



TAX BULLETIN 13-3
Virginia Department of Taxation
February 15, 2013

IMPORTANT INFORMATION REGARDING
2012 VIRGINIA INCOME TAX RETURNS

VIRGINIA INCOME TAX FIXED-DATE CONFORMITY
ADVANCED TO JANUARY 2, 2013

Under emergency legislation (HOUSE BILL 2150; Chapter 4 of the 2013 Acts of Assembly) passed by the 2013 General Assembly and signed by Governor McDonnell on February 15, 2013, Virginia's fixed-date of conformity to the terms of the Internal Revenue Code ("IRC") will advance from December 31, 2011, to January 2, 2013. This notice is intended to provide taxpayers with directions on how to reconcile this legislation with their 2012 Virginia income tax returns. This legislation extends conformity to the temporary enhancements to the federal earned income tax credit ("EITC") to Taxable Year 2012, and allows Virginia to conform to the federal American Taxpayer Relief Act of 2012 for Taxable Year 2012.

Virginia Income Tax

For approximately thirty years, Virginia conformed to federal income tax law. Whenever federal income tax law changed, the changes automatically affected Virginia income taxes, unless otherwise exempted. In 2003, Virginia began conforming to the IRC as of a specific, fixed date, moving the date each year. The Governor signed legislation advancing the date as of which Virginia conforms to the IRC from December 31, 2011, to January 2, 2013. This bulletin explains the fixed-date conformity adjustments that may be necessary on taxpayers' 2012 income tax returns.

Conformity to the Internal Revenue Code for Taxable Year 2012

Effective for taxable years beginning on and after January 1, 2012, Virginia's fixed-date of conformity to the terms of the IRC will advance from December 31, 2011, to January 2, 2013, with limited exceptions. Virginia will continue to disallow the five-year carry back of net operating losses ("NOL") allowed for NOLs generated in Taxable Years 2008 and 2009.

American Taxpayer Relief Act of 2012

Virginia will conform to the provisions of the federal American Taxpayer Relief Act of 2012 for Taxable Year 2012. This federal bill extended certain federal income tax rates, tax credits, AMT provisions, estate tax provisions, provisions of the federal research and experimentation tax credit, certain itemized and above-the-line deductions for individuals, and the repeal of the Pease limitation.

Earned Income Tax Credit

For purposes of computing the Virginia low-income tax credit, Virginia will conform to the enhanced federal EITC under IRC § 32(b)(3) for Taxable Year 2012. Although the American Taxpayer Relief Act of 2012 extended the temporary enhancements to the federal EITC under IRC § 32(b)(3) through Taxable Year 2018, Virginia law does not presently conform to this change for Taxable Year 2013 and beyond. Since individual returns for Taxable Year 2013 are not due until May 1, 2014, the General Assembly will be able to consider conforming to the extension during the 2014 session.

Exceptions to Conformity

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

Virginia will continue to partially deconform from the domestic production activities deduction allowed under IRC § 199 for Taxable Years 2010, 2011, and 2012. The federal domestic production activities deduction is equal to nine percent of qualified production activities income of the taxpayer in 2010 and thereafter. Instead of allowing the full amount of this deduction to flow through, Virginia will allow a deduction equal to two-thirds of the federal deduction. This is equivalent to allowing a deduction of six

percent of the qualifying income, as had been allowed in Taxable Years 2008 through 2010. For taxable years beginning on and after January 1, 2013, Virginia will fully conform to the domestic production activities deduction allowed under IRC § 199.

Instructions for Taxpayers

Individuals and corporations should consult the instructions for the appropriate 2012 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 2012 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.

Further Instructions

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.