DEPARTMENT OF TAXATION
2022 Fiscal Impact Statement

1. **Patron** Joseph P. McNamara
2. **Bill Number** HB 106
   House of Origin:
   X **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

   Second House:
   ____ **In Committee**
   ____ **Substitute**
   ____ **Enrolled**
3. **Committee** House Finance
4. **Title** Rolling Conformity with the Internal Revenue Code

5. **Summary/Purpose:**

   This bill would conform Virginia to the IRC on a rolling basis. This would allow Virginia to conform to federal tax changes to the IRC as soon as they are enacted by Congress. This would also allow Virginia to conform to the American Rescue Plan Act ("ARPA").

   For taxable years beginning on and after January 1, 2022, this bill would deconform Virginia from certain federal tax changes that exceed specified threshold amounts. This deconformity would not apply to any federal tax changes that the General Assembly subsequently adopts.

   The Secretary of Finance would be required to provide an annual report on the fiscal impact of amendments to the Internal Revenue Code occurring since the adjournment of the prior year's regular session of the General Assembly to the Chairmen of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance.

   If this bill is enacted during the 2022 Regular Session of the General Assembly, the portion that would conform Virginia to the IRC on a rolling basis would become effective July 1, 2022. The portion of this bill that would deconform from federal legislation based on the projected revenue impact would be effective for taxable years beginning on or after January 1, 2022.

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

7. **Fiscal Impact Estimates are:** Preliminary. (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 unknown General Fund revenue impact beginning in Fiscal Year 2022. It is unknown to what extent Congress will enact changes to the IRC that would impact Virginia income tax returns in the future. Such changes may result in a positive or negative revenue impact on their own, or when aggregated with other changes that may occur during a particular year. In addition, Congress often enacts changes to the IRC that apply retroactively to taxable years that have already occurred. The continuation of this practice would increase any positive or revenue impact from future changes to the IRC.

Conformity to the IRC for provisions enacted during 2021 would have a 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. 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)	-
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)**

The General Fund revenue impact of conforming to ARPA is assumed in the introduced budget.

However, as drafted, this bill would deconform from the federal tax treatment of expenses related to business assistance programs other than Restaurant Revitalization grants. The introduced budget assumes conformity to such federal tax treatment for Taxable Years 2021 and after. As a result, this bill would require a budget amendment to account for the positive revenue impact resulting from deconforming from such treatment in the amount of $61.0 million in Fiscal Year 2022 and $35.0 million in Fiscal Year 2023.

This bill would not become effective until July 1, 2022. Consequently, certain taxpayers could be required to file amended returns or file on extension to account for such changes on their Taxable Year 2021 returns. It is unknown to what extent taxpayers would make conformity adjustments during FY 2022 even though the bill would not become effective until July 1, 2022.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

Congress often passes tax legislation that is retroactive to prior taxable years. Because the revenue thresholds in this bill are limited to taxable years beginning on and after January 1, 2022, Virginia would automatically conform to any retroactive federal tax provisions impacting taxable years before January 1, 2022. If the intent of this bill is to ensure that the revenue thresholds apply to future changes made by Congress that are retroactive as well as prospective, the following amendments are suggested:

Page 1, Line 56, after 11. a
Strike: For taxable years beginning on and after January 1, 2022, (i) any amendment
Insert: (i) Any amendment enacted on or after January 1, 2022

Page 2, Line 59, after all amendments adopted during
Strike: the taxable year
Insert: a taxable year beginning on or after January 1, 2022

The bill would deconform from federal tax law for a given taxable year if all amendments adopted during such taxable year exceed a 0.6 percent threshold. It is unclear how "taxable year" would be defined since taxpayers can have different taxable years. It is suggested that this language be clarified. If the intent is that the threshold would apply to all amendments adopted during a calendar year, it may not be possible to determine whether the threshold has been exceed until the calendar year is complete. For example, the first report is required to be filed no later than 60 days prior to 2023 General Assembly Session. Because Calendar Year 2022 would not have ended by that date, Calendar Year 2022 deconformity would not be able to be fully determined on this report.

11. Other comments:

Virginia's History with Rolling and Fixed Date Conformity

Prior to 1971, the Virginia Constitution did not allow provisions incorporated into Virginia law if they could be subsequently revised without approval of the General Assembly. The new constitution adopted in 1971 included a provision allowing incorporation of the IRC "as those laws may be or become effective." From 1972 until 2002, Virginia relied on the new constitutional provision to automatically conform to any Congressional changes in the definition of income. As a result, Virginia was a rolling conformity state during that period.

The Job Creation and Worker Assistance Act of 2002 ("JCWAA") substantially reduced Virginia taxable income of businesses by creating a new depreciation deduction and modifying the carryback period for net operating loss deductions. The 2002 Appropriation Act included a provision temporarily fixing the date of conformity to the IRC as of December 31, 2001. In 2003, the General Assembly adopted fixed date conformity by adopting the IRC as it existed on December 31, 2002 and specifically excepting the depreciation/NOL provisions modified by JCWAA. Since 2002, Virginia has been a fixed date conformity state. Annual conformity bills have generally advanced the date of fixed conformity and revised the list of exceptions as needed.

Virginia's Current Conformity to Federal Income Tax 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 conform Virginia to the IRC on a rolling basis. This would allow Virginia to conform to federal tax changes to the IRC as soon as they are enacted by Congress. This would also allow Virginia to conform to ARPA.

Deconformity from Federal Tax Changes Exceeding Specified Threshold Amounts

For taxable years beginning on and after January 1, 2022, this bill would deconform Virginia from:

- Any amendment with a projected impact that would increase or decrease general fund revenues by greater than 0.3 percent in the fiscal year in which the amendment was enacted or any of the succeeding four fiscal years and

- All amendments adopted during the taxable year if the aggregate projected impact of such amendments would increase or decrease general fund revenues by greater than 0.6 percent in the fiscal year in which the amendments were enacted or any of the succeeding four fiscal years.

This deconformity would not apply to any amendment that the General Assembly subsequently adopts. For purposes of this bill, "amendment" would be defined as a single amendment to the Internal Revenue Code or a group of such amendments enacted in the same act of Congress that collectively surpass the threshold impact. The Secretary of Finance, in consultation with the Chairmen of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance, would be responsible for determining whether any amendment to the Internal Revenue Code meets the criteria above.

Annual Report on Federal Tax Changes

The Secretary of Finance would also be required to provide an annual report on the fiscal impact of amendments to the Internal Revenue Code occurring since the adjournment of the prior year's regular session of the General Assembly to the Chairmen of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance. The report would be required to be presented no later than 60 days prior to the regular session of the General Assembly. The Secretary of Finance would also be required to provide updates to the same chairmen on any further amendments to the Internal Revenue Code occurring between presentation of the required report and the first day of the subsequent regular session of the General Assembly.

If this bill is enacted during the 2022 Regular Session of the General Assembly, the portion that would conform Virginia to the IRC on a rolling basis would become effective July 1, 2022. The portion of this bill that would deconform from federal legislation based on the projected revenue impact would be effective for taxable years beginning on or after January 1, 2022.

Similar Legislation

Senate Bill 630 is identical to this bill.

House Bill 1003 and **Senate Bill 94** would (1) advance Virginia's fixed date of conformity to the IRC from December 31, 2020 to December 31, 2021 and (2) conform to the federal tax treatment of expenses related to certain business assistance programs for Taxable Year 2021 and after.

House Bill 971 and **Senate Bill 583** would (1) advance Virginia's fixed date of conformity to the IRC from December 31, 2020 to December 31, 2021, (2) conform to the federal tax treatment of expenses related to certain business assistance programs for Taxable Year 2021 and after, and (3) retroactively increase the maximum Taxable Year 2020 deduction for business expenses funded with forgiven PPP loans from $100,000 to $1 million and the maximum Taxable Year 2020 subtraction for Rebuild Virginia grant recipients from $100,000 to $1 million.

cc : Secretary of Finance

Date: 1/23/2022 JJS
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