# DEPARTMENT OF TAXATION
# 2026 Fiscal Impact Statement

1. **Patron** Vivian E. Watts

2. **Bill Number** HB 977
   **House of Origin:**
   __X__ **Introduced**
   _____ **Substitute**
   _____ **Engrossed**

   **Second House:**
   _____ **In Committee**
   _____ **Substitute**
   _____ **Enrolled**

3. **Committee** House Finance

4. **Title** Income Tax; Conformity

5. **Summary/Purpose:**

   This bill would end Virginia's rolling conformity with the Internal Revenue Code ("IRC") and replace it with fixed date conformity with the IRC as of December 31, 2024. This would result in Virginia deconforming from all changes made to federal tax law by 2025 HR 1 (P.L. 119-21).

   This bill would be effective for taxable years beginning on and after January 1, 2025.

   **This bill contains an emergency clause that provides that it would be effective from its passage.**

6. **Budget amendment necessary:** Yes.
   <u>Page 1, Revenue Estimates</u>

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. **Fiscal implications:**

   <u>Administrative Costs</u>

   This bill would have an unknown but significant impact on the Department of Taxation's administrative costs. The bill would deconform from more than 30 separate federal provisions spanning both individual and business tax regimes. These include changes to deductions for mortgage premiums, transportation fringe benefits, ABLE account enhancements, wagering losses, and energy-related cost recovery. Please see Line 11 for more details. Each provision would require thorough guidance to taxpayers regarding required state-level modifications, systems programming, and forms redesign, making the cumulative administrative cost impossible to quantify at this time.

   <u>Revenue Impact</u>

   This bill would have an unknown impact on General Fund revenues. This bill, as introduced, would have ended Virginia's rolling conformity with the Internal Revenue Code

(“IRC”) and replaced it with fixed date conformity with the IRC as of December 31, 2024. This would result in Virginia deconforming from all changes made to federal tax law by HR 1. Because the Introduced Executive Budget assumes substantial conformity with HR 1 and includes a reduction in revenues attributable to the provisions of HR 1, this bill could result in additional General Fund revenues available for appropriation of $101.6 million in FY 2026, $148.6 million in FY 2027, and $183.2 million in FY 2028. However, the actual impact would be indeterminate as it is unclear the extent to which the taxpayers would be able to comply with Virginia tax law and make the necessary adjustments.

**9. Specific agency or political subdivisions affected:**

Department of Taxation

**10. Technical amendment necessary:** No.

**11. Other comments:**

Virginia’s History with Rolling and Fixed Date Conformity

Prior to 1971, the Virginia Constitution did not allow provisions incorporated into Virginia law if they could be subsequently revised without approval of the General Assembly. The new constitution adopted in 1971 included a provision allowing incorporation of the IRC “as those laws may be or become effective.” From 1972 until 2002, Virginia relied on the new constitutional provision to automatically conform to any Congressional changes in the definition of income. As a result, Virginia was a rolling conformity state during that period.

The Job Creation and Worker Assistance Act of 2002 (“JCWAA”) substantially reduced Virginia taxable income of businesses by creating a new depreciation deduction and modifying the carryback period for net operating loss deductions. The 2002 Appropriation Act included a provision temporarily fixing the date of conformity to the IRC as of December 31, 2001. In 2003, the General Assembly adopted fixed date conformity by adopting the IRC as it existed on December 31, 2002 and specifically excepting the depreciation/NOL provisions modified by JCWAA. From 2002 to 2023, Virginia has been a fixed date conformity state. Annual conformity bills have generally advanced the date of fixed conformity and revised the list of exceptions as needed.

In 2023, the General Assembly adopted rolling conformity by automatically conforming Virginia to amendments to the IRC enacted after January 1, 2023, except:

- Any amendments that would increase or decrease General Fund revenues by more than $15 million in the fiscal year in which the amendment was enacted or any of the succeeding four fiscal years, or
- All amendments occurring between adjournment sine die of the previous regular session of the General Assembly and the first day of the subsequent regular session of the General Assembly if the cumulative impact of such amendments would increase or decrease General Fund revenues by more than $75 million in the fiscal year in which the amendments were enacted or any of the succeeding four fiscal years.
- Generally, the same exceptions that were in place during fixed date conformity.

In 2025, the General Assembly temporarily paused rolling conformity by providing that Virginia would not automatically conform to any federal tax changes enacted on or after January 1, 2025, but before January 1, 2027, with a projected revenue impact that would increase or decrease General Fund revenues by any amount in the fiscal year in which the amendment was enacted or any of the succeeding four fiscal years. However, Virginia continues to conform to any federal tax changes that the General Assembly subsequently adopts and to any federal tax extenders.

Virginia's Current Conformity to Federal Income Tax Law

Beginning on January 1, 2025, Virginia no longer automatically conforms to the IRC on a rolling basis. Virginia law currently deconforms from the following provisions:

- Bonus depreciation allowed for certain assets under federal income taxation.
- The five-year carry-back of net operating losses ("NOLs") generated in certain taxable years.
- Tax exclusions related to cancellation of debt income.
- Tax deductions related to the application of the applicable high yield debt obligation rules.
- Suspension of the federal overall limitation on itemized deductions.
- The reduction in the medical expense deduction floor.
- Certain business provisions of the federal CARES Act.
- The deduction of business expenses through certain COVID-related small business assistance programs.
- *On or after January 1, 2025, but before January 1, 2027—any amendment to the IRC enacted with a projected impact on general fund revenues.
- On or after January 1, 2027—any amendment to the IRC with a projected impact on general fund revenues of more than $15 million, AND all amendments to the IRC enacted after a projected cumulative impact on general fund revenues exceeding $75 million. These threshold amounts apply to the year an amendment was enacted or any of the succeeding four fiscal years, and do not apply to amendments to the IRC adopted by the General Assembly and federal tax extenders. The dollar amounts are indexed for inflation.

The Secretary of Finance is required to provide an annual report on the fiscal impact of amendments to the IRC occurring since the adjournment sine die of the prior year's regular session of the General Assembly to the Chairmen of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance.

2025 H.R. 1 (P.L. 119-21)

2025 H.R. made significant changes to several individual and corporate income tax provisions, and made many of the temporary provisions of the 2017 Tax Cuts and Jobs Act ("TCJA") permanent. Most of the changes made to corporate income tax provisions are effective for Taxable Years 2025 and thereafter, while the changes to the individual income tax provisions are generally effective for Taxable Years 2026 and thereafter. Such changes include the following provision from which Virginia would deconform under this bill:

- **The new special depreciation deduction, under IRC § 168(n), for real property used in domestic qualified production activities.** Virginia has historically deconformed from similar special depreciation provision under IRC Sections 168(k), 168(l), and 168(m).
- **The new limits on itemized deductions, which reduces the value of itemized deductions for taxpayers in the 37% tax bracket and eliminates the prior "Pease" limit on itemized deductions.** Virginia would maintain the Pease limit on itemized deduction on the state income tax return.
- **The new transitional rules for domestic research and experimental ("R&E") expenditures retroactive and catch-up deductions, and the return to full expensing of domestic R&E expenditures.** From 2022 to 2024 domestic R&E expenditures were required to be amortized over a 5 year period, and Virginia would require such expenditures to continue to be amortized over a 5 year period.
- **The increased dollar limitations for expensing of certain depreciable business assets from $1 to $2.5 million, and its phaseout threshold was raised from $2.5 to $4 million of total qualifying purchases.** Virginia would require business taxpayer to continue to use the lower amounts.

2025 H.R. 1 also increased the amount of business interest taxpayers can deduct by allowing a more generous definition of adjusted taxable income ("ATI") which is used in the calculation of the limitation on the amount of interest that may be deduction for federal income tax purposes.

Several other provisions from the bill with a minimal state revenue impact include:
- Extension and modification of limitation on deduction for qualified residence interest (Mortgage Premium)
- Termination of miscellaneous itemized deduction other than educator expenses (no limitation on educator expenses)
- Extension and modification of qualified transportation fringe benefits
- Modification and extension of limitation on excess business losses of noncorporate taxpayers
- Extension and modification of limitation on deduction and exclusion for moving expenses
- Extension and modification of limitation on wagering losses
- Extension of increased limitation on contributions to ABLE accounts and permanent enhancement
- Extension of rollovers from qualified tuition programs to ABLE accounts permitted
- Extension of treatment of certain individuals performing services in the Sinai Peninsula and enhancement to include additional areas
- Extension and modification of limitation on casualty loss deduction (add state disasters)
- Extension and modification of exclusion from gross income of student loans discharged on account of death or disability
- Exclusion for employer student loan payments (indexing).

Proposal

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**This bill contains an emergency clause that provides that it would be effective from its passage.**

Similar Bills

**SB 664** would conform Virginia to the IRC as it existed January 1, 2026, with certain exceptions. Rolling conformity would be retained but would remain paused with limited exceptions for extenders.

cc : Secretary of Finance

Date: 01/26/2026 JLOF
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