DEPARTMENT OF TAXATION
2022 Fiscal Impact Statement

1. **Patron** Joseph P. McNamara

2. **Bill Number** HB 289
House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. **Committee** House Finance

4. **Title** Virginia Income Tax; Indexing; Chained Consumer Price Index for All Urban Consumers

5. **Summary/Purpose:**

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

This bill would be effective for taxable years beginning on and after January 1, 2022.

6. **Budget amendment necessary:** Yes.
Item(s): Page 1, Revenue Estimates

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

7b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2022-23	($6.7 million)	GF
2023-24	($28.1 million)	GF
2024-25	($58.1 million)	GF
2025-26	($89.7 million)	GF
2026-27	($123.5 million)	GF
2027-28	($158.8 million)	GF

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation 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 $6.7 million in Fiscal Year 2023, $28.1 million in Fiscal Year 2024, $58.1 million in Fiscal Year 2025, $89.7 million in Fiscal Year 2026, $123.5 million in Fiscal Year 2027, and $158.8 million in Fiscal

Year 2028. Under this bill, the estimated increases in the personal exemptions would be as follows:

Taxable Year	Current Law Exemptions		HB 289 Proposed Exemptions	
	Personal and Dependent	Age and Blind	Personal and Dependent	Age and Blind
2021	$930	$800	$930	$800
2022	$930	$800	$930	$800
2023	$930	$800	$940	$808
2024	$930	$800	$960	$826
2025	$930	$800	$980	$843
2026	$930	$800	$1,002	$862
2027	$930	$800	$1,024	$881
2028	$930	$800	$1,047	$901

The estimated new bracket structure under this bill would be as follows:

Taxable Year	Current Law Tax Brackets			HB 289 Proposed Income Tax Brackets		
	3%	5%	5.75%	3%	5%	5.75%
2021	$3,000	$5,000	$17,000	$3,000	$5,000	$17,000
2022	$3,000	$5,000	$17,000	$3,000	$5,000	$17,000
2023	$3,000	$5,000	$17,000	$3,031	$5,052	$17,177
2024	$3,000	$5,000	$17,000	$3,096	$5,161	$17,546
2025	$3,000	$5,000	$17,000	$3,162	$5,271	$17,921
2026	$3,000	$5,000	$17,000	$3,232	$5,387	$18,316
2027	$3,000	$5,000	$17,000	$3,304	$5,507	$18,723
2028	$3,000	$5,000	$17,000	$3,378	$5,629	$19,140

There would be no increases for Taxable Year 2022 because the indexing ratio would be defined as the percentage, if any, by which the chained CPI-U, as published by the U.S. Department of Labor or any successor index, for the most recent calendar year exceeds the chained CPI-U published at the close of the 12-month period ending on December 31, 2021. For Taxable Year 2022, such computation would result in comparing chained CPI-U for “the most recent calendar year,” which is Calendar Year 2021, to the chained CPI-U for the base year, which is also Calendar Year 2021.

This bill would reduce the individual income tax liability of taxpayers by indexing Virginia’s tax brackets and personal exemptions to inflation. In the event that the indexing set forth in this bill would otherwise operate to increase tax liability or decrease the personal exemptions for a taxable year, the tax brackets and personal exemptions would instead remain the same as the year before. Therefore, this bill could never result in a positive revenue impact through increasing tax liability or reducing the personal exemptions.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

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.

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.

Proposed Legislation

This bill would index Virginia's individual income tax brackets, personal exemption, and additional personal exemption for blind or the aged for inflation using the C-CPI-U.

Such indexing would be determined by applying the indexing ratio. "Indexing ratio" would be defined as the percentage, if any, by which the chained CPI-U, as published by the U.S. Department of Labor or any successor index, for the most recent calendar year exceeds the chained CPI-U published at the close of the 12-month period ending on December 31, 2021. If the percentage is less than zero, the indexing ratio would be zero.

This bill would be effective for taxable years beginning on and after January 1, 2022.

cc : Secretary of Finance

Date: 1/29/2022 RWC
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