TAX BULLETIN 14-1

Virginia Department of Taxation

February 20, 2014

IMPORTANT INFORMATION REGARDING 2013 VIRGINIA INCOME TAX RETURNS

Extension of Virginia's Conformity to the Federal Enhanced Earned Income Tax Credit to Taxable Years Ending Before January 1, 2018

Under emergency legislation (House Bill 1085; Chapter 1 of the 2014 Acts of Assembly and Senate Bill 288; Chapter 2 of the 2014 Acts of Assembly) passed by the 2014 General Assembly and signed by Governor McAuliffe, Virginia's conformity to the federal enhanced Earned Income Tax Credit ("EITC") was extended to taxable years ending before January 1, 2018. This notice is intended to provide taxpayers with directions on how to reconcile this legislation with their 2013 Virginia income tax returns.

Virginia Low-Income Tax Credits

Virginia's allows an individual to claim either the Tax Credit for Low-Income Individuals or a credit equal to 20 percent of the federal EITC that was claimed for the taxable year:

- The Tax Credit for Low-Income Individuals is a nonrefundable individual income tax credit equal to $300 each for the individual, the individual's spouse, and any person claimed as a dependent on such individual's or married person's income tax return for the taxable year.

- Virginia also allows a nonrefundable individual income tax credit equal to 20 percent of the federal EITC claimed by an individual for the taxable year. The credit is for any individual or married persons that are eligible for the federal EITC for the taxable year and claimed such credit.

Enhanced Federal EITC

The federal EITC is a refundable tax credit for eligible individuals who have earned income in a taxable year that is below certain threshold amounts. The amount of the federal EITC is based on the presence and number of qualifying children in the worker's family, as well as the amount of adjusted gross income and earned income.

In 2009, the American Recovery and Reinvestment Act temporarily increased the credit percentage for individuals with three or more qualifying children from 40 percent to 45 percent and reduced the EITC marriage penalty by increasing the phaseout amount for married couples.

The expanded calculation of the EITC was scheduled to sunset on December 31, 2010, reverting back to the calculation as it existed prior to Taxable Year 2009. However, the enhanced EITC provisions were extended through Taxable Year 2012 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. On January 2, 2013, Congress enacted the American Taxpayer Relief Act of 2012, which further extended the enhanced EITC provisions to taxable years ending before January 1, 2018.

During the 2014 Session, the General Assembly extended Virginia's conformity to the enhanced federal EITC to taxable years ending before January 1, 2018. As a result, low-income taxpayers may claim the portion of the Virginia Low-Income Tax Credit that is based on the federal EITC without making complex adjustments on their Virginia income tax returns for Taxable Years 2013 through 2017.

Filing Information for 2013 Income Tax Returns

Because the General Assembly did not advance Virginia's date of conformity to the Internal Revenue Code during the 2014 Session, Virginia's date of conformity remains January 2, 2013. However, Congress did not enact any federal tax legislation that would impact Virginia after January 2, 2013. Therefore, taxpayers may still use their federal adjusted gross income (or federal taxable income, for corporations) as the starting point for calculating their Virginia taxable income for Taxable Year 2013, except as provided in Tax Bulletin 13-3 (Public Document 13-19 (2/15/2013)) and Tax Bulletin 13-13 (Public Document 13-209 (11/08/2013)).

Bonus Depreciation

Virginia will continue to disallow any bonus depreciation allowed for certain assets under 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's 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.

Applicable High Yield Discount Obligations

Virginia will continue to 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 continue to deconform from this federal tax provision.

Cancellation of Debt Income

Virginia will continue to 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 Taxable Year 2009, taxpayers were allowed to elect a partial deferral of these exclusions for specified debt reacquired in Taxable Year 2009. Taxpayers that deferred cancellation of debt income from transactions in 2009 on their federal returns were allowed to elect to report the addition required by conformity in three equal amounts for Taxable Years 2009, 2010 and 2011.

For Taxable Year 2010, Virginia extended the treatment of deferral of cancellation of debt to transactions completed on or before the adoption of the Appropriations Act on April 21, 2010 (Chapter 874 of the 2010 Acts of Assembly). Because the change to the Virginia treatment of this income was not fully known until the Appropriations Act was passed by the General Assembly at its reconvened session on April 21, 2010, the treatment adopted for transactions that occurred in 2009 was extended to transactions that were completed on or before April 21, 2010. Taxpayers who elected in 2010 to report this addition over three years must continue to report the income from qualified transactions in three equal amounts for Taxable Years 2010, 2011 and 2012.

Domestic Production Activities Deduction

For Taxable Years 2010, 2011, and 2012, Virginia partially deconformed from the federal domestic production activities deduction allowed under IRC § 199. For taxable years beginning on and after January 1, 2013, Virginia fully conforms to the federal domestic production activities deduction.

Further Instructions for Taxpayers

Individuals and corporations should consult the instructions for the appropriate 2013 Virginia income tax return for information about how to properly add back income related to bonus depreciation, applicable high yield discount obligations, cancellation of debt income, and domestic production expenses that are deducted for federal income tax purposes. In addition, individuals and corporations who have already filed a 2013 Virginia income tax return but need to make a fixed-date conformity adjustment should consult the instructions for the appropriate income tax return for further information about filing an amended return.

If you have additional questions, please visit the Department's website at http://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.