DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. Patron Robert S. Bloxom, Jr.

2. Bill Number HB 2704
House of Origin:
X **Introduced**
____ **Substitute**
____ **Engrossed**

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

3. Committee House Rules

4. Title Tax Policy Fund

5. Summary/Purpose:

This bill would create a special nonreverting fund that would be known as the Tax Policy Fund. This bill would provide that, if the General Assembly does not enact legislation during the 2019 Session that gives at least $100 million in Virginia income tax relief to Virginia taxpayers, any additional revenues generated by the federal Tax Cuts and Jobs Act ("TCJA") in Fiscal Year 2020 would be transferred to the Tax Policy Fund.

The Governor would be required to submit, with his budget proposal for the 2020-2022 biennium, a plan to provide tax reform to Virginia taxpayers with revenues in the Tax Policy Fund. Such tax reform would distribute the additional revenues to Virginia taxpayers proportionately on the basis of their Virginia income tax liability for Taxable Year 2018.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

Due to uncertainty about the systems and processing changes that may be required for the 2018 and 2019 income tax filing seasons, the Department of Taxation ("the Department") is unable to assign administrative costs to this bill at this time. At this time, it is uncertain what Virginia tax policy changes will be adopted in reaction to the TCJA. Accordingly, the Department will reevaluate its costs once action is taken and may request additional funding.

Revenue Impact

This bill would create a special nonreverting fund to be known as the Tax Policy Fund, where any additional revenues generated by the TCJA in Fiscal Year 2020 would be required to be transferred. The requirement to make transfers to this fund would only be triggered if the General Assembly does not enact legislation during the 2019 Session giving at least $100 million in Virginia income tax relief to Virginia taxpayers. This bill would have an unknown negative General Fund revenue impact in Fiscal Year 2020. If the requirement to make a transfer to the Tax Policy Fund is triggered, it is estimated that up to $611.1 million would be required to be transferred from the General Fund in Fiscal Year 2020.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

This bill would require that, if the General Assembly does not enact legislation during the 2019 Session of the General Assembly that provides at least $100 million in Virginia income tax relief to Virginia taxpayers, any additional revenues generated by TCJA in Fiscal Year 2020 must be transferred to the Tax Policy Fund. If the General Assembly were to enact legislation to provide less than $100 million in Virginia income tax relief, it is unclear whether, in calculating the additional revenues generated by TCJA under this bill, such amount would be allowed to be decreased by any reduction in revenues resulting from legislation providing such partial relief.

This bill would also require that any tax reform plan submitted related to the Tax Policy Fund would distribute additional revenues to Virginia taxpayers proportionately on the basis of their Virginia income tax liability for Taxable Year 2018. It is unclear whether the refund amount would be calculated based only on the tax liability reported on each taxpayer’s return or whether the Department would be required to audit taxpayers to determine whether the tax liability reported on the return is correct.

11. Other comments:

Tax Cuts and Jobs Act

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. The provisions that affect individual taxpayers include, but are not limited to:

- Increasing the standard deduction amount to $24,000 for joint filers and $12,000 for individual filers;
- Repealing the "Pease Limitation" that reduced the otherwise allowable amount of itemized deductions by 3 percent of the amount by which federal adjusted gross income exceeded a threshold amount (up to an 80 percent reduction);

- Expanding the charitable contribution deduction by increasing the percentage limitation on the amount of cash contributions that may be made to public charities;
- Imposing a $10,000 limitation on the state and local tax ("SALT") deduction;
- Limiting the home mortgage interest deduction to interest expenses attributable to mortgage balances no greater than $750,000 (for mortgages incurred December 15, 2017 or later);
- Repealing the home mortgage interest deduction for all home equity loan interest expenses;
- Repealing certain miscellaneous deductions subject to 2 percent floor, such as the deduction for unreimbursed employee expenses (including travel and home office expenses) and the deduction for tax preparation fees; and
- Repealing the deduction for casualty losses other than for losses incurred in a federally-declared disaster area.

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.

The provisions that impact businesses include, but are not limited to:

- Expanding IRC § 179 small business expensing by raising the annual dollar limitation from $500,000 to $1 million of qualifying property and raising the threshold for reducing the deduction amount from $2 million to $2.5 million of qualifying purchases;
- Increasing first-year bonus deprecation from 50 percent to 100 percent of the purchase price of qualified property;
- Expanding the universe of taxpayers that can use the cash method of accounting by increasing the threshold for the cash method from $5 million in gross receipts (generally $1 million for those businesses that are required to use the inventory method) to $25 million;
- Imposing a 30 percent of adjusted income limit on the deduction for interest expenses for most businesses with gross receipts of over $25 million;
- Imposing an 80 percent of taxable income limitation on the net operating loss deduction, generally repealing the ability to carry back losses, and providing the ability to indefinitely carry forward losses;
- Repealing the IRC § 199 domestic production activities deduction; and
- Eliminating the ability of taxpayers to immediately deduct certain research and experimentation expenditures and requiring them to be amortized.

Most of the provisions of the TCJA impacting business taxpayers are effective beginning in Taxable Year 2018 and are permanent. However, the provision providing 100 percent bonus depreciation is currently scheduled to sunset after Taxable Year 2022.

The TCJA 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.

History of Virginia's Response to Federal Tax Reform

During the 1987 Session, the General Assembly enacted legislation in response to the federal Tax Reform Act of 1986 that increased the:

- Amounts of the personal exemption and standard deduction;
- Threshold for the top individual income tax rate bracket; and
- Individual income tax filing threshold.

This legislation also required excess revenues from federal tax reform to be set aside in a special fund for purposes of providing future tax relief. During the 1989 Session, the General Assembly enacted legislation that utilized such revenue to provide a one-time, nonrefundable individual income tax credit in an amount equal to $35 per personal and dependent exemption claimed. Taxpayers with Virginia adjusted gross income of less than $17,000 for individuals and $34,000 for married persons filing joint returns received the full amount of the credit. The amount of the credit declined gradually based on a taxpayer's income in excess of such amounts so that a taxpayer with Virginia adjusted gross income greater than $34,000 for individuals and $68,000 for married persons filing joint returns received no credit.

During the 1989 Session, the General Assembly also enacted a smaller $22.50 tax credit for Taxable Year 1990 through Taxable Year 1993. However, this credit was repealed during the 1990 Session in order to instead eliminate the sales and use tax on nonprescription drugs.

Proposed Legislation

This bill would create a special nonreverting fund that would be known as the Tax Policy Fund. This bill would provide that, if the General Assembly does not enact legislation during the 2019 Session that gives at least $100 million in Virginia income tax relief to Virginia taxpayers, any additional revenues generated by the federal TCJA in Fiscal Year 2020 would be transferred to the Tax Policy Fund.

The Governor would be required to submit, with his budget proposal for the 2020-2022 biennium, a plan to provide tax reform to Virginia taxpayers with revenues in the Tax Policy Fund. Such tax reform would distribute such additional revenues to Virginia taxpayers proportionately on the basis of their Virginia income tax liability for Taxable Year 2018.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

Similar Legislation

House Bill 1851, House Bill 2110, House Bill 2765, Senate Bill 1225, Senate Bill 1443, and **Senate Bill 1631** would make various, different tax policy changes and require that certain additional revenues from the TCJA to be transferred to a fund.

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.

cc : Secretary of Finance

Date: 1/28/2019 JLOF
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