DEPARTMENT OF TAXATION
2016 Fiscal Impact Statement

1. **Patron** Timothy D. Hugo

2. **Bill Number** HB 880
   House of Origin:
   X **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

   Second House:
   ____ **In Committee**
   ____ **Substitute**
   ____ **Enrolled**

3. **Committee** House Finance

4. **Title** Income Tax; Employee Withholding Allowances

5. **Summary/Purpose:**

This bill would permit an employee to adjust the amount of individual income taxes withheld by his employer by claiming a withholding allowance for itemized deductions in lieu of a standard deduction. Under current law, an employee generally cannot make a withholding allowance for itemized deductions in lieu of a standard deduction, unless he requests and is granted permission from the Tax Commissioner to do so.

This bill would be effective for taxable years beginning on or after January 1, 2017.

6. **Budget amendment necessary:** Yes
   Page 1, Revenue Estimates

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

7b. Revenue Impact:

Fiscal Year	*Dollars*	*Fund*
2015-16	($0)	GF
2016-17	($52.2 million)	GF
2017-18	($16.6 million)	GF
2018-19	($3.1 million)	GF
2019-20	($3.2 million)	GF
2020-21	($3.6 million)	GF
2021-22	($3.6 million)	GF

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have a negative General Fund revenue impact of $52.2 million in Fiscal Year 2017, $16.6 million in Fiscal Year 2018, $3.1 million in Fiscal Year 2019, $3.2 million in Fiscal Year 2020, $3.6 million in Fiscal Year 2021, and $3.6 million in Fiscal Year 2022.

Although this bill would not decrease a taxpayer's tax liability, it would accelerate the beneficial effects of itemized deductions for certain taxpayers, allowing them to have less income tax withheld from their pay. This would result in a large revenue shift in Fiscal Year 2017 and Fiscal Year 2018, as well as smaller revenue shifts in Fiscal Year 2019 and thereafter. Under current law, the amount of income tax to be withheld is determined using a taxpayer's personal exemptions and his standard deduction. This bill would allow an employee to reduce his withholding by basing such withholding payments on anticipated itemized deductions.

By reducing the amount of income tax withholding during a fiscal year, this bill would shift revenue to the following fiscal year in the form of reduced income tax refunds that the Department would be required to issue. Such a reduction in the amount of income tax refunds would partially offset the negative revenue impact of this bill. The positive General Fund revenue offset would begin in Fiscal Year 2018. The Department's revenue estimates represent the net impact of this bill, taking into consideration both the negative General Fund revenue impact of reduced withholding in a particular fiscal year and the offsetting impact of reduced tax refunds that would be issued in the following fiscal year.

The computation of additional Virginia withholding exemptions would be very complex because after estimating the itemized deductions, a taxpayer would also be required to estimate the income from other sources, additions, subtractions and credits that must be reported on the Virginia return. Failure to account for these items could result in a significant amount of over-withholding or under-withholding. An employee would not be able to use the same number of federal exemptions for Virginia withholding purposes because of differences between federal credits and exemption amounts and Virginia credits, additions, subtractions and exemption amounts. Because the computation of additional Virginia withholding exemptions would be very complex and could result in a significant amount of over-withholding or under-withholding, the impact of this bill may be higher or lower than estimated.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Every employer making payment of wages is generally required to withhold Virginia income tax with respect to the wages of each employee who is a Virginia resident and each nonresident employee who performs services in Virginia. The amount to be withheld with respect to the wages of each employee for each payroll period is an amount which, if an equal amount was collected for each similar payroll period with respect to a similar amount of wages for each payroll period during an entire calendar year, would aggregate or approximate the income tax liability of such employee after making allowance for the following:

- The personal exemptions to which such employee could be entitled on the basis of his status during such payroll period;
- A standard deduction from wages in accordance with the laws of the United States relating to federal income taxes; and
- Any credit available to the employee for income taxes paid to other states.

An allowance is not currently permitted for any other deduction. In determining the amount to be deducted and withheld under this article, the wages may, at the election of the employer, be computed to the nearest dollar.

In order to determine the amount of tax to be withheld for each individual, the employer must use tables prepared and distributed by the Tax Commissioner. The tables must be computed for the several permissible withholding periods and must take account of the number of exemptions and the standard deduction allowed under federal law. The amounts computed for withholding must be such that the amount withheld for any individual during his taxable year approximates in the aggregate as closely as practicable the income tax which is levied and imposed for that taxable year, upon his salary, wages or compensation for personal services of any kind for the employer.

Every employee must furnish his employer with a signed withholding exemption certificate relating to the withholding exemptions which he claims. An employee receiving wages is entitled to claim the exemptions for which such employee qualifies under the laws of the United States relating to federal income taxes.

A taxpayer may write to the Tax Commissioner and request permission to claim additional withholding allowances, provided that such taxpayer can show that the amount withheld according to the withholding tables will result in a substantial overpayment of the employee's income tax. The Department typically requires that the employee show that the amount withheld according to the withholding tables has resulted in a refund of $300 or more for the preceding taxable year. In Taxable Year 2015, the Department received eight such requests.

In 1989, the General Assembly enacted House Bill 1950 (1989 *Acts of Assembly*, Chapter 289), effective January 1, 1991, which would have allowed taxpayers who itemized their deductions to claim additional withholding allowances without first writing to the Tax Commissioner and requesting permission. The effective date of this legislation was delayed numerous times since its enactment in 1989. It briefly became effective from July 1, 2002 to January 1, 2003. The effective date was delayed again until July 1, 2008. In 2008, the General Assembly enacted House Bill 1261 (2008 *Acts of Assembly*, Chapter 228), which permanently repealed the 1989 legislation.

Proposed Legislation

This bill would permit an employee to adjust the amount of individual income taxes withheld by his employer by claiming a withholding allowance for itemized deductions in lieu of a standard deduction. The Department would be required to prepare and distribute tables which take account of the standard deduction or itemized deductions. This bill would permit an employee who makes a withholding allowance for itemized deductions in lieu of a standard deduction to claim additional exemptions to approximate the difference between the employee's itemized deductions and the standard deduction.

This bill would also clarify that such allowances for personal exemptions and for a standard deduction or itemized deductions must be determined in accordance with the income tax laws of Virginia, rather than under federal law.

This bill would require that the Department of Taxation develop and make publicly available guidelines implementing the provisions of this bill, including guidelines for determining under what circumstances an employee would be allowed for income tax withholding purposes to make an allowance for itemized deductions in lieu of a standard deduction. Such guidelines would be exempt from the provisions of the Administrative Process Act.

This bill would be effective for taxable years beginning on or after January 1, 2017.

Similar Bills

Senate Bill 230 would codify existing withholding filing requirements that are currently set forth in the Appropriations Act and would also impose penalties upon employers that fail to comply with such requirements.

House Bill 1331 would codify existing withholding filing requirements that are currently set forth in the Appropriations Act.

House Bill 951 and **Senate Bill 325** would allow the Department to disclose to a taxpayer whether his employer has submitted required withholding records to the Department.

cc : Secretary of Finance

Date: 2/1/2016 JJS
HB880F161