VIRGINIA ACTS OF ASSEMBLY — CHAPTER

An Act to amend and reenact §§ 58.1-332, 58.1-390.1, and 58.1-390.2 of the Code of Virginia and to amend the Code of Virginia by adding a section numbered 58.1-390.3, relating to income taxation; pass-through entities.

[H 1121]

Approved

Be it enacted by the General Assembly of Virginia:

1. That §§ 58.1-332, 58.1-390.1, and 58.1-390.2 of the Code of Virginia are amended and reenacted and that the Code of Virginia is amended by adding a section numbered 58.1-390.3 as follows:

§ 58.1-332. Credits for taxes paid other states.

A. Whenever a Virginia resident has become liable to another state for income tax on any earned or business income or any gain on the sale of a capital asset (within the meaning of § 1221 of the Internal Revenue Code), not including an asset used in a trade or business, to the extent that such gain is included in federal adjusted gross income, for the taxable year, derived from sources outside the Commonwealth and subject to taxation under this chapter, the amount of such tax payable by him shall, upon proof of such payment, be credited on the taxpayer's return with the income tax so paid to the other state.

However, no franchise tax, license tax, excise tax, unincorporated business tax, occupation tax or any tax characterized as such by the taxing jurisdiction, although applied to earned or business income, shall qualify for a credit under this section, nor shall any tax which, if characterized as an income tax or a commuter tax, would be illegal and unauthorized under such other state's controlling or enabling legislation qualify for a credit under this section.

The credit allowable under this section shall not exceed: (i) such proportion of the income tax otherwise payable by him under this chapter as his income upon which the tax imposed by the other state was computed bears to his Virginia taxable income upon which the tax imposed by this Commonwealth was computed or (ii) the income tax otherwise payable under this chapter in the event that the income upon which the tax imposed by the other state is computed is less than the Virginia taxable income upon which the tax imposed by this Commonwealth is computed and all income derived from sources outside the Commonwealth and subject to taxation under this chapter is earned income or business income reported on federal form Schedule C from a single state contiguous to Virginia. The credit provided for by this section shall not be granted to a resident individual when the laws of another state, under which the income in question is subject to tax assessment, provide a credit to such resident individual substantially similar to that granted by subsection B of this section.

B. Whenever a nonresident individual of this Commonwealth has become liable to the state where he resides for income tax upon his Virginia taxable income for the taxable year, derived from Virginia sources and subject to taxation under this chapter, the amount of such tax payable under this chapter shall be credited with such proportion of the tax so payable by him to the state where he resides, upon proof of such payment, as his income subject to taxation under this chapter bears to his entire income upon which the tax so payable to such other state was imposed. The credit, however, shall be allowed only if the laws of such state: (i) grant a substantially similar credit to residents of Virginia subject to income tax under such laws or (ii) impose a tax upon the income of its residents derived from Virginia sources and exempt from taxation the income of residents of this Commonwealth. No credit shall be allowed against the amount of the tax on any income taxable under this chapter which is exempt from taxation under the laws of such other state.

C. *1.* For purposes of this section, the amount of any state income tax paid by an electing small business corporation (S corporation) shall be deemed to have been paid by its individual shareholders in proportion to their ownership of the stock of such corporation.

2. For taxable years beginning on and after January 1, 2021, but before January 1, 2026, for purposes of this section, the amount of any state income tax paid by a pass-through entity under a law of another state substantially similar to § 58.1-390.3 shall be deemed to have been paid by its individual owners in proportion to their ownership.

§ 58.1-390.1. Definitions.

The following words and terms, when used in this article, shall have the following meanings unless the context clearly indicates otherwise:

"Owner" means any individual or entity who is treated as a partner, member, or shareholder of a pass-through entity for federal income tax purposes.

"Pass-through entity" means any entity, including a limited partnership, a limited liability partnership, a general partnership, a limited liability company, a professional limited liability company, a business trust, or a Subchapter S corporation, that is recognized as a separate entity for federal income tax purposes, in which the partners, members, or shareholders report their share of the income, gains, losses, deductions, and credits from the entity on their federal income tax returns *or make the election and pay the tax levied pursuant to § 58.1-390.3*.

"Qualifying pass-through entity" means a pass-through entity that is 100 percent owned by natural persons or, in the case of a Subchapter S corporation, 100 percent owned by natural persons or other persons eligible to be shareholders in an S corporation.

§ 58.1-390.2. Taxation of pass-through entities.

Except as provided for in this article, owners of pass-through entities shall be liable for tax under this chapter only in their separate or individual capacities on income passed through to the owners of pass-through entities. Any taxes imposed on the pass-through entity itself, ~~such as, but not limited to,~~ *including the tax levied pursuant to § 58.1-390.3,* sales and use taxes, withholding taxes with respect to employees or nonresident owners, and minimum taxes in lieu of income taxes, shall be paid by the pass-through entity.

§ 58.1-390.3. Elective income tax on pass-through entities.

A. 1. For taxable years beginning on and after January 1, 2021, but before January 1, 2022, a qualifying pass-through entity may make an election, in a format and according to such requirements and procedures to be established by the Department, to pay the tax levied by this section at the entity level for the taxable year. Such election shall be made on or before a date to be determined by the Department, which shall be set no earlier than one year after the extended due date for filing the applicable return. Notwithstanding §§ 58.1-1812 and 58.1-1833, no interest shall accrue on underpayments or overpayments solely attributable to such election.

2. For taxable years beginning on and after January 1, 2022, but before January 1, 2026, a qualifying pass-through entity may make an annual election, on its timely filed return pursuant to § 58.1-392, to pay the tax levied by this section at the entity level for the taxable period covered by such return. Such election shall be made on or before the due date for filing the applicable return, including any extensions that have been granted.

B. A tax at the rate of 5.75 percent is hereby annually imposed on the Virginia taxable income, as calculated pursuant to § 58.1-391, for each taxable year of every qualifying pass-through entity that makes the election provided under subsection A.

C. A qualifying pass-through entity that elects to pay the tax levied by subsection B shall be eligible for all credits, deductions, or other adjustments to taxable income under § 58.1-391, provided that a qualifying pass-through entity's taxable income shall be adjusted to eliminate any federal deduction for state and local income taxes.

D. Any person that is subject to the tax imposed under § 58.1-320 or 58.1-360 and is an owner of a qualifying pass-through entity making the election pursuant to this section shall be entitled to a credit against the tax imposed, provided that taxable income has been adjusted to add back any deduction for state and local income taxes paid by the qualifying pass-through entity. Such credit shall be in an amount equal to such person's pro rata share of the tax paid under this section by any qualifying pass-through entity of which such person is an owner. If the amount of the credit allowed pursuant to this subsection exceeds such person's tax liability for the tax imposed under § 58.1-320 or 58.1-360, as applicable, such excess shall be treated as an overpayment and refundable pursuant to § 58.1-499.

E. If any qualifying pass-through entity makes an election pursuant to this section, the Department shall assess and collect tax, interest, and penalties as if such tax is a corporate income tax imposed pursuant to the provisions of Article 10 (§ 58.1- 400 et seq.).

F. The Department shall develop and make publicly available guidelines implementing the provisions of this section and the credit authorized by subdivision C 2 of § 58.1-332.