

DEPARTMENT OF TAXATION

2023 Fiscal Impact Statement

1. **Patron** Joseph P. McNamara

3. **Committee** Passed House and Senate

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

2. **Bill Number** HB 1405

House of Origin:

 Introduced

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 X **Enrolled**

5. **Summary/Purpose:**

This bill would amend the requirements for an affiliated group to elect to change its corporate income tax filing status by removing the condition that its tax liability for the previous tax year not be decreased by such a change in filing status. This bill would retain all other current requirements regarding changing an affiliated group's filing status.

If enacted during the regular session of the 2023 General Assembly, this bill would become effective July 1, 2023. As a result, this bill would apply to applications filed with the Department on or after July 1, 2023.

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

7. **Fiscal Impact Estimates are:** Unknown. (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 negative General Fund revenue impact beginning as early as Fiscal Year 2024. It is anticipated that only those affiliated groups that expect to reduce their overall Virginia income tax liability in the initial years after the two-year transition period would choose to make the filing status change that would be allowed under this bill. However, the extent to which corporate groups would make a filing status change under this bill and the resulting revenue impact is unknown.

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, an affiliated group of corporations electing to file a consolidated return is treated as one entity combining their financial activities for the purpose of computing their federal income tax liability.

For Virginia income tax purposes, each corporation with nexus with the state has 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 nexus in Virginia the ability to elect to file on a consolidated basis similar to the federal consolidated return or to file on a 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.

Generally, the Department does not grant permission to change to or from the consolidated filing status. However, Virginia law allows an affiliated group that has filed on the same basis for at least the preceding 12 years 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 ("prior year test"); 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 ("greater of the two rule").

The table below reflects data regarding corporate tax filing methods for Taxable Year 2020:

Corporate Return Filing Method	Number of Returns	Percentage of Returns	Income Tax Liability (in millions)	Percentage of Total Income Tax Liability
Separate Returns	66,092	96%	\$652	56%
Consolidated Returns	2,155	3%	\$266	23%
Combined Returns	492	1%	\$242	21%
All Returns	68,739	100%	\$1,160	100%

Proposed Legislation

This bill would amend the requirements for an affiliated group to elect to change its corporate income tax filing status by removing the condition that its tax liability for the previous tax year not be decreased by such a change in filing status, namely the prior year test.

This bill would retain the other current requirements, including the requirement that the electing affiliated group has filed on the same basis for preceding 12 years and the greater of the two rule.

If enacted during the regular session of the 2023 General Assembly, this bill would become effective July 1, 2023. As a result, this bill would apply to applications filed with the Department on or after July 1, 2023.

Similar Legislation

Senate Bill 796 is identical to this bill.

cc : Secretary of Finance

Date: 2/16/2023 RWC
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