TAX BULLETIN 19-1

Virginia Department of Taxation

February 15, 2019

IMPORTANT INFORMATION REGARDING 2018 VIRGINIA INCOME TAX RETURNS

VIRGINIA'S CONFORMITY TO THE INTERNAL REVENUE CODE ADVANCED TO DECEMBER 31, 2018

Under emergency legislation enacted by the 2019 General Assembly (House Bill 2529 and Senate Bill 1372), Virginia's date of conformity to the terms of the Internal Revenue Code will advance from February 9, 2018 to December 31, 2018. This bulletin is intended to provide taxpayers with directions on how to reconcile this legislation with their 2018 Virginia income tax returns.

Virginia's Conformity Legislation

During the 2019 General Assembly Session, legislation was enacted to advance Virginia's date of conformity to the Internal Revenue Code from February 9, 2018 to December 31, 2018. This legislation allows Virginia to generally conform to the Tax Cuts and Jobs Act and the Bipartisan Budget Act of 2018 for Taxable Year 2018 and after. This legislation also includes Virginia income tax law changes that may affect business taxpayers filing income tax returns for Taxable Year 2018 and thereafter. This bulletin explains the adjustments that may be necessary on Taxable Year 2018 income tax returns to address conformity and the Virginia tax law changes affecting businesses.

In addition, this legislation provides a refund of up to $110 for an individual or $220 for married persons filing a joint return. In order to receive a refund, taxpayers need to file a complete return for Taxable Year 2018 before July 1, 2019. A refund is allowed up to the amount of a taxpayer's tax liability after the application of any deductions, subtractions, or credits to which the individual or married persons are otherwise entitled. Such refunds are required to be issued on or after October 1, 2019, but before October 15, 2019.

This legislation also includes Virginia income tax law changes that may affect individual taxpayers filing income tax returns for Taxable Year 2019 and thereafter. The Department will publish additional guidance regarding such provisions in the future.

Federal Tax Cuts and Jobs Act

On December 22, 2017, Congress enacted Public Law 115-97, known as the "Tax Cuts and Jobs Act" ("the TCJA"), which substantially changed the federal income taxation of individuals and businesses. Virginia will generally conform to the individual income tax provisions of this federal legislation for Taxable Year 2018, including the following:

- Expanding the charitable contribution deduction;
- Imposing a $10,000 annual limitation on the state and local tax deduction;
- Limiting the home mortgage interest deduction;
- Repealing the deduction for all home equity loan interest expenses;
- Repealing certain miscellaneous deductions subject to a 2% floor, such as the deduction for unreimbursed employee expenses and the deduction for tax preparation fees; and
- Repealing the deduction for casualty losses other than for losses incurred in a federally-declared disaster area.

For Taxable Year 2017, Virginia deconformed from the provision of the TCJA that temporarily increased the amount of the medical expense deduction. As a result, certain individual income taxpayers were required to report an addition. For Taxable Year 2018, Virginia will fully conform to such provision, and no such addition will be required.

Virginia will also generally conform to the provisions of the TCJA that affect businesses for Taxable Year 2018 and thereafter, including the following:

- Expanding IRC § 179 small business expensing;
- Expanding the universe of taxpayers that can use the cash method of accounting;
- Imposing an 80% of taxable income limitation on the net operating loss deduction, generally repealing the ability to carry back losses, and providing the ability to indefinitely carry forward losses; and
- Repealing the IRC § 199 domestic production activities deduction.

Corporate Income Tax Subtraction for Global Intangible Low-Taxed Income

Under the TCJA, U.S. shareholders of controlled foreign corporations must include in gross income their pro rata share of Global Intangible Low-Taxed Income ("GILTI"). GILTI is income earned by a foreign corporation that exceeds a 10% rate of return on its tangible assets and that is not already taxed by the United States in the current year.

Virginia's existing subtraction for Subpart F income (*Va. Code* § 58.1-402(C)(7)) is expanded to allow a corporate income tax subtraction for Taxable Year 2018 and after for amounts included in federal taxable income by the operation of IRC § 951A related to GILTI. This subtraction applies only to the extent included in and not otherwise subtracted from federal taxable income. Therefore, taxpayers may report a subtraction equal to the net inclusion of GILTI after taking into account the offset of any deduction under IRC § 250 or any other section of the Internal Revenue Code.

Deduction for Certain Disallowed Business Interest

For federal income tax purposes, a taxpayer may claim a deduction for interest paid or accrued on certain debts related to its trade or business. Prior to the enactment of the TCJA, this deduction was limited for certain types of interest if the taxpayer's debt-to-equity ratio exceeded 1.5 to 1.0 and the taxpayer's net interest expense exceeded 50% of the taxpayer's adjusted taxable income. Under the TCJA, this deduction is generally limited to the sum of business interest income, 30% of adjusted taxable income, and floor plan financing interest. 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.

For Taxable Year 2018 and thereafter, Virginia will conform to this federal business interest limitation. In addition, Virginia will allow an individual or corporate income tax deduction equal to 20% of the amount of business interest that is disallowed as a deduction pursuant to the business interest limitation.

Existing Exceptions to Conformity for Taxable Year 2018

Virginia will continue to deconform from the following provisions of federal tax law:

- Bonus depreciation allowed for certain assets under federal income taxation;
- Five-year carry back of certain net operating losses ("NOLs") generated in Taxable Years 2008 and 2009;
- Tax exclusions related to cancellation of debt income; and
- Tax deductions related to the application of the applicable high yield debt obligation rules.

Virginia's deconformity from these provisions is explained in Tax Bulletin 17-1.

Instructions for Taxpayers

Taxpayers should consult the instructions for the appropriate 2018 Virginia income tax return for information regarding how to make adjustments related to bonus depreciation, the carry back of certain NOLs, cancellation of debt income, and applicable high yield discount obligations. Taxpayers who have already filed a 2018 Virginia income tax return but need to make an adjustment should consult the instructions for the appropriate income tax return and the

Department's website for further information about filing an amended return. If you have additional questions, please visit https://www.tax.virginia.gov, or contact the Department at 804.367.8031 for individual income tax questions or 804.367.8037 for corporate income tax questions.