on the medical expense deduction from 10 percent to 7.5 percent. During the 2018 session, the General Assembly deconformed from a similar provision for Taxable Year 2017.

This bill would be effective for taxable years beginning on and after January 1, 2018. Because some taxpayers will be preparing their 2019 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 bill would be effective for taxable years beginning on and after January 1, 2018.

Similar Legislation

House Bill 1413 is identical to this bill.

House Bill 734 would conform Virginia to the IRC on a rolling basis, but would deconform from provisions with a revenue impact greater than $10 million in order to give the General Assembly the opportunity to determine whether to specifically conform to such provisions.

cc : Secretary of Finance

Date: 2/10/2020 JLOF
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