DEPARTMENT OF TAXATION
2021 Fiscal Impact Statement

1. Patron Vivian E. Watts

2. Bill Number HB 1935

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

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

3. Committee Passed House and Senate

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, 2019 to December 31, 2020. This would allow Virginia to generally conform to the Coronavirus Aid, Relief, and Economic Security ("CARES") Act (H.R.748) and the Consolidated Appropriations Act, 2021 (H.R.133) ("the CAA"). However, this bill would specifically deconform Virginia from three provisions of the CARES Act that temporarily ease limitations applicable to the net operating loss deduction, excess business losses, and the business interest deduction.

This bill would deconform Virginia from the provision of the CAA that permanently reduces the medical expense deduction threshold.

This bill would conform to the federal tax exemption for Paycheck Protection Program ("PPP") loan forgiveness and Economic Injury Disaster Loan ("EIDL") program funding, but would deconform from the provisions of the CAA allowing deductions for business expenses funded by forgiven PPP loan and EIDL funding proceeds. However, this bill would provide a Virginia-specific individual and corporate income tax deduction of up to $100,000 for business expenses funded by forgiven PPP loan proceeds that are paid or incurred during Taxable Year 2020.

This bill would also provide an individual and corporate income tax subtraction for up to $100,000 of all grant funds received by the taxpayer for Taxable Year 2020 under the Rebuild Virginia program.

Because some taxpayers will be preparing their 2020 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 Secretary of Finance bill.

6. Budget amendment necessary: Yes.
Item(s): Page 1, Revenue Estimates

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

7b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2020-21	($66.6 million)	GF
2021-22	($112.4 million)	GF
2022-23	($10.9 million)	GF
2023-24	$4.3 million	GF
2024-25	$1.5 million	GF
2025-26	$3.2 million	GF
2026-27	$3.3 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 $100.8 million in Fiscal Year 2021, $119.9 million in Fiscal Year 2022; and $6.4 million in Fiscal Year 2023, and a positive General Fund revenue impact of $6.4 million in Fiscal Year 2024, $2.1 million in Fiscal Year 2025, $3.9 million in Fiscal Year 2026, and $3.5 million in Fiscal Year 2027.

The Introduced Executive Budget already assumes a reduction of $34.2 million in Fiscal Year 2021 and $7.5 million in Fiscal Year 2022 to account for the negative revenue impact of conforming to the individual provisions set forth in the CARES Act. However, because the CAA was not enacted by Congress until December 27, 2020, it was not assumed in the Introduced Executive Budget. Also, the deduction and subtraction for certain small businesses assistance provided by this bill were not assumed in the Introduced Executive Budget. Accordingly, a budget amendment would be required to reduce revenues by $66.6 million in Fiscal Year 2021 and $112.4 million in Fiscal Year 2022 to account for generally conforming to the CAA as well as the deduction and subtraction provided by this bill.

The revenue impact of conforming to the CARES Act under this bill is attributable to the following provisions (amounts in millions):

Provision	**FY 2021**	**FY 2022**	**FY 2023**	**FY 2024**
COVID-19 Related Retirement Distributions	-	($8.5)	($1.4)	($0.2)
Above-the-Line Charitable Contributions Deduction	($11.1)	($2.8)	-	-
Deduction Limitations for Certain Charitable Contributions	($19.5)	$4.3	$5.8	$2.3
Exclusion of Educational Payments	($3.6)	($0.5)	-	-
Total (CARES Act Provisions)	**($34.2)**	**($7.5)**	**$4.5**	**$2.1**

The revenue impact of conforming to the CAA under this bill is attributable to the following provisions (amounts in millions):

Provision	FY 2021	FY 2022	FY 2023	FY 2024
Extension of the $300 deduction for non-itemizers to Taxable Year 2021	-	($21.5)	($5.4)	-
Enhancing the charitable deduction for individuals for certain contributions	($4.5)	($19.8)	$5.4	$7.2
Temporary full business meals deduction	-	($17.8)	($10.5)	($2.2)
Extension of exclusion for certain employer payments of student loans	-	($8.5)	($6.2)	($6.6)
Depreciation of certain residential rental property over a 30-Year Period	-	($8.1)	($1.4)	($0.9)
Temporary enhancement of the earned income tax credit for certain taxpayers	($3.2)	-	-	-
Repeal of the deduction for qualified tuition	-	$7.7	$7.9	$7.4
All other provisions	($1.3)	($1.8)	($0.7)	($0.7)
Total (CAA Provisions)	**($9.0)**	**($69.7)**	**($10.9)**	**$4.3**

Other provisions of the CAA that affect Virginia tax returns either have a relatively minimal impact on Virginia revenues, as reflected in the “all other provisions” category in the table above, or have no impact because their extension is already assumed in the official General Fund revenue forecast.

This bill would allow an individual and corporate income tax deduction for business expenses funded by forgiven PPP loan proceeds to the extent they do not exceed $100,000 and they were paid or incurred during Taxable Year 2020. This bill would also allow an individual and corporate income tax subtraction for up to $100,000 of all grant funds received by the taxpayer under the Rebuild Virginia program for Taxable Year 2020. The estimated revenue impact of these provisions is shown below (amounts in millions):

Provision	FY 2021	FY 2022
Virginia Deduction for Business Expenses Funded by PPP Loans	($56)	($42)
Virginia Subtraction for Rebuild Virginia Grants*	($2)	($1)
Total (Virginia Deduction and Subtraction)	($58)	($43)

**Totals based upon this amount may not sum due to rounding.*

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, 2019. 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.

- **The reduction in the medical expense deduction floor for Taxable Year 2019 and Taxable Year 2020.** During the 2020 Session, Virginia deconformed from the reduction of the adjusted gross income limitation on the medical expense deduction from 10 percent to 7.5 percent floor for Taxable Year 2019 and Taxable Year 2020. During the 2018 session, the General Assembly deconformed from this provision for Taxable Year 2017 as well.

<u>CARES Act</u>

On March 27, 2020, the CARES Act was signed into law. This federal legislation provides emergency economic assistance to businesses and individuals affected by COVID-19. Several of the changes made in the CARES Act will impact Virginia taxpayers. To conform to these federal tax provisions, Virginia would be required to enact legislation advancing its date of conformity.

Individual Provisions

There are four provisions in the CARES Act that have an impact on Virginia individual taxpayers preparing and filing their Virginia income tax returns during the 2021 tax filing season. These provisions include:

- Modifying federal rules with respect to COVID-19 related distributions from certain retirement plans;
- Expanding the types of educational payments that are excluded from an employee's gross income to include eligible loan repayments made before January 1, 2021;
- Providing a $300 "above the line" charitable contributions deduction for Taxable Year 2020 to individual taxpayers that claim the standard deduction; and
- Enhancing the deduction limitations for individuals and corporations on cash contributions to certain charitable organizations.

Business Provisions

There are four provisions in the CARES Act that have an impact on Virginia business taxpayers preparing and filing their Virginia income tax returns during the 2021 tax filing season. These provisions include:

- Enhancing the NOL deduction for Taxable Years 2018, 2019, and 2020;
- Allowing noncorporate taxpayers to deduct excess business losses arising in Taxable Year 2018, 2019, and 2020;
- Increasing the limitation on the business interest deduction for Taxable Year 2019 and 2020; and
- Excluding the forgiveness of certain Paycheck Protection Program loans from taxation.

The first three provisions modify changes previously adopted by the Tax Cuts and Jobs Act ("TCJA") and are retroactive to prior taxable years.

Consolidated Appropriations Act, 2021

On December 27, 2020, the CAA was signed into law. This federal legislation provides additional emergency economic assistance to businesses and individuals affected by COVID-19. This legislation contains 28 provisions that will impact Virginia returns

Individual Tax Provisions

A number of the federal tax provisions in the CAA will have an impact on Virginia individual taxpayers preparing and filing their Virginia income tax returns during the 2021 tax filing season. These provisions include:

- Making the 7.5 percent adjusted gross income floor for the medical expense deduction permanent;
- Expanding the educator expense tax deduction to include personal protective equipment and other supplies related to the prevention of the spread of COVID-19;
- Excluding certain emergency financial aid grants from gross income;
- Making the $300 deduction for non-itemizers applicable to Taxable Year 2021;
- Enhancing the charitable deduction for individuals for certain contributions;
- Repealing the deduction for qualified tuition;
- Temporarily enhancing the earned income tax credit for certain taxpayers;
- Permanently extending the exclusion from gross income for members of a qualified volunteer emergency response organization;
- Modifying the minimum age for distributions from certain pension plan trusts during working retirement;
- Temporarily providing special rules for health and dependent care flexible spending arrangements; and
- Exclusion for certain employer payments of student loans.

Business Tax Provisions

A number of the federal tax provisions in the CAA will have an impact on Virginia business taxpayers preparing and filing their Virginia income tax returns during the 2021 tax filing season. These provisions include:

- Allowing taxpayers to both deduct expenses paid with PPP loans and utilize tax-free forgiveness of such loans;
- Providing an exclusion from gross income for EIDL loans, EIDL grants, and certain loan repayment assistance, and allows taxpayers to deduct expenses paid with forgiven EIDL funds;
- Allowing farmers that opted to utilize the two-year carryback of NOLs prior to the CARES Act to continue to do so;
- Providing for the depreciation of certain residential rental property over a 30-year period; and
- Temporarily allowing a full deduction for certain business meals.

Disaster Relief Provisions

A number of disaster tax relief provisions in the CAA relating to persons affected by certain disasters in 2020 will have an impact on taxpayers preparing and filing their Virginia income tax returns during the 2021 tax filing season. These provisions include:

- Disaster-related rules for use of retirement funds;
- Disaster relief contributions; and
- Qualified disaster-related personal casualty losses.

These provisions provide relief to taxpayers affected by certain hurricanes and wildfires during 2020. Relief from disasters related to COVID-19 was previously provided by the CARES Act.

Federal Extenders

A number of the federal tax provisions that were extended in the CAA will have an impact on taxpayers preparing and filing their Virginia income tax returns during the 2021 tax filing season. These extender provisions include:

- Look-through treatment of payments between related controlled foreign corporations under foreign personal holding company rules;
- Modification and extension of exclusion from gross income of discharge of qualified principal residence indebtedness;
- Seven-year recovery period for motorsports entertainment complexes;
- Special expensing rules for certain film, television, and live theatrical productions;
- Certain empowerment zone tax incentives;
- Mortgage insurance premiums treated as qualified residence interest;
- Classification of certain race horses as 3-year property;
- Accelerated depreciation for business property on Indian reservations; and
- Energy efficient commercial buildings deduction.

<u>Proposed Legislation</u>

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from December 31, 2019 to December 31, 2020. This would allow Virginia to generally conform to the CARES Act and the CAA.

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.

Virginia would deconform from the following provisions of the CARES Act:

- Enhancing the NOL deduction for Taxable Years 2018, 2019, and 2020.
- Allowing noncorporate taxpayers to deduct excess business losses arising in Taxable Year 2018, 2019, and 2020.
- Increasing the limitation on the business interest deduction for Taxable Year 2019 and 2020.

This bill would deconform Virginia from the provision of the CAA that permanently reduces the medical expense deduction threshold.

This bill would conform to the federal tax exemption for Paycheck Protection Program ("PPP") loan forgiveness and Economic Injury Disaster Loan ("EIDL") program funding, but would deconform from the provisions of the CAA allowing deductions for business expenses funded by forgiven PPP loan and EIDL funding proceeds. However, this bill would provide a Virginia-specific individual and corporate income tax deduction of up to $100,000 for business expenses funded by forgiven PPP loan proceeds that are paid or incurred during Taxable Year 2020.

This bill would provide an individual and corporate income tax subtraction for up to $100,000 of all grant funds received by the taxpayer for Taxable Year 2020 under the Rebuild Virginia program established by the Governor and administered by the Department of Small Business and Supplier Diversity.

Because some taxpayers will be preparing their 2020 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 1146 is identical to this bill.

cc : Secretary of Finance

Date: 5/17/2021 JJS
HB1935FER161