

DEPARTMENT OF TAXATION

2016 Fiscal Impact Statement

1. **Patron** Mark L. Cole

3. **Committee** House Finance

4. **Title** Income Tax; Deductions for H-1B Visa Employees

2. **Bill Number** HB 110

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would disallow corporations, pass-through entities, and sole proprietorships from deducting wages, salaries, and other benefits paid or incurred on behalf of employees employed pursuant to an H-1B visa granted by U.S. Citizenship and Immigration Services for Virginia income tax purposes. This would be accomplished by requiring employers to add back such deductions claimed for federal purposes when calculating their Virginia taxable income.

This bill would be effective for taxable years beginning on or after January 1, 2016.

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

7. **Fiscal Impact Estimates are:** Not available. (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, but potentially significant, positive General Fund revenue impact, beginning in Fiscal Year 2017. Based on applications filed by employers during the federal Fiscal Year 2015, there are 19,043 H-1B workers in Virginia with an average salary of \$78,685. However, such revenue impact is unknown because of fluctuations in the number of H-1B workers from year to year. Moreover, it is unknown how many employers of H-1B workers are organizations or government entities that are exempt from Virginia income taxation.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

H1-B Visa Program

The H-1B visa program allows U.S. employers to hire nonimmigrant aliens as workers in specialty occupations. A specialty occupation is one that requires the application of a body of highly specialized knowledge and the attainment of at least a bachelor's degree or its equivalent. Each H-1B petition may only be approved for a maximum period of three years. Extensions are typically filed for H-1B workers intending to work beyond the initial three-year period, up to a maximum of six years.

The intent of the H-1B provisions is to help employers who cannot otherwise obtain needed business skills and abilities from the U.S. workforce by authorizing the temporary employment of qualified individuals who are not otherwise authorized to work in the United States. Based on applications filed by employers during the federal Fiscal Year 2015, H-1B visa workers were most common in the following industries: computer systems design and related services; management, scientific, and technical consulting services; colleges, universities, and professional schools; architectural, engineering, and related services; and software publishers.

Federal law establishes certain standards in order to protect similarly-employed U.S. workers from being adversely affected by the employment of the nonimmigrant workers, as well as to protect the H-1B nonimmigrant workers. Employers must attest to the Department of Labor that they will pay wages to the H-1B nonimmigrant workers that are at least equal to the actual wage paid by the employer to other workers with similar experience and qualifications for the job in question, or the prevailing wage for the occupation in the area of intended employment, whichever is greater.

Federal Deduction for Business Expenses

Taxpayers may claim a federal income tax deduction for their ordinary and necessary business expenses. This deduction is allowed in the calculation of federal adjusted gross income ("FAGI"). Business expenses are the cost of carrying on a trade or business. Such expenses include employee wages and salaries, as well as certain costs attributable to employee benefits. Common examples of employee benefits include health insurance, qualified retirement plan contributions, and group-term life insurance. Employers can generally deduct the cost of providing these benefits on their federal income tax return.

Virginia's Conformity to Federal Tax Law

The starting point for computing Virginia taxable income is FAGI. Since FAGI has already been reduced by a taxpayer's ordinary and necessary business expenses, the benefit of such deductions flows through to a taxpayer's Virginia income tax return, unless the General Assembly enacts legislation that specifically disallows part or all of such deductions.

In the case of a pass-through entity ("PTE"), the benefit of such deductions flows through to its Virginia informational tax return. However, since a PTE does not pay any income tax at the entity level, PTEs file Virginia tax returns to report their income and expenses, and they pass this information along to PTE owners. Each PTE owner then reports his share of the PTE net profit or loss on his Virginia income tax return and pays the appropriate amount of income tax. Each PTE owner's share of the PTE net profit or loss should reflect his share of any deductions taken for ordinary and necessary business expenses.

Proposed Legislation

This bill would disallow corporations, pass-through entities, and sole proprietorships from deducting wages, salaries, and other benefits paid or incurred on behalf of employees employed pursuant to an H-1B visa granted by U.S. Citizenship and Immigration Services for Virginia income tax purposes. This would be accomplished by requiring employers to add back such deductions claimed for federal purposes when calculating their Virginia taxable income.

Special rules would apply to pass-through entities. The amount added to federal adjusted gross income by the pass-through entity owners would be:

- A proportional amount based on his or its ownership share or interest in such entity or
- In accordance with a written agreement of the owners of the pass-through entity, provided that the aggregate amount of such wages, salaries, and other benefits deducted or subtracted for the taxable year in computing the net income of the pass-through entity is added back to income for the taxable year for Virginia income tax purposes.

This bill would require that the Tax Commissioner develop and make publicly available guidelines. Such guidelines would be exempt from the provisions of the Administrative Process Act.

This bill would be effective for taxable years beginning on or after January 1, 2016.

cc : Secretary of Finance

Date: 1/23/2016 JJS
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