

DEPARTMENT OF TAXATION

2022 Fiscal Impact Statement

1. **Patron** Vivian E. Watts

3. **Committee** House Finance

4. **Title** Income Tax; Deduction for Certain
Disallowed Business Interest

2. **Bill Number** HB 352

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would increase the Virginia individual and corporate income tax deduction for business interest from 20 percent to 50 percent of the business interest disallowed as a deduction under the business interest limitation. In addition, this bill would increase the deduction from 20 percent to 100 percent of the business interest disallowed as a deduction under the business interest limitation for certain taxpayers that file federally as part of a consolidated group that is not subject to a business interest limitation on its consolidated return for the taxable year.

This bill would be effective for taxable years beginning on and after January 1, 2022.

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 significant negative General Fund revenue impact beginning in Fiscal Year 2023. The portion of the bill that would increase the deduction percentage from 20 percent to 50 percent would result in a negative General Fund revenue impact of \$45.9 million in Fiscal Year 2023, \$32.8 million in Fiscal Year 2024, \$33.8 million in Fiscal Year 2025, \$35.3 million in Fiscal Year 2026, \$36.7 million in Fiscal Year 2027, and \$38.2 million in Fiscal Year 2028.

The portion of this bill that would increase the deduction from 20 percent to 100 percent for certain taxpayers that file federally as part of a consolidated group would have an unknown negative revenue impact. The Department estimates that, if Virginia were to allow a 100 percent deduction for all taxpayers, it would have an estimated negative General Fund revenue impact of \$122.3 million in Fiscal Year 2023, \$87.4 million in Fiscal Year 2024; \$90.2 million in Fiscal Year 2025; \$94.0 million in Fiscal Year 2026; \$97.8 million in Fiscal Year 2027; and \$101.8 million in Fiscal Year 2028. However, the 100 percent deduction allowed under this bill would only be available to certain taxpayers that meet specified criteria. It is uncertain to what extent taxpayers would meet such criteria and qualify for the deduction that this bill would provide.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Business Interest Limitation

Tax Cuts and Jobs Act's Creation of the Limitation

On December 22, 2017, the federal Tax Cuts and Jobs Act ("the TCJA") was signed into law. This federal tax reform legislation substantially changed the federal income taxation of individuals and businesses. One of the provisions that impacted certain businesses was a limitation on the deductibility of business interest. Under the TCJA, the deduction of business interest is generally limited to the sum of business interest income, 30 percent of adjusted taxable income, and floor plan financing interest ("the business interest limitation"). Any business interest that is disallowed because of this business interest limitation is treated as business interest paid or accrued in the following taxable year, and may be carried forward indefinitely, subject to certain restrictions.

The business interest limitation does not apply to certain taxpayers including small businesses that have annual gross receipts for the three-taxable-year period ending with the prior taxable year equal to or less than \$25 million. In addition, real property and farming businesses may opt out of the new limitation if they use the alternative depreciation system to depreciate certain property used in their businesses.

Virginia's Conformity to the Limitation and Allowance of a Deduction

During the 2019 Session, the General Assembly enacted legislation generally conforming to the TCJA, including the federal business interest limitation. In addition, the legislation allowed a state-specific deduction beginning with Taxable Year 2018 to individuals and corporations subject to the federal business interest limitation. The state-specific deduction is equal to 20 percent of the amount of business interest that is disallowed as a deduction under the business interest limitation. The effect of this state-specific deduction is to accelerate a taxpayer's ability to claim their business interest for Virginia income tax purposes by allowing a larger aggregate deduction during the year in which interest

expense is paid or accrued than is allowed on the federal return. However, in future taxable years, taxpayers are required to reconcile this acceleration on their Virginia income tax returns.

Virginia's Deconformity from CARES Act's Suspension of the Limitation

On March 27, 2020, Congress enacted the Coronavirus Aid, Relief, and Economic Security ("CARES") Act (H.R.748). The CARES Act temporarily and retroactively increased the business interest limitation from 30 percent to 50 percent for Taxable Years 2019 and 2020. During the 2021 Session, the General Assembly enacted legislation generally conforming to the CARES Act but deconforming this provision. As a result, the business interest limitation for Virginia purposes remained at 30 percent for Taxable Years 2019 and 2020, the level set by the TCJA.

2021 Unitary Combined Reporting Work Group

During the 2021 Special Session I, House Joint Resolution Number 563 was passed, which directed the Division of Legislative Services, in conjunction with the Department, to establish a Work Group to assess the feasibility of transitioning to unitary combined reporting for corporate income tax purposes in Virginia. Such resolution also required the Work Group to submit a summary report with its findings and recommendations to the General Assembly.

One of the recommendations of the Work Group was that Virginia should consider easing the business interest limitation. However, the Work Group also determined that there is a need to understand the exact revenue impacts involved with easing of such limitation.

Proposed Legislation

This bill would increase the Virginia individual and corporate income tax deduction for business interest from 20 percent to 50 percent of the business interest disallowed as a deduction under the business interest limitation. This bill would also increase the deduction from 20 percent to 100 percent for any taxpayer that:

- Has filed either:
 - A separate return; or
 - As part of a Virginia combined return; and
- Is a part of a federal consolidated group that is not subject to a business interest limitation on its federal consolidated return for the taxable year.

This bill would be effective for taxable years beginning on and after January 1, 2022.

Similar Legislation

House Bill 1006 would increase the Virginia individual and corporate income tax deduction for business interest from 20 percent to 100 percent of the business interest disallowed as a deduction under the business interest limitation.

Senate Bill 288 would increase the Virginia individual and corporate income tax deduction for business interest from 20 percent to 60 percent of the business interest disallowed as a deduction under the business interest limitation.

cc : Secretary of Finance

Date: 1/27/2022 JJS
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