

DEPARTMENT OF TAXATION

2006 Fiscal Impact Statement

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

2. **Bill Number** HB 1535

House of Origin:

 Introduced

 Substitute

 Engrossed

3. **Committee** Passed House and Senate

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

Second House:

 In Committee

 Substitute

 X **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 considers implementation of this bill as "routine," and does not require additional funding.

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: 03/13/2006 CHC
HB1535FER161.DOC