

# DEPARTMENT OF TAXATION

## 2020 Fiscal Impact Statement

1. **Patron** Michael J. Weibert

3. **Committee** House Finance

4. **Title** Eliminate the Virginia individual income tax;  
Impose an entity-level tax on pass-through  
entities

2. **Bill Number** HB 1358

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would eliminate Virginia's individual income tax. The tax imposed on the income of estates and trusts would continue to be applied at the bracketed rates that currently apply for individual income tax purposes.

This bill would impose a tax directly on pass-through entities at the bracketed rates that currently apply for individual income tax purposes. Individual and corporate owners of pass-through entities would no longer be directly subject to taxation on the income of such entities.

This bill would be effective for taxable years beginning on or after January 1, 2020.

6. **Budget amendment necessary:** Yes.

Item(s): Page 1, Revenue Estimates

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

#### 7b. **Revenue Impact:**

<i><b>Fiscal Year</b></i>	<i><b>Dollars</b></i>	<i><b>Fund</b></i>
2020-21	(\$24.1 Billion)	GF
2021-22	(\$16.4 Billion)	GF
2022-23	(\$17.2 Billion)	GF
2023-24	(\$18.0 Billion)	GF
2024-25	(\$19.0 Billion)	GF
2025-26	(\$19.6 Billion)	GF

### 8. **Fiscal implications:**

#### Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have a significant estimated negative General Fund revenue impact of 24.1 billion in FY 2021, 16.4 billion in FY 2022, 17.2 billion in FY 2023, 18.0 billion in FY 2024, 19.0 billion in FY 2025, and 19.6 billion in FY 2026. These estimates include \$8.6 billion in Taxable Year 2020 withholding and estimated payments collected during FY 2020 that would be required to be refunded in FY 2021.

The negative revenue impact would be increased to an unknown extent by the provision of this bill that would impose the individual income tax on pass-through entity income that flows through to a corporation and is currently be subject to the higher corporate income tax rate. In addition, revenues would be impacted to an unknown extent depending on how the pass-through entity level tax is implemented.

The Department of Taxation (“the Department”) collected individual income tax revenues of \$14.1 billion in FY 2018 and \$15.2 billion in FY 2019. This accounted for 74 percent of General Fund revenues collected by the Department in FY 2019.

**9. Specific agency or political subdivisions affected:**

Department of Taxation

**10. Technical amendment necessary:** No.

**11. Other comments:**

Virginia’s Individual Income Tax

Under current law, the Virginia individual income tax is imposed at the following 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.

## State Taxation of Individual Income

Nine states (Alaska, Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming) do not impose an individual income tax.

Certain neighboring states have recently made structural changes to their tax rates and bracket structures. For example, North Carolina recently reformed its individual income tax by enacting a flat individual income tax rate and gradually decreasing this rate over a period of several years. Prior to Taxable Year 2014, North Carolina had three individual income tax rates of 6 percent, 7 percent, and 7.75 percent. For Taxable Year 2014, North Carolina replaced its tiered tax structure with a flat individual income tax rate of 5.8 percent. This rate decreased to 5.75 percent for Taxable Years 2015 and 2016, to 5.499 percent for Taxable Year 2017 and 2018, and is scheduled to decrease to 5.25 percent for Taxable Year 2019 and thereafter.

Tennessee only taxes individuals on interest and dividends. Tennessee enacted legislation that reduces the rate for this tax from six percent to five percent in Taxable Year 2016, and continues to reduce the rate by one percent annually, eventually eliminating the tax for the taxable years beginning on or after January 1, 2021.

## Virginia's Tax Imposed on the Income of Estates and Trusts

Virginia imposes a tax on the Virginia taxable income of estates and trusts equal to the bracketed rates imposed for purposes of the individual income tax. The Virginia taxable income of a resident estate or trust means its federal taxable income for the taxable year to which there shall be added or subtracted the share of the estate or trust in the Virginia fiduciary adjustment. The respective shares of an estate or trust and its beneficiaries in the Virginia fiduciary adjustment is generally in proportion to their respective shares of distributable net income of the estate or trust.

The Virginia taxable income of a nonresident estate or trust means its share of income, gain, loss, and deduction attributable to Virginia sources, increased or reduced by:

- The amount derived from or connected with Virginia sources of any income, gain, loss, and deduction recognized for federal income tax purposes but excluded from the computation of distributable net income of the estate or trust; and
- The net amount of additions, subtractions, and modifications with respect to income derived from or connected with Virginia sources.

## Virginia and Pass-Through Entities

For Virginia income tax purposes, pass-through entities are not generally liable to pay income taxes. Instead, the owners of pass-through entities are subject to taxation on any income passed through to such owners from a pass-through entity. For individual owners, they pay taxes on such income based on the bracketed rates imposed for Virginia individual income tax purposes. For corporate owners, they pay taxes on such income based on the 6 percent, flat rate imposed for Virginia corporate income tax purposes.

A pass-through entity is required to pay a withholding tax to the extent that it:

- Has taxable income from Virginia sources;
- Is required to allocate any portion of such income to at least one nonresident owner who was a nonresident owner during any portion of the previous taxable year; and
- Does not qualify for an exemption.

The tax is imposed at a rate equal to 5 percent of the share of taxable income from Virginia sources that is allocable to each nonresident owner.

#### Proposed Legislation

This bill would eliminate Virginia's individual income tax. The tax imposed on the income of estates and trusts would continue to be applied at the bracketed rates that currently apply for individual income tax purposes.

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This bill would be effective for taxable years beginning on or after January 1, 2020.

cc : Secretary of Finance

Date: 1/19/2020 RWC  
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