DEPARTMENT OF TAXATION
2022 Fiscal Impact Statement

1. **Patron** Kathy J. Byron

2. **Bill Number** HB 1003
   House of Origin:
   X **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

   Second House:
   ____ **In Committee**
   ____ **Substitute**
   ____ **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, 2020 to December 31, 2021. This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from December 31, 2020 to December 31, 2021. This would allow Virginia to generally conform to the American Recovery Plan Act ("ARPA") of 2021 (H.R. 1319).

   This bill would also change Virginia's existing policy with regards to certain COVID-19 business assistance programs by allowing full deductibility of expenses paid or incurred with forgiven Paycheck Protection Program ("PPP") loan proceeds, Economic Injury Disaster Loan ("EIDL") funding, and certain other COVID-19 business assistance program funds for Taxable Year 2021 and after.

   Because some taxpayers will be preparing their 2021 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. **No Fiscal Impact** (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 negative General Fund revenue impact of $158.6 million in Fiscal Year 2022, $35.6 million in Fiscal Year 2023, and $0.6 million in Fiscal Year

2024. This revenue impact would be the result of conforming to ARPA. No budget amendment is needed because the General Fund revenue impact of conforming to ARPA is assumed in the introduced budget.

Such impact is attributable to conforming to the following provisions of ARPA (amounts in millions):

Provision	FY 2022	FY 2023	FY 2024
Full Conformity to Federal Tax Treatment of Expenses Related to Business Assistance Programs	($67.0)	($35.0)	-
Changes to Federal Earned Income Tax Credit	($32.6)	($0.5)	($0.5)
Child and Dependent Care Tax Treatment	($58.4)	-	-
Employer-Provided Dependent Care	($0.5)	-	-
Student Loan Forgiveness Exemption	($0.1)	($0.1)	($0.1)
TOTAL	**($158.6)**	**($35.6)**	**($0.6)**

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, 2020. 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.** During the 2021 session, Virginia permanently deconformed from the reduction in the adjusted gross income limitation on the medical expense deduction from 10 percent to 7.5 percent. Previously, Virginia deconformed from this provisions for Taxable Years 2017, 2019, and 2020.

- **Certain business provisions of the federal CARES Act**. During the 2021 session, Virginia deconformed from several provisions of the CARES Act that effectively suspended certain provisions of the TCJA temporarily. Specifically, these provisions suspended certain net operating loss (“NOL”) limitations for Taxable Years 2018, 2019, and 2020; suspended the excess business loss limitation for Taxable Year 2018, 2019, and 2020; and increased the business interest limitation for Taxable Year 2019 and 2020.

- **The deduction of business expenses through certain COVID-related small business assistance programs.** During the 2021 Session, the General Assembly enacted legislation that partially deconformed from the full federal deductibility of business expenses funded by forgiven PPP loan proceeds. Instead, for Taxable Year 2020 only, Virginia allowed a deduction of up to $100,000 for business expenses funded by PPP loan proceeds. In addition, that 2021 legislation fully deconformed from the provision that allowed taxpayers to claim a federal deduction for business expenses funded by forgiven EIDL funding proceeds.

American Rescue Plan Act

On March 11, 2021, ARPA 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 ARPA will impact Virginia taxpayers. To conform to these federal tax provisions, Virginia would be required to enact legislation advancing its date of conformity.

There are five provisions in ARPA that have an impact on Virginia taxpayers preparing and filing their Virginia income tax returns during the 2022 tax filing season. These provisions include:

- Expanding eligibility for the Earned Income Tax Credit, with most changes effective solely for Taxable Year 2021;

- Enhancing the Child and Dependent Care Tax Credit for Taxable Year 2021, which benefits Virginia taxpayers who claim the Virginia Child and Dependent Care Deduction;

- Increasing the amount taxpayers can contribute to Child and Dependent Care Flexible Spending Accounts for Taxable Year 2021;

- Excluding student loan forgiveness from gross income for Taxable Years 2021 through 2025; and

- Allowing certain business taxpayers to receive tax-free assistance under the Restaurant Revitalization and Targeted EIDL Advance grant programs while also deducting the business expenses paid with such tax-free funds.

Proposed Legislation

This bill would advance Virginia's date of conformity to the IRC from December 31, 2020 to December 31, 2021. This would allow Virginia to generally conform to ARPA.

During the 2021 Session, the General Assembly enacted legislation that generally deconformed Virginia from the federal deductibility of business expenses funded by forgiven PPP loan and EIDL program funding. In addition, that 2021 legislation provided a Virginia-specific deduction of up to $100,000 for business expenses funded by forgiven PPP loan proceeds that were paid or incurred during Taxable Year 2020. This bill allow full deductibility of expenses paid or incurred with forgiven PPP loan proceeds beginning in Taxable Year 2021, even if such expenses exceed $100,000. The bill would also would allow full deductibility of expenses paid or incurred with EIDL program funding and funding from certain other COVID-19 business assistance programs beginning in Taxable Year 2021.

Because some taxpayers will be preparing their 2021 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 94 is identical to this bill.

House Bill 971 and **Senate Bill 583** are identical to this bill, except they would also increase the maximum Taxable Year 2020 deduction for business expenses funded with forgiven PPP loans from $100,000 to $1 million.

House Bill 106 would conform Virginia to the IRC on a rolling basis, but would deconform from provisions with a revenue impact greater than certain specified thresholds in order to give the General Assembly the opportunity to determine whether to specifically conform to such provisions.

cc : Secretary of Finance

Date: 1/23/2022 RWC
HB1003F161