

SENATE BILL NO. 692

AMENDMENT IN THE NATURE OF A SUBSTITUTE

(Proposed by the Senate Committee on \_\_\_\_\_  
on \_\_\_\_\_)

(Patron Prior to Substitute--Senator Petersen)

A BILL to amend and reenact §§ 58.1-322.02, 58.1-332, 58.1-390.1, and 58.1-390.2 of the Code of Virginia and to amend the Code of Virginia by adding a section numbered 58.1-390.3, relating to income taxation; pass-through entities.

**Be it enacted by the General Assembly of Virginia:**

**1. That §§ 58.1-322.02, 58.1-332, 58.1-390.1, and 58.1-390.2 of the Code of Virginia are amended and reenacted and that the Code of Virginia is amended by adding a section numbered 58.1-390.3 as follows:**

**§ 58.1-322.02. Virginia taxable income; subtractions.**

In computing Virginia taxable income pursuant to § 58.1-322, to the extent included in federal adjusted gross income, there shall be subtracted:

1. Income derived from obligations, or on the sale or exchange of obligations, of the United States and on obligations or securities of any authority, commission, or instrumentality of the United States to the extent exempt from state income taxes under the laws of the United States, including, but not limited to, stocks, bonds, treasury bills, and treasury notes but not including interest on refunds of federal taxes, interest on equipment purchase contracts, or interest on other normal business transactions.

2. Income derived from obligations, or on the sale or exchange of obligations, of the Commonwealth or of any political subdivision or instrumentality of the Commonwealth.

3. Benefits received under Title II of the Social Security Act and other benefits subject to federal income taxation solely pursuant to § 86 of the Internal Revenue Code.

25 4. Up to \$20,000 of disability income, as defined in § 22(c)(2)(B)(iii) of the Internal Revenue  
26 Code; however, any person who claims a deduction under subdivision 5 of § 58.1-322.03 may not also  
27 claim a subtraction under this subdivision.

28 5. The amount of any refund or credit for overpayment of income taxes imposed by the  
29 Commonwealth or any other taxing jurisdiction.

30 6. The amount of wages or salaries eligible for the federal Work Opportunity Credit which was  
31 not deducted for federal purposes on account of the provisions of § 280C(a) of the Internal Revenue Code.

32 7. Any amount included therein less than \$600 from a prize awarded by the Virginia Lottery.

33 8. The wages or salaries received by any person for active and inactive service in the National  
34 Guard of the Commonwealth of Virginia, not to exceed the amount of income derived from 39 calendar  
35 days of such service or \$3,000, whichever amount is less; however, only those persons in the ranks of O3  
36 and below shall be entitled to the deductions specified in this subdivision.

37 9. Amounts received by an individual, not to exceed \$1,000 for taxable years beginning on or  
38 before December 31, 2019, and \$5,000 for taxable years beginning on or after January 1, 2020, as a reward  
39 for information provided to a law-enforcement official or agency, or to a nonprofit corporation created  
40 exclusively to assist such law-enforcement official or agency, in the apprehension and conviction of  
41 perpetrators of crimes. This subdivision shall not apply to the following: an individual who is an employee  
42 of, or under contract with, a law-enforcement agency, a victim or the perpetrator of the crime for which  
43 the reward was paid, or any person who is compensated for the investigation of crimes or accidents.

44 10. The amount of "qualified research expenses" or "basic research expenses" eligible for  
45 deduction for federal purposes, but which were not deducted, on account of the provisions of § 280C(c)  
46 of the Internal Revenue Code and which shall be available to partners, shareholders of S corporations, and  
47 members of limited liability companies to the extent and in the same manner as other deductions may pass  
48 through to such partners, shareholders, and members.

49 11. Any income received during the taxable year derived from a qualified pension, profit-sharing,  
50 or stock bonus plan as described by § 401 of the Internal Revenue Code, an individual retirement account  
51 or annuity established under § 408 of the Internal Revenue Code, a deferred compensation plan as defined

52 by § 457 of the Internal Revenue Code, or any federal government retirement program, the contributions  
53 to which were deductible from the taxpayer's federal adjusted gross income, but only to the extent the  
54 contributions to such plan or program were subject to taxation under the income tax in another state.

55 12. Any income attributable to a distribution of benefits or a refund from a prepaid tuition contract  
56 or savings trust account with the Virginia College Savings Plan, created pursuant to Chapter 7 (§ 23.1-  
57 700 et seq.) of Title 23.1. The subtraction for any income attributable to a refund shall be limited to income  
58 attributable to a refund in the event of a beneficiary's death, disability, or receipt of a scholarship.

59 13. All military pay and allowances, to the extent included in federal adjusted gross income and  
60 not otherwise subtracted, deducted, or exempted under this section, earned by military personnel while  
61 serving by order of the President of the United States with the consent of Congress in a combat zone or  
62 qualified hazardous duty area that is treated as a combat zone for federal tax purposes pursuant to § 112  
63 of the Internal Revenue Code.

64 14. For taxable years beginning before January 1, 2015, the gain derived from the sale or exchange  
65 of real property or the sale or exchange of an easement to real property which results in the real property  
66 or the easement thereto being devoted to open-space use, as that term is defined in § 58.1-3230, for a  
67 period of time not less than 30 years. To the extent that a subtraction is taken in accordance with this  
68 subdivision, no tax credit under this chapter for donating land for its preservation shall be allowed for  
69 three years following the year in which the subtraction is taken.

70 15. Fifteen thousand dollars of military basic pay for military service personnel on extended active  
71 duty for periods in excess of 90 days; however, the subtraction amount shall be reduced dollar-for-dollar  
72 by the amount by which the taxpayer's military basic pay exceeds \$15,000 and shall be reduced to zero if  
73 such military basic pay amount is equal to or exceeds \$30,000.

74 16. The first \$15,000 of salary for each federal and state employee whose total annual salary from  
75 all employment for the taxable year is \$15,000 or less.

76 17. Unemployment benefits taxable pursuant to § 85 of the Internal Revenue Code.

77 18. Any amount received as military retirement income by an individual awarded the  
78 Congressional Medal of Honor.

79           19. Items of income attributable to, derived from, or in any way related to (i) assets stolen from,  
80 hidden from, or otherwise lost by an individual who was a victim or target of Nazi persecution or (ii)  
81 damages, reparations, or other consideration received by a victim or target of Nazi persecution to  
82 compensate such individual for performing labor against his will under the threat of death, during World  
83 War II and its prelude and direct aftermath. This subtraction shall not apply to assets acquired with such  
84 items of income or with the proceeds from the sale of assets stolen from, hidden from, or otherwise lost  
85 to, during World War II and its prelude and direct aftermath, a victim or target of Nazi persecution. The  
86 provisions of this subdivision shall only apply to an individual who was the first recipient of such items  
87 of income and who was a victim or target of Nazi persecution, or a spouse, surviving spouse, or child or  
88 stepchild of such victim.

89           As used in this subdivision:

90           "Nazi regime" means the country of Nazi Germany, areas occupied by Nazi Germany, those  
91 European countries allied with Nazi Germany, or any other neutral European country or area in Europe  
92 under the influence or threat of Nazi invasion.

93           "Victim or target of Nazi persecution" means any individual persecuted or targeted for persecution  
94 by the Nazi regime who had assets stolen from, hidden from, or otherwise lost as a result of any act or  
95 omission in any way relating to (i) the Holocaust, (ii) World War II and its prelude and direct aftermath,  
96 (iii) transactions with or actions of the Nazi regime, (iv) treatment of refugees fleeing Nazi persecution,  
97 or (v) the holding of such assets by entities or persons in the Swiss Confederation during World War II  
98 and its prelude and aftermath. A "victim or target of Nazi persecution" also includes any individual forced  
99 into labor against his will, under the threat of death, during World War II and its prelude and direct  
100 aftermath.

101           20. The military death gratuity payment made after September 11, 2001, to the survivor of  
102 deceased military personnel killed in the line of duty, pursuant to 10 U.S.C. Chapter 75; however, the  
103 subtraction amount shall be reduced dollar-for-dollar by the amount that the survivor may exclude from  
104 his federal gross income in accordance with § 134 of the Internal Revenue Code.

105           21. The death benefit payments from an annuity contract that are received by a beneficiary of such  
106 contract, provided that (i) the death benefit payment is made pursuant to an annuity contract with an  
107 insurance company and (ii) the death benefit payment is paid solely by lump sum. The subtraction under  
108 this subdivision shall be allowed only for that portion of the death benefit payment that is included in  
109 federal adjusted gross income.

110           22. Any gain recognized from the sale of launch services to space flight participants, as defined in  
111 49 U.S.C. § 70102, or launch services intended to provide individuals with the training or experience of a  
112 launch, without performing an actual launch. To qualify for a deduction under this subdivision, launch  
113 services must be performed in Virginia or originate from an airport or spaceport in Virginia.

114           23. Any gain recognized as a result of resupply services contracts for delivering payload, as defined  
115 in 49 U.S.C. § 70102, entered into with the Commercial Orbital Transportation Services division of the  
116 National Aeronautics and Space Administration or other space flight entity, as defined in § 8.01-227.8,  
117 and launched from an airport or spaceport in Virginia.

118           24. Any income taxed as a long-term capital gain for federal income tax purposes, or any income  
119 taxed as investment services partnership interest income (otherwise known as investment partnership  
120 carried interest income) for federal income tax purposes. To qualify for a subtraction under this  
121 subdivision, such income shall be attributable to an investment in a "qualified business," as defined in §  
122 58.1-339.4, or in any other technology business approved by the Secretary of Administration, provided  
123 that the business has its principal office or facility in the Commonwealth and less than \$3 million in annual  
124 revenues in the fiscal year prior to the investment. To qualify for a subtraction under this subdivision, the  
125 investment shall be made between the dates of April 1, 2010, and June 30, 2020. No taxpayer who has  
126 claimed a tax credit for an investment in a "qualified business" under § 58.1-339.4 shall be eligible for the  
127 subtraction under this subdivision for an investment in the same business.

128           25. For taxable years beginning on and after January 1, 2014, any income of an account holder for  
129 the taxable year taxed as (i) a capital gain for federal income tax purposes attributable to such person's  
130 first-time home buyer savings account established pursuant to Chapter 12 (§ 36-171 et seq.) of Title 36

131 and (ii) interest income or other income for federal income tax purposes attributable to such person's first-  
132 time home buyer savings account.

133 Notwithstanding the statute of limitations on assessments contained in § 58.1-312, any subtraction  
134 taken under this subdivision shall be subject to recapture in the taxable year or years in which moneys or  
135 funds withdrawn from the first-time home buyer savings account were used for any purpose other than  
136 the payment of eligible costs by or on behalf of a qualified beneficiary, as provided under § 36-174. The  
137 amount subject to recapture shall be a portion of the amount withdrawn in the taxable year that was used  
138 for other than the payment of eligible costs, computed by multiplying the amount withdrawn and used for  
139 other than the payment of eligible costs by the ratio of the aggregate earnings in the account at the time of  
140 the withdrawal to the total balance in the account at such time.

141 However, recapture shall not apply to the extent of moneys or funds withdrawn that were (i)  
142 withdrawn by reason of the qualified beneficiary's death or disability; (ii) a disbursement of assets of the  
143 account pursuant to a filing for protection under the United States Bankruptcy Code, 11 U.S.C. §§ 101  
144 through 1330; or (iii) transferred from an account established pursuant to Chapter 12 (§ 36-171 et seq.) of  
145 Title 36 into another account established pursuant to such chapter for the benefit of another qualified  
146 beneficiary.

147 For purposes of this subdivision, "account holder," "eligible costs," "first-time home buyer savings  
148 account," and "qualified beneficiary" mean the same as those terms are defined in § 36-171.

149 26. For taxable years beginning on and after January 1, 2015, any income for the taxable year  
150 attributable to the discharge of a student loan solely by reason of the student's death. For purposes of this  
151 subdivision, "student loan" means the same as that term is defined under § 108(f) of the Internal Revenue  
152 Code.

153 27. a. Income, including investment services partnership interest income (otherwise known as  
154 investment partnership carried interest income), attributable to an investment in a Virginia venture capital  
155 account. To qualify for a subtraction under this subdivision, the investment shall be made on or after  
156 January 1, 2018, but before December 31, 2023. No subtraction shall be allowed under this subdivision  
157 for an investment in a company that is owned or operated by a family member or an affiliate of the

158 taxpayer. No subtraction shall be allowed under this subdivision for a taxpayer who has claimed a  
159 subtraction under subdivision 24 or a tax credit under § 58.1-339.4 for the same investment.

160 b. As used in this subdivision 27:

161 "Qualified portfolio company" means a company that (i) has its principal place of business in the  
162 Commonwealth; (ii) has a primary purpose of production, sale, research, or development of a product or  
163 service other than the management or investment of capital; and (iii) provides equity in the company to  
164 the Virginia venture capital account in exchange for a capital investment. "Qualified portfolio company"  
165 does not include a company that is an individual or sole proprietorship.

166 "Virginia venture capital account" means an investment fund that has been certified by the  
167 Department as a Virginia venture capital account. In order to be certified as a Virginia venture capital  
168 account, the operator of the investment fund shall register the investment fund with the Department prior  
169 to December 31, 2023, (i) indicating that it intends to invest at least 50 percent of the capital committed  
170 to its fund in qualified portfolio companies and (ii) providing documentation that it employs at least one  
171 investor who has at least four years of professional experience in venture capital investment or  
172 substantially equivalent experience. "Substantially equivalent experience" includes, but is not limited to,  
173 an undergraduate degree from an accredited college or university in economics, finance, or a similar field  
174 of study. The Department may require an investment fund to provide documentation of the investor's  
175 training, education, or experience as deemed necessary by the Department to determine substantial  
176 equivalency. If the Department determines that the investment fund employs at least one investor with the  
177 experience set forth herein, the Department shall certify the investment fund as a Virginia venture capital  
178 account at such time as the investment fund actually invests at least 50 percent of the capital committed  
179 to its fund in qualified portfolio companies.

180 28. a. Income attributable to an investment in a Virginia real estate investment trust. To qualify for  
181 a subtraction under this subdivision, the investment shall be made on or after January 1, 2019, but before  
182 December 31, 2024. No subtraction shall be allowed for an investment in a trust that is managed by a  
183 family member or an affiliate of the taxpayer. No subtraction shall be allowed under this subdivision for

184 a taxpayer who has claimed a subtraction under subdivision 24 or 27 or a tax credit under § 58.1-339.4  
185 for the same investment.

186 b. As used in this subdivision 28:

187 "Distressed" means satisfying the criteria applicable to a locality described in subdivision E 2 of §  
188 2.2-115.

189 "Double distressed" means satisfying the criteria applicable to a locality described in subdivision  
190 E 3 of § 2.2-115.

191 "Virginia real estate investment trust" means a real estate investment trust, as defined in 26 U.S.C.  
192 § 856, that has been certified by the Department as a Virginia real estate investment trust. In order to be  
193 certified as a Virginia real estate investment trust, the trustee shall register the trust with the Department  
194 prior to December 31, 2024, indicating that it intends to invest at least 90 percent of trust funds in Virginia  
195 and at least 40 percent of trust funds in real estate in localities that are distressed or double distressed. If  
196 the Department determines that the trust satisfies the preceding criteria, the Department shall certify the  
197 trust as a Virginia real estate investment trust at such time as the trust actually invests at least 90 percent  
198 of trust funds in Virginia and at least 40 percent of trust funds in real estate in localities that are distressed  
199 or double distressed.

200 29. For taxable years beginning on and after January 1, 2019, any gain recognized from the taking  
201 of real property by condemnation proceedings.

202 30. For taxable years beginning on and after January 1, 2020, but before January 1, 2021, up to  
203 \$100,000 of all grant funds received by the taxpayer under the Rebuild Virginia program established by  
204 the Governor and administered by the Department of Small Business and Supplier Diversity.

205 31. For taxable years beginning on and after January 1, 2022, but before January 1, 2026, any  
206 amount of income derived from a pass-through entity having Virginia taxable income, as determined under  
207 § 58.1-391, if such pass-through entity makes the election authorized, and pays the tax imposed, by §  
208 58.1-390.3.

209 **§ 58.1-332. Credits for taxes paid other states.**



210           A. Whenever a Virginia resident has become liable to another state for income tax on any earned  
211 or business income or any gain on the sale of a capital asset (within the meaning of § 1221 of the Internal  
212 Revenue Code), not including an asset used in a trade or business, to the extent that such gain is included  
213 in federal adjusted gross income, for the taxable year, derived from sources outside the Commonwealth  
214 and subject to taxation under this chapter, the amount of such tax payable by him shall, upon proof of such  
215 payment, be credited on the taxpayer's return with the income tax so paid to the other state.

216           However, no franchise tax, license tax, excise tax, unincorporated business tax, occupation tax or  
217 any tax characterized as such by the taxing jurisdiction, although applied to earned or business income,  
218 shall qualify for a credit under this section, nor shall any tax which, if characterized as an income tax or a  
219 commuter tax, would be illegal and unauthorized under such other state's controlling or enabling  
220 legislation qualify for a credit under this section.

221           The credit allowable under this section shall not exceed: (i) such proportion of the income tax  
222 otherwise payable by him under this chapter as his income upon which the tax imposed by the other state  
223 was computed bears to his Virginia taxable income upon which the tax imposed by this Commonwealth  
224 was computed or (ii) the income tax otherwise payable under this chapter in the event that the income  
225 upon which the tax imposed by the other state is computed is less than the Virginia taxable income upon  
226 which the tax imposed by this Commonwealth is computed and all income derived from sources outside  
227 the Commonwealth and subject to taxation under this chapter is earned income or business income  
228 reported on federal form Schedule C from a single state contiguous to Virginia. The credit provided for  
229 by this section shall not be granted to a resident individual when the laws of another state, under which  
230 the income in question is subject to tax assessment, provide a credit to such resident individual  
231 substantially similar to that granted by subsection B of this section.

232           B. Whenever a nonresident individual of this Commonwealth has become liable to the state where  
233 he resides for income tax upon his Virginia taxable income for the taxable year, derived from Virginia  
234 sources and subject to taxation under this chapter, the amount of such tax payable under this chapter shall  
235 be credited with such proportion of the tax so payable by him to the state where he resides, upon proof of  
236 such payment, as his income subject to taxation under this chapter bears to his entire income upon which

237 the tax so payable to such other state was imposed. The credit, however, shall be allowed only if the laws  
238 of such state: (i) grant a substantially similar credit to residents of Virginia subject to income tax under  
239 such laws or (ii) impose a tax upon the income of its residents derived from Virginia sources and exempt  
240 from taxation the income of residents of this Commonwealth. No credit shall be allowed against the  
241 amount of the tax on any income taxable under this chapter which is exempt from taxation under the laws  
242 of such other state.

243 C. 1. For purposes of this section, the amount of any state income tax paid by an electing small  
244 business corporation (S corporation) shall be deemed to have been paid by its individual shareholders in  
245 proportion to their ownership of the stock of such corporation.

246 2. For taxable years beginning on and after January 1, 2021, but before January 1, 2026, for  
247 purposes of this section, the amount of any state income tax paid by a pass-through entity under a law of  
248 another state substantially similar to § 58.1-390.3 shall be deemed to have been paid by its individual  
249 owners in proportion to their ownership.

250 **§ 58.1-390.1. Definitions.**

251 The following words and terms, when used in this article, shall have the following meanings unless  
252 the context clearly indicates otherwise:

253 "Owner" means any individual or entity who is treated as a partner, member, or shareholder of a  
254 pass-through entity for federal income tax purposes.

255 "Pass-through entity" means any entity, including a limited partnership, a limited liability  
256 partnership, a general partnership, a limited liability company, a professional limited liability company, a  
257 business trust or a Subchapter S corporation, that is recognized as a separate entity for federal income tax  
258 purposes, in which the partners, members, or shareholders report their share of the income, gains, losses,  
259 deductions, and credits from the entity on their federal income tax returns or make the election and pay  
260 the tax levied pursuant to § 58.1-390.3.

261 "Qualifying pass-through entity" means a pass-through entity that is 100 percent owned by natural  
262 persons or other individuals eligible to be shareholders in an S corporation.

263 **§ 58.1-390.2. Taxation of pass-through entities.**

264 Except as provided for in this article, owners of pass-through entities shall be liable for tax under  
265 this chapter only in their separate or individual capacities on income passed through to the owners of pass-  
266 through entities. Any taxes imposed on the pass-through entity itself, ~~such as, but not limited to,~~ including  
267 the tax levied pursuant to § 58.1-390.3, sales and use taxes, withholding taxes with respect to employees  
268 or nonresident owners, and minimum taxes in lieu of income taxes, shall be paid by the pass-through  
269 entity.

270 **§ 58.1-390.3. Elective income tax on pass-through entities.**

271 A. For taxable years beginning on and after January 1, 2022, but before January 1, 2026, a  
272 qualifying pass-through entity may make an annual election, on its timely filed return pursuant to § 58.1-  
273 392, to pay the tax levied by this section at the entity level for the taxable period covered by such return.  
274 Such election shall be made on or before the due date for filing the applicable return, including any  
275 extensions that have been granted.

276 B. A tax at the rate of 5.75 percent is hereby annually imposed on the Virginia taxable income, as  
277 calculated pursuant to § 58.1-391, for each taxable year of every qualifying pass-through entity that makes  
278 the election provided under subsection A.

279 C. A pass-through entity that elects to pay the tax levied by this subsection shall be eligible for all  
280 credits, deductions, or other adjustments to taxable income provided under § 58.1-391.

281 D. If a pass-through entity makes an election pursuant to this section and an individual owner  
282 taxpayer of such pass-through entity claims the subtraction provided by subsection 31 of § 58.1-322.02,  
283 such individual owner taxpayer shall not be eligible to claim any other deduction, subtraction, credit, or  
284 other adjustment for any amount of taxable income derived from the pass-through entity having Virginia  
285 taxable income.

286 E. The Department of Taxation shall develop and make publicly available guidelines implementing  
287 the provisions of this section, the subtraction authorized by subsection 31 of § 58.1-322.02, and the credit  
288 authorized by subdivision C 2 of § 58.1-332.

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