DEPARTMENT OF TAXATION
2023 Fiscal Impact Statement

1. **Patron** Joseph P. McNamara

2. **Bill Number** HB 2193
   House of Origin:
   X **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

   Second House:
   ____ **In Committee**
   ____ **Substitute**
   ____ **Enrolled**

3. **Committee** House Finance

4. **Title** Income tax; rolling conformity; report

5. **Summary/Purpose:**

   This bill would conform Virginia to the Internal Revenue Code ("IRC") on a rolling basis. This would allow Virginia to conform to federal tax changes to the IRC as soon as they are enacted by Congress. This would also allow Virginia to conform to the Inflation Reduction Act ("IRA") and the Consolidated Appropriations Act of 2023 ("CAA").

   This bill would deconform Virginia from any amendment enacted on or after January 1, 2023 that would increase or decrease General Fund revenues by more than $50 million in the fiscal year in which the amendment was enacted or any of the succeeding four fiscal years. This deconformity would not apply to any federal tax changes that the General Assembly subsequently adopts or a federal tax extender as defined under the bill.

   The Secretary of Finance would be required to provide an annual report on the fiscal impact of amendments to the Internal Revenue Code occurring since the adjournment sine die of the prior year's regular session of the General Assembly to the Chairmen of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance.

   If this bill is enacted during the 2023 Regular Session of the General Assembly, the portion that would conform Virginia to the IRC on a rolling basis would become effective July 1, 2023. The portion of this bill that would deconform from federal legislation based on the projected revenue impact would be effective for any amendment enacted on or after January 1, 2023.

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 unknown General Fund revenue impact beginning in Fiscal Year 2024. It is unknown to what extent Congress will enact changes to the IRC that would impact Virginia income tax returns in the future. Such changes may result in a positive or negative revenue impact on their own or when aggregated with other changes that may occur during a particular year. In addition, Congress often enacts changes to the IRC that apply retroactively to taxable years that have already occurred. The continuation of this practice would increase any revenue impacts from future changes to the IRC.

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, the Introduced Executive Budget 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**

These estimates assume that the General Assembly will also adopt legislation with an emergency clause to conform to the tax provisions enacted by Congress during 2022. If such legislation does not pass, the timing of the revenue estimates above would differ because taxpayers may not be entitled to claim certain provisions on their returns during the Taxable Year 2022 filing season.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

<u>Virginia's History with Rolling and Fixed Date Conformity</u>

Prior to 1971, the Virginia Constitution did not allow provisions incorporated into Virginia law if they could be subsequently revised without approval of the General Assembly. The new constitution adopted in 1971 included a provision allowing incorporation of the IRC "as those laws may be or become effective." From 1972 until 2002, Virginia relied on the new constitutional provision to automatically conform to any Congressional changes in the definition of income. As a result, Virginia was a rolling conformity state during that period.

The Job Creation and Worker Assistance Act of 2002 ("JCWAA") substantially reduced Virginia taxable income of businesses by creating a new depreciation deduction and modifying the carryback period for net operating loss deductions. The 2002 Appropriation Act included a provision temporarily fixing the date of conformity to the IRC as of December 31, 2001. In 2003, the General Assembly adopted fixed date conformity by adopting the IRC as it existed on December 31, 2002 and specifically excepting the depreciation/NOL provisions modified by JCWAA. Since 2002, Virginia has been a fixed date conformity state. Annual conformity bills have generally advanced the date of fixed conformity and revised the list of exceptions as needed.

<u>Virginia's Current Conformity to Federal Income Tax Law</u>

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 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.

- **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.

- **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.** 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. 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.

<u>Proposed Legislation</u>

This bill would conform Virginia to the IRC on a rolling basis. This bill would also allow Virginia to conform to federal tax changes to the IRC as soon as they are enacted by Congress.

This bill would deconform Virginia from any amendment enacted by Congress on or after January 1, 2023 that would increase or decrease General Fund revenues by more than $50 million in the fiscal year in which the amendment was enacted or any of the succeeding four fiscal years.

This deconformity would not apply to any amendment that the General Assembly subsequently adopts or a federal tax extender, as defined under the bill. For purposes of this bill, "amendment" would be defined as a single amendment to the Internal Revenue Code or a group of such amendments enacted in the same act of Congress that collectively surpass the threshold impact. “Federal tax extender” would be defined as an amendment to federal tax law which extends the expiration date of a federal tax provision to which Virginia conforms or has previously conformed. The Secretary of Finance, in consultation with the Chairmen of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance, would be responsible for determining whether any amendment to the Internal Revenue Code meets the criteria above.

The Secretary of Finance would be required to provide an annual report on the fiscal impact of amendments to the IRC occurring since the adjournment of the prior year's regular session of the General Assembly to the Chairmen of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance. The report would be required to be presented no later than November 15 prior to the regular session of the General Assembly. The Secretary of Finance would also be required to provide updates to the same chairmen on any further amendments to the IRC occurring between submission of the required report and the first day of the subsequent regular session of the General Assembly.

If this bill is enacted during the 2023 Regular Session of the General Assembly, the portion that would conform Virginia to the IRC on a rolling basis would become effective July 1, 2023. The portion of this bill that would deconform from federal legislation based on the projected revenue impact would be effective for amendments enacted by Congress on or after January 1, 2023.

<u>Similar Legislation</u>

Senate Bill 1405 is identical to this bill except it would index the $50 million threshold beginning January 1, 2024.

House Bill 1595 and **Senate Bill 882** would advance Virginia’s date of conformity from December 31, 2021 to December 31, 2022.

cc : Secretary of Finance

Date: 1/29/2023 JLOF
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