DEPARTMENT OF TAXATION
2023 Fiscal Impact Statement

1. **Patron** Roxann L. Robinson

2. **Bill Number** HB 1595
   House of Origin:
   _____ **Introduced**
   _____ **Substitute**
   _____ **Engrossed**

   Second House:
   X **In Committee**
   _____ **Substitute**
   _____ **Enrolled**

3. **Committee** Senate Finance and Appropriations

4. **Title** Commonwealth's Tax System; Conformity with Federal Law, Emergency

5. **Summary/Purpose:**

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from December 31, 2021 to December 31, 2022. This would allow Virginia to conform to the Inflation Reduction Act ("IRA") of 2022, as well as the tax-related provisions contained in the Consolidated Appropriations Act ("CAA") of 2023.

This bill would also clarify that the deduction for qualified educator expenses and the Beneficial Hardwood Management Practices Tax Credit would become effective upon passage of this bill, which would allow such tax benefits to be claimed on 2022 Virginia income tax returns without processing delays.

Because many taxpayers will be preparing their 2022 Virginia returns while the General Assembly is in session, **this bill contains an emergency clause** which states that it would be in force from its passage.

This is a Department of Taxation bill.

6. **Budget amendment necessary:** Yes.
   Item(s): Page 1, Revenue Estimates

7. **Fiscal Impact Estimates are:** Preliminary. (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 overall estimated negative General Fund revenue impact of $0.21 million in Fiscal Year 2023 and a positive General Fund revenue impact of $23.4 million in

Fiscal Year 2024, $28.6 million in Fiscal Year 2025, $37.3 million in Fiscal Year 2026, $40.0 million in Fiscal Year 2027, $34.9 million in Fiscal Year 2028, and $31.6 million in Fiscal Year 2029. The Introduced Executive Budget assumes a reduction in revenues attributable to the provisions of the Inflation Reduction Act of $0.21 million in Fiscal Year 2023 and $0.30 million in Fiscal Year 2024. Because the budget bill was introduced prior to passage of the CAA, it does not yet reflect the estimated impact of conformity to the CAA provisions. Accordingly, this bill would allow the Introduced Executive Budget to be adjusted to reflect a positive General Fund revenue impact of $23.7 million in Fiscal Year 2024 to reflect conformity to the CAA.

The portion of this bill associated with conforming to IRA is assumed in the Introduced Executive Budget and results in the following revenue impact (amounts in millions):

	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
TOTAL (IRA)	**($0.2)**	**($0.3)**	**($0.2)**	**($0.2)**	**($0.3)**	**($0.5)**	**($0.8)**

The General Fund revenue impact of this bill is attributable to conforming to the following Secure 2.0 provisions of the CAA of 2023 (amounts in millions):

Secure 2.0 Provisions of CAA	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Retirement Provisions	$17.2	$23.8	$33.2	$37.3	$32.9	$29.7
Conservation Easement Provision	$6.4	$5.0	$4.3	$3.0	$2.6	$2.7
TOTAL (CAA)	**$23.7**	**$28.8**	**$37.5**	**$40.3**	**$35.5**	**$32.4**

The provision clarifying the effective date for the deduction for qualified educator expenses and the Beneficial Hardwood Management Practices Tax Credit would not have a General Fund revenue impact as both tax preferences are assumed in both the 2022 Appropriation Act (Chapter 2, 2022 Acts of Assembly, Special Session I) and the Introduced Executive Budget to have an impact in Fiscal Year 2023 when Taxable Year 2022 returns are filed.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Virginia's date of conformity to the IRC is currently fixed to the IRC as it existed on December 31, 2021. Virginia law currently deconforms from the following IRC provisions:

- **Bonus depreciation allowed for certain assets under federal income taxation.** Taxpayers who claim bonus depreciation on their federal returns upon purchasing an asset are required to make adjustments on their Virginia returns for the taxable year in which they purchased such asset and in each subsequent year until the asset has been fully depreciated for federal and Virginia purposes.

- **The five-year carry-back of net operating losses ("NOLs") generated in certain taxable years**. Although no longer available, taxpayers who benefited from the use of a five-year carry-back on their federal returns for losses generated during 2008 and 2009 are required to make adjustments on their Virginia returns for the taxable year in which such losses were generated and in each subsequent year until all such losses have been fully utilized for both federal and Virginia purposes.

- **Tax deductions related to the application of the applicable high yield debt obligation rules**. Although no longer available, taxpayers who benefited from the suspension of the application of the applicable high yield debt obligation rules for certain debts issued between September 30, 2008 and December 31, 2009 on their federal returns, are required to make adjustments on their Virginia returns for the taxable year in which they claimed a deduction and in each subsequent year until such deductions are fully claimed for both federal and Virginia purposes.

- **Tax exclusions related to cancellation of debt income**. Although no longer available, taxpayers who benefited from a deferral of income realized upon the reacquisition of certain business debt during 2009 and 2010 on their federal returns are required to make adjustments on their Virginia returns for the taxable year in which they deferred such income and in each subsequent year until such income is fully reported for both federal and Virginia purposes. However, for transactions completed on or before April 21, 2010, taxpayers were permitted to partially defer such income by reporting the income over three taxable years.

- **Suspension of the federal overall limitation on itemized deductions**. During the 2019 Session, Virginia deconformed from the federal suspension of the overall limitation on itemized deductions (the "Pease Limitation"). This has the effect of reinstating the Pease Limitation for Virginia income tax purposes only beginning with Taxable Year 2019.

- **The reduction in the medical expense deduction floor.** During the 2021 session, Virginia permanently deconformed from the reduction in the adjusted gross income limitation on the medical expense deduction from 10 percent to 7.5 percent. Previously, Virginia deconformed from this provisions for Taxable Years 2017, 2019, and 2020.

- **Certain business provisions of the federal CARES Act**. During the 2021 session, Virginia deconformed from several provisions of the CARES Act that effectively suspended certain provisions of the TCJA temporarily. Specifically, these provisions suspended certain net operating loss ("NOL") limitations for Taxable Years 2018, 2019, and 2020; suspended the excess business loss limitation for Taxable Year 2018, 2019, and 2020; and increased the business interest limitation for Taxable Year 2019 and 2020.

- **The deduction of business expenses through certain COVID-related small business assistance programs prior to Taxable Year 2021.** During the 2021 Session, the General Assembly enacted legislation that partially deconformed from the full federal deductibility of business expenses funded by forgiven Paycheck Protection Program ("PPP") loan proceeds. During the 2022 Session, the General Assembly enacted legislation fully conforming to the federal deductibility of business expenses funded by forgiven PPP loan proceeds and Economic Injury Disaster Loan program funds.

Inflation Reduction Act of 2022

On August 16, 2022, the Inflation Reduction Act of 2022 (H.R.5376) was signed into law. This federal legislation included three provisions that impact Virginia taxpayers. These provisions accomplished the following:

- **Enhancements to the Energy Efficient Commercial Building Deduction**: Prior to the enactment of the IRA, taxpayers were eligible to receive a deduction for up to $1.88 per square foot when making efficiency improvements above certain energy thresholds to commercial buildings. The IRA enhanced this deduction by increasing the value of the deduction to $5 per square foot, expanding what projects qualify for the deduction, and allowing a deduction be taken on a specific commercial building every 3 years.

- **Cost Recovery for Qualified Property and Energy Storage Technology**: Under current federal law, certain specified categories of property known as "5-year property" can be depreciated and deducted over a shorter 5-year period, rather than over the useful life of the property, which is often 20 years or more. The IRA adds three categories of property to the 5-year property classification, effective for property placed in service after December 31, 2024.

- **Extension of the Limit on Excess Business Losses:** The IRA extends an existing federal provision that limits excess business losses of noncorporate taxpayers by two years, which was previously set to expire on January 1, 2027.

Secure 2.0 Provisions of the CAA of 2023

On December 29, 2022, the Consolidated Appropriations Act ("CAA") of 2023 (H.R.2617) was signed into law. This federal legislation contained approximately 100 provisions amending the rules governing the federal treatment of retirement accounts and addressing charitable conservation easements. These provisions are collectively known as Secure 2.0 provisions. A vast majority of the provisions in Secure 2.0 are intended to either increase the number of employers offering retirement plans to their employees, increase the amounts contributed to retirement plans, or permit greater access to retirement funds without penalty. Of the approximately 100 retirement provisions, there are several that would have a substantial impact on Virginia taxpayers. These provisions include:

- Option to treat employer matching or non-elective contributions as Roth contributions;

- Option for employers to offer pension-linked emergency savings accounts that are generally treated as Roth IRAs that benefit from tax exempt treatment;
- Exclusion of certain disability-related first responder retirement payments;
- Treatment of student loan payments as elective deferrals for purposes of matching contributions, which will allow employees with student debt to benefit from employer retirement contributions even if they are unable to make contributions themselves;
- Elective deferrals generally limited to regular contribution limitations; and,
- One-time election to enhance qualified charitable contribution distributions.

Effective Date of Tax Preferences for Educators and Certain Hardwood Practices

During the 2022 Special Session, the General Assembly enacted legislation to create two new tax benefits, an individual income tax deduction for qualified educator expenses and an individual income tax credit for beneficial hardwood management practices. All laws enacted during a special session of the General Assembly generally (excluding general appropriations acts, decennial reapportionment acts, and emergency acts) take effect on the first day of the fourth month following the month of adjournment of the special session, unless a subsequent date is specified. Because the 2022 Special Session did not fully adjourn, it is unclear when these bills would become effective. Such effective date would likely be after most Virginia individual income taxpayers are required to file their income tax returns. As a result, under current law, the Department may be required to hold 2022 Virginia income tax returns to the extent that such tax benefits are claimed, delaying taxpayer refunds until such legislation becomes effective.

Proposed Legislation

This bill would advance Virginia's date of conformity to the IRC from December 31, 2021 to December 31, 2022. This would allow Virginia to conform to IRA as well as the CAA of 2023, including the Secure 2.0 provisions.

This bill would also clarify that the deduction for qualified educator expenses and the Beneficial Hardwood Management Practices Tax Credit would become effective upon passage of this bill, which would allow such tax benefits to be claimed on 2022 Virginia income tax returns without processing delays.

Because many taxpayers will be preparing their 2022 Virginia returns while the General Assembly is in session, **this bill contains an emergency clause** which states that it would be in force from its passage.

Similar Legislation

Senate Bill 882 is identical to this bill, except that it does not contain the provision specifying the effective dates for the deduction for qualified educator expenses and the Beneficial Hardwood Management Practices Tax Credit.

cc : Secretary of Finance

Date: 1/23/2023 RWC
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