TAX BULLETIN 21-4

Virginia Department of Taxation

March 15, 2021

IMPORTANT INFORMATION REGARDING 2020 VIRGINIA INCOME TAX RETURNS

VIRGINIA'S CONFORMITY TO THE INTERNAL REVENUE CODE ADVANCED TO DECEMBER 31, 2020

Under emergency legislation enacted by the 2021 General Assembly (House Bill 1935, Chapter 117 of 2021 Acts of Assembly and Senate Bill 1146, Chapter 118 of the 2021 Acts of Assembly), Virginia's date of conformity to the terms of the Internal Revenue Code will advance from December 31, 2019 to December 31, 2020. This bulletin is intended to provide taxpayers with guidance on reconciling this legislation with their 2020 Virginia income tax returns.

Virginia's Conformity Legislation

During the 2021 General Assembly Session, legislation was enacted to advance Virginia's date of conformity to the Internal Revenue Code from December 31, 2019 to December 31, 2020. This allows Virginia to generally conform to the Coronavirus Aid, Relief, and Economic Security ("CARES") Act (H.R.748) and the Consolidated Appropriations Act, 2021 (H.R.133) ("the CAA"). However, this legislation specifically deconforms from three provisions of the CARES Act that temporarily change limitations applicable to the net operating loss deduction, excess business losses, and the business interest deduction. This legislation also deconforms from the provision of the CAA that permanently reduces the medical expense deduction threshold.

The legislation conforms to the federal tax exemption for Paycheck Protection Program ("PPP") loan forgiveness and certain funding received under the Economic Injury Disaster Loan ("EIDL") program. However, it partially deconforms from the provision of the CAA that allows taxpayers to claim a federal deduction for business expenses funded by forgiven PPP loan proceeds. Instead, the bill permits a deduction for Taxable Year 2020 of up to $100,000 for business expenses funded by forgiven PPP loan proceeds. In addition, the legislation fully deconforms from the provision of the CAA that allows taxpayers to claim a federal deduction for business expenses funded by forgiven EIDL funding proceeds.

The legislation also provides an individual and corporate income tax subtraction for Taxable Year 2020 for up to $100,000 of all grant funds received by a taxpayer under the Rebuild Virginia program.

This bulletin explains the conformity adjustments that may be necessary as a result of this legislation on returns for Taxable Year 2020 as well as certain prior and future taxable years.

CARES Act

On March 27, 2020, Congress enacted the CARES Act. This federal legislation provides emergency economic assistance to businesses and individuals affected by the coronavirus disease 2019 ("COVID-19) crisis. Virginia conforms to the individual tax provisions of this federal legislation. However, Virginia deconforms from the following business changes made by the CARES Act:

- Suspending certain net operating loss ("NOL") limitations for Taxable Years 2018, 2019, and 2020;
- Suspending the excess business loss limitation for Taxable Year 2018, 2019, and 2020; and
- Increasing the business interest limitation for Taxable Year 2019 and 2020.

Virginia's deconformity from these three changes will affect the timing of deductions, which could impact taxable years other than the years specified above. Taxpayers benefiting from these changes for federal purposes for Taxable Years 2018, 2019, or 2020 will have to keep separate records for Virginia purposes, computing carrybacks, carryforwards and deductions for Virginia as if these CARES Act changes were not made. If such records indicate that the taxpayer was entitled to smaller deductions for Virginia purposes than for federal purposes for a particular year, a fixed date conformity addition will be required for that year equal to the difference between the deduction allowed for Virginia purposes and the deduction allowed for federal purposes. Similarly, if such records indicate that the taxpayer was entitled to larger deductions for Virginia purposes than for federal purposes for a particular year, a fixed date conformity subtraction will be required for that year equal to the difference between the deduction allowed for Virginia purposes and the deduction allowed for federal purposes.

Taxpayers should consult the Department's website for additional guidance on how to make adjustments related to Virginia's deconformity from the temporary CARES Act business changes specified above. Because such changes are retroactive, taxpayers may be required not only to make adjustments to Taxable Year 2020 returns and returns for subsequent taxable years, but also returns for previous taxable years. This may require the filing of amended Virginia returns.

Consolidated Appropriations Act, 2021

On December 27, 2020, Congress enacted the CAA. This federal legislation provides additional emergency economic assistance to businesses and individuals affected by COVID-19. The legislation also provides tax relief to victims of certain 2020 disasters and extends several provisions, commonly known as "tax extenders," which were scheduled to expire. Virginia generally conforms to the CAA with certain exceptions as generally described below.

Paycheck Protection Program Loans and Expenses

The CARES Act provided Paycheck Protection Program (“PPP”) loans for small businesses with 500 or fewer employees. Such loans may be forgiven, in whole or in part, if a business uses loan funds on the payment of payroll costs and other eligible expenses. Loan forgiveness is generally taxable for federal income tax purposes. However, the CARES Act provides that the forgiveness of PPP loans is exempt from federal income taxation.

In Notice 2020-32, the Internal Revenue Service announced that this loan forgiveness modifies the definition of income that is in the Internal Revenue Code (“IRC”) and, therefore, IRC sections prohibiting deductions against tax-exempt income apply. As a result, taxpayers were initially prohibited from deducting business expenses funded by a forgiven PPP loan.

For federal purposes, the CAA supersedes Notice 2020-32 by allowing a taxpayer to claim deductions for expenses funded by a forgiven PPP loan. Therefore, there is no longer a prohibition for federal purposes on claiming both the exemption for PPP loan forgiveness and deductions for expenses paid using loaned funds.

However, for Virginia purposes, the deduction will be limited to $100,000 for business expenses funded by forgiven PPP loan proceeds. As a result, for those taxpayers who have received PPP loan forgiveness of $100,000 or less for Taxable Year 2020, no adjustment will be required on the 2020 Virginia return. However, taxpayers who have received PPP loan forgiveness of more than $100,000 for Taxable Year 2020 must report a fixed date conformity addition (not below zero) equal to:

- The amount of business expense deduction disallowed under the principles in Internal Revenue Service (“IRS”) Notice 2020-32 and subsequent pre-CAA IRS guidance;

- Less $100,000.

In the case of a pass-through entity, the $100,000 limitation applies to the pass-through entity that received the Paycheck Protection Program loan. Accordingly, to the extent that the $100,000 limitation has been applied at the pass-through entity level, the limitation is not required to be applied again at the owner level for that portion that has been allocated by the pass-through entity and has already been limited.

See the Department’s website for additional information regarding the calculation of this fixed date conformity addition.

Economic Injury Disaster Loan Program Funds and Expenses

The CARES Act expanded access to loans under the Economic Injury Disaster Loan (“EIDL”) program, established an emergency grant to allow an EIDL applicant to request a $10,000 advance on that loan, and provided repayment assistance for certain loan recipients. The CAA provided that the forgiveness of EIDL loans, emergency EIDL grants, and certain loan repayment assistance are exempt from federal income tax. Similar to the PPP, the CAA also provided that a taxpayer may claim deductions for expenses funded by tax-exempt EIDL funds.

For those taxpayers who have received EIDL funding, Virginia will conform to the provision of the CAA allowing all such funding to be tax-exempt. However, Virginia will not allow a deduction for expenses paid using such EIDL funding. As a result, taxpayers currently preparing and filing their Virginia income tax returns for Taxable Year 2020 must report a fixed date conformity addition equal to the amount of business expenses paid using tax-exempt EIDL funding. To compute such amount, taxpayers should consult the principles discussed in IRS Notice 2020-32 and subsequent pre-CAA IRS guidance regarding PPP expenses. See the Department’s website for additional information regarding the calculation of such addition.

Subtraction for Rebuild Virginia Grants

For federal income tax purposes, the receipt of a government grant by a business must be included in income unless a specific exclusion applies. As a result, grant funds received by the taxpayer under the Rebuild Virginia program (“Rebuild Virginia grants”) are generally taxable.

Because Virginia conforms to federal tax law, Rebuild Virginia grants are generally included in income for Virginia income tax purposes as well. However, under this legislation, Virginia will allow an individual and corporate income tax subtraction for up to $100,000 of all Rebuild Virginia grants received by a taxpayer during Taxable Year 2020 to the extent such grants were included in and not otherwise subtracted from income.

In the case of a pass-through entity, the $100,000 limitation applies to the pass-through entity that received the Rebuild Virginia grant. Accordingly, to the extent that the $100,000 limitation has been applied at the pass-through entity level, the limitation is not required to be applied again at the owner level for that portion that has been allocated by the pass-through entity and has already been limited.

See the Department's website for additional information regarding the calculation of such subtraction.

Virginia's Deconformity from the Increased Medical Expense Deduction

As explained in Tax Bulletin 20-1, Virginia deconforms from the 7.5 percent of federal adjusted gross income floor for the medical expense deduction. Under this legislation, Virginia will continue to deconform from such floor. As a result, taxpayers currently preparing and filing their Virginia income tax returns for Taxable Year 2020 are required to use a 10 percent floor on their Virginia Schedule A. No adjustment is necessary because such 10 percent floor is already incorporated into the Virginia Schedule A. See the Department's instructions for additional information regarding the calculation of such deduction.

Existing Exceptions to Conformity for Taxable Year 2020

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;
- Tax deductions related to the application of the applicable high yield debt obligation rules; and
- The suspension of the federal overall limitation on itemized deductions

Virginia's deconformity from these provisions is explained in prior tax bulletins.

Additional Instructions for Taxpayers

Taxpayers should consult the instructions for the appropriate 2020 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. No adjustments are necessary for Virginia's deconformity from the suspension of the federal overall limitation on itemized deductions and the increased medical expense deduction because these are incorporated into the Department's forms and instructions.

Taxpayers who received PPP loan forgiveness and EIDL funding should consult the Department's website for guidance on how to make adjustments related to Virginia's partial deconformity from the federal tax treatment of PPP loan forgiveness and EIDL funding. In addition, taxpayers who received Rebuild Virginia grants should similarly consult the Department's website regarding the Rebuild Virginia subtraction.

Taxpayers who have already filed a 2020 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. Please note that, for calendar year filers, Taxable Year 2020 Virginia income tax returns are due April 15, 2021 for corporations and pass-through entities, and May 3, 2021 for individuals. 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.