DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

1. Patron Charles J. Colgan

2. Bill Number SB 1384

House of Origin:
X **Introduced**
___ **Substitute**
___ **Engrossed**

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

3. Committee Senate Finance

4. Title Income Tax: Conformity to the Internal Revenue Code

5. Summary/Purpose:

This bill would advance Virginia's date of conformity to the Internal Revenue Code (IRC) from January 22, 2010 to December 31, 2010.

Virginia would continue to disallow:

- any bonus depreciation allowed for certain assets under federal income taxation and any five year carry-back of NOLs allowed for NOLs generated in either taxable year 2008 or 2009;
- deductions for applicable high yield discount obligations under IRC § 163(e)(5)(f); and
- tax exclusions under IRC § 108(i) related to cancellation of debt income realized in connection with a reacquisition of business debt at a discount after December 31, 2008, and before January 1, 2011.

Virginia would continue to allow the federal deduction for qualified domestic production activities under IRC § 199 at a level equal to two-thirds of the federal deduction.

In addition, this bill would reconform to a 2009 law that temporarily increased the federal earned income tax credit (EITC) for taxable year 2010, and repeal the provision adopted in the 2010-2012 Budget that disallows the deduction for qualified motor vehicle taxes.

Because some taxpayers will be preparing their 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. In addition, this bill would make the repeal of provisions relating to the federal EITC and the deduction for qualified motor vehicle taxes retroactive to taxable years beginning on and after January 1, 2010.

This bill also contains an enactment clause to override conflicting provisions of the 2010 Appropriations Act.

This is a Department of Taxation bill.

6. **Budget amendment necessary:** No.

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

8. **Fiscal implications:**

   Administrative Costs

   TAX considers implementation of this bill as routine, and does not require additional funding.

   Revenue Impact

   The introduced Executive Budget, as amended, assumes the passage of this bill and therefore incorporates the fiscal impact of all but one of the federal tax laws passed during 2010. The following amounts were incorporated into the introduced Executive Budget for this bill: a revenue decrease of $25.39 million for FY 2011 and $8.21 million for FY 2012.

   The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, was enacted after the Governor's budget amendments were proposed, and contains two provisions that would flow through to Virginia's revenue: an extension of the increase in the federal EITC; and an extension of the parity for exclusion for employer-provided mass transit and parking benefits.

   The extension of the increase in the federal EITC to taxable year 2011 would reduce General fund revenue by $6.6 million in FY 2012. Therefore, this bill conforms to the EITC increase for taxable year 2010 only, and for which funds are already accounted for in the introduced Executive Budget. Action on the increase for taxable year 2011 is deferred until the 2012 Session of the General Assembly.

   The Governor has submitted an Executive Budget amendment that reduces General Fund revenue by ($600,000) in FY 2011 and ($520,000) in FY 2012 for the provision that allows employers to provide the same amount of benefits for both parking and mass transit passes.

9. **Specific agency or political subdivisions affected:**

   Department of Taxation

10. **Technical amendment necessary:** No.

11. Other comments:

Current Law

Virginia's conformity to the IRC is currently fixed to the IRC as it existed on January 22, 2010. Since that date, Congress has enacted five significant measures that would affect income taxation in Virginia:

- The Amendment in Nature of a Substitute to the Reconciliation Act (H.R. 4872), in combination with the Patient Protection and Affordable Care Act (H.R. 3590), which expand healthcare coverage and provide several tax-related requirements and incentives;

- The Hiring Incentives to Restore Employment Act (H.R. 2847), which extends the increase in expensing of certain depreciable business assets;

- The Education Jobs and Medicaid Assistance Act (H.R. 1586), which modifies certain affiliation rules;

- The Small Business Jobs and Credit Act (H.R. 5297); and

- The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which extends certain tax provisions scheduled to expire in 2010.

Unless the date of IRC conformity is advanced, none of the provisions of this Act will flow through to Virginia taxable income. Because federal adjusted gross income (individuals) and federal taxable income (corporations) are the starting point for Virginia tax returns, if this bill is not enacted, Virginia taxpayers would be required to make complex "Fixed-Date Conformity" adjustments to remove the changes made by this Act when they prepare their Virginia tax returns.

Federal Law

In 2009, the ARRA temporarily increased the earned income tax credit for taxable years 2009 and 2010. The expanded calculation of the EITC is scheduled to sunset on December 31, 2010, reverting back to the calculation as it existed prior to January 1, 2009.

The ARRA also created a temporary deduction for sales tax paid on a qualified motor vehicle that was purchased in 2009. An individual taxpayer was able claim an itemized deduction for the sales tax paid on up to $49,500 of the purchase price for a new car. The deduction was only eligible for 2009 income tax returns filed in 2010. For this reason, the deduction for taxable year 2010 is no longer applicable.

The Small Business Jobs and Credit Act of 2010 increased the maximum amount a taxpayer may expense under IRC § 179 to $500,000 and increases the phase-out threshold amount to $2 million for taxable years 2010 and 2011. The maximum amount a taxpayer may expense, for taxable years beginning after 2009 and before 2012, is $500,000 of the cost of qualifying property placed in service for the taxable year.

In 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act extended many of the federal tax provisions that were scheduled to expire on December 31, 2010, and expanded others. Among the various provisions, the Act extended the expanded calculation of the EITC adopted by ARRA through 2012.

Proposal

This bill would advance Virginia's date of conformity to the Internal Revenue Code (IRC) from January 22, 2010 to December 31, 2010. Virginia would continue to disallow any bonus depreciation allowed for certain assets under federal income taxation and any five year carry-back of NOLs allowed for NOLs generated in either taxable year 2008 or 2009. In addition, Virginia would continue to disallow the IRC § 163(e)(5)(f) provision for tax deductions related to applicable high yield discount obligations.

In order to make filing less complicated for certain low-income taxpayers, and to allow them to benefit from federal changes made under the American Recovery and Reinvestment Act (ARRA) of 2009, Virginia would reconform to the temporary modifications made to the federal earned income tax credit (EITC) for taxable year 2010 only.

The EITC increase was extended to taxable year 2011 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, but the proposal does not conform to this change for taxable year 2011. Since individual returns for taxable year 2011 are due May 1, 2012, the 2012 Session of the General Assembly will be able to revisit the fiscal impact of conforming to this provision.

This bill would also repeal the provision adopted in the 2010-2012 Appropriations Act that disallows the deduction for qualified motor vehicle taxes. The federal deduction was only applicable to qualified vehicles purchased in 2009. Therefore, the deduction could only be eligible for 2009 income tax returns filed in 2010. For this reason, the provision disallowing the deduction for taxable year 2010 is unnecessary and is repealed.

Virginia would continue to deconform to other items. This includes any tax exclusions under IRC § 108(i) related to cancellation of debt income realized in connection with a reacquisition of business debt at a discount after December 31, 2008, and before January 1, 2011. For Virginia income tax purposes, taxpayers that incur cancellation of debt income from transactions in 2009 would continue to be able to elect to report the addition required by conformity in equal amounts in taxable years 2009, 2010 and 2011.

Finally, Virginia would continue to allow the federal deduction for qualified domestic production activities under IRC § 199 at a level equal to two-thirds of the federal deduction.

Because some taxpayers will be preparing their 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. In addition, this bill would make the repeal of provisions relating to the federal EITC and the deduction for qualified motor vehicle taxes retroactive to taxable years beginning on and after January 1, 2010.

This bill also contains an enactment clause to override the 2010 Appropriations Act.

Similar Bills

House Bill 1874 is identical to this bill.

cc : Secretary of Finance

Date: 1/16/2011 TG
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