DEPARTMENT OF TAXATION
2023 Fiscal Impact Statement

1. **Patron** David R. Sutterlein

2. **Bill Number** SB 1423
House of Origin:
__X__ **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. **Committee** Senate Finance and Appropriations

4. **Title** Income Tax: Qualified Business Income Deduction, and Rate Reduction

5. **Summary/Purpose:**

This bill would reduce Virginia income taxes on business by:

- Providing for a new individual income tax deduction in an amount equal to fifty percent of certain federal qualified business income deductions, excluding qualified real estate investment trust dividends; and

- Reducing Virginia's corporate income tax rate from six percent to five percent.

Both of these changes would be effective for taxable years beginning on and after January 1, 2023.

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 $71.9 million in Fiscal Year 2023, $452.3 million in Fiscal Year 2024, $444.8 million in Fiscal Year 2025, $463.2 million in Fiscal Year 2026, $480.2 million in Fiscal Year 2027, and $500.0 million in Fiscal Year 2028. No budget amendment is needed because the revenue impact of this bill is assumed in the Introduced Executive Budget. The fiscal impact of each change made by this bill to Virginia's business income tax system is set forth in the chart below:

	FY 23	FY 24	FY 25	FY 26	FY 27	FY 28
Decrease Corporate Income Tax Rate to 5% (TY 23)	($71.9)	($290.2)	($334.0)	($348.4)	($360.6)	($374.6)
Introduce Qualified Business Income Deduction of 50% (TY 23)	---	($162.1)	($110.8)	($114.8)	($119.6)	($125.4)
Total	**($71.9)**	**($452.3)**	**($444.8)**	**($463.2)**	**($480.2)**	**($500.0)**

The estimates regarding the qualified business income deduction assume adoption of the 5.5 percent individual income tax in Taxable Year 2024, as proposed in the Introduced Executive Budget. If such individual rate reduction were not enacted, the qualified business income estimates would be required to be adjusted.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Qualified Business Income Deduction

The TCJA allows owners of sole proprietorships, partnerships, S corporations and some trusts and estates to claim a federal qualified business income ("QBI") deduction on their personal income tax returns. The QBI deduction does not apply to corporations. The QBI deduction allows eligible taxpayers to deduct the lesser of (i) up to 20% of their combined qualified business income plus twenty percent of qualified real estate investment trust ("REIT") dividends and qualified publicly traded partnership ("PTP") income, or (ii) twenty percent of taxable income less net capital gains.

The QBI deduction is subject to limitations depending on the taxpayer's income, including the type of trade or business that may qualify, the amount of W-2 wages paid by the business, and the unadjusted basis immediately after acquisition of certain depreciable property held by the trade or business.

On the federal return the QBI deduction is claimed after determining federal adjusted gross income ("FAGI"). FAGI is the starting point for Virginia and most other states' income tax returns, as a result Virginia and most other states do not conform to the QBI deduction. Only four states currently conform to the QBI deduction in some manner. Iowa is phasing in conformity with the deduction, and Colorado, Idaho, and North Dakota, which do not use FAGI as a starting point for their state income tax, fully conform to the QBI deduction.

Corporate Income Tax Rate

Virginia's corporate income tax is currently imposed at the rate of 6 percent on the Virginia taxable income of domestic and foreign corporations doing business in Virginia. A "corporation" is defined as any entity created as a corporation under the laws of any state or local domestic or foreign jurisdiction, and any association, joint stock company, or any other entity subject to corporate income tax under the Internal Revenue Code.

A corporation's taxable income is determined by allocation and apportionment when the income is derived from sources both within and without Virginia. Multistate corporations allocate and apportion federal taxable income after Virginia modifications are made to determine the amount of income attributable to Virginia. No allocation or apportionment is necessary when the entire business of a corporation is conducted or transacted within Virginia. Instead, the Virginia corporate income tax is imposed upon the entire Virginia taxable income of the corporation for each taxable year.

Virginia's corporate income tax rate has remained unchanged since 1972, when it was increased from 5 percent to 6 percent.

Proposed Legislation

This bill would reduce Virginia income taxes on businesses by:

- Providing for a new individual income tax deduction in an amount equal to fifty percent of certain federal qualified business income deductions, excluding qualified real estate investment trust dividends; and

- Reducing Virginia's corporate income tax rate from six percent to five percent.

Both of these changes would be effective for taxable years beginning on and after January 1, 2023.

Similar Legislation

House Bill 2138 and **Senate Bill 1355** are identical to this bill, except that they would also increase the disallowed business interest expense deduction from thirty to fifty percent.

House Bill 2406 would provide a new individual income tax deduction in an amount equal to fifty percent of certain federal qualified business income deductions.

cc : Secretary of Finance

Date: 1/21/2023 RWC
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