

# DEPARTMENT OF TAXATION

## 2020 Fiscal Impact Statement

1. **Patron** Richard C. Sullivan, Jr.

2. **Bill Number** HB 1716

3. **Committee** House Finance

**House of Origin:**

           **Introduced**

  X   **Substitute**

           **Engrossed**

4. **Title** Individual and Corporate Income Tax;  
Increase the Business Interest Deduction

**Second House:**

           **In Committee**

           **Substitute**

           **Enrolled**

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

The Department of Taxation ("the Department") understands that the Patron intends on offering a substitute for this bill. This fiscal impact statement is based on the substitute.

This bill would increase Virginia's individual and corporate income tax deduction for the amount of business interest that is disallowed as a deduction for federal income tax purposes from 20 percent of such amount to 35 percent.

This bill would be effective for taxable years beginning on and after January 1, 2021.

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

Item(s): Page 1, Revenue Estimates

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

#### 7b. **Revenue Impact:**

<i><b>Fiscal Year</b></i>	<i><b>Dollars</b></i>	<i><b>Fund</b></i>
2020-21	(\$6.7 million)	GF
2021-22	(\$14.8 million)	GF
2022-23	(\$15.8 million)	GF
2023-24	(\$16.4 million)	GF
2024-25	(\$16.9 million)	GF
2025-26	(\$17.6 million)	GF

### 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 estimated negative General Fund revenue impact of \$6.7 million in Fiscal Year 2021; \$14.8 million in Fiscal Year 2022; \$15.8 million in Fiscal Year 2023; \$16.4 million in Fiscal Year 2024, \$16.9 million in Fiscal Year 2025 and \$17.6 million in Fiscal Year 2026. This bill would increase the existing Virginia deduction from 20 percent of the amount of business interest that is disallowed as a deduction for federal income tax purposes to 35 percent of such amount.

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

Department of Taxation

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

### **11. Other comments:**

#### Current Law

For federal income tax purposes, a taxpayer may claim a deduction for interest paid or accrued on certain debts related to its trade or business. Prior to the enactment of the federal Tax Cuts and Jobs Act (“the TCJA”) this deduction was limited for certain types of interest if the taxpayer’s debt-to-equity ratio exceeded 1.5 to 1.0 and the taxpayer’s net interest expense exceeded 50 percent of the taxpayer’s adjusted taxable income.

On December 22, 2017 Congress enacted the TCJA, which imposed limitations on the deductibility of business interest. Therefore, this deduction is generally limited to the sum of business interest income, 30 percent of adjusted taxable income, and floor plan financing interest (“the business interest limitation”). Any business interest that is disallowed because of this business interest limitation is treated as business interest paid or accrued in the following taxable year, and may be carried forward indefinitely, subject to certain restrictions.

The business interest limitation does not apply to certain taxpayers including small businesses that have annual gross receipts for the three-taxable-year period ending with the prior taxable year equal to or less than \$25 million. In addition, real property and farming businesses may opt out of the new limitation if they use the alternative depreciation system to depreciate certain property used in their businesses.

During the 2019 Session, the General Assembly enacted legislation conforming to the federal business interest limitation. In addition, the legislation allowed a state-specific deduction beginning with Taxable Year 2018 to individuals and corporations subject to the federal business interest limitation. The state-specific deduction is equal to 20 percent of the amount of business interest that is disallowed as a deduction under the business interest limitation. The effect of this state-specific deduction is to accelerate a taxpayer’s ability to claim their business interest for Virginia income tax purposes by allowing a larger aggregate deduction during the year in which interest expense is paid or accrued than is allowed on the federal return. However, in future taxable years, taxpayers are required to reconcile this acceleration on their Virginia income tax returns.

## Other States

The majority of states conform to the federal business interest limitation. Eight states (Connecticut, Georgia, Indiana, Mississippi, Missouri, South Carolina, Tennessee, and Wisconsin) have enacted legislation expressly deconforming from the federal business interest limitation. Arkansas and California do not generally conform to the current version of the IRC. As a result, these two states also deconform from the federal business interest limitation.

## Proposed Legislation

This bill would increase Virginia's individual and corporate income tax deduction for the amount of business interest that is disallowed as a deduction for federal income tax purposes from 20 percent of such amount to 35 percent.

This bill would be effective for taxable years beginning on and after January 1, 2021.

cc : Secretary of Finance

Date: 1/28/2020 JJS  
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