

DEPARTMENT OF TAXATION

2011 Fiscal Impact Statement

1. **Patron** Charles J. Colgan

2. **Bill Number** SB 1384

3. **Committee** Passed House and Senate

House of Origin:

 Introduced

 Substitute

 Engrossed

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

Second House:

 In Committee

 Substitute

 X **Enrolled**

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 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 certain cancellation of debt income, with the election to add back over three taxable years deferrals from transactions in 2009 or after January 1, 2010, but before April 21, 2010.

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 reconfirm 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 Appropriations Act 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 Conference Committee Report on HB 1500 incorporates the fiscal impact of conforming to federal tax changes as specified by this bill, which is a revenue decrease of \$48.09 million in FY 2011 and \$8.45 million in FY 2012. These amounts include:

- The extension of the increase in the federal EITC to taxable year 2011, which would reduce General fund revenue by \$6.6 million in FY 2012. Action on the increase for taxable year 2011 is deferred until the 2012 Session of the General Assembly.
- The extension of the treatment of the federal deferral of certain cancellation of debt income to transactions completed on or before April 21, 2010, which would reduce General Fund revenue by \$14.9 million in FY 2011 and increases General Fund revenue by \$7.4 million in FY 2012 and 2013.

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 these Acts 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 reconfirm 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. This bill would also allow the treatment adopted for transactions occurring in 2009 to be extended to transactions completed on or before April 21, 2010. This modification is made because the change to the Virginia treatment of certain cancellation of debt income was not fully known until the Appropriations Act was passed by the General Assembly at its reconvened session on April 21, 2010.

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 repeal and override the conformity provisions contained in the 2010 Appropriations Act.

Similar Legislation

House Bill 1874 is identical to this bill and has been signed into law by the Governor (Chapter 2, 2011 Acts of Assembly).

cc : Secretary of Finance

Date: 3/22/2011 TG
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