REVISED
01/20/19

DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. Patron A. Benton Chafin, Jr.

2. Bill Number SB 1211

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

3. Committee Senate Finance

4. Title Advances Conformity with the Internal Revenue Code; Increases Standard Deduction; Emergency

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

5. Summary/Purpose:

The Department of Taxation ("the Department") understands that the Patron will offer technical amendments for this bill. This fiscal impact statement is drafted based on such technical amendments.

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 provisions of this bill amending Virginia's conformity statute would be effective for Taxable Year 2018 and after.

The bill would increase the Virginia standard deduction from $3,000 to $6,000 for individuals and married taxpayers filing separately, and from $6,000 to $12,000 for married taxpayers filing joint returns. The provisions of this bill increasing the Virginia standard deduction would be effective for Taxable Year 2018 and after.

This bill would index the standard deduction using Chained Consumer Price Index for All Urban Consumers. The provisions of this bill indexing the Virginia standard deduction would be effective for Taxable Year 2019 and after.

This bill contains an emergency clause which states that it would be in force from its passage.

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*
2018-19	$1,787,806	0	GF
2019-20	$171,700	0	GF
2020-21	$27,200	0	GF
2021-22	$16,000	0	GF
2022-23	$16,000	0	GF

7b. Revenue Impact:

Fiscal Year	*Dollars*	*Fund*
2018-19	($395.6 million)	GF
2019-20	($786.2 million)	GF
2020-21	($510.0 million)	GF
2021-22	($533.6 million)	GF
2022-23	($558.9 million)	GF
2023-24	($583.6 million)	GF
2024-25	($607.7 million)	GF

8. Fiscal implications:

Administrative Costs

In order to implement the standard deduction change in the middle of tax filing season, the Department of Taxation ("the Department") would incur costs of $1,787,806 in FY 2019, $171,700 in FY 2020, and minimal costs each year thereafter. These costs include the costs of adjusting returns that have already been filed to reflect the standard deduction increase and mailing letters explaining such adjustments, as well as hiring additional wage employees to adjust returns and respond to questions regarding return adjustments.

Revenue Impact

This bill would result in a negative General Fund revenue impact of $395.6 million in Fiscal Year 2019; $786.2 million in Fiscal Year 2020; $510.0 million in Fiscal Year 2021; $533.6 million in Fiscal Year 2022; $558.9 mil in Fiscal Year 2023; $583.6 million in Fiscal Year 2024; and $607.7 million in Fiscal Year 2025. If this bill is enacted, the budget would need to be adjusted to reduce the revenue estimate by $395.6 million in Fiscal Year 2019 and $786.2 million in Fiscal Year 2020.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Virginia's Date of Conformity to the Internal Revenue Code

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.

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.

Bipartisan Budget Act of 2018

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.

Federal Standard Deduction

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.

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 ("C-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.

Virginia Standard Deduction

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.

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.

Proposed Legislation

This bill would advance Virginia's date of conformity to the 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 TCJA and the "BBA that affect Taxable Year 2018 and after. This would allow Virginia to fully conform to the TCJA. Therefore, Virginia would conform to all provisions of the IRC, except:

- Bonus depreciation allowed for certain assets under federal income taxation;
- The five-year NOLs generated in certain taxable years;
- Tax exclusions related to cancellation of debt income; and
- Tax deductions related to the application of the applicable high yield debt obligation rules.

The provisions of this bill amending Virginia's conformity statute would be effective for Taxable Year 2018 and after.

This bill would increase the Virginia standard deduction from $3,000 to $6,000 for individuals and married taxpayers filing separately, and from $6,000 to $12,000 for married taxpayers filing joint returns. The provisions of this bill increasing the Virginia standard deduction would be effective for Taxable Year 2018 and after.

This bill would index the standard deduction using C-CPI-U by the percentage, if any, by which C-CPI-U, as published by the U.S. Department of Labor or any successor index, for the most recent calendar year differs from the C-CPI-U published at the close of the 12-month period ending on December 31, 2018. The provisions of this bill indexing the Virginia standard deduction would be effective for Taxable Year 2019 and after.

This bill contains an emergency clause which states that it would be in force from its passage.

<u>Similar Bills</u>

House Bill 1618, House Bill 2708, and **Senate Bill 1237** 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 2018 through Taxable Year 2025.

House Bill 1851, **House Bill 2110**, and **Senate Bill 1225** are identical bills that would increase the standard deduction to $6,000 for a single individual and $12,000 for married persons filing jointly; index the standard deduction for inflation; and make several other tax policy changes.

House Bill 2529 would allow a taxpayer to elect either to claim the standard deduction or to itemize his or her deductions, regardless their federal election; would increase the standard deduction to $4,000 for a single individual and to $8,000 for married persons filing jointly; and make several other tax policy changes.

House Bill 1980 would increase the standard deduction to $6,000 for single individuals and $12,000 for married persons filing jointly and make other tax policy changes.

House Bill 2086 would increase the standard deduction to $4,500 for single individuals and to $9,000 for married persons filing jointly, index such deduction for inflation; would deconform from the provision of TCJA that suspended the overall limitation on itemized deductions; and would make other tax policy changes.

House Bill 2673 would allow a taxpayer to elect either to claim the standard deduction or to itemize his or her deductions, regardless their federal election; would increase the standard deduction to $3,500 for single individuals and $7,000 for married persons filing jointly; and make several other tax policy changes.

House Bill 2765 would increase the standard deduction to $3,750 for single individuals and $7,500 for married persons filing jointly; and make several other tax policy changes.

Senate Bill 1443 and **Senate Bill 1631** are identical bills that would increase the standard deduction to $6,000 for a single individual and $12,000 for married persons filing jointly; index the standard deduction for inflation; and make several other tax policy changes.

Senate Bill 1531 would increase the standard deduction to $12,000 for a single individual and $24,000 for married persons filing jointly.

Senate Bill 1657 would provide a nonrefundable credit to single individuals of $250 and to married persons filing jointly of $500, provided that the taxpayers did not itemize on their federal return.

Senate Bill 1744 would increase the standard deduction for Taxable Year 2018 only to $4,000 for single individuals and $8,000 for married persons filing jointly.

cc : Secretary of Finance

Date: 1/20/2019 JJS
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