

**ROLLING TAX CONFORMITY:
A BETTER OPTION
FOR VIRGINIA**

A VSCPA White Paper



EXECUTIVE SUMMARY

The Virginia Society of Certified Public Accountants (VSCPA) is the professional association of the Commonwealth’s CPAs, representing more than 13,500 members in public accounting, business and industry, government and education. The VSCPA has a longstanding position to promote certainty for Virginia taxpayers. As a follow-up to the 2018 white paper “Virginia Tax Conformity: 2018 and Beyond,” the VSCPA has developed a recommendation on rolling tax conformity for the consideration by the Virginia General Assembly and governor. The VSCPA believes adoption of rolling conformity would provide Virginia taxpayers a better ability to plan for and prepare their Virginia taxes, allow more timely updates to tax preparation software and offer potential administrative cost savings to the Commonwealth.

WHAT IS TAX CONFORMITY?

For the purposes of this discussion, the VSCPA defines tax conformity as the adoption of federal definitions of income. Conformity DOES NOT include alignment to federal tax rates, tax brackets, exemption amounts, deduction amounts or credits. Virginia sets its own tax rates, tax brackets, exemption amounts, deduction amounts and credits. To put it simply, in Virginia, conformity for individuals is the calculation of federal adjusted gross income; for businesses, it is federal taxable income.

Forty-three states and the District of Columbia (D.C.) impose an income tax on individuals, while 45 states and D.C. impose an income tax on corporations. States conform to provisions of the federal tax code primarily to reduce the compliance burden of state taxation. How much each state conforms varies significantly, but all states that impose an income tax incorporate parts of the federal code into their state taxation systems.

Three approaches to conformity exist.

Rolling conformity

Unless the state specifically elects to decouple from a provision, implementation of federal income tax changes is adopted automatically as they are enacted. Nineteen states plus D.C. use rolling conformity for individuals and 22 states plus D.C. use it for corporations.

Fixed date (or “static”) conformity.

Conformity with federal law is adopted as of a specific date. Twenty states use fixed date conformity for individuals, while 21 states use it for corporations. Virginia is among the states that uses fixed date conformity for both individuals and corporations.

Selective conformity.

For individuals, four states selectively incorporate certain federal income tax provisions and/or definitions, mainly by referencing them in their own code. Two states use their own definitions for corporations.

The starting point for calculating state income taxes varies as well. For individuals, 29 states, including Virginia and Washington, D.C., use federal adjusted gross income as the starting point, while six use federal taxable income. Six other states use state-specific definitions of income. (The remaining two states only tax interest and dividend income.)

For corporations, 16 states, including Virginia, start with federal taxable income, while 21 start with federal taxable income before net operating losses and special deductions. Three use federal taxable income before net operating losses only. The remaining eight states plus D.C. use different methods.



THE CHALLENGES OF FIXED DATE CONFORMITY IN VIRGINIA

Virginia has conformed to federal income tax law since 1972. For 30 years, its conformity to federal tax law changes was automatic, using rolling conformity. The passage of S.B. 1049 during the 2003 General Assembly session switched Virginia to fixed date conformity and decoupled from two provisions of federal law that would have had a negative impact on Virginia’s revenue.

Only one of these actions was necessary. The General Assembly could have simply decoupled on the two provisions because of their fiscal impact and otherwise continued with rolling conformity. In fact, the introduced version of S.B. 1049 did exactly that. (The language that appears in the box at right restores the language as it appeared in S.B. 1049 as introduced.) Fixed date conformity is not necessary to achieve decoupling; rather, simply including “except for” achieves this aim.

Fixed date conformity requires emergency legislation each year that retroactively rolls forward the date with which Virginia law conforms to federal law. This delay creates uncertainty for Virginia taxpayers, hinders their ability to plan during the year and leaves them unclear about their actual Virginia tax liability until after the tax year has ended. Taxpayers required to make quarterly estimated tax payments are particularly hindered by this model because their payments are due during the course of the tax year; retroactive legislation could cause them to incur penalties and interest through no fault of their own.

While making changes retroactively is not ideal, normally the General Assembly has been able to tackle conformity legislation quickly and easily, more often than not passing it unanimously. It is typically signed by the governor no later than the first week of February.

However, the passage of the Tax Cuts and Jobs Act (TCJA) in late 2017 exacerbated the issue of uncertainty for Virginia taxpayers. The tremendous complexity of the TCJA, the most significant federal tax

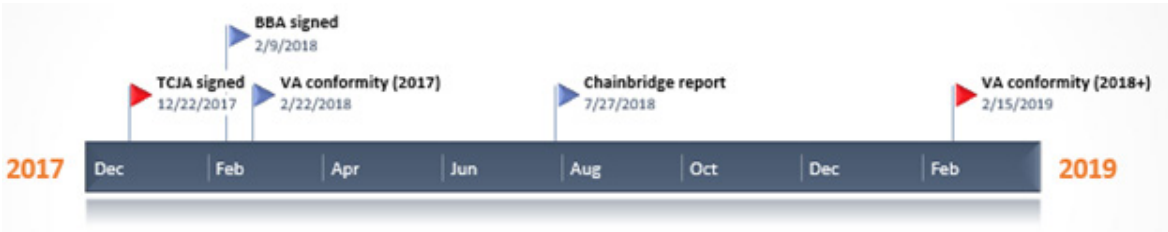
legislation since 1986, coupled with a significant fiscal impact to Virginia created a longer-than-usual delay between its passage and Virginia’s adoption.

The Virginia legislature is a part-time body, meeting for only a short time early each year unless a special session is called. The session coincides with the beginning of tax season and Virginia taxpayers and tax practitioners anxiously await the passage of conformity legislation so they can prepare and file Virginia returns. This is particularly true of Virginia’s farmers, fishermen and merchant seamen, who must file their returns by March 1 to avoid estimated tax penalties.

Most legislation passed by the General Assembly and signed by the governor has an effective date of July 1 (or later, if specified) after adjournment of the regular session of the legislature. Virginia individual income tax returns are due by May 1, making regular legislation unworkable. Instead, the bill must be passed as emergency legislation, requiring an 80 percent majority of the Assembly and taking effect immediately upon approval by the governor.

Due to the late 2017 passage of the TCJA and uncertainty about its full impact on Virginia, the 2018 General Assembly limited conformity to TCJA changes affecting 2017 returns only, with certain decoupling provisions. One of those provisions — the denial of the lowered medical expense deduction floor — created difficulties for affected taxpayers, tax preparers and tax administrators because it meant that taxpayers had to calculate deductible medical expenses twice, once for the federal return and again for the Virginia return.

This legislation did not take effect until Feb. 22, 2018, less than two weeks before the March 1 filing deadline for certain taxpayers. There was tremendous confusion, particularly since some taxpayers had already filed their returns, and because of inadvertent errors in the worksheet created to address this decoupling.



PROPOSED CHANGE IN LANGUAGE

§ 58.1-301. Conformity to Internal Revenue Code.

A. Any term used in this chapter shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required.

B. Any reference in this chapter to the laws of the United States relating to federal income taxes shall mean the provisions of the Internal Revenue Code of 1954, and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as they existed on December 31, 2018 the same may be or become effective at any time or from time to time, except for:

It was another year before legislation was passed that covered conformity for 2018 returns. There was significant uncertainty leading up to its passage, arising primarily from differing ideas about what to do with additional revenues generated by federal tax changes. The political climate, the short session and 2019 being an election year for all 140 seats in the legislature contributed to delayed passage. At one point, it appeared that emergency legislation might not pass. It is important to note that it was mostly federal policy changes, not conformity itself, that caused the increased revenues. Without policy changes, Virginia revenues would have increased significantly regardless of adoption of a new conformity date. However, failure to advance the date of conformity to adopt TCJA changes would have caused greater complexity for Virginia taxpayers — requiring up to 20 adjustments to individual returns and up to 30 for corporate returns.

The VSCPA believes that reinstating rolling tax conformity is a better option for Virginia.

ROLLING CONFORMITY IS BEST FOR VIRGINIA TAXPAYERS

Rolling conformity will provide certainty for Virginia taxpayers, tax preparers, software manufacturers and the Virginia Department of Taxation itself. Virginia currently conforms to all but a handful of federal provisions, and few of those affect the average taxpayer.

For those taxpayers and the system that supports them — tax preparation software companies, tax preparers and the Virginia Department of Taxation — rolling conformity provides certainty about how the amount of tax is determined, aiding in tax planning and reducing associated costs.

Rolling conformity would not prohibit lawmakers from enacting legislation to decouple from federal law. It is even possible to impose specific guardrails to trigger decoupling. For example, following a similar provision found in Maryland law, Virginia could include a provision whereby a fiscal impact of more than a certain amount or percentage of the budget, as confirmed by Virginia’s annual revenue, would lead to automatic decoupling from federal law after a review by the Secretary of Finance and the chairs of the House and Senate money committees unless action is taken to prevent the decoupling. If there are no federal changes, or if federal changes do not trigger automatic decoupling, no additional legislation would be required. If such a provision is included, the trigger threshold should be sufficiently high as to not defeat the purpose of having rolling conformity.

This proposal in no way restricts the actions of the Virginia General Assembly. The body could still enact emergency legislation if significant changes are needed.



VSCPA GUIDING PRINCIPLES OF VIRGINIA TAX POLICY

The VSCPA has developed guiding principles in tax policy to use as a framework when developing positions on tax-related legislative and regulatory matters. These guidelines recommend that Virginia tax laws and regulations meet the following guiding principles:

- 1. Conformity:** Whenever possible, Virginia’s tax laws should conform to federal tax laws. There should be as little delay as possible between the passage of federal tax law changes and adoption by the Commonwealth.
- 2. Simplicity:** Earliest possible conformity helps to minimize complexity in Virginia return preparation, allowing taxpayers to accurately comply with the rules in a cost-efficient manner.
- 3. Transparency:** Changes to Virginia’s tax laws should be undertaken in an inclusive and transparent manner, allowing ample time for all stakeholders to become familiar with proposed changes and provide feedback to policymakers.
- 4. Equity:** Any changes to the law should be equitable — based on the taxpayer’s ability to pay, with consideration of both horizontal and vertical equity. Horizontal equity is achieved when two similarly situated taxpayers pay the same amount. Vertical equity is achieved when taxpayers with greater ability to pay taxes pay more than taxpayers with less ability to pay.
- 5. Certainty:** Tax rules should clearly specify when and how a tax must be paid, and how the amount due is determined, which aids in tax planning and estimated tax payments.
- 6. Competitiveness:** Virginia’s economy cannot be viewed in a vacuum. Our tax structure should be designed to enhance the Commonwealth’s competitive position in the region, the country and the world. Maintaining Virginia’s AAA bond rating and rank among the best states to do business and raise children is critical to our attractiveness for businesses, individuals and investors.

CONCLUSION

Adopting rolling conformity in Virginia would create certainty in the tax system for all parties by reducing the burden on taxpayers, the legislature and tax administrators without removing the authority from the General Assembly to make amendments in the future. We urge the General Assembly and the governor to quickly adopt our proposal to the benefit of all.

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FURTHER READING

“Virginia Tax Conformity — 2018 and Beyond,” VSCPA 2018 white paper: vscpa.com/sites/default/files/resources/TaxConformityWhitepaper.pdf

VSCPA Tax Conformity Updates:
vscpa.com/tax-reform-and-tax-conformity

