

## **Understanding the Impact of Virginia Tax Reform (HB 2529, SB 1372) in Response to the Federal Tax Cuts and Jobs Act of 2017**

On Monday, February 11, the Virginia General Assembly enacted state tax reform in response to impacts from the Federal Tax Cuts and Jobs Act of 2017 (TCJA). The new state tax law returns (or intends to return) individual income tax revenue resulting from enactment of the TCJA back to taxpayers. With a couple of relatively minor exceptions, additional new business-related tax revenue generated for the state as a result of the TCJA is retained in the state general fund.

The TCJA was the largest federal tax reform legislation in over 30 years - impacting both individuals and businesses. Beginning in tax year 2018, federal tax changes included up to 20 modifications for individuals and up to 30 modifications for business and corporate tax returns. The estimated federal tax impact on Virginia residents and businesses amounted to a *reduction* of about \$4 billion per year in federal tax collections mainly due to a lowering of federal income tax rates. In contrast, the TCJA modified income definitions and rules that created large potential state revenue *increases* by subjecting more income to Virginia's unchanged tax rates. Without changes to Virginia tax law, estimated increases in state revenue resulting from the TCJA would have amounted to \$594 million in FY 2019, growing to \$950 million in FY 2024. Individual income tax changes under the new federal law are temporary and expire after tax year 2025. The business tax changes are permanent.

Over the years, Virginia has routinely conformed to small changes in federal income tax laws. However due to the large changes in TCJA, Virginia conformity to the new federal income definitions was a bigger than normal issue and became wrapped up in the larger Virginia tax reform response to TCJA. The enactment of HB 2529 (Hugo)/SB 1372 (Norment) conformed Virginia to most new provisions in TCJA beginning in tax year 2018, while also reforming several Virginia income tax provisions to provide tax relief.

First, Virginia will provide a one-time individual income tax refund of up to \$110 for single filers and \$220 for married filers prior to October 1, 2019, to all taxpayers with tax liability. The expected cost is \$420 million. For businesses, \$32 million in permanent tax relief is provided beginning in tax year 2018 by 1) a subtraction modification to certain corporate global intangible low-taxed income

(“GILTI”) and 2) a partial 20 percent restoration of net interest deductions eliminated in the new federal law. Finally, an additional \$80 million is reserved in the Taxpayer Relief Fund in FY 2019. In total, \$532 million is returned or reserved for taxpayers in FY 2019, equaling the estimated individual income revenue resulting from federal tax reform. The remaining \$62 million, mostly resulting from federal business provision changes, remains in the state general fund.

The bulk of the new state tax reform is effective in tax year 2019 through tax year 2025 – matching the temporary nature of the federal individual tax changes. For individuals, the Virginia standard deduction is increased from \$3,000 to \$4,500 for singles and married filing separately, and from \$6,000 to \$9,000 for married filing joint returns. New state law de-conforms from the federal \$10,000 limitation on property tax deductions and allows an individual income tax deduction for the actual amount of real and personal property taxes imposed by Virginia or any other taxing jurisdiction. New state tax law also re-imposes the “Pease” limitation for high income taxpayers. This *reduces* itemized deductions by 3 percent of the amount by which a taxpayer's adjusted gross income exceeds the threshold amount (\$261,500 for singles; \$313,800 for married filers). Finally, any individual taxpayer revenues generated from TCJA above the amount returned must be transferred to the "Taxpayer Relief Fund" for future tax relief.

The following table presents the estimated state revenue impacts from the TCJA and the corresponding enacted state tax reform. <sup>i</sup>

	<b>Estimated Revenue Impact (\$ Mil.)</b>					
<b>TCJA Impact:</b>	<b><u>FY 19</u></b>	<b><u>FY 20</u></b>	<b><u>FY 21</u></b>	<b><u>FY 22</u></b>	<b><u>FY 23</u></b>	<b><u>FY 24</u></b>
Individual Income	\$532	\$444	\$467	\$493	\$520	\$546
Business and International	<u>\$62</u>	<u>\$167</u>	<u>\$187</u>	<u>\$306</u>	<u>\$423</u>	<u>\$405</u>
<b>Total TCJA Est. Impact</b>	<b>\$594</b>	<b>\$611</b>	<b>\$654</b>	<b>\$799</b>	<b>\$943</b>	<b>\$951</b>
<b>State Tax Reform:</b>						
\$110 S/\$220M Refund	(\$420)	\$0	\$0	\$0	\$0	\$0

50% Standard Deduction Increase, Unlimited Property Tax Deduction, Deconform Pease Limitation	\$0	(\$308)	(\$204)	(\$208)	(\$212)	(\$216)
International GILTI and 20% Net Interest Deduction	(\$32)	(\$23)	(\$24)	(\$26)	(\$27)	(\$28)
Taxpayer Relief Fund	(\$80)	(\$113)	(\$238)	(\$260)	(\$281)	(\$302)
<b>Remaining for State GF</b>	<b>\$62</b>	<b>\$167</b>	<b>\$187</b>	<b>\$306</b>	<b>\$423</b>	<b>\$405</b>

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<sup>i</sup> For a more complete description of state revenue impacts see the Virginia Department of Taxation fiscal impact statement on SB 1372.

<http://lis.virginia.gov/cgi-bin/legp604.exe?191+oth+SB1372FER161+PDF>