



TAX BULLETIN 10-4
Virginia Department of Taxation
March 30, 2010

IMPORTANT INFORMATION REGARDING
2009 VIRGINIA INCOME TAX RETURNS

VIRGINIA INCOME TAX FIXED-DATE CONFORMITY
ADVANCED TO JANUARY 22, 2010

Under legislation passed by the 2010 General Assembly and now before the Governor (House Bills 29 and 30), Virginia's fixed-date of conformity to the terms of the Internal Revenue Code will advance from December 31, 2008, to January 22, 2010. This notice is intended to provide taxpayers with directions on how to reconcile this legislation on their 2009 Virginia income tax returns. Additional information regarding 2010 Virginia income tax returns will be available at a later date.

Changes Affecting Taxable Year 2009

Effective for taxable years beginning on and after January 1, 2009, Virginia's fixed-date of conformity to the terms of the Internal Revenue Code will advance from December 31, 2008, to January 22, 2010, with limited exceptions. Virginia will continue to disallow any 5-year carry-back of net operating losses ("NOL") allowed for NOLs generated in either taxable year 2008 or 2009. The additional exceptions include the following:

Bonus Depreciation

Virginia will continue to disallow any bonus depreciation allowed for certain assets under Internal Revenue Code ("IRC") § 168(k). The fixed-date conformity will not include any bonus depreciation that is allowed under IRC §§ 168(l), 168(m), 1400L, and 1400N. These sections allow bonus depreciations in limited circumstances and were designed to benefit the following:

- Cellulosic biofuel plant property – IRC § 168(l);
- Reuse and recycling property – IRC § 168(m);

- New York Liberty Zone property – IRC § 1400L; and
- Gulf Opportunity Zone property – IRC § 1400N.

Virginia' fixed-date conformity will allow any bonus depreciation that is allowed under IRC § 168(n), which is designed to benefit qualified disaster assistance property.

When reporting any adjustments related to bonus depreciation, the adjustments for all of the categories of bonus depreciation should be grouped together on the applicable line of the taxpayer's income tax return.

American Recovery and Reinvestment Act Provisions

Virginia will conform to most provisions of the American Recovery and Reinvestment Act for taxable year 2009, including the increase in the federal earned income tax credit, the itemized deduction for sales taxes on a new car, the equalization of transit and parking benefits and the expensing of certain depreciable business assets.

Virginia will disallow the income tax deductions related to applicable high yield discount obligations under IRC § 163(e)(5)(F). The American Recovery and Reinvestment Act ("ARRA") established a provision that suspends the application of the applicable high yield debt obligation (AHYDO) rules for certain debts issued after September 30, 2008, and before January 1, 2010. Virginia will not conform to this federal tax provision.

Cancellation of Debt Income

Virginia will disallow the income tax exclusions related to cancellation of debt income realized in connection with a reacquisition of business debt at a discount after December 31, 2008, and before January 1, 2011. Under IRC § 108(i), the income realized upon the reacquisition of certain business debt during 2009 and 2010 may be deferred and reported in taxable years 2014 through 2018.

For Virginia income tax purposes, a partial deferral of some of these exclusions will be allowed for specified debt reacquired in taxable year 2009. Taxpayers that incur cancellation of debt income from transactions in 2009 will be able to elect to report the addition required by conformity in equal amounts over three taxable years: 2009, 2010 and 2011.

VIRGINIA INCOME TAX

For approximately thirty years, Virginia conformed to federal income tax law. Whenever federal income tax law changed, the changes automatically affected Virginia income taxes, unless otherwise exempted. In 2003, Virginia began a period of fixed conformity, moving the date each year. In 2009, a provision was enacted that fixed Virginia's conformity to Internal Revenue Code terminology to the Internal Revenue Code as it existed on December 31, 2008. Because of changes in federal law since that date,

some taxpayers would have had to make adjustments to their federal adjusted gross income or federal taxable income through the fixed-date conformity adjustments on the 2009 income tax return. This bulletin will instruct taxpayers about which fixed-date conformity adjustments are still necessary for their 2009 income tax returns, if applicable.

Impact of Federal Legislation on 2009 Virginia Income Tax Returns

By advancing Virginia's date of conformity to January 22, 2010, Virginia conforms to two significant measures enacted by Congress since December 31, 2008, which affect income taxation in Virginia:

- The American Recovery and Reinvestment Act of 2009, which provides a variety of monetary provisions for states and localities to help improve the economy and tax relief for individuals and families.
- Legislation Providing Immediate Tax Deductions for Haiti Charitable Contributions

Special Instructions for Taxpayers

Taxpayers Who Have Not Yet Filed

All Taxpayers

For Virginia income tax purposes, a partial deferral of some of the income tax deductions related to cancellation of debt income realized in connection with a reacquisition of business debt at a discount will be allowed for specified debt reacquired in taxable year 2009. Taxpayers that incur cancellation of debt income from transactions in 2009 will be able to elect to report the addition required by conformity in equal amounts over three taxable years: 2009, 2010 and 2011.

For individuals, this addition should be entered on Line 33 of Part II on the Form 760PY (part-year residents), on Line 31 of Part I on the Form 763 (nonresidents), or as Code 13 on the Schedule ADJ (residents). For corporations, this addition should be entered as Code 15 on the Schedule 500 ADJ. Finally, this addition should be entered on Line 3 of Schedule 3 of the Form 770 for fiduciaries or as Code 17 on the Schedule 502 ADJ for pass-through entities.

Individuals

Individuals who have a special, fixed-date conformity adjustment for bonus depreciation are still required to make the corresponding adjustments described on Pages 17 through 19 of the Instructions for Form 760. In addition, if the federal bonus depreciation has an effect on any other item included in federal adjusted gross income, an adjustment must still be made as either an addition (refer to Line B of Page 18) or as a subtraction (refer to Line B of Page 19) on Form 760. Individuals who are required to

make a fixed-date conformity adjustment and who also itemize deductions should use the worksheet provided on Page 12 of the Form 760 Instructions to determine if the fixed-date conformity adjustments require any modification to allowable itemized deductions. The worksheet should not be filed with the Virginia return.

Part-Year or Nonresident Individuals

For individuals who must file either a Form 760PY Part-Year Resident Individual Income Tax Return or a Form 763 Nonresident Individual Income Tax Return, the changes explained for individuals apply. The corresponding fixed-date conformity instructions for part year residents are located on Pages 13 and 14 of the Form 760PY Instructions. The corresponding fixed-date conformity instructions for nonresidents are located on Pages 11 and 14 of the Form 763 Instructions.

Corporations

Corporations that have not yet filed their income tax returns should make special, fixed-date conformity adjustments relating to the bonus depreciation. Adjustments relating to the bonus depreciation are entered on Line 1 of Section A and Line 1 of Section B on the Schedule 500 ADJ and explained on Page 6 of the Form 500 Instructions. In addition, if the federal bonus depreciation has an effect on any other item included in federal taxable income, an adjustment is still required to be made as either an addition on Line 2 of Section A or as a subtraction on Line 2 of Section B of Schedule 500 ADJ.

Pass-Through Entities and Fiduciaries

For pass-through entities filing Form 502, adjustments relating to the bonus depreciation are described on Pages 7 and 8 of the Form 502 Instructions. The adjustments relating to bonus depreciation are entered on Lines 8 and 14 of Form 502. In addition, if the federal bonus depreciation has an effect on any other item included in federal taxable income, an adjustment is still required to be made as either an addition on Line 9 or a subtraction on Line 15 of Form 502.

Fiduciaries that have a special, fixed-date conformity adjustment for bonus depreciation are still required to make the corresponding adjustments that are described on Page 7 of the Instructions for Form 770. In addition, if the federal bonus depreciation has an effect on any other item included in federal taxable income, an adjustment is still required to be made as either an addition (refer to Line 3b of Page 8 of the 770 Instructions) or as a subtraction (refer to Line 8b of Page 9 of the 770 Instructions).

Treatment of the 5-Year Net Operating Loss Carryback

The treatment of any 5 year net operating loss carryback is not affected by the legislation advancing Virginia's conformity date. All taxpayers should follow the

instructions given in Virginia Tax Bulletin 03-1 (2/18/2003) regarding any necessary adjustment for a 5 year net operating loss carryback.

Taxpayers Who Have Already Filed

All Taxpayers

For Virginia income tax purposes, a partial deferral of some of the income tax deductions related to cancellation of debt income realized in connection with a reacquisition of business debt at a discount will be allowed for specified debt reacquired in taxable year 2009. Taxpayers that incur cancellation of debt income from transactions in 2009 will be able to elect to report the addition required by conformity in equal amounts over three taxable years: 2009, 2010 and 2011.

If taxpayers having this type of deduction have already filed the 2009 Virginia income tax return without this addition, an amended 2009 return must now be filed. In doing so, for individuals, this addition should be entered on Line 33 of Part II on the Form 760PY (part-year residents), on Line 31 of Part I on the Form 763 (nonresidents), or as Code 13 on the Schedule ADJ (residents). For corporations, this addition should be entered as Code 15 on the Schedule 500 ADJ. Finally, this addition should be entered on Line 3 of Schedule 3 of the Form 770 for fiduciaries or as Code 17 on the Schedule 502 ADJ for pass-through entities.

Individuals

Individuals who have already filed a 2009 individual income tax return with a fixed-date conformity adjustment that is not now required should file an amended 2009 Virginia individual income tax return. Amended individual income tax returns are filed using the 2009 Form 760 by filling in the oval at the top of Page 1 to indicate that the return is an amended return. Taxpayers should fill out the form completely and disregard those fixed-date conformity additions and subtractions explained above. Also, any taxpayer filing an amended return should follow the special instructions for amended returns on Page 3 of the Form 760 Instructions.

Part-Year or Nonresident Individuals

For nonresidents, instructions for filing an amended return are found on Page 3 of the Form 763 Instructions. Instructions for part-year residents filing an amended return are found on Page 4 of the Form 760PY Instructions.

Corporations

Corporations that have already filed a 2009 corporation income tax return with a fixed-date conformity adjustment that is not now required should file an amended 2009 Virginia corporation income tax return. For Form 500 filers, amended returns are filed

by completing the Amended Return Section on Page 1 of Form 500 and Schedule 500ADJ, Section C. Taxpayers should fill out the form completely as if it were the original return and recompute the proper fixed-date conformity adjustments explained above.

Pass-Through Entities and Fiduciaries

For pass-through entities filing Form 502, amended returns are filed using the Form 502 by checking the amended return box located on Page 1. Taxpayers should fill out the form completely as if it were the original return and recompute the proper fixed-date conformity adjustments explained above.

Fiduciaries that have already filed a 2009 individual income tax return with a fixed-date conformity adjustment that is not now required should file an amended 2009 Virginia fiduciary income tax return. Amended fiduciary income tax returns are filed using the 2009 Form 770 by checking the amended return box located on Page 1. Taxpayers should fill out the form completely as if it were the original return and recompute the proper fixed-date conformity adjustments. Also, any taxpayer filing an amended return should follow the special instructions for amended returns on Page 2 of the Form 770 Instructions.

Changes Affecting 2010 Virginia Income Tax Returns

More information will be provided at a later date giving more detailed instructions regarding the changes affecting 2010 Virginia income tax returns.

If you have additional questions, please visit our website at <http://www.tax.virginia.gov>, or contact us at (804) 367-8031 for individual income tax questions or (804) 367-8037 for corporate income tax questions.