

SENATE BILL NO. 692

AMENDMENT IN THE NATURE OF A SUBSTITUTE

(Proposed by the House Committee on Finance

on February 28, 2022)

(Patron Prior to Substitute--Senator Petersen)

A BILL to amend and reenact §§ 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 §§ 58.1-332, 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:

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

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

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

The credit allowable under this section shall not exceed: (i) such proportion of the income tax otherwise payable by him under this chapter as his income upon which the tax imposed by the other state was computed bears to his Virginia taxable income upon which the tax imposed by this Commonwealth

27 was computed or (ii) the income tax otherwise payable under this chapter in the event that the income
28 upon which the tax imposed by the other state is computed is less than the Virginia taxable income upon
29 which the tax imposed by this Commonwealth is computed and all income derived from sources outside
30 the Commonwealth and subject to taxation under this chapter is earned income or business income
31 reported on federal form Schedule C from a single state contiguous to Virginia. The credit provided for
32 by this section shall not be granted to a resident individual when the laws of another state, under which
33 the income in question is subject to tax assessment, provide a credit to such resident individual
34 substantially similar to that granted by subsection B of this section.

35 B. Whenever a nonresident individual of this Commonwealth has become liable to the state where
36 he resides for income tax upon his Virginia taxable income for the taxable year, derived from Virginia
37 sources and subject to taxation under this chapter, the amount of such tax payable under this chapter shall
38 be credited with such proportion of the tax so payable by him to the state where he resides, upon proof of
39 such payment, as his income subject to taxation under this chapter bears to his entire income upon which
40 the tax so payable to such other state was imposed. The credit, however, shall be allowed only if the laws
41 of such state: (i) grant a substantially similar credit to residents of Virginia subject to income tax under
42 such laws or (ii) impose a tax upon the income of its residents derived from Virginia sources and exempt
43 from taxation the income of residents of this Commonwealth. No credit shall be allowed against the
44 amount of the tax on any income taxable under this chapter which is exempt from taxation under the laws
45 of such other state.

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

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

53 **§ 58.1-390.1. Definitions.**

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

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

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

64 "Qualifying pass-through entity" means a pass-through entity that is 100 percent owned by natural
65 persons or, in the case of a Subchapter S corporation, 100 percent owned by natural persons or other
66 persons eligible to be shareholders in an S corporation.

67 **§ 58.1-390.2. Taxation of pass-through entities.**

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

74 **§ 58.1-390.3. Elective income tax on pass-through entities.**

75 A. 1. For taxable years beginning on and after January 1, 2021, but before January 1, 2022, a
76 qualifying pass-through entity may make an election, in a format and according to such requirements and
77 procedures to be established by the Department, to pay the tax levied by this section at the entity level for
78 the taxable year. Such election shall be made on or before a date to be determined by the Department,
79 which shall be set no earlier than one year after the extended due date for filing the applicable return.

80 Notwithstanding §§ 58.1-1812 and 58.1-1833, no interest shall accrue on underpayments or overpayments
81 solely attributable to such election.

82 2. For taxable years beginning on and after January 1, 2022, but before January 1, 2026, a
83 qualifying pass-through entity may make an annual election, on its timely filed return pursuant to § 58.1-
84 392, to pay the tax levied by this section at the entity level for the taxable period covered by such return.
85 Such election shall be made on or before the due date for filing the applicable return, including any
86 extensions that have been granted.

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

90 C. A qualifying pass-through entity that elects to pay the tax levied by subsection B shall be eligible
91 for all credits, deductions, or other adjustments to taxable income under § 58.1-391, provided that a
92 qualifying pass-through entity's taxable income shall be adjusted to eliminate any federal deduction for
93 state and local income taxes.

94 D. Any person that is subject to the tax imposed under § 58.1-320 or 58.1-360 and is an owner of
95 a qualifying pass-through entity making the election pursuant to this section shall be entitled to a credit
96 against the tax imposed, provided that taxable income has been adjusted to add back any deduction for
97 state and local income taxes paid by the qualifying pass-through entity. Such credit shall be in an amount
98 equal to such person's pro rata share of the tax paid under this section by any qualifying pass-through
99 entity of which such person is an owner. If the amount of the credit allowed pursuant to this subsection
100 exceeds such person's tax liability for the tax imposed under § 58.1-320 or 58.1-360, as applicable, such
101 excess shall be treated as an overpayment and refundable pursuant to § 58.1-499.

102 E. If any qualifying pass-through entity makes an election pursuant to this section, the Department
103 shall assess and collect tax, interest, and penalties as if such tax is a corporate income tax imposed pursuant
104 to the provisions of Article 10 (§ 58.1- 400 et seq.).

105 F. The Department shall develop and make publicly available guidelines implementing the
106 provisions of this section and the credit authorized by subdivision C 2 of § 58.1-332.

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