DEPARTMENT OF TAXATION
2022 Fiscal Impact Statement

1. Patron Vivian E. Watts

2. Bill Number HB 1343

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

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

3. Committee House Finance

4. Title Income Tax; Sales and Use Tax; structural tax changes

5. Summary/Purpose:

This bill would make several changes to Virginia's tax structure.

This bill would increase the Virginia standard deduction from $4,500 to $6,000 for single individuals and married taxpayers filing separately, and from $9,000 to $12,000 for married persons filing joint returns.

This bill would also index Virginia's individual income tax brackets, filing threshold, standard deduction, personal exemption, and additional personal exemption for blind or the aged for inflation using Chained Consumer Price Index for All Urban Consumers ("C-CPI-U").

This bill would allow any individual or married couple to claim a refundable individual income tax credit beginning with Taxable Year 2022 equal to 50 percent of the federal earned income tax credit ("EITC") claimed by such individual or married couple for the same taxable year. This bill would increase the refundable portion by 5 percent per year beginning with Taxable Year 2023 until the credit becomes fully refundable for Taxable Year 2032 and thereafter.

This bill would also impose the Retail Sales and Use Tax ("RSUT") on digital personal property delivered electronically and several personal and professional services, including communications services that are not subject to the Communications Sales and Use Tax ("CSUT") and are not digital personal property.

The bill would provide for RSUT exemptions for enumerated services including certain health care services, veterinary services, professional services, Internet access services, and services provided by a person who does not receive more than $2,500 per year in gross receipts for performance of such services. The bill would also exempt services purchased by a nonprofit organization and services purchased by a homeowners' association or by a landlord for the benefit of his tenant.

The bill would also repeal the service exemptions currently provided for the sale of custom programs and modification of prewritten programs and impose CSUT on prepaid calling services and on digital subscription services, including streaming services.

The bill also exempts food purchased for human consumption and essential personal hygiene products from all state and regional sales taxes. Current law provides that most personal and professional services, digital products delivered electronically where no tangible personal property was offered as part of the sale, custom software, modifications to pre-written software, and digital subscription and streaming services are exempt from RSUT. Current law also provides that maintenance contracts and warranties, the terms of which provide for both repair or replacement parts and repair labor, are subject to tax upon one-half of the total charge for such contracts only. Food for human consumption and essential personal hygiene products are currently taxed at a reduced rate of 2.5 percent statewide, comprised of a 1.5 percent state rate and 1 percent local rate.

The portions of this bill that would modify the standard deduction and require the indexing of certain provisions would be effective for taxable years beginning on and after January 1, 2023. The portion of this bill that would modify the EITC would be effective for taxable years beginning on or after January 1, 2022. The provisions of the bill affecting RSUT and CSUT would become effective July 1, 2022.

6. **Budget amendment necessary:** Yes.
Item(s): Page 1, Revenue Estimates
274 and 276, Department of Taxation

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

Fiscal Year	***Dollars***	***Positions***	***Fund***
2022-23	$849,489	3	GF
2023-24	$273,653	3	GF
2024-25	$270,353	3	GF
2025-26	$274,753	3	GF
2026-27	$278,953	3	GF
2027-28	$225,130	3	GF

8. **Fiscal implications:**

Administrative Costs

This bill would result in administrative costs to the Department of Taxation ("the Department") of $849,489 in Fiscal Year 2023, $273,653 in Fiscal Year 2024, $270,353 in Fiscal Year 2025, $274,753 in Fiscal Year 2026, $278,953 in Fiscal Year 2027, and $225,130 in Fiscal Year 2028. Such costs would primarily consist of updating the Department's systems to implement the changes that would be made by this bill, including two FTEs for field audits and one FTE for customer service in the contact center.

Revenue Impact

The portion of this bill that would require indexing with respect to several structural tax provisions and increase the standard deduction would have an estimated negative General Fund revenue impact of $23.4 million in Fiscal Year 2023, $73.6 million in Fiscal Year 2024, $126.3 million in Fiscal Year 2025, $182.2 million in Fiscal Year 2026, $240.5 million in Fiscal Year 2027, and $300.9 million in Fiscal Year 2028.

The portion of this bill that would enhance the EITC would have an estimated negative General Fund revenue impact of $97 million in Fiscal Year 2023, $104 million in Fiscal Year 2024, $116 million in Fiscal Year 2025, $128 million in Fiscal Year 2026, $141 million in Fiscal Year 2027, and $155 million in Fiscal Year 2028. The introduced budget assumes a reduction of $159 million in Fiscal Year 2023 and $156 million in Fiscal Year 2024 to account for providing a 75 percent refundable EITC. Accordingly, a budget amendment would be required to increase revenues by $62 million in Fiscal Year 2023 and $52 million in Fiscal Year 2024 to account for the provision of a refundable EITC as proposed in this bill.

The table below shows the estimated impact of extending RSUT to digital personal property (in $ millions):

Fiscal Year	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
GF-Unrestricted	15.1	17.8	19.0	20.3	21.6	22.9
GF-Restricted	7.4	8.7	9.4	10.0	10.6	11.3
Transportation	6.0	7.1	7.6	8.1	8.6	9.1
Local Option	6.7	7.8	8.4	9.0	9.5	10.1
Other	3.3	3.9	4.1	4.4	4.7	5.0
Total	38.6	45.3	48.5	51.7	55.0	58.2

The table below shows the estimated impact of extending RSUT to the services identified in the bill (in $ millions*):

Fiscal Year	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
GF-Unrestricted	352.6	400.9	417.9	435.8	449.0	463.0
GF-Restricted	173.6	197.4	205.7	214.5	221.1	227.9
Transportation	140.1	159.3	166.1	173.1	178.4	184.0
Local Option	155.7	177.0	184.5	192.4	198.3	204.4
Other	76.6	87.1	90.8	94.7	97.5	100.6
Total	898.6	1,021.7	1,065.0	1,110.5	1,144.3	1,179.8

These estimates include both Business-to-Consumer (BTC) and Business-to-Business (BTB) transactions.

The table below shows the estimated impact of extending CSUT to streaming services (in $ millions):

Fiscal Year	2023	2024	2025	2026	2027	2028
Local	48.7	57.3	61.8	66.5	71.4	76.6

The table below shows the estimated impact of eliminating the tax on food purchased for human consumption and essential personal hygiene products as proposed by the bill (in $ millions):

Fiscal Year	2023	2024	2025	2026	2027	2028
GF-Restricted, K-12	(236.1)	(265.1)	(271.7)	(273.3)	(274.7)	(275.8)
CTF	(119.3)	(133.9)	(137.2)	(138.1)	(138.7)	(139.3)
Local	(238.5)	(267.8)	(274.5)	(276.1)	(277.5)	(278.6)
Total (2.49%)	(593.9)	(666.7)	(683.4)	(687.5)	(690.9)	(693.7)

The introduced budget assumes the elimination of the state portion of the tax on food purchased for human consumption effective January 1, 2023. In addition, the introduced budget contains a $900,000 General Fund revenue adjustment to account for a partial elimination for essential personal hygiene products. The table below shows the estimated impact for Fiscal Year 2023 and 2024 after taking into account these budget adjustments (in $ millions):

Fiscal Year	2023	2024
GF Restricted, K-12	(129.0)	(1.9)
CTF	($65.6)	($1.4)
Local	($238.5)	($267.8)
Total	($433.1)	($271.1)

The tables below show the total estimated revenue impact of all changes proposed by the legislation before and after accounting for amounts included in the introduced budget:

Total Impact

		Fiscal Year ($M)					
		2023	**2024**	**2025**	**2026**	**2027**	**2028**
IIT Changes-General Fund	Indexing Exemptions, Standard Deduction, Brackets, and Filing Threshold	(23.4)	(73.6)	(126.3)	(182.2)	(240.5)	(300.9)
	Refundable EITC	(96.6)	(104.1)	(115.8)	(128.2)	(140.9)	(154.8)
SUT	Food and Personal Hygiene Products	(593.9)	(666.7)	(683.4)	(687.5)	(690.9)	(693.7)
	Selected Services *	898.6	1,021.7	1,065.0	1,110.5	1,144.3	1,179.8
	Digital Downloads	38.6	45.3	48.5	51.7	55.0	58.2
CSUT to Streaming Services (Distributed entirely to localities)		48.7	57.3	61.8	66.5	71.4	76.6
Total Impact		**271.9**	**279.8**	**249.8**	**230.8**	**198.4**	**165.2**

Compared to Introduced Budget

		Fiscal Year ($M)					
		2023	**2024**	**2025**	**2026**	**2027**	**2028**
IIT Changes-General Fund	Indexing Exemptions, Standard Deduction, Brackets, and Filing Threshold	(23.4)	(73.6)	(126.3)	(182.2)	(240.5)	(300.9)
	Refundable EITC	62.4	51.9	43.7	35.0	26.1	16.7
SUT	Food and Personal Hygiene Products	(433.1)	(271.1)	(278.7)	(280.3)	(281.8)	(282.9)
	Selected Services *	898.6	1,021.7	1,065.0	1,110.5	1,144.3	1,179.8
	Digital Downloads	38.6	45.3	48.5	51.7	55.0	58.2
CSUT to Streaming Services (Distributed entirely to localities)		48.7	57.3	61.8	66.5	71.4	76.6
Impact Compared to Introduced Budget		**591.7**	**831.4**	**814.0**	**801.2**	**774.5**	**747.6**

Total Impact by Fund

Fiscal Year ($M)	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
GF-Unrestricted	247.7	240.9	194.9	145.6	89.3	30.1
GF-Restricted	(55.1)	(59.0)	(56.6)	(48.8)	(43.0)	(36.6)
Transportation	26.8	32.5	36.4	43.1	48.3	53.7
Local Option	(27.5)	(25.6)	(19.8)	(8.3)	1.7	12.5
Other	79.9	90.9	94.9	99.1	102.2	105.5
Total	271.9	279.8	249.8	230.8	198.4	165.2

Total Impact by Fund Compared to Introduced Budget

Fiscal Year ($M)	2023	2024	2025	2026	2027	2028
GF-Unrestricted	406.7	396.9	354.4	308.9	256.2	201.7
GF-Restricted	52.0	204.2	212.3	221.7	228.8	236.3
Transportation	80.5	165.0	172.2	179.8	185.6	191.6
Local Option	(27.5)	(25.6)	(19.8)	(8.3)	1.7	12.5
Other	79.9	90.9	94.9	99.1	102.2	105.5
Total	591.7	831.4	814.0	801.2	774.5	747.6

9. Specific agency or political subdivisions affected:

Department of Taxation
All localities

10. Technical amendment necessary: Yes.

In order to allow sufficient time to implement changes required by this bill related to the taxability of services, the Department suggests the following amendment:

Page 22: Line 1351
Insert: 2. That the provisions of this act affecting the taxability of services for purposes of taxes levied under or pursuant to authority granted by Chapter 6 of Title 58.1 shall become effective on July 1, 2023.

11. Other comments:

<u>Federal Standard Deduction</u>

On December 22, 2017, the Tax Cuts and Jobs Act (Public Law 115-97) was signed into law. This federal tax reform legislation substantially changed the federal income taxation of individuals and businesses. These changes included substantially increasing the federal standard deduction beginning with Taxable Year 2018 as follows:

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

In addition, beginning with Taxable Year 2019, these amounts have been indexed for inflation based on chained CPI-U. Therefore, for Taxable Year 2021, the amount of the federal standard deduction, after indexing, is as follows:

- $25,100 for married taxpayers filing jointly;
- $18,800 for heads of household; and

- $12,550 for single taxpayers and married taxpayers filing separately.

Like most other individual provisions of the TCJA, the increase in the amount of the federal standard deduction is currently scheduled to sunset after December 31, 2025, and revert to the amounts in the law prior to passage of the Tax Cuts and Jobs Act. Additional federal legislation would be required to make such increase effective beyond Taxable Year 2025.

Virginia's Standard Deduction

Under current law, taxpayers that do not itemize their deductions for federal purposes are permitted to claim a standard deduction on their Virginia income tax returns. During the 2019 Session, the General Assembly enacted legislation that increased the amounts of Virginia's standard deduction for Taxable Year 2019 through Taxable Year 2025.

The standard deduction amounts are $4,500 for single individuals and $9,000 for married couples. Virginia's standard deduction amounts have changed over the years. The history of such changes from Taxable Year 1987 to the present is shown below:

Year	Virginia Standard Deduction for Single Taxpayers	Virginia Standard Deduction for Married Taxpayers
1987	$2,000	$2,000
1988	$2,700	$2,700
1989-2004	$3,000	$5,000
2005-2018	$3,000	$6,000
2019-present	$4,500	$9,000

Prior to 1987, the Virginia standard deduction was not a flat amount. Instead, for Taxable Year 1986 for example, the Virginia standard deduction was 15 percent of federal adjusted gross income with a $1,300 minimum and a $2,000 maximum.

For taxable years beginning on or after January 1, 2026, the Virginia standard deduction is scheduled to revert to its pre-2019 form. Therefore, the Virginia standard deduction will be $3,000 for single filers and to $6,000 for married couples. In addition, the amounts of the Virginia standard deduction are not currently indexed for inflation.

Federal Indexing and the Tax Cuts and Jobs Act

Effective in 1985, 1986, and all taxable years after 1989, the federal individual income tax brackets, standard deduction, and personal exemptions were all indexed using CPI-U. CPI-U is a measure calculated by the Bureau of Labor Statistics that is used to track changes in the prices paid by urban consumers for common goods and services over time. This represents approximately 87 percent of the total population of the United States. The index produces monthly data on these changes. Typically, the Index for a given month is released approximately two or three weeks after the month ends.

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") (Public Law 115-97) was signed into law. This federal tax reform legislation substantially changes the federal income taxation of individuals and businesses, including the method of indexing used. The TCJA requires the use of chained CPI-U, instead of CPI-U, in indexing various federal tax provisions for inflation, including the standard deduction. Chained CPI-U, like CPI-U, is a measure of the average change over time in prices paid by urban consumers, but the chained CPI-U differs from the CPI-U in that it accounts for the ability of individuals to alter their consumption patterns in response to relative price changes. Chained CPI-U reflects people's ability to lessen the impact of inflation by buying fewer goods or services that have risen in price and buying more goods and services whose price have risen less, or not at all. Therefore, chained CPI-U is a slower-growing method of calculating cost-of-living adjustments.

The change to chained CPI-U for inflation indexing is effective for taxable years beginning after 2017 and will remain in effect after 2025, because it is not subject to the sunset provision that applies to other individual income tax provisions of the TCJA.

Virginia Individual Income Tax Rate Brackets

Under current law, the Virginia individual income tax is imposed on the following income brackets at these rates:

Virginia Taxable Income	Virginia Tax Rates
$3,000 and less	2 percent
$3,001 to $5,000	3 percent
$5,001 to $17,000	5 percent
$17,001 or more	5.75 percent

In 1971, when Virginia studied conforming to the federal income tax law, Virginia originally considered having on the first three tax brackets shown above. Therefore, the top marginal tax rate would have been 5 percent, applicable to Virginia taxable income of $5,001 or more. However, by 1972, when the General Assembly voted to conform to federal income tax law, it enacted four tax brackets at the same tax rates as under current law.
The amount of Virginia taxable income subject to Virginia's top marginal tax rate was last modified during the 1987 Session, in response to the 1986 federal tax reform.

Year	Taxable Income Subject to 5.75 percent Tax Rate
1972—1986	$12,001 or more
1987	$14,001 or more
1988	$15,001 or more
1989	$16,001 or more
1990—Present	$17,001 or more

Since 1990, the General Assembly has not enacted any legislation affecting Virginia individual income tax rates or brackets and the brackets are not currently indexed for inflation. The federal individual income tax rate brackets are indexed for inflation.

Federal Individual Income Tax Filing Threshold

The current federal individual income tax filing threshold for taxpayers is generally equal to the amount of a taxpayer's standard deduction. The amount of the filing threshold may differ depending on a variety of circumstances. The following chart shows the current federal individual income tax filing thresholds:

Filing Status	Age at the End of 2021	Filing Threshold
Single	Under 65 65 or Older	$12,550 $14,250
Married Filing Jointly	Under 65 (both spouses) 65 or Older (one spouse) 65 or Older (both spouses)	$25,100 $26,450 $27,800
Married Filing Separately	Any Age	$5
Head of Household	Under 65 65 or Older	$18,800 $20,500
Qualified Widow(er)	Under 65 65 or Older	$25,100 $26,450

Virginia's Individual Income Tax Filing Threshold

The Virginia individual income tax filing threshold is the amount of income at which a taxpayer is required to pay income tax and file an income tax return. Virginia's current individual income tax filing thresholds are $11,950 for single individuals and a married individual filing a separate return, and $23,900 for married couples. The following chart shows Virginia's filing thresholds for Taxable Year 1978 to the present:

Filing Status	1978 - 1986	1987 - 2004	2005 - 2007	2008 - 2009	2010 - 2011	2012 - Present
Single	$3,000	$5,000	$7,000	$11,250	$11,650	$11,950
Married	$3,000	$8,000	$14,000	$22,500	$23,300	$23,900
Married Separate	$3,000	$4,000	$7,000	$11,250	$11,650	$11,950

Other States Individual Income Tax Filing Threshold

Of the 41 states that impose an individual income tax, 12 and the District of Columbia require taxpayers to file an individual income tax return if they were required to file a federal individual income tax return for such taxable year. 18 states require residents to file an individual income tax return only if their income exceeds the state standard deduction and/or personal exemption amount(s). The remaining 11 states, including

Virginia, set a threshold amount independent of the federal threshold and the state standard deduction and/or personal exemption amount(s).

The following chart shows the current individual income tax filing thresholds for Virginia and the states bordering Virginia that impose an individual income tax.

	Filing Threshold Single	Filing Threshold Married
Virginia	$11,950	$23,900
Kentucky	$2,690	$2,690
Maryland	$12,400	$24,800
North Carolina	$10,750	$21,500
Washington D.C.	$12,550	$25,100
West Virginia	$2,000	$4,000

Virginia Personal Exemption

Currently, a $930 personal exemption may be claimed for each person filing a return (for married couples, each spouse is entitled to an exemption) and for each dependent. In 1971, when Virginia studied conforming to federal income tax law, Virginia's personal exemptions were originally intended to be the same as the federal personal exemptions. However, by 1972, when Virginia voted to conform to federal income tax law, Virginia's personal exemption amount was less than the federal amount because Virginia did not conform to the 1972 federal increase. Virginia's personal exemption amounts have changed over the years, as shown below:

Year(s)	Virginia Personal Exemption
1972	$600
1973-1986	$600
1987	$700
1988-2005	$800
2006-2007	$900
2008-present	$930

In addition to the $930 personal exemption, an $800 personal exemption for age or blindness may be claimed for each filer who is blind or who has attained the age of 65 before the close of the taxable year. Virginia's additional personal exemptions for age or blindness have changed over the years, as shown below:

Year(s)	Personal Exemption for Blindness/Age
1972	$600
1973-1986	$600 for blindness $1,000 for age
1987	$900
1988-present	$800

Beginning in Taxable Year 1973, the General Assembly allowed an additional $400 personal exemption for taxpayers who claimed the additional federal personal exemption for age. Therefore, for Taxable Years 1973 through 1986, the total Virginia additional personal exemption for age was $1,000. There was no additional amount allowed for blindness. Thus, taxpayers who claimed the federal personal exemption for blindness were entitled to only a $600 additional personal exemption on Virginia returns filed from 1973 through 1986.

For Taxable Years 2018 through 2025, the TCJA effectively eliminated the federal personal exemption by making the amount of the exemption equal to $0. However, the TCJA did not remove the statutory language in the IRC granting personal exemptions. Therefore, federal law still contains a provision allowing personal exemptions, but the amount of such exemption is $0. Because Virginia's personal exemption deduction is based on the number of personal exemptions allowable for federal income tax purposes and not on the amount of such exemptions, the TCJA has no effect on Virginia's personal exemption.

The amounts of the Virginia personal exemption are not currently indexed for inflation. Before it was temporarily suspended, the federal personal exemption was indexed for inflation.

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.

No household may claim both credits in the same taxable year. For purposes of these credits, "household" means an individual or married persons, regardless of whether such married persons file joint or separate Virginia individual income tax returns.

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 2022, an individual's AGI and earned income must be less than:

- $53,057 ($59,187 for married filing jointly) if they have three or more qualifying children;
- $49,399 ($55,529 for married filing jointly) if they have two qualifying children;
- $43,492 ($46,622 for married filing jointly) if they have one qualifying child; or
- $16,480 ($22,610 for married filing jointly) if they do not have a qualifying child

The maximum federal EITC for Taxable Year 2022 is $6,935 for an individual with three or more qualifying children, $6,164 for an individual with two qualifying children, $3,733 for an individual with one qualifying child, and $560 for an individual with no qualifying children.

<u>Department of Social Services Reporting Requirement</u>

DSS is required to provide notice regarding the availability of the federal EITC and Virginia's nonrefundable individual income tax credit equal to 20 percent of the federal EITC to certain individuals. Such individuals include all recipients of Temporary Assistance for Needy Families ("TANF"), food stamps, or medical assistance who had earned income in the prior taxable year based on information available through the Virginia Employment Commission, and according to information made available by the Department, either did not file federal or state income taxes or filed taxes but did not claim the federal or state EITC.

<u>Refundable Tax Credits</u>

For Taxable Year 2021, Virginia allows 33 income tax credits. Of these credits, four are currently refundable:

- Agricultural Best Management Practices Tax Credit;
- Conservation Tillage and Precision Agriculture Equipment Credit;
- Motion Picture Production Tax Credit; and
- Research and Development Expenses Tax Credit.

<u>Retail Sales and Use Tax</u>

Current law provides an exemption from sales tax for the following types of services:

- Professional, insurance, or personal service transactions which involve sales as inconsequential elements for which no separate charges are made;
- services rendered by repairmen for which a separate charge is made;
- amounts separately charged for labor or services rendered in installing, applying, remodeling, or repairing property sold or rented;
- transportation charges separately stated;
- separately stated charges for alterations to apparel, clothing and garments;
- charges for gift wrapping services performed by a nonprofit organization;

Additionally, custom programs and amounts separately charged for labor or services rendered in connection with the modification of prewritten programs are also exempt from the tax.

Maintenance contracts and warranties, the terms of which provide for both repair or replacement parts and repair labor, are subject to tax upon one-half of the total charge for such contracts only. The bill would eliminate the current provision for application of the tax to only one-half of the total charge for these contracts but it is unclear how these contracts would be treated prospectively. The current 50% taxability rule provides ease of administration for sellers of such contracts as it may be difficult or impossible to determine, at the time of sale, the value of any tangible personal property or taxable service that may accrue to the purchaser during the life of the contract.

The initial purchase of prepaid calling cards is subject to RSUT because the purchaser receives tangible personal property but the recharge of a prepaid card is not subject to tax so long as the purchaser does not receive another card. “Prepaid calling service” for purposes of RSUT excludes unlimited prepaid calling cards because current law requires that for RSUT to apply, the value of the card must decrease in units or dollars with use. The bill would amend the definition of “prepaid calling service” to clarify that all prepaid calling services would be subject to CSUT.

Communications Sales and Use Tax

The Communications Sales and Use Tax is levied on the customers of communications services at a rate of five percent. The sale or recharge of a prepaid calling service is currently exempt from the tax. Digital products delivered electronically, such as software, downloaded music, ringtones, and reading materials are also exempt. Revenue from CSUT, after deductions for telephone relay service and franchise fees, is allocated amongst the localities of the Commonwealth based on each locality’s pro rata distribution from CSUT revenues in 2010.

Digital Downloads and Streaming

Services not involving an exchange of tangible personal property which provide access to or use of the Internet and any other related electronic communication service, including software, data, content and other information services delivered electronically via the Internet, are currently exempt from RSUT and CSUT. This exemption currently extends to streaming services.

The bill would impose RSUT on “digital personal property” and CSUT on “digital subscription services.” “Digital personal property” would be defined as digital products delivered electronically, including software, digital audio and audiovisual products, reading materials, and other data or applications, that the purchaser owns or has the ability to continually access, whether by downloading, streaming, or otherwise accessing the content, without having to pay an additional subscription or usage fee to the seller after paying the initial purchase price. “Digital subscription services” would be defined as a service, including audio and visual streaming services, which for a fee allows the user to access and use software, reading materials, or other digital data or applications for a defined period of time, and which products the user does not own or have permanent access to outside of such period of time.

Whether an item of digital content would be subject to RSUT or CSUT would depend substantially upon whether such content was owned by the purchaser or rather was subject to a subscription or other ongoing charge for the purchaser to maintain access. Determining the proper situs of sales transactions for purposes of collecting and allocating the correct amount of local and regional RSUT may also prove challenging since the traditional rules for determining the situs for sales involving the exchange of tangible personal property may not readily apply to the exchange of intangible items.

Food Purchased for Human Consumption and Essential Personal Hygiene Products

Food purchased for human consumption and essential personal hygiene products are subject to a reduced 1.5 percent state sales tax rate and 1 percent local option sales tax rate for a total rate of 2.5 percent. These items are not subject to the regional sales tax levied in transportation districts or the additional local sales tax levied in some localities to pay for school construction.

“Food purchased for human consumption” has the same meaning as “food” defined in the Food Stamp Act of 1977, as amended, and federal regulations adopted pursuant to that Act, except it does not include seeds and plants which produce food for human consumption. “Food purchased for human consumption” does not include food sold by any retail establishment where the gross receipts derived from the sale of food prepared by such retail establishment for immediate consumption on or off the premises of the retail establishment constitutes more than 80 percent of the total gross receipts of that retail establishment, including but not limited to motor fuel purchases, regardless of whether such prepared food is consumed on the premises of that retail establishment.

“Essential personal hygiene products” means (i) nondurable incontinence products such as diapers, disposable undergarments, pads, and bed sheets and (ii) menstrual cups and pads, pantyliners, sanitary napkins, tampons, and other products used to absorb or contain menstrual flow.

Other States

Twenty-eight states and the District of Columbia allow individuals to claim an EITC equal to a certain percentage of the federal EITC. There are also several localities (such as New York City, Montgomery County, Maryland, and San Francisco) that have credit programs based on EITC. Twenty-three states (California, Colorado, Connecticut, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Jersey, New Mexico, New York, Oklahoma, Oregon, Rhode Island, Vermont and Wisconsin) and the District of Columbia allow such credits to be refundable. Five states (Delaware, Hawaii, Ohio, South Carolina and Virginia) do not allow such credit to be refunded.

As of January 2021, Virginia is one of thirteen states that imposes sales tax on groceries, as sales tax is not levied on groceries in 37 states or the District of Columbia. In addition, 13 states and the District of Columbia specifically exempt at least some type of personal hygiene products from sales tax.

Sunset Dates for New Income Tax Credits and Sales Tax Exemptions

Section 3-5.14 of the 2020 Appropriation Act provides that any new sales tax exemption or tax credit enacted by the General Assembly after the 2019 Session, but prior to the 2024 Session, must have a sunset date of not later than June 30, 2025. Further, during the 2012 Session, the General Assembly enacted House Bill 246, which prohibits any committee of the General Assembly from reporting any legislation that would add a new credit or renew an existing credit unless the legislation contains a sunset date of no longer than five years from the effective date of the new or renewed credit.

Proposed Legislation

This bill would make several changes to Virginia's tax structure.

Standard Deduction

This bill would increase the Virginia standard deduction from $4,500 to $6,000 for single individuals and married taxpayers filing separately, and from $9,000 to $12,000 for married persons filing joint returns.

Indexing Certain Amounts

This bill would also index Virginia's individual income tax brackets, filing threshold, standard deduction, personal exemption, and additional personal exemption for blind or the aged for inflation using C-CPI-U. Such indexing would be determined by adjusting the relevant amounts annually by a percentage equal to the percentage increase in the C-CPI-U, as published by the Bureau of Labor Statistics for the US Department of Labor or any successor index for computing the standard deduction for federal purposes, from September 1 through August 31 for the year immediately preceding the affected taxable year. The Department would be required to round such amounts to the nearest dollar.

Refundable Earned Income Tax Credit

This bill would allow any individual or married couple to claim a refundable individual income tax credit beginning with Taxable Year 2022 equal to 50 percent of the federal EITC claimed by such individual or married couple for the same taxable year. This bill would increase the refundable portion by 5 percent per year beginning with Taxable Year 2023 until the credit becomes fully refundable for Taxable Year 2032 and thereafter.

The portions of this bill that would modify the standard deduction and require the indexing of certain provisions would be effective for taxable years beginning on and after January 1, 2023. The portion of this bill that would modify the EITC would be effective for taxable years beginning on or after January 1, 2022.

Retail Sales and Use Tax

This bill also imposes RSUT on digital personal property, defined in the bill as a digital product delivered electronically that the purchaser owns or has the ability to continually access without having to pay an additional subscription or usage fee to the seller after paying the initial purchase price.

The bill would make the following services subject to RSUT:

- Admissions;
- Charges for recreation,
- Fitness, or sports facilities;
- Nonmedical personal services or counseling;
- Dry cleaning and laundry services;
- Companion animal care;
- Residential home repair or maintenance,
- Landscaping, or cleaning services when paid for directly by a resident or homeowner;
- Vehicle and engine repair;
- Repairs or alterations to tangible personal property;
- Storage of tangible personal property;
- Delivery or shipping services;
- Travel, event, and aesthetic planning services; and
- Communications services that are not subject to the communications sales and use tax and are not digital personal property.

The bill would exempt certain services from RSUT, including:

- Health care services that must be performed by a person licensed or certified by the Department of Health Professions,
- Veterinary services,
- Professional services,
- Internet access services,
- Services provided by a person who does not receive more than $2,500 per year in gross receipts for performance of such services
- Services purchased by a nonprofit organization, and
- Services purchased by a homeowners' association or by a landlord for the benefit of his tenant.

The bill would also repeal the service exemptions currently provided for the sale of custom programs and modification of prewritten programs.

The bill would also exempt food purchased for human consumption and essential personal hygiene products from all state and regional sales taxes and provide that, beginning July 1, 2022, food purchased for human consumption and essential personal hygiene products would be exempt from the local sales tax, and the grocery tax is eliminated.

Communications Sales and Use Tax

The bill would also impose CSUT on prepaid calling services and digital subscription services, defined in the bill as services for which the user pays in order to access and use software, reading materials, or other digital data or applications for a defined period of time, which products the user does not own or have permanent access to outside of such period of time. Digital subscription service would include streaming services.

The provisions of the bill affecting RSUT and CSUT would become effective July 1, 2022.

Similar Bills

House Bill 90 and **Senate Bill 380** would provide an RSUT exemption for food purchased for human consumption and essential personal hygiene products and would dedicate state sales tax revenue to provide supplemental school payments to localities.

House Bill 472, **SB 7**, **SB 11**, and **SB 560** would increase Virginia's standard deduction.

House Bill 289 would require indexing with respect to certain income tax provisions.

SB 343 and **SB 515** would make the Virginia EITC fully refundable.

House Bill 1008, SB 609, and **SB 571** would provide an RSUT exemption for food purchased for human consumption and essential personal hygiene products.

Senate Bill 451 would provide an RSUT exemption for essential personal hygiene products.

cc : Secretary of Finance

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