JLARC
JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION

Fiscal Impact Review

2019 General Assembly Session

Date: January 25, 2019

Bill number: HB 2529 (third substitute); State income tax; itemization; standard deduction

Review requested by: Chairman Cox, House Rules

JLARC Staff Fiscal Estimates

JLARC staff concur with the fiscal impact statement issued by the Department of Taxation, which indicates that HB 2529 will have a negative fiscal impact on state revenue compared to the revenue assumptions in the Governor's proposed budget, which assumes conformity with federal tax rules. The bill would not have a negative fiscal impact on the current budget (Chapter 2, 2018 Special Session 1, Acts of Assembly). The current budget does not include the additional state revenue expected from the federal Tax Cuts and Jobs Act of 2017 (TCJA). HB 2529 would not fully eliminate the additional state revenue expected from TCJA.

An explanation of the JLARC staff review is included on the pages that follow.

Authorized for release:

Hal E Greer

Hal E. Greer, Director

Attachment

Bill summary

HB 2529 is intended to reduce the the tax burden on Virginia households by reducing the additional state tax liability due to conformity to the federal Tax Cuts and Jobs Act of 2017 (TCJA). The most significant provision would a**llow taxpayers to itemize deductions** on their Virginia income tax return, regardless of whether the taxpayer itemized deductions on their federal return.

HB 2529 would also **increase the Virginia standard deduction** from $3,000 to $4,000 for individual taxpayers and married taxpayers filing separately, and from $6,000 to $8,000 for married taxpayers filing joint tax returns. This provision, and the state-specific itemization provision above, would be effective for the tax years 2019 through 2025, consistent with the expiration date of TCJA.

HB 2529 would also undo a limitation imposed by TCJA on the **federal deduction for state and local income and property taxes (SALT)**. TCJA limited the SALT deduction, which was previously unlimited, to $10,000 per household. This TCJA provision is set to expire in tax year 2025, reverting to the previous federal policy.

HB 2529 would expand Virginia's corporate income tax subtraction to include certain overseas profits defined under TCJA as **"global intangible low-taxed income (GILTI)"**. This provision of HB 2529 would be effective beginning in tax year 2018.

Fiscal implications

The analysis below is based on estimates in the Fiscal Impact Statement prepared by the Department of Taxation (TAX) for the first substitute version of HB 2529, and estimates in the Fiscal Impact Statement prepared by TAX for GILTI (included in the third substitute version of HB 2529). JLARC staff did not review the microsimulation model used by TAX to estimate impacts, or the assumptions of the model.

The fiscal impacts estimated by TAX for HB 2529 are based on the Governor's proposed budget, which assumes conformity with the Internal Revenue Code, including the provisions of TCJA. (Revenue estimates contained in fiscal impact statements for all introduced legislation are reported as compared to the Governor's proposed budget. This is the accepted process and makes budget reconciliation possible.) TAX contracted with Chainbridge Software, LLC, which estimates that TCJA would increase state revenue by approximately $1.2 billion for FY19 and FY20, and an additional $3.3 billion for FY21 through FY24.

TAX estimates HB 2529 will result in a reduction in general fund revenue of $574 million in FY20, $393 million in FY21, and about $1.7 billion for the subsequent four years, offsetting most of the additional state revenue from TCJA attributable to the individual provisions (Table 1). The fiscal impact of HB 2529 would end in FY26, because the bill's provisions expire on December 31, 2025.

TABLE 1
General fund revenues assumed in the Governor's proposed budget would decline because of HB 2529

	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Revenue impact	($7.1)	($573.9M)	($392.6M)	($406.6M)	($422.5M)	($438.2M)	($452.2M)

SOURCE: Department of Taxation.
NOTE: The estimated impact of HB 2529 for FY19 is relatively small because only one provision of the bill (GILTI) is effective for the full tax year 2018.

The fiscal impact is largest in FY20 because it reflects the fiscal impact over 18 months rather than 12 months. The bill applies to the full tax year 2019, but would not be in effect until July 1, 2019. Taxpayers would not adjust their withholding or estimated payments for tax year 2019 until FY20.

Even though HB 2529 would have a negative impact on the general fund revenue assumed in the Governor's proposed budget, it would not fully eliminate the additional state revenue from TCJA, for two primary reasons. First, almost all the additional state revenue from TCJA in FY19, estimated by Chainbridge Consulting, LLC as $594 million, is not affected by HB 2529, which takes effect in FY20. Second, HB 2529 does not address some provisions of TCJA, primarily the provisions affecting businesses. The estimated increase in state revenue from TCJA if HB 2529 is enacted is approximately $450 million per year on average between FY21 and FY25 (Table 2).

The Fiscal Impact Statement prepared by TAX includes an estimated administrative cost impact of $1 million (general funds) in FY20 and $0.9 million (general funds) in subsequent years, for ten new full-time employees for compliance and responding to taxpayer calls. These costs appear reasonable and are a relatively small proportion of the total fiscal impact.

TABLE 2
TCJA increases general fund revenue even if HB 2529 is enacted

	FY19	FY20	FY21	FY22	FY23	FY24	FY25
TCJA provisions							
Individual	$532.1M	$443.8M	$466.7M	$492.5M	$520.0M	$546.1M	$573.5M
Business	29.4	114.6	181.5	300.3	417.2	398.2	363.1
International	*32.6*	52.7	5.5	5.8	6.0	6.3	6.5
Total	594.2	611.1	653.7	798.8	943.2	950.6	943.1
HB 2529	(7.1)	(573.9)	(392.6)	(406.6)	(422.5)	(438.2)	(452.2)
Net increase in GF revenue due to TCJA	**587.1M**	**37.2M**	**261.1M**	**392.0M**	**520.7M**	**512.4M**	**490.9M**

SOURCE: Chainbridge Consulting, LLC; Department of Taxation

Budget amendment necessary? Yes, budget amendments will be necessary to reflect a decrease in the revenue collections assumed in the Governor's proposed budget, and an increase in administrative costs for TAX.

Agencies affected: Department of Taxation

Prepared by: Ellen Miller and Erik Beecroft

Date: January 25, 2019

ATTACHMENT
Stand-alone impact of each tax policy change in HB 2529

The estimated costs of the individual tax policy changes in HB 2529 are shown in Table A-1. These changes reflect the revenue impact that would result if each provision was enacted as a stand-alone provision, without taking into account interactions with any of the other provisions. The largest portion of the fiscal impact for HB 2529 is due to **allowing taxpayers to itemize deductions on their state return** even if they take the standard deduction on their federal return. Single taxpayers who have deductions greater than $3,000 (the state standard deduction under current law) and less than $12,000 (the federal standard deduction under TCJA) would reduce their state tax liability by itemizing deductions. Married taxpayers who have deductions greater than $6,000 (the state standard deduction under current law) and less than $24,000 (the federal standard deduction under TCJA) would also reduce their state tax liability by itemizing deductions. The fiscal impact of this state-specific itemization provision of HB 2529 depends on the additional number of households that would choose to itemize on their state return and their average reduction in tax liability for itemizing. TAX estimates this provision would reduce state revenue by $378 million in FY20 (based on 18 months), $258 million in FY21, and an average of $280 million in subsequent years.

TABLE A-1
Stand-alone impact to state of each tax policy change in HB 2529

Policy change	FY19	FY20	FY21	FY22	FY23	FY24	FY25
State-specific itemization	n.a.	($378.0M)	($257.8M)	($266M)	($275.9M)	($285.3M)	($292.7M)
Increase state standard deduction	n.a.	(238.5)	(156.2)	(157.0)	(158.2)	(159.0)	(159.2)
Deconform from SALT deduction cap	n.a.	(56.3)	(42.2)	(47.2)	(52.7)	(58.6)	(65.0)
Allow subtraction for GILTI	($7.1M)	(5.4)	(5.5)	(5.8)	(6.0)	(6.3)	(6.5)

SOURCE: Department of Taxation.
NOTE: The sum of the costs of each policy change is larger than the overall fiscal impact of HB 2529 because the changes interact with each other, reducing the overall total cost.

The next largest source of fiscal impact for HB 2529 is the **increase in the state standard deduction**. HB 2529 would increase the standard deduction by $1,000 for single taxpayers and by $2,000 for married taxpayers. Every $1,000 increase in the state standard deduction generally reduces tax liability by $57.50 per household because the state tax rate is 5.75% for taxable incomes above $17,000. The fiscal impact of this provision can be roughly estimated as the number of single households expected to take the standard state deduction multiplied by $57.50, plus the number of married households expected to take the standard state deduction multiplied by $115. TAX ran a simulation of this change through the Chainbridge PolicyLinks model and estimated this provision would reduce state revenue by $239 million in FY20 (based on 18 months), $156 million in FY21, and an average of $158 million in subsequent years.

The other provisions of HB 2529, **undoing the TCJA limits on the federal SALT deduction and allowing a subtraction for GILTI**, have much smaller fiscal impacts. The SALT provision in HB 2529 primarily affects the small number of taxpayers who pay more than $10,000 in property taxes annually, the limit imposed by TCJA. The fiscal impact of the GILTI provision is relatively small because it applies to relatively few taxpayers. TAX estimates these provisions together would reduce state revenue by $62 million in FY20 (based on 18 months), $48 million in FY21, and an average of $62 million in subsequent years.

<u>The overall fiscal impact is smaller than the sum of stand-alone impacts</u>

The sum of the fiscal impact estimates in Table A-1 are larger than the estimated fiscal impact of HB 2529 (shown in Table 1) because the impact in Table A-1 of each provision is estimated independently of the other provisions, as though only that provision were enacted. Enacting the provisions together in HB 2529 reduces the overall impact because of interactions among the provisions. For example, the number of taxpayers that will benefit from an increase in Virginia's standard deduction will decline if Virginia allows taxpayers to itemize deductions on their state tax return even if they did not do so on their federal return.

Another way to understand the fiscal impacts is by "stacking" the provisions: first estimating the fiscal impact of increasing the standard deduction, then estimating the <u>incremental</u> impact of the other provisions: allowing state-specific itemization, undoing the cap on state and local taxes, and allowing a subtraction for GILTI. This approach shows how much of the overall impact estimate can be attributed to each provision. The impact of state-specific itemization is reduced substantially, although it is still larger than the other provisions (Table A-2).

TABLE A-2
Incremental cost of the HB 2529 policy changes

Incremental impact of each policy change	FY20	FY21
Increase state standard deduction	($238.5M)	($156.2M)
Allowing state-specific itemization	(271.9)	(187.1)
Deconform from SALT deduction cap	(58.1)	(43.8)
Allow subtraction for GILTI	(5.4)	(5.5)
Total impact of all policy changes	**($573.9M)**	**($392.6M)**

SOURCE: Chainbridge Consulting, LLC; Department of Taxation.
NOTE: The stacking order matches the order used by Chainbridge Consulting, LLC in estimating the effects of TCJA on Virginia revenue.