COMMONWEALTH of VIRGINIA

Department of Taxation

November 1, 2025

The Honorable L. Louise Lucas
Chair, Senate Finance and Appropriations Committee

The Honorable Luke E. Torian
Chair, House Appropriations Committee and Joint Subcommittee on Tax Policy

The Honorable Vivian E. Watts
Chair, House Finance Committee

Dear Chairs Lucas, Torian, and Watts,

During the 2025 Session, the General Assembly enacted its 2025 Appropriation Act (House Bill 1600, Chapter 725), Item 257(F) of which requires Virginia Tax to convene a workgroup to study the treatment of net operating losses ("NOLs") in Virginia when compared to other states and to make recommendations to simplify such treatment in Virginia. The report of the study is enclosed.

If you have any questions or comments regarding the study or the enclosed report, please do not hesitate to contact me.

Sincerely,

James J Alex
State Tax Commissioner
Commonwealth of Virginia

C: The Honorable Stephen E. Cummings, Secretary of Finance
Kristin Collins, Deputy Tax Commissioner

Study Regarding the Treatment of Net Operating Losses in Virginia

Final Report

Department of Taxation

October 31, 2025

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Executive Summary

Item 257(F) of the 2025 Appropriation Act (House Bill 1600, Chapter 725) requires the Department of Taxation ("the Department") to convene a workgroup to study the treatment of net operating losses ("NOLs") in Virginia when compared to other states and to make recommendations to simplify such treatment in Virginia (*See* Appendix A, Item 257 of the 2025 Appropriations Act).

The Department contacted those stakeholders identified in the legislation and other relevant stakeholders to notify them of the meeting and to request that each stakeholder appoint two representatives to participate in the meeting. The workgroup meeting was held on July 1, 2025. Following the meeting, the Department solicited written comments to be provided by July 15, 2025. All comments received from the workgroup are attached.

The workgroup generally agreed that a post-apportionment NOL calculation (used by a majority of states) would likely result in a simpler and easier to track Virginia NOL than a pre-apportionment NOL calculation (used by Virginia and a minority of other states). The workgroup also agreed that Virginia's calculation for NOLs is unique, even among the minority of states that calculate NOLs on a pre-apportionment basis. The workgroup concluded that Virginia's NOL calculation is overly complicated and creates a burden on taxpayers attempting to comply with the complexity of Virginia's unique NOL rules. Based on these findings, the workgroup has drafted recommended legislation to transition Virginia from its current pre-apportion NOL calculation to a less complex post-apportionment NOL calculation (See Appendix B, Workgroup's Recommended Draft Legislation).

Background

A net operating loss, or NOL, occurs when a taxpayer's allowable tax deductions are greater than their taxable income for a given year. Generally, after a taxpayer generates an NOL, it is carried forward or back to be used to offset or reduce taxable income in other taxable years. For the year(s) in which such an NOL is utilized, the taxpayer is allowed a net operating loss deduction ("NOLD").

Apportionment

At the state level, multistate taxpayers must divide or "apportion" their income between the various states in which they operate for state income tax purposes. This is referred to as "apportionment," and in Virginia, multistate taxpayers must apportion their income to Virginia based on the amount of payroll, property and sales (double weighted) the taxpayer has in Virginia as compared with the overall totals of these amounts.

<u>Pre vs. Post Apportionment</u>

When determining what portion of a multistate taxpayer's NOL or NOLD should be applied to the taxpayer's state income tax return, states have taken two different approaches:

- The pre-apportionment method—requiring taxpayers to calculate these amounts prior to apportioning their income to the states, and
- The post apportionment method—requiring taxpayers to calculate these amounts after apportioning their income to the state.

Virginia and a minority of other states have adopted the pre-apportionment method, while the majority of states use the post-apportionment method.

Legislative History

The introduced versions of House Bill 2681 (2025) and Senate Bill 1426 (2025) would have, for Taxable Year 2022, defined "net operating loss" as the excess of any allowable income tax deductions over the gross income used in computing entire net income. This legislation would have also defined "entire net income" as total net income from all sources, which is the same as the taxable income before net operating loss deduction and special deductions, that the taxpayer is required to report for purposes of the federal income tax, with the adjustments required by Article 10 (§ 58.1-400 et seq.).

The House Finance Committee adopted a substitute for HB 2681, which would have required the Department to convene this workgroup to study Virginia's treatment of NOLs. The substitute version of HB 2681 was approved by the House of Delegates but was passed by indefinitely in the Senate Finance and Appropriations Committee. Ultimately, neither HB 2681 nor SB 1426 were enacted by the General Assembly. However, language which is virtually identical to the amended version of HB 2681 was included in Item 257(F) of the 2025 Appropriation Act.

This budget language required the Department to convene a workgroup of stakeholders including:

- The Taxation Section of the Virginia Bar Association;
- The Virginia Society of Certified Public Accountants; and
- Tax practitioners experienced in the preparation of corporate tax returns involving NOLs.

The workgroup was further directed to study the treatment of NOLs in Virginia when compared to other states, to make recommendations to simplify the treatment of NOLs in Virginia, and to consider:

- Transition rules to the proposed simplified method of determining NOLs;
- The effective date of any such transition; and
- What legislative, regulatory, or guideline amendments would be necessary to best effectuate such transition.

History of Federal NOLs

In federal tax law, the concept of NOLs, carryforwards, and carrybacks was introduced in the Revenue Act of 1918. This Act permitted corporations to retain tax losses generated in a current year to offset taxable income in another tax period and limited the carryover period for NOLs to one year forward and one year back. Rules were later enacted governing the succession, or lack thereof, of a target corporation's preexisting NOLs following a reorganization or acquisition of another corporation.

The NOL carryback and carryforward provisions established in 1918 were eliminated under the Revenue Act of 1933. NOLs continued to be disallowed as a deduction until the enactment of the Revenue Act of 1939, under which they could only be carried forward to the subsequent two years. While NOLs have been a permanent feature of federal income taxes since that time, the rules regarding carrybacks and carryforwards have changed several times over the years. The federal treatment of NOLs is codified in 26 U.S. Code § 172, which includes provisions for the carryover periods and limits on the amount of NOLs allowed as a deduction.

After changes made by the Tax Cuts and Jobs Act of 2017 ("TCJA"), NOLs arising in tax years beginning after December 31, 2017, generally may no longer be carried back but can be carried forward indefinitely, with no expiration. Post-TCJA NOLs are only eligible to offset 80 percent of taxable income in a future period. Pre-TCJA NOL rules remain unchanged, with NOLs eligible to offset 100 percent of taxable income and a general rule that NOLs must be carried back to the two preceding tax years with any excess carried forward for a period of 20 years before they expire if unused.

The Coronavirus Aid, Relief, and Economic Security Act of 2020 ("CARES Act") retroactively restored the NOL carryback by allowing NOLs from 2018, 2019, and 2020 to be carried back up to five years. The CARES Act also temporarily delayed the imposition of the 80 percent limit until after December 31, 2020.

History of Virginia NOLs

Prior to 1972, only manufacturers were allowed to claim NOLs carried from other taxable years on their Virginia returns. In 1972, Virginia adopted federal taxable income ("FTI") as the starting point for computing corporate Virginia income tax. By starting with FTI, Virginia incorporated the federal allowance of NOLD for any business and the federal allowance of NOLD to individuals to the extent that federal adjusted gross income ("FAGI") included business income. Because Virginia required several additions and subtractions to FTI, the net Virginia modifications had to follow the NOLD as it was used to reduce the amount of FTI that was taxable on the Virginia return.

The federal return reported the entire NOLD available, which often resulted in a negative amount of taxable income. However, when calculating the NOLD available in subsequent years only the amount of income offset by the NOLD in prior years was considered to have been used or absorbed on the federal returns. Amounts below zero, if any, were

ignored. Therefore, Virginia did not recognize a federal NOLD to the extent that it reduced FTI below zero. This effectively limited NOLD for Virginia purposes to the amount of a corporation's income before claiming NOLD on its federal return. This amount of NOLD absorbed was also used to calculate the portion of net Virginia modifications from the loss year that must be reported on the Virginia return.

In 1982, the General Assembly changed how multistate income was allocated and apportioned and added a Virginia combined return for affiliated corporations to report their income. This new type of return required that income, additions, subtractions, allocation, and apportionment be computed separately for each corporation, then, the bottom-line income and loss amounts are combined. This meant that the 1972 policies for determining the NOL claimed and the applicable portion of net modifications had to be applied for each affiliate.

In 1984, the Department published comprehensive regulations for corporate income tax, effective for taxable years beginning on and after January 1, 1985. These regulations laid out the policies relevant to NOL, including limiting NOLD to the amount claimed each year and associated net modifications from the loss year. They also explained how combined returns were to be prepared but did not include specific explanations of how NOLD policies applied to combined returns. These regulations did state that consolidated returns could not include corporations that used different apportionment factors.

In 1990, the General Assembly passed legislation that stated permission to file a consolidated return would not be denied because affiliates used different apportionment factors and directed the Department to issue regulations implementing this policy. Because of this legislation, the Department published amended regulations in 1993 that specified how a consolidated return handled corporations with different apportionment factors. This amendment also clarified and expanded other policies, including detailed instructions and examples of how NOLD is reported under Virginia's statutory separate, consolidated, and combined filing methods. These statutory filing methods coupled with Virginia's NOLD rules are the source of the complicated calculations for Virginia NOLDs.

The complexity of NOLD calculations further increased when the General Assembly began to selectively deconform from specific provisions of the Internal Revenue Code. This started in 2003 when deconformity was limited to bonus depreciation. In subsequent years, more deconformity provisions were added and, in some cases later modified or deleted, which directly affected the computation of Virginia NOLDs. Virginia has also deconformed from federal rules regarding when NOLs can be utilized, including deconforming from federal carryback provisions for NOLs and instead electing to only allow NOLs to be carried forward.

Complexity of NOLs in Virginia

Calculation of NOLs and NOLDs for state income tax purposes, especially when dealing with multistate taxpayers filing on a combined or consolidated basis, can be very complex in the best of circumstances. However, several developments in Virginia tax law including

Virginia's deconformity decisions and treatment of Internal Revenue Code ("IRC") § 163(j) have made this calculation even more difficult in recent years.

Virginia's Conformity to Federal Income Tax Laws

Beginning in 1972, Virginia automatically conformed ("rolling conformity") to federal income tax laws. Whenever a federal income tax law change affected the definition of taxable income, it automatically affected Virginia income tax law, unless the General Assembly enacted a specific exception. In 2003, Virginia began conforming to the IRC as of a fixed date, usually December 31 of the preceding year, in order to protect Virginia revenues from automatically being impacted by major federal tax law changes. From 2003 until 2023, the General Assembly generally advanced the date in order to conform to any federal changes made during the prior year, but deconformed from specific provisions. In 2023, Virginia returned to rolling conformity with certain revenue triggers. In addition to continuing to deconform from specific provisions, Virginia also deconformed to any amendments with a projected revenue impact exceeding a $15 million threshold or all amendments with a cumulative impact exceeding a $75 million threshold. In 2025, Virginia temporarily paused rolling conformity until 2027 by not automatically conforming to any amendments to the IRC, except extenders, that would have any projected revenue impact in the year it was enacted or any of the succeeding four fiscal years.

For each federal provision that Virginia deconforms from taxpayers are required to make a Fixed Date Conformity ("FDC") modifications to their FTI or FAGI for Virginia income tax purposes. These FDC modifications also are included in Virginia taxpayer's NOL and NOLD calculation.

Virginia and FDC Modifications Impact on Net Operating Losses

Virgina requires corporations to make certain additions and subtractions, including FDC modifications, to their FTI to calculate their Virginia taxable income ("VTI"). Just as FTI is modified by Virginia additions and subtractions, so also federal NOLs are also subject to Virginia modification from the loss year that follow the federal NOL to the year the loss is used. Thus, if the federal NOL is used in a carryback or carryover year, the net amount of these Virginia additions and subtractions will be applied in the same ratio to the applicable year. After all modifications, including the FDC modifications explained below, are applied the taxpayer then multiplies the federal NOLD by the taxpayers apportionment formula for the year of use to arrive at the amount of the NOLD for Virginia purposes. Under current Virgina law the federal NOLD may be used only to reduce FTI, and a federal NOLD cannot create or increase a NOL.

The impact of FDC modifications on a taxpayer's NOLD is significant, even apart from the potential changes in a taxpayer's apportionment factors from the year of the loss to the year the loss is taken. Taxpayers may be required to make and track multiple FDC adjustments over multiple years for each item of FTI that Virginia has deconformed from for the loss year and each year to which the loss has been carried on their federal returns. Only then can the taxpayer determine the amount of the federal NOLD available for Virginia purposes, to which Viginia modifications (described above) from the loss year

must also be applied based on the portion of FTI (modified by FDC) deemed to have been offset by federal NOLD (modified by FDC).

Changing to a post-apportionment Virginia NOLD will eliminate half of these calculations. Taxpayers would still have to make all of the FDC modifications to the current-year's FTI or loss but would no longer have to make FDC calculations to determine the amount of federal NOLD available for Virginia purposes. All subsequent loss carryover calculations would be done on the Virginia return after apportionment.

IRC § 163(j) Business Interest Limitation

One of the more recent deconformity provisions that is causing additional complexity is Virginia's treatment of the federal limitation on business interest under IRC § 163(j). Prior to Taxable Year 2018, interest was generally deductible for federal income tax purposes in the year paid or accrued. The TCJA imposed a limitation on the deductibility of business interest that generally limits a taxpayer's deduction for business interest to the sum of the following amounts:

- The taxpayer's business interest income for the taxable year;
- 30 percent of the taxpayer's adjusted taxable income ("ATI") for the taxable year; plus
- The taxpayer's floor plan financing for the taxable year.

Any business interest that is disallowed because of the business interest limitation is treated as business interest paid or accrued in the following taxable year, and may be carried forward indefinitely, subject to certain restrictions. The definition of ATI was amended in 2025 by the One Big Beautiful Bill Act to allow a more generous deduction than was permitted under the TCJA.

Virginia currently allows a corporate and individual income tax deduction equal to 50 percent of the amount of business interest that is disallowed as a deduction for federal income tax purposes pursuant to the federal business interest limitation. This Virginia specific deduction accelerates the deduction of business interest for Virginia income tax purposes by allowing a larger deduction during the year in which interest expense is paid or accrued than is allowed on the federal return. However, in future taxable years, taxpayers will be required to reconcile this acceleration on their Virginia income tax returns by taking a smaller deduction for business interest than permitted on their federal returns.

NOLs in Other States

Unlike Virginia, the majority of states (36 plus the District of Columbia) calculate a state NOL using post-apportionment rules. Only 10 other states besides Virginia use pre-apportionment rules to calculate a state NOL. The recent trend among other states has been transitioning from pre-apportionment to post-apportionment.

Coordination of NOL Simplification with Virginia's System Replacement

The Integrated Revenue Management System ("IRMS") is Virginia's legacy core tax processing and tax accounting system that administers 36 taxes, processing around 12 million tax returns a year. The age of the core IRMS technologies and related supporting applications has created functional and technological gaps that impact the Department's ability to efficiently perform tax operations and limits the agency's ability to make timely changes in response to legislative requests.

As a result, the Department is currently in the process of replacing IRMS with a new tax operating system, with the goals of improving service to individuals and businesses, reducing long-term processing costs, minimizing risk exposure, enhancing innovation, and rapidly implementing legislative changes. The phased implementation of the new tax system is currently scheduled to occur for corporate income tax in September 2027, effective for Taxable Year 2027. Scheduling any changes to Virginia's NOL methodology to coincide with that implementation would facilitate a more efficient and streamlined transition, reducing the cost to the Department of implementing such changes.

Workgroup Meeting

The Department contacted those stakeholders identified in the legislation and other relevant stakeholders to notify them of the workgroup meeting and requested that each stakeholder appoint two representatives to participate in the workgroup meeting. The following stakeholders and their representatives participated in the workgroup meeting:

- Virginia Society of Certified Public Accountants ("VSCPA") - Amol Jain, Kristofer Thomas, and Emily Walker;
- Virginia Bar Association's ("VBA") Tax Section - Kyle Wingfield (Chair) and Alec Sauble (Vice Chair);
- Council on State Taxation ("COST") - Patrick Reynolds; and
- (AT&T) - Garrett McGuire, Jon Griebert, and Jeb Stuart.

The workgroup meeting was held on July 1, 2025. All stakeholders that responded to the request for participation were in attendance, either in person or virtually. Prior to the meeting, the Department gave the stakeholders an agenda with an outline of the topics to be discussed (*See* Appendix C, Workgroup Documents).

At the beginning of the meeting, representatives from the Department provided an overview of the legislation, the workgroup mandate, and the history of NOLs in Virginia. Following the overview, each stakeholder participant was given an opportunity to provide recommendations to simplify the treatment of NOLs in Virginia.

Jeb Stuart, a representative from AT&T, stated that his understanding is that, in its current form, the Virginia NOL is a complicated calculation. At times, the company has significant losses and therefore significant differences between federal and state treatment of NOLs. In order to comply with state tax laws, Mr. Stuart expressed that taxpayers expend too much time calculating the NOLs in order to get it right on their state tax returns.

He briefly explained the concept of a deferred tax asset, where an NOL is treated as an asset on the taxpayer's balance sheet. For many states with simpler NOL calculations, that value is fixed as of the tax year when the NOL is generated because it's a post-apportioned NOL, and the only change to the value of that asset is if the relevant state changes its tax rate.

In contrast, because Virginia currently uses a pre-apportioned NOL calculation, the asset value changes every year based purely on what the taxpayer's apportionment factor is for that year. As the business changes, there is considerable volatility in the apportionment factor, resulting in the asset value of Virginia NOLs on the taxpayer's balance sheet also being volatile. A change to a post-apportion NOL would take some of the volatility out of taxpayers' financial statements, and would be simpler because that apportioned loss would be what is carried forward as the taxpayer's NOL.

Pat Reynolds, the representative for COST, stated that a common complaint among COST's members is that Virginia's calculation of NOLs is very complicated. He asked whether there is another state's model that Virginia could follow in its shift to a post-apportionment calculation.

At this point, the Department asked whether any of the workgroup participants had a specific state or model that worked particularly well for NOLs that they would like to see Virginia implement or use as a template for simplifying the NOL calculation.

Kris Thomas, a representative for VSCPA, stated that VTI computation is completely unique to all the jurisdictions with which he has experience. Because of FDC modifications, taxpayers must change their FTI to compute an NOL that will be carried forward. Virginia further has the distinction between FDC modifications and the other state modifications. This is a point of confusion that he has experienced with many of his clients. To him, that is the "low hanging fruit" that can get cleaned up to solve many problems that are unique to Virginia. He cited New Jersey and New York as two recent states that have switched from pre-apportionment to post-apportionment.

He also pointed out another issue, which is the interaction between the IRC § 163(j) computation and NOLs. Taxpayers who are subject to the IRC § 163(j) limitation at the federal level receive a 30 or 50 percent acceleration of the deduction on the Virginia return. In subsequent years when they actually earn taxable income, because the deduction was a Virginia modification and not a FDC modification, there is a disconnect where taxpayers are not getting the value of that IRC § 163(j) carry forward that was previously limited. Because the accelerated IRC §163(j) deduction is not a FDC modification it is not added to the NOL, and thus part of the value of the deduction is lost.

Jeb Stuart suggested considering a transition option that would allow a taxpayer to use the apportionment factor in the year of the loss. Due to merger activity, the current apportionment factors can often look much different than they were in the year of loss.

The Department asked the workgroup if there were any other thoughts on transition rules, other good models besides New York and New Jersey, or any issues that they were aware of in other states that had transitioned.

Jeb Stuart said that, because New York and New Jersey transitioned to post-apportionment NOLs along with changing to a mandatory unitary combined return, their transitions were probably more complicated than would be the case for Virginia, assuming that Virginia does not change its return filing type.

The Department asked for clarification on whether it was mostly combined returns that are the issue or if the workgroup participants also experience issues with consolidated returns. Kris Thomas stated that it was more complicated with combined returns because of the requirement to track the value of the NOLs and the state modifications. He added that, the bigger the structure of the business, the more complicated and "painful" it is to track.

The Department asked if the participants were aware of any separate company states that made the transition and whether the option to transition from unitary to separate company reporting would make estimating the revenue impact of such a transition easier. Jeb Stuart predicted that a transition to post-apportionment NOLs would likely make revenue forecasting easier because the NOLs would have a more definitive value versus pre-apportionment NOLs where the value would depend on the taxpayers' apportionment factors in a given year.

The Department then asked for comments on the effective date for the transition and whether it could coincide with the updating of the Department's IRMS system which is currently scheduled to occur in September 2027 (effective for Taxable Year 2027) for corporate income tax purposes.

Kris Thomas stated that obviously the more notice that taxpayers had of a transition, the better. As soon as the legislation implementing the transition is passed, taxpayers will have to reflect it in their financial statements so understating the rules will be necessary at that point. He explained that it would be less than ideal if any additional guidance were published after implementation as it would make it difficult for companies to update their financial statements. Jeb Stuart stated that legislation that provides a framework would likely be enough, at least for certain companies, to be able to estimate the impact for financial statement purposes, which can then be adjusted later once additional guidance is published. The important aspects for taxpayers would be an understanding of the broad issues of pre-apportionment versus post-apportionment and clarity on the requirements or options for converting the old NOLs to the new method.

Kris Thomas asked whether changes could be effectuated without legislation, specifically for aspects such as Virginia's modifications to FTI, which is administrative policy that has been developed by the Department, and if those changes could occur before the passage of more comprehensive NOL legislation. The Department responded that, because any transition would be a departure from long-standing policy, its preference would be starting with legislation and then developing any additional policy after that legislative directive.

The Department pointed out that there may be taxpayers that prefer the current NOL system, and the legislative process will ensure that they have an opportunity for input. Additionally, the regulatory process generally takes longer than legislation. Legislation could also facilitate comprehensive changes instead of accomplishing the transition in a piecemeal or incremental manner.

The Department asked if there were any other aspects besides Virginia's modifications to FTI that they would like to simplify. Kris Thomas suggested that the most simplified approach would be a post-apportioned NOL, which would reduce much of the volatility. Kris Thomas explained that taxpayers and the Department would both have a better idea of a NOL's value under a post-apportionment approach.

The Department acknowledged that the revenue impact on Virginia is going to be a key question that will be asked during the legislative process, and it is unclear whether the Department has the data to accurately provide such estimates. It asked the participants if they had any suggestions about developing estimates based on what they had seen in other states. Kris Thomas suggested an approach similar to the one that New York took where NOLs are changed to post-apportionment as of a certain date and a certain apportionment factor.

Jeb Stuart suggested that thought be given to rules regarding successorship in the cases of mergers and acquisitions. In regard to successorship, generally conforming to the federal treatment of NOLs should be considered because that is common among the states and, if there is a Virginia specific NOL, it will be necessary to have those rules in place.

Written Comments

In its written comments, COST reiterated that its members have found that the calculation of NOLs in Virginia is needlessly complex and more difficult than methods used by other states. COST respectfully urges the workgroup to recommend legislation to simplify the NOL calculations and supports transitioning to calculation of NOLs on a post-apportionment basis. COST suggests that the NOLs should be the post-apportioned federal loss, plus or minus state modifications, which would eliminate the separate tracking of NOLs. Such simplifications are more stable and consistent with the calculations of deferred tax assets and liabilities under generally accepted accounting principles (*See* Appendix D, Written Comments).

In his written comments, Kris Thomas provided some information on recent changes to other states' NOL treatment, namely New York, Kentucky, and Louisiana. He highlighted that, while most of these transitions were from pre- to post-apportionment methodologies coupled with a shift to mandatory unitary combined reporting, Louisiana changed to a post-apportionment method from a 72 percent limitation and a last-in-first-out method (*See* Appendix D).

Additional Written Comments

The Department circulated the draft report and received two additional written comments from COST and the VSCPA (*See* Appendix E). The Department made amendments to the Workgroup's Recommended Draft Legislation (Appendix B) in response to some of these comments and opted to address the more discrete and complicated issues identified in the guidelines that would be needed to implement any new NOL methodology. Such guidelines would be made available to the public for comment prior to being adopted and published by the Department.

Conclusion and Findings

The NOL workgroup brought together tax practitioners experienced in the preparation of corporate tax returns involving NOLs. The Department is grateful to everyone that participated and provided input for this report. The workgroup identified the following areas of consensus:

1. Workgroup participants generally agreed that Virginia's treatment of NOLs is too complicated.

2. There was agreement that, to simplify such treatment, Virginia should transition from a pre-apportionment to a post-apportionment methodology.

3. Changing to a post-apportionment methodology will make it easier for taxpayers to track the value of their NOLs.

4. Legislation, rather than regulations, would be preferable to implement a new NOL methodology. (*See* Appendix B, Workgroup's Recommended Draft Legislation)

5. If a new NOL methodology is adopted during the 2026 General Assembly session, implementation of such new methodology should be for taxable years beginning on and after January 1, 2027. The new methodology would be prospective only.

6. The recommended transition rules would allow any corporation filing a Taxable Year 2026 return to calculate a transitional NOLD by taking their total federal NOL available to be carried over to post-2026 Virginia returns, net applicable Virginia modifications, and multiplied by their Taxable Year 2026 apportionment formula. On their Taxable Year 2027 or later Virginia return, a taxpayer's available Virginia NOLD would be their transitional NOLD plus their NOL for the taxable year, if any, calculated under the new rules.

Appendices

Appendix A: Item 257 of the 2025 Appropriation Act (House Bill 1600, Chapter 725)

2025 Session

Budget Bill - HB1600 (Chapter 725)

All Items » Item 257

Department of Taxation

Item 257	First Year - FY2025	Second Year - FY2026
Planning, Budgeting, and Evaluation Services (71500)	**$6,176,511**	~~**$5,176,511**~~ ***$5,946,893***
Tax Policy Research and Analysis (71507)	$3,899,793	$2,899,793
Appeals and Rulings (71508)	$1,415,043	~~$1,415,043~~ *$2,185,425*
Revenue Forecasting (71509)	$861,675	$861,675
Fund Sources:		
General	$6,176,511	~~$5,176,511~~ *$5,946,893*

Authority: §§ 2.2-1503, 15.2-2502, 58.1-202, 58.1-207, 58.1-210, 58.1-213, 58.1-816, and 58.1-3406, and Title 10.1, Chapter 14, Code of Virginia.

A. The Department of Taxation shall continue the staffing and responsibility for the revenue forecasting of the Commonwealth Transportation Funds, including the Department of Motor Vehicles Special Fund, as provided in § 2.2-1503, Code of Virginia. The Department of Motor Vehicles shall provide the Department of Taxation with direct access to all data records and systems required to perform this function. The Department of Planning and Budget shall effectuate the transfer of three full-time equivalent positions and sufficient funding to ensure the successful consolidation of this function.

B. Notwithstanding the provisions of § 58.1-202.2, Code of Virginia, no report on public-private partnership contracts shall be required in years following the final report upon the completion of contract or when no such contract is active.

C. The Department of Taxation shall report no later than September 1 on an annual basis, to the Chairmen of the House Appropriations, House Finance and Senate Finance and Appropriation Committees, on the amount of state sales and use tax revenues authorized to be remitted for the preceding fiscal year under the provisions of § 58.1-608.3, § 58.1-3851.1, and § 58.1-3851.2, of the Code of Virginia, as amended by the 2015 General Assembly.

D. Out of this appropriation, $1,000,000 the first year from the general fund shall be used for initial costs associated with the replacement of the Department of Taxation's Integrated Revenue Management System (IRMS). Such funds shall be allocated in accordance with continued efforts related to the workgroup required by Item 273 Paragraph D of the 2022 and 2023 Appropriation Acts. Accordingly, the workgroup is hereby continued and directed to review the plan for implementation of an IRMS modernization project as developed by the Department of Taxation based upon recommendations of the workgroup's 2022 assessment. Such review shall include consideration of methodologies for refactoring and replacement, the project roadmap and timeline, costs and funding structure, and the governance structure required for the modernization effort. In addition, the workgroup shall provide periodic oversight of the implementation of the IRMS modernization project. The workgroup shall include the Secretary of Finance or his designee, staff from the House Appropriations and Senate Finance and

Appropriations Committees, the Director of the Department of Planning and Budget, and the Chief Information Officer of the Virginia Information Technologies Agency. The workgroup shall submit an update on its findings and recommendations to the Governor and the Chairs of the House Appropriations and Senate Finance and Appropriations Committees by November 1, 2024, with an annual executive summary of the interim activity of the project implementation by November 1 of each subsequent year until implementation of a new system is complete.

E. The Department of Taxation shall assess implementing market-based sourcing for sales in the corporate income apportionment formula. The Department shall assess the administrative feasibility, the impact on major classifications of corporations operating in Virginia, the impact on corporate expansion within and into Virginia, and the projected impact on Virginia's tax revenue as a result of adopting market-based sourcing. The Department shall present recommendations to the Joint Subcommittee on Tax Policy for evaluation of the fiscal implications and incorporate any feedback from the Joint Subcommittee prior to the submission of the final report. The Department may establish a work group of stakeholders with the Secretary of Finance and the Chairs of the House Finance, House Appropriations, and Senate Finance and Appropriations Committees participating in selecting its members. The Department shall submit a report with recommendations by November 15, 2025 to the Chairs of House Finance, House Appropriations, and Senate Finance and Appropriations Committees.

F. The Department of Taxation shall convene a work group composed of tax practitioners experienced in the preparation of corporate tax returns involving net operating losses, including members recommended by the Taxation Section of the Virginia Bar Association and the Virginia Society of Certified Public Accountants. The work group shall study the treatment of net operating losses in Virginia when compared to other states and shall make recommendations to simplify such treatment in Virginia. The work group shall consider at a minimum: (i) transition rules to the proposed simplified method of determining net operating losses; (ii) the effective date of any such transition; and (iii) what legislative, regulatory, or guideline amendments would be necessary to best effectuate such transition. The work group shall complete its meetings by October 1, 2025, and the Department shall submit a report of the work group's findings and recommendations to the Chairs of the Senate Finance and Appropriations, House Finance, and House Appropriations Committee by November 1, 2025.

Appendix B: Workgroup's Recommended Draft Legislation

Workgroup Recommendation for
Post-Apportionment Corporate
Net Operating Loss
Draft Legislation

Be it enacted by the General Assembly of Virginia:

That § 58.1-402 of the Code of Virginia is amended and reenacted and to amend the Code of Virgina by adding Chapter 3 of Title 58.1 a section numbered 58.1-402.1 as follows

§ 58.1-402. Virginia taxable income.

A. For purposes of this article, Virginia taxable income for a taxable year means the federal taxable income and any other income taxable to the corporation under federal law for such year of a corporation adjusted as provided in subsections B, C, D, E, G, H, ~~and~~ I, and J. For taxable years beginning on and after January 1, 2027, federal taxable income means any income taxable to the corporation under federal law for such year excluding net operating loss deductions under I.R.C. § 172.

For a regulated investment company and a real estate investment trust, such term means the "investment company taxable income" and "real estate investment trust taxable income," respectively, to which shall be added in each case any amount of capital gains and any other income taxable to the corporation under federal law which shall be further adjusted as provided in subsections B, C, D, E, G, H, ~~and~~ I, and J.

B. There shall be added to the extent excluded from federal taxable income:

1. Interest, less related expenses to the extent not deducted in determining federal taxable income, on obligations of any state other than Virginia, or of a political subdivision of any such other state unless created by compact or agreement to which the Commonwealth is a party;

2. Interest or dividends, less related expenses to the extent not deducted in determining federal taxable income, on obligations or securities of any authority, commission or instrumentality of the United States, which the laws of the United States exempt from federal income tax but not from state income taxes;

3. [Repealed.]

4. The amount of any net income taxes and other taxes, including franchise and excise taxes, which are based on, measured by, or computed with reference to net income, imposed by the

Commonwealth or any other taxing jurisdiction, to the extent deducted in determining federal taxable income;

5. Unrelated business taxable income as defined by § 512 of the Internal Revenue Code;

6. [Repealed.]

7. The amount required to be included in income for the purpose of computing the partial tax on an accumulation distribution pursuant to § 667 of the Internal Revenue Code;

8. a. For taxable years beginning on and after January 1, 2004, the amount of any intangible expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with one or more related members to the extent such expenses and costs were deductible or deducted in computing federal taxable income for Virginia purposes. This addition shall not be required for any portion of the intangible expenses and costs if one of the following applies:

(1) The corresponding item of income received by the related member is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government that has entered into a comprehensive tax treaty with the United States government;

(2) The related member derives at least one-third of its gross revenues from the licensing of intangible property to parties who are not related members, and the transaction giving rise to the expenses and costs between the corporation and the related member was made at rates and terms comparable to the rates and terms of agreements that the related member has entered into with parties who are not related members for the licensing of intangible property; or

(3) The corporation can establish to the satisfaction of the Tax Commissioner that the intangible expenses and costs meet both of the following: (i) the related member during the same taxable year directly or indirectly paid, accrued or incurred such portion to a person who is not a related member, and (ii) the transaction giving rise to the intangible expenses and costs between the corporation and the related member did not have as a principal purpose the avoidance of any portion of the tax due under this chapter.

b. A corporation required to add to its federal taxable income intangible expenses and costs pursuant to subdivision a may petition the Tax Commissioner, after filing the related income tax return for the taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under this article for such taxable year including tax upon any amount of intangible expenses and costs required to be added to federal taxable income pursuant to subdivision a, to consider evidence relating to the transaction or transactions between the corporation and a related

member or members that resulted in the corporation's taxable income being increased, as required under subdivision a, for such intangible expenses and costs.

If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and convincing evidence, that the transaction or transactions between the corporation and a related member or members resulting in such increase in taxable income pursuant to subdivision a had a valid business purpose other than the avoidance or reduction of the tax due under this chapter, the Tax Commissioner shall permit the corporation to file an amended return. For purposes of such amended return, the requirements of subdivision a shall not apply to any transaction for which the Tax Commissioner is satisfied (and has identified) that the transaction had a valid business purpose other than the avoidance or reduction of the tax due under this chapter. Such amended return shall be filed by the corporation within one year of the written permission granted by the Tax Commissioner and any refund of the tax imposed under this article shall include interest at a rate equal to the rate of interest established under § 58.1-15 and such interest shall accrue as provided under § 58.1-1833. However, upon the filing of such amended return, any related member of the corporation that subtracted from taxable income amounts received pursuant to subdivision C 21 shall be subject to the tax imposed under this article on that portion of such amounts for which the corporation has filed an amended return pursuant to this subdivision. In addition, for such transactions identified by the Tax Commissioner herein by which he has been satisfied by clear and convincing evidence, the Tax Commissioner may permit the corporation in filing income tax returns for subsequent taxable years to deduct the related intangible expenses and costs without making the adjustment under subdivision a.

The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of any petition pursuant to this subdivision, to include costs necessary to secure outside experts in evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this subdivision upon payment of such fee.

No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision shall be maintained in any court of this Commonwealth.

c. Nothing in subdivision B 8 shall be construed to limit or negate the Department's authority under § 58.1-446;

9. a. For taxable years beginning on and after January 1, 2004, the amount of any interest expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with one or more related members to

the extent such expenses and costs were deductible or deducted in computing federal taxable income for Virginia purposes. This addition shall not be required for any portion of the interest expenses and costs, if:

(1) The related member has substantial business operations relating to interest-generating activities, in which the related member pays expenses for at least five full-time employees who maintain, manage, defend or are otherwise responsible for operations or administration relating to the interest-generating activities; and

(2) The interest expenses and costs are not directly or indirectly for, related to or in connection with the direct or indirect acquisition, maintenance, management, sale, exchange, or disposition of intangible property; and

(3) The transaction giving rise to the expenses and costs between the corporation and the related member has a valid business purpose other than the avoidance or reduction of taxation and payments between the parties are made at arm's length rates and terms; and

(4) One of the following applies:

(i) The corresponding item of income received by the related member is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government that has entered into a comprehensive tax treaty with the United States government;

(ii) Payments arise pursuant to a pre-existing contract entered into when the parties were not related members provided the payments continue to be made at arm's length rates and terms;

(iii) The related member engages in transactions with parties other than related members that generate revenue in excess of $2 million annually; or

(iv) The transaction giving rise to the interest payments between the corporation and a related member was done at arm's length rates and terms and meets any of the following: (a) the related member uses funds that are borrowed from a party other than a related member or that are paid, incurred or passed-through to a person who is not a related member; (b) the debt is part of a regular and systematic funds management or portfolio investment activity conducted by the related member, whereby the funds of two or more related members are aggregated for the purpose of achieving economies of scale, the internal financing of the active business operations of members, or the benefit of centralized management of funds; (c) financing the expansion of the business operations; or (d) restructuring the debt of related members, or the pass-through of acquisition-related indebtedness to related members.

b. A corporation required to add to its federal taxable income interest expenses and costs pursuant to subdivision a may petition the Tax Commissioner, after filing the related income tax return for the taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under this article for such taxable year including tax upon any amount of interest expenses and costs required to be added to federal taxable income pursuant to subdivision a, to consider evidence relating to the transaction or transactions between the corporation and a related member or members that resulted in the corporation's taxable income being increased, as required under subdivision a, for such interest expenses and costs.

If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and convincing evidence, that the transaction or transactions between the corporation and a related member or members resulting in such increase in taxable income pursuant to subdivision a had a valid business purpose other than the avoidance or reduction of the tax due under this chapter and that the related payments between the parties were made at arm's length rates and terms, the Tax Commissioner shall permit the corporation to file an amended return. For purposes of such amended return, the requirements of subdivision a shall not apply to any transaction for which the Tax Commissioner is satisfied (and has identified) that the transaction had a valid business purpose other than the avoidance or reduction of the tax due under this chapter and that the related payments between the parties were made at arm's length rates and terms. Such amended return shall be filed by the corporation within one year of the written permission granted by the Tax Commissioner and any refund of the tax imposed under this article shall include interest at a rate equal to the rate of interest established under § 58.1-15 and such interest shall accrue as provided under § 58.1-1833. However, upon the filing of such amended return, any related member of the corporation that subtracted from taxable income amounts received pursuant to subdivision C 21 shall be subject to the tax imposed under this article on that portion of such amounts for which the corporation has filed an amended return pursuant to this subdivision. In addition, for such transactions identified by the Tax Commissioner herein by which he has been satisfied by clear and convincing evidence, the Tax Commissioner may permit the corporation in filing income tax returns for subsequent taxable years to deduct the related interest expenses and costs without making the adjustment under subdivision a.

The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of any petition pursuant to this subdivision, to include costs necessary to secure outside experts in

evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this subdivision upon payment of such fee.

No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision shall be maintained in any court of this Commonwealth.

c. Nothing in subdivision B 9 shall be construed to limit or negate the Department's authority under § 58.1-446.

d. For purposes of subdivision B 9:

"Arm's-length rates and terms" means that (i) two or more related members enter into a written agreement for the transaction, (ii) such agreement is of a duration and contains payment terms substantially similar to those that the related member would be able to obtain from an unrelated entity, (iii) the interest is at or below the applicable federal rate compounded annually for debt instruments under § 1274(d) of the Internal Revenue Code that was in effect at the time of the agreement, and (iv) the borrower or payor adheres to the payment terms of the agreement governing the transaction or any amendments thereto.

"Valid business purpose" means one or more business purposes that alone or in combination constitute the motivation for some business activity or transaction, which activity or transaction improves, apart from tax effects, the economic position of the taxpayer, as further defined by regulation.

10. a. For taxable years beginning on and after January 1, 2009, the amount of dividends deductible under §§ 561 and 857 of the Internal Revenue Code by a Captive Real Estate Investment Trust (REIT). For purposes of this subdivision, a REIT is a Captive REIT if:

(1) It is not regularly traded on an established securities market;

(2) More than 50 percent of the voting power or value of beneficial interests or shares of which, at any time during the last half of the taxable year, is owned or controlled, directly or indirectly, by a single entity that is (i) a corporation or an association taxable as a corporation under the Internal Revenue Code; and (ii) not exempt from federal income tax pursuant to § 501(a) of the Internal Revenue Code; and

(3) More than 25 percent of its income consists of rents from real property as defined in § 856(d) of the Internal Revenue Code.

b. For purposes of applying the ownership test of subdivision 10 a (2), the following entities shall not be considered a corporation or an association taxable as a corporation:

(1) Any REIT that is not treated as a Captive REIT;

(2) Any REIT subsidiary under § 856 of the Internal Revenue Code other than a qualified REIT subsidiary of a Captive REIT;

(3) Any Listed Australian Property Trust, or an entity organized as a trust, provided that a Listed Australian Property Trust owns or controls, directly or indirectly, 75 percent or more of the voting or value of the beneficial interests or shares of such trust; and

(4) Any Qualified Foreign Entity.

c. For purposes of subdivision B 10, the constructive ownership rules prescribed under § 318(a) of the Internal Revenue Code, as modified by § 856(d)(5) of the Internal Revenue Code, shall apply in determining the ownership of stock, assets, or net profits of any person.

d. For purposes of subdivision B 10:

"Listed Australian Property Trust" means an Australian unit trust registered as a Management Investment Scheme, pursuant to the Australian Corporations Act, in which the principal class of units is listed on a recognized stock exchange in Australia and is regularly traded on an established securities market.

"Qualified Foreign Entity" means a corporation, trust, association or partnership organized outside the laws of the United States and that satisfies all of the following criteria:

(1) At least 75 percent of the entity's total asset value at the close of its taxable year is represented by real estate assets, as defined in § 856(c)(5)(B) of the Internal Revenue Code, thereby including shares or certificates of beneficial interest in any REIT, cash and cash equivalents, and U.S. Government securities;

(2) The entity is not subject to a tax on amounts distributed to its beneficial owners, or is exempt from entity level tax;

(3) The entity distributes, on an annual basis, at least 85 percent of its taxable income, as computed in the jurisdiction in which it is organized, to the holders of its shares or certificates of beneficial interest;

(4) The shares or certificates of beneficial interest of such entity are regularly traded on an established securities market or, if not so traded, not more than 10 percent of the voting power or value in such entity is held directly, indirectly, or constructively by a single entity or individual; and

(5) The entity is organized in a country that has a tax treaty with the United States.

e. For taxable years beginning on or after January 1, 2016, for purposes of subdivision B 10, any voting power or value of the beneficial interests or shares in a REIT that is held in a segregated

asset account of a life insurance corporation as described in § 817 of the Internal Revenue Code shall not be taken into consideration when determining if such REIT is a Captive REIT.

11. For taxable years beginning on or after January 1, 2016, to the extent that tax credit is allowed for the same donation pursuant to § 58.1-439.12:12, any amount claimed as a federal income tax deduction for such donation under § 170 of the Internal Revenue Code, as amended or renumbered.

C. There shall be subtracted to the extent included in and not otherwise subtracted from federal taxable income:

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 this Commonwealth or of any political subdivision or instrumentality of this Commonwealth.

3. Dividends upon stock in any domestic international sales corporation, as defined by § 992 of the Internal Revenue Code, 50 percent or more of the income of which was assessable for the preceding year, or the last year in which such corporation has income, under the provisions of the income tax laws of the Commonwealth.

4. The amount of any refund or credit for overpayment of income taxes imposed by this Commonwealth or any other taxing jurisdiction.

5. Any amount included therein by the operation of the provisions of § 78 of the Internal Revenue Code (foreign dividend gross-up).

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

7. Any amount included therein by the operation of § 951 of the Internal Revenue Code (subpart F income) or, for taxable years beginning on and after January 1, 2018, § 951A of the Internal Revenue Code (Global Intangible Low-Taxed Income).

8. Any amount included therein which is foreign source income as defined in § 58.1-302.

9. [Repealed.]

10. The amount of any dividends received from corporations in which the taxpaying corporation owns 50 percent or more of the voting stock.

11. [Repealed.]

12, 13. [Expired.]

14. For taxable years beginning on or after January 1, 1995, the amount for "qualified research expenses" or "basic research expenses" eligible for deduction for federal purposes, but which were not deducted, on account of the provisions of § 280C(c) of the Internal Revenue Code.

15. For taxable years beginning on or after January 1, 2000, the total amount actually contributed in funds to the Virginia Public School Construction Grants Program and Fund established in Chapter 11.1 (§ 22.1-175.1 et seq.) of Title 22.1.

16. For taxable years beginning on or after January 1, 2000, but before January 1, 2015, the gain derived from the sale or exchange of real property or the sale or exchange of an easement to real property which results in the real property or the easement thereto being devoted to open-space use, as that term is defined in § 58.1-3230, for a period of time not less than 30 years. To the extent a subtraction is taken in accordance with this subdivision, no tax credit under this chapter for donating land for its preservation shall be allowed for three years following the year in which the subtraction is taken.

17. For taxable years beginning on and after January 1, 2001, any amount included therein with respect to § 58.1-440.1.

18. For taxable years beginning on and after January 1, 1999, income received as a result of (i) the "Master Settlement Agreement," as defined in § 3.2-3100; and (ii) the National Tobacco Grower Settlement Trust dated July 19, 1999, by (a) tobacco farming businesses; (b) any business holding a tobacco marketing quota, or tobacco farm acreage allotment, under the Agricultural Adjustment Act of 1938; or (c) any business having the right to grow tobacco pursuant to such a quota allotment.

19, 20. [Repealed.]

21. For taxable years beginning on and after January 1, 2004, any amount of intangible expenses and costs or interest expenses and costs added to the federal taxable income of a corporation pursuant to subdivision B 8 or B 9 shall be subtracted from the federal taxable income of the related member that received such amount if such related member is subject to Virginia income tax on the same amount.

22. For taxable years beginning on and after January 1, 2009, any gain recognized from the sale of launch services to space flight participants, as defined in 49 U.S.C. § 70102, or launch services intended to provide individuals the training or experience of a launch, without performing an actual launch. To qualify for a deduction under this subdivision, launch services must be performed in Virginia or originate from an airport or spaceport in Virginia.

23. For taxable years beginning on and after January 1, 2009, any gain recognized as a result of resupply services contracts for delivering payload, as defined in 49 U.S.C. § 70102, entered into with the Commercial Orbital Transportation Services division of the National Aeronautics and Space Administration or other space flight entity, as defined in § 8.01-227.8, and launched from an airport or spaceport in Virginia.

24. For taxable years beginning on or after January 1, 2011, any income taxed as a long-term capital gain for federal income tax purposes, or any income taxed as investment services partnership interest income (otherwise known as investment partnership carried interest income) for federal income tax purposes. To qualify for a subtraction under this subdivision, such income must be attributable to an investment in a "qualified business," as defined in § 58.1-339.4, or in any other technology business approved by the Secretary of Administration, provided the business has its principal office or facility in the Commonwealth and less than $3 million in annual revenues in the fiscal year prior to the investment. To qualify for a subtraction under this subdivision, the investment must be made between the dates of April 1, 2010, and June 30, 2020. No taxpayer who has claimed a tax credit for an investment in a "qualified business" under § 58.1-339.4 shall be eligible for the subtraction under this subdivision for an investment in the same business.

25. a. Income, including investment services partnership interest income (otherwise known as investment partnership carried interest income), attributable to an investment in a Virginia venture capital account. To qualify for a subtraction under this subdivision, the investment shall be made on or after January 1, 2018, but before December 31, 2023. No subtraction shall be allowed under this subdivision for an investment in a company that is owned or operated by an affiliate of the taxpayer. No subtraction shall be allowed under this subdivision for a taxpayer who has claimed a subtraction under subdivision C 24 for the same investment.

b. As used in this subdivision 25:

"Qualified portfolio company" means a company that (i) has its principal place of business in the Commonwealth; (ii) has a primary purpose of production, sale, research, or development of a

product or service other than the management or investment of capital; and (iii) provides equity in the company to the Virginia venture capital account in exchange for a capital investment. "Qualified portfolio company" does not include a company that is an individual or sole proprietorship.

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

26. a. Income attributable to an investment in a Virginia real estate investment trust. To qualify for a subtraction under this subdivision, the investment shall be made on or after January 1, 2019, but before December 31, 2024. No subtraction shall be allowed for an investment in a trust that is managed by an affiliate of the taxpayer. No subtraction shall be allowed under this subdivision for a taxpayer who has claimed a subtraction under subdivision C 24 or 25 for the same investment.

b. As used in this subdivision 26:

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

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

"Virginia real estate investment trust" means a real estate investment trust, as defined in 26 U.S.C. § 856, that has been certified by the Department as a Virginia real estate investment trust.

In order to be certified as a Virginia real estate investment trust, the trustee shall register the trust with the Department prior to December 31, 2024, indicating that it intends to invest at least 90 percent of trust funds in Virginia and at least 40 percent of trust funds in real estate in localities that are distressed or double distressed. If the Department determines that the trust satisfies the preceding criteria, the Department shall certify the trust as a Virginia real estate investment trust at such time as the trust actually invests at least 90 percent of trust funds in Virginia and at least 40 percent of trust funds in real estate in localities that are distressed or double distressed.

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

28. For taxable years beginning before January 1, 2021, up to $100,000 of all grant funds received by the taxpayer under the Rebuild Virginia program established by the Governor and administered by the Department of Small Business and Supplier Diversity.

D. For taxable years beginning on and after January 1, 2006, there shall be subtracted from federal taxable income contract payments to a producer of quota tobacco or a tobacco quota holder as provided under the American Jobs Creation Act of 2004 (P.L. 108-357) as follows:

1. If the payment is received in installment payments, then the recognized gain, including any gain recognized in taxable year 2005, may be subtracted in the taxable year immediately following the year in which the installment payment is received.

2. If the payment is received in a single payment, then 10 percent of the recognized gain may be subtracted in the taxable year immediately following the year in which the single payment is received. The taxpayer may then deduct an equal amount in each of the nine succeeding taxable years.

E. Adjustments to federal taxable income shall be made to reflect the transitional modifications provided in § 58.1-315.

F. Notwithstanding any other provision of law, the income from any disposition of real property which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business, as defined in § 453(l)(1)(B) of the Internal Revenue Code, of property made on or after January 1, 2009, may, at the election of the taxpayer, be recognized under the installment method described under § 453 of the Internal Revenue Code, provided that (i) the election relating to the dealer disposition of the property has been made on or before the due date prescribed by law (including extensions) for filing the taxpayer's return of the tax imposed under this chapter for the taxable year in which the disposition occurs, and (ii) the dealer disposition is

in accordance with restrictions or conditions established by the Department, which shall be set forth in guidelines developed by the Department. Along with such restrictions or conditions, the guidelines shall also address the recapture of such income under certain circumstances. The development of the guidelines shall be exempt from the Administrative Process Act (§ 2.2-4000 et seq.).

G. There shall be deducted to the extent included in and not otherwise subtracted from federal taxable income a percentage of the business interest disallowed as a deduction pursuant to § 163(j) of the Internal Revenue Code in the amount of:

1. 20 percent for taxable years beginning on and after January 1, 2018, but before January 1, 2022;

2. 30 percent for taxable years beginning on and after January 1, 2022, but before January 1, 2024; and

3. 50 percent for taxable years beginning on and after January 1, 2024.

For purposes of subsection G, "business interest" means the same as that term is defined under § 163(j) of the Internal Revenue Code.

H. For taxable years beginning before January 1, 2021, there shall be deducted to the extent not otherwise subtracted from federal taxable income up to $100,000 of the amount that is not deductible when computing federal taxable income solely on account of the portion of subdivision B 10 of § 58.1-301 related to Paycheck Protection Program loans.

I. For taxable years beginning on and after January 1, 2026, there shall be deducted the amount paid or cost incurred for installing a qualifying upgrade required to interconnect a triggering project. No deduction shall be allowed under this section for a taxpayer who has claimed a deduction under subdivision 19 of § 58.1-322.03 for the same amount paid or cost incurred to install such qualifying upgrade.

For purposes of this subsection, "qualifying upgrade" and "triggering project" have the same meanings as provided for those terms in § 56-596.5.

J. For taxable years beginning on and after January 1, 2027, there shall be deducted the Virginia net operating loss deduction described in § 58.1-402.1.

§ 58.1-402.1. Virginia Net Operating Loss Deduction.

A. Virginia net operating loss. For purposes of this chapter, for a taxable year beginning on or after January 1, 2027, "Virginia net operating loss" means the amount by which a corporate taxpayer's federal and Virginia deductions for the taxable year, excluding any federal and

Virginia net operating loss deduction, exceed its gross income after taking into account any additions or subtractions pursuant to § 58.1-402, and after allocation as described in § 58.1-407 and apportionment as described in § 58.1-408 et seq. Such excess shall be computed with the modifications specified in subsection D of IRC § 172 mutatis mutandis. For purposes of this section, "federal deductions" shall mean federal deductions after taking into account any adjustments pursuant to § 58.1-301. Such loss shall be adjusted as follows:

1. For corporations subject to the provisions of § 58.1-405, the Virginia net operating loss earned that year shall be calculated or applied without allocation and apportionment.

2. For corporations filing on a combined or consolidated basis, the Virginia net operating loss as affiliated members join and exit the group shall be tracked under the principles of Treasury Regulations 1.172-1 et seq. and 1.1502-1 et seq., mutatis mutanda.

B. Virginia net operating loss deduction. The amount of the Virginia net operating loss deduction that may be claimed for any taxable year shall be the aggregate Virginia net operating losses for taxable years beginning on and after January 1, 2027, plus any transitional Virginia net operating loss deduction under subsection C, with the following adjustments:

1. The deduction shall be the lesser of the aggregate amount of the Virginia net operating losses arising in the taxable year, or 80 percent of the excess (if any) of Virginia taxable income computed without regard to the deduction under § 250 of the Internal Revenue Code for which one or more subtractions are claimed under § 58.1-402.

2. The entire amount of the Virginia net operating losses shall be carried to the earliest year to which such loss may be carried.

3. The portion of such loss carried to each of the subsequent taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried.

4. In determining the amount of any such loss carried to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year.

5. In no case shall Virginia taxable income, after all other adjustments, allocation and apportionment, be reduced below zero by a Virginia net operating loss deduction.

C. Transitional net operating loss deduction. If any corporation (i) filed a Virginia income tax return for a taxable year ending in 2026, (ii) had a net operating loss available under I.R.C. § 172 to be carried to the taxable year beginning after December 31, 2026, and before January 1, 2028,

and (iii) filed a Virginia income tax return for the taxable year beginning after December 31, 2026, and before January 1, 2028, then the corporation may compute a transitional Virginia net operating loss by multiplying its available federal net operating loss, as adjusted by Virginia modifications that follow the federal net operating loss, by the corporation's apportionment factor for the taxable year beginning after December 31, 2026, and before January 1, 2028. If the corporation is not eligible to allocate and apportion income, its apportionment factor shall be 100%.

D. Consolidated and combined returns. 1. In a consolidated Virginia income tax return, the Virginia net operating deduction shall be computed and applied on a consolidated basis and its net income or loss included in the consolidated taxable income shall not be reduced below zero by a Virginia net operating loss deduction.

2. In a combined Virginia income tax return, each included corporation shall compute and apply its Virginia net operating loss deduction on a separate basis and its net income or loss included in the combined taxable income shall not be reduced below zero by a Virginia net operating loss deduction. To the extent that one affiliate's current loss offsets another affiliate's current income on a combined Virginia income tax return, that loss shall not be carried forward and deducted in subsequent years.

2. The Department of Taxation shall promulgate guidelines implementing the provisions of this act. Such guidelines shall be exempt from the provisions of the Administrative Process Act (§ 2.2-4000 et seq.). Before issuing final guidelines, the Department shall promulgate and make publicly preliminary guidelines. The Department shall cooperate with and seek the counsel of interested groups and shall not promulgate any guidelines, preliminary or final, without first seeking such counsel.

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Appendix C: Workgroup Materials

2025 Net Operating Loss (NOL) Workgroup Meeting

July 1, 2025 | 2:00 PM

1957 Westmoreland Street, Richmond, VA 23230

Facilitators: Cassandra Hamilton and Vickie Duffy

Agenda:

2:00 PM	**Welcome & Introductions** Ryan Cunningham, Lead Tax Law Analyst
2:10 PM	**2025 Legislation and Treatment of NOLs in Other States** James Ford, Senior Tax Law Analyst
2:30 PM	**History of NOLs in Virginia** John Josephs, Senior Tax Law Analyst
2:50 PM	**Comments, Questions, and Open Discussion** Ryan Cunningham, Lead Tax Law Analyst
3:50 PM	**Next Steps** Ryan Cunningham, Lead Tax Law Analyst
4:00 PM	**Conclusion**

NOL Workgroup

Department of Taxation

July 1, 2025

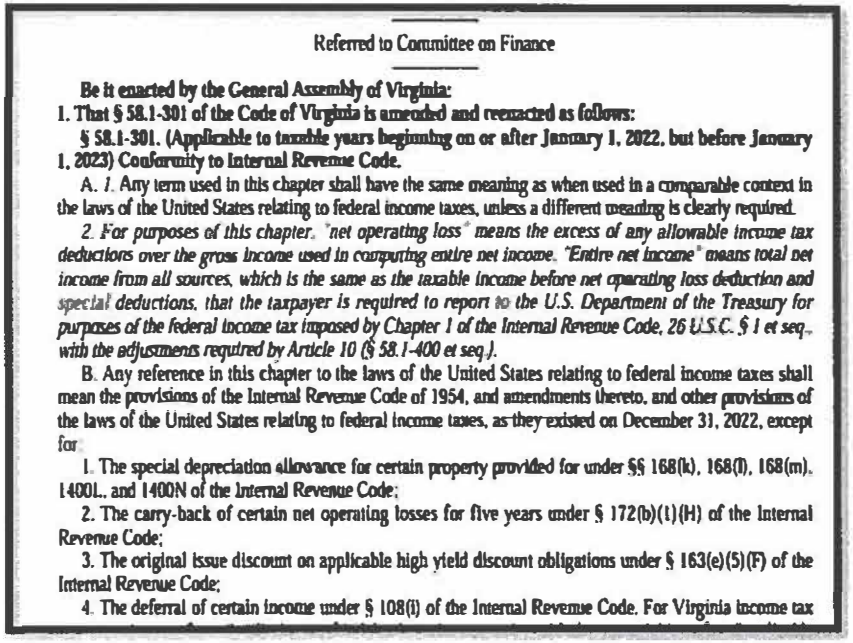
Virginia Tax

- Introductions
- Review of HB 2681/SB 1426 and Item 257 of the 2025 Appropriation Act (House Bill 1600, Chapter 725)
- Statement of Purpose
- Overview: Workgroup Road Map
- Open Forum: Input and Discussion
- Next Steps

- **Kristin Collins,** Deputy Commissioner
- **Charles Kennington,** Assistant Commissioner
- **James Savage,** Director of Tax Legislation
- **Ryan Cunningham,** Income Tax Team Lead
- **James Ford,** Senior Tax Law Analyst
- **John Josephs,** Senior Tax Law Analyst
- **Matt Style,** Principal Economist

Legislative Mandate

HB 2681/SB 1426



Referred to Committee on Finance

Be it enacted by the General Assembly of Virginia:

1. That § 58.1-301 of the Code of Virginia is amended and reenacted as follows:

§ 58.1-301. (Applicable to taxable years beginning on or after January 1, 2022, but before January 1, 2023) Conformity to Internal Revenue Code.

A. *1.* Any term used in this chapter shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required.

2. For purposes of this chapter, "net operating loss" means the excess of any allowable income tax deductions over the gross income used in computing entire net income. "Entire net income" means total net income from all sources, which is the same as the taxable income before net operating loss deduction and special deductions, that the taxpayer is required to report to the U.S. Department of the Treasury for purposes of the federal income tax imposed by Chapter 1 of the Internal Revenue Code, 26 U.S.C. § 1 et seq., with the adjustments required by Article 10 (§ 58.1-400 et seq.).

B. Any reference in this chapter to the laws of the United States relating to federal income taxes shall mean the provisions of the Internal Revenue Code of 1954, and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as they existed on December 31, 2022, except for:

1. The special depreciation allowance for certain property provided for under §§ 168(k), 168(l), 168(m), 1400L, and 1400N of the Internal Revenue Code;

2. The carry-back of certain net operating losses for five years under § 172(b)(1)(H) of the Internal Revenue Code;

3. The original issue discount on applicable high yield discount obligations under § 163(e)(5)(F) of the Internal Revenue Code;

4. The deferral of certain income under § 108(i) of the Internal Revenue Code. For Virginia income tax

Virginia Tax

Legislative Mandate

HB 2681/SB 1426

(Patron Prior to Substitute—Delegate Ballard)

A BILL to direct the Department of Taxation to convene a work group to analyze the treatment of net operating losses in Virginia when compared to other states; report.

Be it enacted by the General Assembly of Virginia:

1. § 1. That the Department of Taxation shall convene a work group composed of tax practitioners experienced in the preparation of corporate tax returns involving net operating losses, including members recommended by the Taxation Section of the Virginia Bar Association and the Virginia Society of Certified Public Accountants. The work group shall study the treatment of net operating losses in Virginia when compared to other states and shall make recommendations to simplify such treatment in Virginia. The work group shall consider at a minimum: (i) transition rules to the proposed simplified method of determining net operating losses; (ii) the effective date of any such transition; and (iii) what legislative, regulatory, or guideline amendments would be necessary to best effectuate such transition. The work group shall complete its meetings by October 1, 2025, and the Department shall submit a report of the work group's findings and recommendations to the Chairmen of the Senate Committee on Finance and Appropriations, the House Committee on Finance, and the House Committee on Appropriations by November 1, 2025.

Virginia Tax

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Item 257 of the 2025 Appropriation Act (House Bill 1600, Chapter 725)

F. The Department of Taxation shall convene a work group composed of tax practitioners experienced in the preparation of corporate tax returns involving net operating losses, including members recommended by the Taxation Section of the Virginia Bar Association and the Virginia Society of Certified Public Accountants. The work group shall study the treatment of net operating losses in Virginia when compared to other states and shall make recommendations to simplify such treatment in Virginia. The work group shall consider at a minimum: (i) transition rules to the proposed simplified method of determining net operating losses; (ii) the effective date of any such transition; and (iii) what legislative, regulatory, or guideline amendments would be necessary to best effectuate such transition. The work group shall complete its meetings by October 1, 2025, and the Department shall submit a report of the work group's findings and recommendations to the Chairs of the Senate Finance and Appropriations, House Finance, and House Appropriations Committee by November 1, 2025.

Virginia Tax

The workgroup shall study the treatment of net operating losses in Virginia when compared to other states and shall make recommendations to simplify such treatment in Virginia.

The workgroup's considerations will include, but not be limited to:

- Transition rules to the proposed simplified method of determining net operating losses,
- The effective date of any such transition, and
- What legislative, regulatory, or guideline amendments would be necessary to best effectuate such transition.

Treatment of NOLs in Other States

- The majority of states (36 plus the District of Columbia) calculate a state NOL using post-apportionment rules.
- Only 11 states (including Virginia) calculate a state NOL using pre-apportionment rules.

- Before 1972, only manufacturers were allowed to claim NOLs carried from other taxable years ("NOLD").
- In 1972, Virginia adopted federal taxable income as the starting point for computing corporate Virginia income tax.
- By starting with federal taxable income, Virginia incorporated:
  - the federal allowance of NOLD for any business, and
  - the federal allowance of NOLD to individuals to the extent that FAGI included business income.
- The NOLD for manufacturers was repealed.

- The 1972 changes brought in two NOLD policies:
  - First, Virginia required several additions and subtractions to federal taxable income, and the net Virginia modifications had to follow the NOLD as it was used to reduce the amount of federal taxable income that was taxable on the Virginia return.
  - Second, the federal return reported the entire NOLD available on Line 29a of the federal corporate income tax return (Form 1120), which often resulted in a negative Line 30. Therefore, Virginia did not recognize a federal NOLD to the extent that it reduced federal taxable income below zero. This effectively limited NOLD for Virginia purposes to the amount of a corporation's income before claiming NOLD on Line 29a of the federal return. This amount of NOLD absorbed was also used to calculate the portion of net Virginia modifications from the loss year that must be reported on the Virginia return.

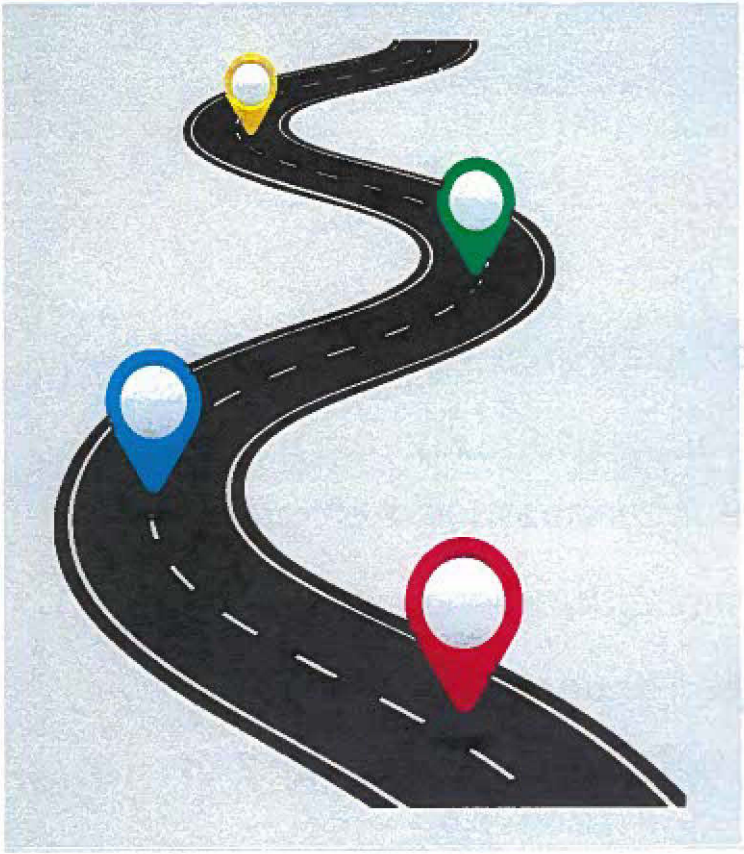
- In 1982, in addition to changing how multistate income is allocated and apportioned, the General Assembly added a new way for affiliated corporations to report their income: a Virginia combined return.
  - This new type of return required that income, additions, subtractions, allocation and apportionment be computed separately for each corporation, then the bottom-line income and loss amounts are combined.
  - This meant that the 1972 policies for determining the NOLD absorbed and the applicable portion of net modifications had to be applied for each affiliate.

- In 1984, the Department published comprehensive regulations for corporate income tax, effective for taxable years beginning on and after January 1, 1985. These regulations explained:
  - The policies relevant to NOLD, including limiting NOLD to the amount absorbed each year and associated net modifications from the loss year.
  - How combined returns were to be prepared, but did not include specific explanations of how NOLD policies applied to combined returns.
  - That a consolidated return could not include corporations that used different apportionment factors.

- In 1990, the General Assembly said that permission to file a consolidated return shall not be denied because affiliates used different apportionment factors and directed the Department to issue regulations implementing this policy.
- This amended regulation was published in 1993 and specified how a consolidated return handled corporations with different apportionment factors. The amendment also clarified and expanded other policies, including detailed instructions and examples of how NOLD is reported under Virginia's statutory separate, consolidated, and combined filing methods.
  - It is the intersection of Virginia's statutory filing methods with Virginia's net operating loss rules that is the source of the complicated calculations that the Department is now required to study and report on simplification.

- In 2003, the General Assembly began selectively deconforming from specific provisions of the Internal Revenue Code.
- Originally, deconformity was limited to "bonus depreciation."
- However in subsequent years, more deconformity provisions were added and deleted, which directly affected the computation of the NOLD.
- As a result, the complexity of NOLD calculations increased.

Overview: Workgroup Road Map



Policy Options

Workgroup Meeting: Today

Written Comments and Suggested Solutions: July 15

Comments & Draft Report

Review Comments and Draft Report

Draft Report Circulated: September 1

Final Report

Additional Written Comments: Oct 1

Final Report Published: Nov 1

Virginia Tax

Open Forum

Questions and Comments

Next Action Items

Workgroup Meeting

- **Completed!**

tep 2

Provide Policy Options and Written Comments by **July 15, 2025**

- To: james.ford@tax.virginia.gov

tep 3

Circulate draft report to stakeholders by September 1, 2025

- **Provide any additional written comments by October 1, 2025.**

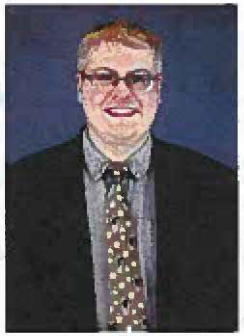
Virginia Tax

Next Steps

- Presentation will be made available on the Virginia Tax webpage: https://www.tax.virginia.gov/ (coming soon)

- Final Report Submitted by November 1, 2025, to the following:
  - The Chairperson of the House Committee on Finance;
  - The Chairperson of the House Committee on Appropriations; and
  - The Chairperson of the Senate Committee on Finance and Appropriations.

Thank you



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