DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. **Patron** Dawn M. Adams

2. **Bill Number** HB 2673
   House of Origin:
   X **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

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

3. **Committee** House Rules

4. **Title** Advances Conformity with the Internal Revenue Code; Tax Policy Changes

5. **Summary/Purpose:**

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from February 9, 2018 to December 31, 2018. This bill would also repeal language currently deconforming Virginia from most of the provisions of the Tax Cuts and Jobs Act ("the TCJA") and the Bipartisan Budget Act of 2018 ("the BBA") that affect Taxable Year 2018 and after. This would allow Virginia to fully conform to the TCJA.

This bill would increase the Virginia standard deduction from $3,000 to $3,500 for individuals and married taxpayers filing separately, and from $6,000 to $7,000 for married taxpayers filing joint returns. The bill would provide that a taxpayer may elect either to claim the Virginia standard deduction or to itemize deductions on his or her Virginia income tax return, regardless of whether the taxpayer elected for the taxable year to itemize deductions on his or her federal income tax return.

This bill would permit taxpayers that claim the Virginia Earned Income Tax Credit ("EITC") a refund in an amount equal to 30 percent of the amount by which the credit exceeds their Virginia income tax liability. The income tax credit for low-income taxpayers would revert to its current form for Taxable Year 2026 and after.

The provisions of this bill regarding Virginia's conformity to the IRC would be effective for taxable years beginning on and after January 1, 2019. The other provisions of this bill would be effective for taxable years beginning on and after January 1, 2019, but before January 1, 2026.

6. **Budget amendment necessary:** Yes.
   Item(s): Page 1, Revenue Estimates
   273 and 275, Department of Taxation

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

7a. Expenditure Impact:

Fiscal Year	***Dollars***	***Positions***	***Fund***
2019-20	$1,017,712	10	GF
2020-21	$893,582	10	GF
2021-22	$893,582	10	GF
2022-23	$893,582	10	GF
2023-24	$893,582	10	GF
2024-25	$893,582	10	GF

7b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2019-20	($290.0 million)	GF
2020-21	($148.7 million)	GF
2021-22	($151.8 million)	GF
2022-23	($157.0 million)	GF
2023-24	($161.1 million)	GF
2024-25	($163.0 million)	GF

8. Fiscal implications:

<u>Administrative Costs</u>

This bill would result in administrative costs to the Department of Taxation ("the Department") of $1,017,712 in Fiscal Year 2020 and $893,582 in Fiscal Year 2021 and each fiscal year thereafter. Such funding would include costs for hiring five new full-time employees for customer service to respond to taxpayer calls arising from this bill and hiring five new full-time employees for compliance purposes.

<u>Revenue Impact</u>

This bill would result in a negative General Fund revenue impact of $496.0 million in Fiscal Year 2020; $361.6 million in Fiscal Year 2021; $371.9 million in Fiscal Year 2022; $383.6 million in Fiscal Year 2023; $394.8 million in Fiscal Year 2024; and $404.1 million in Fiscal Year 2025. However, the Introduced Executive Budget already assumes that Virginia's EITC will become fully refundable beginning in Taxable Year 2019. If this bill is enacted and the EITC changes set forth in this bill are adopted instead of those assumed in the Introduced Executive Budget, the budget would need to be adjusted to reduce General Fund revenues by $290 million in Fiscal Year 2020.

The Department suggests a technical amendment to clarify that this bill would advance the date of conformity effective for Taxable Year 2018 (see Line 10). If such amendment is not adopted and Virginia specifically deconforms from the TCJA for Taxable Year 2018, both the negative revenue impact and administrative costs associated with this bill would increase.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

This bill would advance Virginia's date of conformity to the IRC. However, because the first enactment clause states that this bill would be effective for Taxable Year 2019 and after, it does not advance Virginia's date of conformity for Taxable Year 2018. Therefore, as currently drafted, this bill would deconform from the IRC for Taxable Year 2018 and conform for Taxable Year 2019. This would result in significant issues to taxpayers, tax practitioners, and the Department. Therefore, the Department suggests that the General Assembly consider a technical amendment to specify that the provisions of this bill regarding conformity are effective for Taxable Year 2018 as well.

11. Other comments:

<u>Virginia's Date of Conformity to the Internal Revenue Code</u>

Virginia's date of conformity to the IRC is currently fixed to the IRC as it existed on February 9, 2018. Virginia law currently deconforms from the following IRC provisions:

- **Bonus depreciation allowed for certain assets under federal income taxation.** Taxpayers who claim bonus depreciation on their federal returns upon purchasing an asset are required to make adjustments on their Virginia returns for the taxable year in which they purchased such asset and in each subsequent year until the asset has been fully depreciated for federal and Virginia purposes.

- **The five-year carry-back of net operating losses ("NOLs") generated in certain taxable years**. Although no longer available, taxpayers who benefited from the use of a five-year carry-back on their federal returns for losses generated during 2008 and 2009 are required to make adjustments on their Virginia returns for the taxable year in which such losses were generated and in each subsequent year until all such losses have been fully utilized for both federal and Virginia purposes.

- **Tax exclusions related to cancellation of debt income**. Although no longer available, taxpayers who benefited from a deferral of income realized upon the reacquisition of certain business debt during 2009 and 2010 on their federal returns are required to make adjustments on their Virginia returns for the taxable year in which they deferred such income and in each subsequent year until such income is fully reported for both federal and Virginia purposes. However, for transactions completed on or before April 21, 2010, taxpayers were permitted to partially defer such income by reporting the income over three taxable years.

- **Tax deductions related to the application of the applicable high yield debt obligation rules**. Although no longer available, taxpayers who benefited from the suspension of the application of the applicable high yield debt obligation rules for certain debts issued between September 30, 2008 and December 31, 2009 on their federal returns, are required to make adjustments on their Virginia returns for the taxable year in which they claimed a deduction and in each subsequent year until such deductions are fully claimed for both federal and Virginia purposes.

In addition to these IRC provisions from which Virginia has historically deconformed, the General Assembly enacted legislation during the 2018 Session that deconformed Virginia from:

- The provision of the TCJA that temporarily increased the medical expenses deduction for Taxable Years 2017 and 2018; and
- All of the provisions of the TCJA and the Bipartisan Budget Act of 2018 that affect Taxable Year 2018 and after other than the provision of the TCJA providing tax relief for specified 2016 disaster areas and the provision extending combat zone benefits to members of the armed forces performing services in the Sinai Peninsula of Egypt.

On December 22, 2017, the TCJA was signed into law. This federal tax reform legislation substantially changes the federal income taxation of individuals and businesses. Most of the provisions of the TCJA impacting individual taxpayers are currently scheduled to sunset after December 31, 2025. Future legislation would be required to make the provisions effective beyond Taxable Year 2025. Most of the provisions of the TCJA impacting business taxpayers are effective beginning in Taxable Year 2018 and are permanent. The TCJA also makes fundamental changes to the United States' international tax structure. In general, the TCJA shifts from the prior system of worldwide taxation with deferral to a participation exemption regime with current taxation of certain foreign income.

On February 9, 2018, the BBA was signed into law. In addition to providing a continuing resolution to fund the federal government, the BBA extends more than 30 tax provisions, commonly known as "extenders," which had expired at the end of 2016, so that they apply to Taxable Year 2017. The law expands the tax relief previously provided to victims of Hurricanes Harvey, Irma, and Maria so that it applies to victims of the 2017 California wildfires, clarifies the definition of “disaster areas” for Hurricanes Irma and Harvey, and makes other changes.

<u>Federal Standard Deduction and Itemized Deductions</u>

When completing their federal income tax return, taxpayers are generally allowed to elect to claim either the total amount of their itemized deductions or the flat amount of their standard deduction. Taxpayers will generally choose to deduct the greater of the two amounts.

Standard Deduction

The standard deduction is a fixed dollar amount that reduces a taxpayer’s taxable income and varies according to their filing status. The current amount of the federal standard deduction is $12,000 for single taxpayers; $18,000 for heads of household; and $24,000 for married taxpayers filing jointly.

The federal standard deduction amounts have increased significantly since 1988. The federal Tax Reform Act of 1986 increased the standard deduction amount for Taxable Year 1988 to $3,000 for individuals; $4,400 for heads of household; and $5,000 for married taxpayers filing jointly. The Act also required, beginning in Taxable Year 1989, the Internal Revenue Service to adjust the amount of such deduction annually for inflation based on the percentage change in the Consumer Price Index for Urban Consumers ("CPI-U") for the preceding calendar year. Because of these inflation adjustments, the federal standard deduction increased annually from Taxable Year 1988 through Taxable Year 2002. For Taxable Year 2002, the standard deduction amounts were $4,700 for individuals; $6,900 for heads of household; and $7,850 for married taxpayers filing jointly.

The federal Jobs and Growth Tax Relief Reconciliation Act of 2003 increased the standard deduction for married couples filing jointly to $9,500, which was equal to twice the standard deduction for single taxpayers. This was intended to eliminate the standard deduction marriage penalty. From 2003 until 2017, the federal standard deduction continued to increase annually due to inflation adjustments. For Taxable Year 2017, the standard deduction amounts were $6,350 for individuals; $9,350 for heads of household; and $12,700 for married taxpayers filing jointly.

On December 22, 2017, Congress enacted the TCJA, which substantially increased the federal standard deduction amounts beginning with Taxable Year 2018 as follows:

- From $6,350 to $12,000 for single taxpayers;
- From $9,350 to $18,000 for heads of household; and
- From $12,700 to $24,000 for married taxpayers filing jointly.

In addition, beginning with Taxable Year 2019, the Internal Revenue Service is required to adjust the standard deduction amount based upon a new inflation measure, chained CPI-U.

Like the majority of the individual provisions of the TCJA, the increase in the federal standard deduction is currently scheduled to sunset after December 31, 2025, and revert to its pre-2018 amounts. Future legislation would be required to make such increases effective beyond Taxable Year 2025. However, the 2025 sunset date does not apply to the TCJA's substitution of a new inflation measure for indexing the federal standard deduction and other provisions.

Itemized Deductions

In lieu of deducting the standard deduction amount, taxpayers may elect to claim up to approximately a dozen separate deductions, referred to as "itemized deductions," on their federal return to the extent that they qualify for such deductions. The rationale for each itemized deduction is generally to take account of large or unusual personal expenditures that affect a taxpayer's ability to pay. Certain itemized deductions are also provided as a way of encouraging certain desired behaviors and activities. The most common expenses that may be claimed as an itemized deduction include:

- Home mortgage interest;
- State and local income taxes or sales taxes (but not both);

- Real estate and personal property taxes;
- Gifts to charities;
- Casualty or theft losses;
- Unreimbursed medical expenses; and
- Unreimbursed employee business expenses.

The TCJA included a number of provisions that greatly limit or repeal certain federal itemized deductions.

Virginia Standard Deduction and Itemized Deductions

When completing their Virginia income tax returns, taxpayers are bound by the election they made for federal purposes regarding whether to claim a standard deduction or to itemize their deductions. Therefore, if they claimed the standard deduction on their federal income tax return, they are not allowed to claim itemized deductions on their Virginia return. In contrast, if they claimed itemized deductions on their federal income tax return, they are not allowed to claim the standard deduction on their Virginia return.

Standard Deduction

Taxpayers that do not itemize their deductions for federal purposes are permitted to claim a standard deduction on their Virginia income tax returns. The current amount of the Virginia standard deduction is $3,000 for single individuals and $6,000 for married persons filing jointly. Virginia's standard deduction amounts increased from Taxable Year 1988 to the present, as shown below:

Year	Virginia Standard Deduction for Single Taxpayers	Virginia Standard Deduction for Married Persons Filing Jointly
1987	$2,000	$2,000
1988	$2,700	$2,700
1989-2004	$3,000	$5,000
2005-present	$3,000	$6,000

During the 2005 Session, the General Assembly increased the standard deduction for married persons filing jointly from $5,000 to $6,000. This was intended to eliminate the standard deduction marriage penalty at the state level, similar to how this issue was addressed at the federal level. Since 2005, the Virginia standard deduction amounts have remained at $3,000 for single taxpayers and $6,000 for married taxpayers filing jointly.

Prior to 1987, the Virginia standard deduction was not a fixed amount. For example, in Taxable Year 1986, the Virginia standard deduction was 15 percent of a taxpayer's federal adjusted gross income with a $1,300 minimum and a $2,000 maximum.

Itemized Deductions

Taxpayers that elect to itemize their deductions for federal purposes are permitted to claim such deductions on their Virginia income tax return as well. The amount of itemized deductions that may be claimed on such return is equal to the:

- Federally allowable amount of itemized deductions, *minus*

- Amount claimed as a federal deduction for income taxes paid to Virginia or any other state, locality, foreign country, or other taxing jurisdiction, *plus*

- Amount needed to increase the amount deducted federally for charitable contribution transportation to 18¢ per mile.

Federal Earned Income Tax Credit

The federal EITC is a refundable tax credit for eligible individuals who have earned income in a taxable year that is below certain threshold amounts. The amount of the federal EITC is based on the presence and number of qualifying children in the worker's family, as well as the amount of the worker's federal adjusted gross income ("AGI") and earned income. For purposes of the federal EITC, earned income includes any wages, salaries, tips, and other employee compensation includible in an individual's gross income, plus the individual's net earnings from self-employment without regard to the federal deduction for self-employment taxes. To qualify for the federal EITC for Taxable Year 2019, an individual's AGI and earned income must be less than:

- $50,162 ($55,592 for married filing jointly) if they have three or more qualifying children;
- $46,703 ($52,493 for married filing jointly) if they have two qualifying children;
- $41,094 ($46,884 for married filing jointly) if they have one qualifying child; or
- $15,570 ($21,370 for married filing jointly) if they do not have a qualifying child

The maximum federal EITC for Taxable Year 2019 is $6,557 for an individual with three or more qualifying children, $5,828 for an individual with two qualifying children, $3,526 for an individual with one qualifying child, and $529 for an individual with no qualifying children.

Virginia Low-Income Tax Credits

Virginia allows an individual to claim either a credit equal to 20 percent of the federal EITC that was claimed for the taxable year or the Tax Credit for Low-Income Individuals.

- Virginia allows a nonrefundable individual income tax credit equal to 20 percent of the federal EITC claimed by an individual for the taxable year. The credit is for any individual or married persons that are eligible for the federal EITC for the taxable year and claimed such a credit.

- The Tax Credit for Low-Income Individuals is a nonrefundable individual income tax credit equal to $300 each for the individual, the individual's spouse, and any person claimed as a dependent on such individual's or married person's income tax return for the taxable year.

Proposed Legislation

This bill would advance Virginia's date of conformity to the Internal Revenue Code ("IRC") from February 9, 2018 to December 31, 2018. This bill would also repeal language currently deconforming Virginia from most of the provisions of the Tax Cuts and Jobs Act ("the TCJA") and the Bipartisan Budget Act of 2018 ("the BBA") that affect Taxable Year 2018 and after. This would allow Virginia to fully conform to the TCJA.

The bill would provide that a taxpayer may elect either to claim the Virginia standard deduction or to itemize deductions on his or her Virginia income tax return, regardless of whether the taxpayer elected for the taxable year to itemize deductions on his or her federal income tax return for Taxable Year 2019 and after.

This bill would increase the Virginia standard deduction from $3,000 to $3,500 for individuals and married taxpayers filing separately, and from $6,000 to $7,000 for married taxpayers filing jointly for Taxable Year 2019 and after.

This bill would permit taxpayers that claim the Virginia EITC a refund in an amount equal to 30 percent of the amount by which the credit exceeds their Virginia income tax liability. This bill would also require DSS to provide notice regarding the availability of the new refundable credit to certain recipients of TANF, food stamps, or medical assistance as part of its existing notification requirement.

The provisions of this bill regarding Virginia's conformity to the IRC would be effective for taxable years beginning on and after January 1, 2019. The other provisions of this bill would be effective for taxable years beginning on and after January 1, 2019, but before January 1, 2026.

Similar Legislation

House Bill 1851, **House Bill 1980**, **House Bill 2086**, **House Bill 2110**, **House Bill 2529**, **House Bill 2765**, **Senate Bill 1211, Senate Bill 1225**, **Senate Bill 1443**, and **Senate Bill 1631** would make various, different tax policy changes.

Senate Bill 1531 would increase the standard deduction to $12,000 for single individuals and $24,000 for married taxpayers filing joint returns.

House Bill 2160 and **Senate Bill 1297** would make Virginia's EITC fully refundable.

House Bill 1618 and **Senate Bill 1237** would allow a taxpayer to elect either to claim the Virginia standard deduction or to itemize his or her deductions, regardless of whether the taxpayer elected for the taxable year to itemize deductions on his or her federal return, for Taxable Year 2019 through Taxable Year 2025.

House Bill 2708 would allow a taxpayer to elect either to claim the Virginia standard deduction or to itemize his or her deductions, regardless of whether the taxpayer elected for the taxable year to itemize deductions on his or her federal return, for Taxable Year 2019 and after.

Senate Bill 1320 and **Senate Bill 1372** would advance Virginia's date of conformity to the IRC to December 31, 2018.

House Bill 2355 would advance Virginia's date of conformity to the IRC to December 31, 2018, and would require additional revenues from the permanent individual provisions of the TCJA for Fiscal Year 2019 and Fiscal Year 2020 be transferred to a fund and refunded to taxpayers that realized a Virginia tax increase as an indirect result of the TCJA.

Senate Bill 1739 would advance Virginia's date of conformity to the IRC to December 31, 2018, and require additional revenues from the TCJA for fiscal years beginning on and after July 1, 2018, but before July 2, 2026 to be transferred to a fund and refunded to individual income taxpayers.

Senate Bill 1744 would increase the standard deduction to $4,000 for single individuals and $8,000 for married taxpayers filing jointly for Taxable Year 2018 only, and the standard deduction would revert to its current amounts for Taxable Year 2019 and after.

cc : Secretary of Finance

Date: 1/28/2019 JJS
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