

DEPARTMENT OF TAXATION

2006 Fiscal Impact Statement

1. **Patron** John J. Welch, III

2. **Bill Number** HB 1535

3. **Committee** Senate Finance

House of Origin:

 Introduced

 Substitute

 Engrossed

4. **Title** Income Tax: Subtraction for Certain
Death Benefits

Second House:

 X **In Committee**

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would create a subtraction for death benefit payments received from an annuity contract that are subject to federal income taxation.

This bill would be effective for taxable years beginning on or after January 1, 2007.

6. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

7. **Budget amendment necessary:** No.

8. Fiscal implications:

The revenue impact associated with this bill is unknown due to data limitations.

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, TAX considers implementation of this bill as "routine," and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not "routine." Additionally, TAX will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, TAX will identify the costs at that time.

9. Specific agency or political subdivisions affected:

Department of Taxation

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

11. Other comments:

Federal Law

Proceeds of life insurance contracts payable by reason of death are generally exempt from federal income tax. Payments received from an annuity contract, however, are partially taxable. Complex rules allow recipients of annuity payments to avoid paying tax on a portion of each payment representing the amount invested in the annuity contract, while treating the rest of each payment as taxable income earned on the investment in the annuity contract. These rules also apply to payments received by a designated beneficiary upon the death of the annuitant. In some cases the annuity contract may provide for a guaranteed payment amount upon the annuitant's death even though the value of the account, based on investment and earnings, may be less. To the extent that the guaranteed payment exceeds the value of the account, the excess resembles life insurance, but does not qualify for the federal exemption for life insurance contract proceeds payable by reason of death.

Virginia Law

To the extent that life insurance proceeds and annuity payments are included or excluded from federal adjusted gross income they will be similarly treated for Virginia income tax purposes.

Proposal

This bill would create a subtraction for death benefit payments received from an annuity contract to the extent that any portion of the payments is treated as taxable income on the investment in the annuity contract and subject to federal income taxation. This would effectively exempt all annuity payments received by beneficiaries from Virginia income tax.

This bill would be effective for taxable years beginning on or after January 1, 2007.

cc : Secretary of Finance

Date: 02/20/2006 CHC
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