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SENATE BILL NO. 692

AMENDMENT IN THE NATURE OF A SUBSTITUTE

(Proposed by the Senate Committee on Finance and Appropriations
on February 8, 2022)

(Patron Prior to Substitute—Senator Petersen)

A BILL to amend and reenact §§ 58.1-322.02, 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.

Be it enacted by the General Assembly of Virginia:

1. That §§ 58.1-322.02, 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:

§ 58.1-322.02. Virginia taxable income; subtractions.

In computing Virginia taxable income pursuant to § 58.1-322, to the extent included in federal adjusted gross income, there shall be subtracted:

1. Income derived from obligations, or on the sale or exchange of obligations, of the United States and on obligations or securities of any authority, commission, or instrumentality of the United States to the extent exempt from state income taxes under the laws of the United States, including, but not limited to, stocks, bonds, treasury bills, and treasury notes but not including interest on refunds of federal taxes, interest on equipment purchase contracts, or interest on other normal business transactions.

2. Income derived from obligations, or on the sale or exchange of obligations, of the Commonwealth or of any political subdivision or instrumentality of the Commonwealth.

3. Benefits received under Title II of the Social Security Act and other benefits subject to federal income taxation solely pursuant to § 86 of the Internal Revenue Code.

4. Up to \$20,000 of disability income, as defined in § 22(c)(2)(B)(iii) of the Internal Revenue Code; however, any person who claims a deduction under subdivision 5 of § 58.1-322.03 may not also claim a subtraction under this subdivision.

5. The amount of any refund or credit for overpayment of income taxes imposed by the Commonwealth or any other taxing jurisdiction.

6. The amount of wages or salaries eligible for the federal Work Opportunity Credit which was not deducted for federal purposes on account of the provisions of § 280C(a) of the Internal Revenue Code.

7. Any amount included therein less than \$600 from a prize awarded by the Virginia Lottery.

8. The wages or salaries received by any person for active and inactive service in the National Guard of the Commonwealth of Virginia, not to exceed the amount of income derived from 39 calendar days of such service or \$3,000, whichever amount is less; however, only those persons in the ranks of O3 and below shall be entitled to the deductions specified in this subdivision.

9. Amounts received by an individual, not to exceed \$1,000 for taxable years beginning on or before December 31, 2019, and \$5,000 for taxable years beginning on or after January 1, 2020, as a reward for information provided to a law-enforcement official or agency, or to a nonprofit corporation created exclusively to assist such law-enforcement official or agency, in the apprehension and conviction of perpetrators of crimes. This subdivision shall not apply to the following: an individual who is an employee of, or under contract with, a law-enforcement agency, a victim or the perpetrator of the crime for which the reward was paid, or any person who is compensated for the investigation of crimes or accidents.

10. The amount of "qualified research expenses" or "basic research expenses" eligible for deduction for federal purposes, but which were not deducted, on account of the provisions of § 280C(c) of the Internal Revenue Code and which shall be available to partners, shareholders of S corporations, and members of limited liability companies to the extent and in the same manner as other deductions may pass through to such partners, shareholders, and members.

11. Any income received during the taxable year derived from a qualified pension, profit-sharing, or stock bonus plan as described by § 401 of the Internal Revenue Code, an individual retirement account or annuity established under § 408 of the Internal Revenue Code, a deferred compensation plan as defined by § 457 of the Internal Revenue Code, or any federal government retirement program, the contributions to which were deductible from the taxpayer's federal adjusted gross income, but only to the extent the contributions to such plan or program were subject to taxation under the income tax in another state.

12. Any income attributable to a distribution of benefits or a refund from a prepaid tuition contract or savings trust account with the Virginia College Savings Plan, created pursuant to Chapter 7 (§ 23.1-700 et seq.) of Title 23.1. The subtraction for any income attributable to a refund shall be

60 limited to income attributable to a refund in the event of a beneficiary's death, disability, or receipt of a
61 scholarship.

62 13. All military pay and allowances, to the extent included in federal adjusted gross income and not
63 otherwise subtracted, deducted, or exempted under this section, earned by military personnel while
64 serving by order of the President of the United States with the consent of Congress in a combat zone or
65 qualified hazardous duty area that is treated as a combat zone for federal tax purposes pursuant to § 112
66 of the Internal Revenue Code.

67 14. For taxable years beginning before January 1, 2015, the gain derived from the sale or exchange
68 of real property or the sale or exchange of an easement to real property which results in the real
69 property or the easement thereto being devoted to open-space use, as that term is defined in § 58.1-3230,
70 for a period of time not less than 30 years. To the extent that a subtraction is taken in accordance with
71 this subdivision, no tax credit under this chapter for donating land for its preservation shall be allowed
72 for three years following the year in which the subtraction is taken.

73 15. Fifteen thousand dollars of military basic pay for military service personnel on extended active
74 duty for periods in excess of 90 days; however, the subtraction amount shall be reduced dollar-for-dollar
75 by the amount by which the taxpayer's military basic pay exceeds \$15,000 and shall be reduced to zero
76 if such military basic pay amount is equal to or exceeds \$30,000.

77 16. The first \$15,000 of salary for each federal and state employee whose total annual salary from all
78 employment for the taxable year is \$15,000 or less.

79 17. Unemployment benefits taxable pursuant to § 85 of the Internal Revenue Code.

80 18. Any amount received as military retirement income by an individual awarded the Congressional
81 Medal of Honor.

82 19. Items of income attributable to, derived from, or in any way related to (i) assets stolen from,
83 hidden from, or otherwise lost by an individual who was a victim or target of Nazi persecution or (ii)
84 damages, reparations, or other consideration received by a victim or target of Nazi persecution to
85 compensate such individual for performing labor against his will under the threat of death, during World
86 War II and its prelude and direct aftermath. This subtraction shall not apply to assets acquired with such
87 items of income or with the proceeds from the sale of assets stolen from, hidden from, or otherwise lost
88 to, during World War II and its prelude and direct aftermath, a victim or target of Nazi persecution. The
89 provisions of this subdivision shall only apply to an individual who was the first recipient of such items
90 of income and who was a victim or target of Nazi persecution, or a spouse, surviving spouse, or child
91 or stepchild of such victim.

92 As used in this subdivision:

93 "Nazi regime" means the country of Nazi Germany, areas occupied by Nazi Germany, those
94 European countries allied with Nazi Germany, or any other neutral European country or area in Europe
95 under the influence or threat of Nazi invasion.

96 "Victim or target of Nazi persecution" means any individual persecuted or targeted for persecution by
97 the Nazi regime who had assets stolen from, hidden from, or otherwise lost as a result of any act or
98 omission in any way relating to (i) the Holocaust, (ii) World War II and its prelude and direct aftermath,
99 (iii) transactions with or actions of the Nazi regime, (iv) treatment of refugees fleeing Nazi persecution,
100 or (v) the holding of such assets by entities or persons in the Swiss Confederation during World War II
101 and its prelude and aftermath. A "victim or target of Nazi persecution" also includes any individual
102 forced into labor against his will, under the threat of death, during World War II and its prelude and
103 direct aftermath.

104 20. The military death gratuity payment made after September 11, 2001, to the survivor of deceased
105 military personnel killed in the line of duty, pursuant to 10 U.S.C. Chapter 75; however, the subtraction
106 amount shall be reduced dollar-for-dollar by the amount that the survivor may exclude from his federal
107 gross income in accordance with § 134 of the Internal Revenue Code.

108 21. The death benefit payments from an annuity contract that are received by a beneficiary of such
109 contract, provided that (i) the death benefit payment is made pursuant to an annuity contract with an
110 insurance company and (ii) the death benefit payment is paid solely by lump sum. The subtraction under
111 this subdivision shall be allowed only for that portion of the death benefit payment that is included in
112 federal adjusted gross income.

113 22. Any gain recognized from the sale of launch services to space flight participants, as defined in
114 49 U.S.C. § 70102, or launch services intended to provide individuals with the training or experience of
115 a launch, without performing an actual launch. To qualify for a deduction under this subdivision, launch
116 services must be performed in Virginia or originate from an airport or spaceport in Virginia.

117 23. Any gain recognized as a result of resupply services contracts for delivering payload, as defined
118 in 49 U.S.C. § 70102, entered into with the Commercial Orbital Transportation Services division of the
119 National Aeronautics and Space Administration or other space flight entity, as defined in § 8.01-227.8,
120 and launched from an airport or spaceport in Virginia.

121 24. Any income taxed as a long-term capital gain for federal income tax purposes, or any income

taxed as investment services partnership interest income (otherwise known as investment partnership carried interest income) for federal income tax purposes. To qualify for a subtraction under this subdivision, such income shall be attributable to an investment in a "qualified business," as defined in § 58.1-339.4, or in any other technology business approved by the Secretary of Administration, provided that the business has its principal office or facility in the Commonwealth and less than \$3 million in annual revenues in the fiscal year prior to the investment. To qualify for a subtraction under this subdivision, the investment shall be made between the dates of April 1, 2010, and June 30, 2020. No taxpayer who has claimed a tax credit for an investment in a "qualified business" under § 58.1-339.4 shall be eligible for the subtraction under this subdivision for an investment in the same business.

25. For taxable years beginning on and after January 1, 2014, any income of an account holder for the taxable year taxed as (i) a capital gain for federal income tax purposes attributable to such person's first-time home buyer savings account established pursuant to Chapter 12 (§ 36-171 et seq.) of Title 36 and (ii) interest income or other income for federal income tax purposes attributable to such person's first-time home buyer savings account.

Notwithstanding the statute of limitations on assessments contained in § 58.1-312, any subtraction taken under this subdivision shall be subject to recapture in the taxable year or years in which moneys or funds withdrawn from the first-time home buyer savings account were used for any purpose other than the payment of eligible costs by or on behalf of a qualified beneficiary, as provided under § 36-174. The amount subject to recapture shall be a portion of the amount withdrawn in the taxable year that was used for other than the payment of eligible costs, computed by multiplying the amount withdrawn and used for other than the payment of eligible costs by the ratio of the aggregate earnings in the account at the time of the withdrawal to the total balance in the account at such time.

However, recapture shall not apply to the extent of moneys or funds withdrawn that were (i) withdrawn by reason of the qualified beneficiary's death or disability; (ii) a disbursement of assets of the account pursuant to a filing for protection under the United States Bankruptcy Code, 11 U.S.C. §§ 101 through 1330; or (iii) transferred from an account established pursuant to Chapter 12 (§ 36-171 et seq.) of Title 36 into another account established pursuant to such chapter for the benefit of another qualified beneficiary.

For purposes of this subdivision, "account holder," "eligible costs," "first-time home buyer savings account," and "qualified beneficiary" mean the same as those terms are defined in § 36-171.

26. For taxable years beginning on and after January 1, 2015, any income for the taxable year attributable to the discharge of a student loan solely by reason of the student's death. For purposes of this subdivision, "student loan" means the same as that term is defined under § 108(f) of the Internal Revenue Code.

27. a. Income, including investment services partnership interest income (otherwise known as investment partnership carried interest income), attributable to an investment in a Virginia venture capital account. To qualify for a subtraction under this subdivision, the investment shall be made on or after January 1, 2018, but before December 31, 2023. No subtraction shall be allowed under this subdivision for an investment in a company that is owned or operated by a family member or an affiliate of the taxpayer. No subtraction shall be allowed under this subdivision for a taxpayer who has claimed a subtraction under subdivision 24 or a tax credit under § 58.1-339.4 for the same investment.

b. As used in this subdivision 27:

"Qualified portfolio company" means a company that (i) has its principal place of business in the Commonwealth; (ii) has a primary purpose of production, sale, research, or development of a product or service other than the management or investment of capital; and (iii) provides equity in the company to the Virginia venture capital account in exchange for a capital investment. "Qualified portfolio company" does not include a company that is an individual or sole proprietorship.

"Virginia venture capital account" means an investment fund that has been certified by the Department as a Virginia venture capital account. In order to be certified as a Virginia venture capital account, the operator of the investment fund shall register the investment fund with the Department prior to December 31, 2023, (i) indicating that it intends to invest at least 50 percent of the capital committed to its fund in qualified portfolio companies and (ii) providing documentation that it employs at least one investor who has at least four years of professional experience in venture capital investment or substantially equivalent experience. "Substantially equivalent experience" includes, but is not limited to, an undergraduate degree from an accredited college or university in economics, finance, or a similar field of study. The Department may require an investment fund to provide documentation of the investor's training, education, or experience as deemed necessary by the Department to determine substantial equivalency. If the Department determines that the investment fund employs at least one investor with the experience set forth herein, the Department shall certify the investment fund as a Virginia venture capital account at such time as the investment fund actually invests at least 50 percent of the capital committed to its fund in qualified portfolio companies.

28. a. Income attributable to an investment in a Virginia real estate investment trust. To qualify for a subtraction under this subdivision, the investment shall be made on or after January 1, 2019, but before December 31, 2024. No subtraction shall be allowed for an investment in a trust that is managed by a family member or an affiliate of the taxpayer. No subtraction shall be allowed under this subdivision for a taxpayer who has claimed a subtraction under subdivision 24 or 27 or a tax credit under § 58.1-339.4 for the same investment.

b. As used in this subdivision 28:

"Distressed" means satisfying the criteria applicable to a locality described in subdivision E 2 of § 2.2-115.

"Double distressed" means satisfying the criteria applicable to a locality described in subdivision E 3 of § 2.2-115.

"Virginia real estate investment trust" means a real estate investment trust, as defined in 26 U.S.C. § 856, that has been certified by the Department as a Virginia real estate investment trust. In order to be certified as a Virginia real estate investment trust, the trustee shall register the trust with the Department prior to December 31, 2024, indicating that it intends to invest at least 90 percent of trust funds in Virginia and at least 40 percent of trust funds in real estate in localities that are distressed or double distressed. If the Department determines that the trust satisfies the preceding criteria, the Department shall certify the trust as a Virginia real estate investment trust at such time as the trust actually invests at least 90 percent of trust funds in Virginia and at least 40 percent of trust funds in real estate in localities that are distressed or double distressed.

29. For taxable years beginning on and after January 1, 2019, any gain recognized from the taking of real property by condemnation proceedings.

30. For taxable years beginning on and after January 1, 2020, but before January 1, 2021, up to \$100,000 of all grant funds received by the taxpayer under the Rebuild Virginia program established by the Governor and administered by the Department of Small Business and Supplier Diversity.

31. For taxable years beginning on and after January 1, 2022, but before January 1, 2026, any amount of income derived from a pass-through entity having Virginia taxable income, as determined under § 58.1-391, if such pass-through entity makes the election authorized, and pays the tax imposed, by § 58.1-390.3.

§ 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 other individuals 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. 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 pass-through entity that elects to pay the tax levied by this subsection shall be eligible for all credits, deductions, or other adjustments to taxable income provided under § 58.1-391.

D. If a pass-through entity makes an election pursuant to this section and an individual owner taxpayer of such pass-through entity claims the subtraction provided by subsection 31 of § 58.1-322.02, such individual owner taxpayer shall not be eligible to claim any other deduction, subtraction, credit, or other adjustment for any amount of taxable income derived from the pass-through entity having Virginia taxable income.

E. The Department of Taxation shall develop and make publicly available guidelines implementing the provisions of this section, the subtraction authorized by subsection 31 of § 58.1-322.02, and the credit authorized by subdivision C 2 of § 58.1-332.