

# DEPARTMENT OF TAXATION

## 2020 Fiscal Impact Statement

1. **Patron** Mark L. Keam

3. **Committee** House Finance

4. **Title** Virginia Affiliated Groups; Election to Change  
Corporate Filing Status

2. **Bill Number** HB 1676

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would allow an affiliated group of corporations to elect to or from the consolidated filing status if such group has filed on the same basis for at least the preceding five taxable years. Taxpayers would no longer be required to request permission from the Department of Taxation ("the Department") nor would they be required to meet certain requirements to make such changes.

Under current law, an affiliated group is required to request permission from the Department to make changes to or from the consolidated filing status. Absent extraordinary circumstances, permission to change to or from the consolidated filing method is generally not granted by the Department. In addition, Virginia law provides an exception to make such a change if the affiliated group has filed on the same basis for at least the preceding 20 taxable years and meets certain additional requirements.

This bill would be effective for taxable years beginning on or after January 1, 2020.

6. **Budget amendment necessary:** Yes.

7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

### 8. **Fiscal implications:**

#### Administrative Costs

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, negative General Fund revenue impact beginning in Fiscal Year 2021. During Taxable Year 2017, 42 percent of all Virginia corporate income tax revenues, or \$357 million out of \$859 million, was attributable to combined and consolidated returns. It is likely that a substantial portion of

this revenue would be lost as a result of this bill due to the tax planning that would be created by allowing affiliated groups to elect to change their filing status every five years.

By changing their filing status, such taxpayers could significantly modify how their income and apportionment factors are computed as frequently as every five years. Such tax planning could significantly reduce and, in certain cases eliminate, the tax liability of many corporations. In addition, some corporations that are currently members of an affiliated group but currently file separate returns would likely choose to change their filing status under this bill. This could reduce the remaining \$502 million in corporate income tax revenues generated by such filers under current law.

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

Department of Taxation

## **10. Technical amendment necessary:** Yes. Because permission would no longer be required for an affiliated group to switch their filing status, the Department would not receive advanced notice regarding whether an election to switch filing status has been made by an affiliated group. Therefore, this may result in return processing issues for the electing affiliated group. To ensure that the Department is notified of such election, the following technical amendment is recommended:

Line 49 after least the preceding five years.

Insert: A taxpayer shall provide notification to the Department of Taxation that an election pursuant to this subsection is being made. Such notification shall be submitted on forms as prescribed by the Department of Taxation.

## **11. Other comments:**

### Federal Corporate Tax Filings

For federal income tax purposes, an affiliated group of corporations has the option of filing a consolidated return in lieu of separate returns for each corporation. If a consolidated return is filed, the affiliated group members are treated as one entity and their financial activities are combined for purposes of computing their federal income tax liability. A corporation generally meets the federal requirements for affiliation if it possesses at least 80 percent of the total voting power and at least 80 percent of the total value of a corporation's stock.

### Virginia Corporate Tax Filings

Virginia is a separate return state. As a result, Virginia allows each corporation with nexus with the state the ability to elect to file a separate Virginia return, regardless of its federal tax filings. In addition, Virginia allows corporations that are members of an affiliated group of corporations with Virginia nexus the ability to elect to file on a consolidated or Virginia combined basis. All returns for subsequent years are required to be filed on the same basis unless permission to change is granted by the Department. If a new corporation

becomes a member of an affiliated group, the new corporation must follow the filing method previously elected by the group.

The table below provides information regarding the usage of each filing status based upon preliminary Taxable Year 2017 data:

<b>Taxable Year 2017</b>	<b>Number of Taxpayers</b>	<b>Percentage of All Returns</b>	<b>Income Tax Paid</b>	<b>Percentage of Total Income Tax Paid</b>
Separate Returns	65,236	96%	\$502 million	58%
Consolidated Returns	1,937	3%	\$211 million	25%
VA Combined Returns	447	1%	\$146 million	17%
<b>All Returns</b>	<b>67,620</b>	<b>100%</b>	<b>\$859 million</b>	<b>100%</b>

#### Virginia Affiliated Group Filing Methods

If an affiliated group of corporations elects to file separately, each corporation in the affiliated group that has nexus in Virginia is required to file its own separate corporate income tax return and report only its income, expenses, gains, losses, and allocation and apportionment factors on such return. This type of reporting follows the separate entity concept, in which each corporation in an affiliated group is treated as distinct and separate from the other corporations in such group for purposes of determining each corporation's corporate income tax liability.

A consolidated return includes the aggregate income, expenses, gains, and losses, allocation and apportionment factors of all of the corporations in an affiliated group that have nexus with Virginia. The corporate income tax liability of the affiliated group is computed in the aggregate, and the entire affiliated group files one corporate income tax return.

In a Virginia combined return, each corporation in an affiliated group that has nexus with Virginia determines its income, expenses, gains, losses, and allocation and apportionment factors separately. Each corporation then separately computes its individual corporate income tax liability. The final corporate income tax liability, after apportionment, of each corporation is then combined and included on one corporate income tax return.

#### Changing Corporate Filing Status

The Department has the statutory authority to grant or deny requests by corporations to change their Virginia tax filing status. Because switching to or from the consolidated filing status affects the allocation and apportionment formulas and may distort the business done in Virginia and the income arising from activity in Virginia, the Department generally will grant permission to change to or from a consolidated filing status only in extraordinary circumstances. In contrast, separate and Virginia combined returns do not affect the allocation and apportionment formulas for each corporation. Therefore, permission to change from separate to Virginia combined returns or from Virginia combined to separate returns is generally granted.

During the 2003 Session, the General Assembly enacted legislation that effectively provided an exception to the Department's general rule against switching to or from the consolidated filing status. This legislation provided that an affiliated group that has filed on the same basis for at least the preceding 20 years is allowed to change the basis of the type of return filed from consolidated to separate or from separate or combined to consolidated if:

- The tax computed under the affiliated group's requested return basis would be equal or greater than the tax for the full taxable year immediately preceding the taxable year for which the requested return basis would be applicable; and
- The affiliated group agrees to compute its tax liability under both the requested return basis and the elected return basis and would be liable for the greater of the two amounts for the taxable year in which the requested basis is effective and the immediately succeeding taxable year.

### Other States

Of the jurisdictions that impose a corporate income tax, twenty-seven states and the District of Columbia have enacted mandatory unitary combined reporting. In these states, taxpayers are generally required to file a return with all of their affiliates with which they have a unitary relationship. This differs from Virginia combined reporting, which is based solely on affiliated corporations with Virginia nexus. They are not given the option to file a separate return for each corporation in the affiliated group.

The remaining 15 states are separate return states like Virginia. Seven of these states (Delaware, Louisiana, Maryland, Mississippi, Pennsylvania, South Carolina, and Tennessee) do not offer taxpayers the option to file on a consolidated basis. The remaining eight separate return states (Arkansas, Florida, Georgia, Indiana, Iowa, Missouri, North Carolina, and Oklahoma) allow taxpayers to file on a consolidated basis under certain circumstances. All of the separate return states that allow consolidated filing require taxpayers to apply for permission from a state tax agency before they can change their filing method. These states impose varying restrictions on granting such permission.

From preliminary research completed by the Department, Virginia's restrictions on switching filing status are generally similar in nature to those imposed by other states.

### Proposed Legislation

This bill would allow an affiliated group of corporations to elect to or from the consolidated filing status if such group has filed on the same basis for at least the preceding five taxable years. Taxpayers would no longer be required to request permission from the Department nor would they be required to meet certain requirements to make such changes.

Under current law, an affiliated group is required to request permission from the Department to make changes to or from the consolidated filing status. Permission to make

such a change is only granted if the affiliated group has filed on the same basis for at least the preceding 20 taxable years and meets certain additional requirements.

This bill would be effective for taxable years beginning on or after January 1, 2020.

#### Similar Bills

**Senate Bill 1058** is substantially similar to this bill.

**House Bill 739** and **Senate Bill 756** would generally replace Virginia's three elective filing statuses with one mandatory filing status, unitary combined reporting.

**House Bill 1109** would generally replace Virginia's three elective filing statuses with one mandatory filing status, unitary combined reporting, and would require corporations to file a public disclosure report with the Department with certain data related to their state taxes.

cc : Secretary of Finance

Date: 1/28/2020 JJS  
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