

Individual Income Tax Review

- Prior commissions have studied several elements of the individual income tax. Many of the elements have been at their current level since the late 1980s.

Standard Deduction

- The standard deduction is \$3,000 for single persons and is \$5,000 for married persons. The standard deduction last changed in 1989 when it increased from \$2,700 to the current levels.
 - The Morris Commission recommended increasing the standard deduction to \$3,500 for single persons and \$7,000 for married persons. This fiscal impact is \$66 million annually.
 - Eliminating the "marriage penalty" by increasing the standard deduction for married persons from \$5,000 to \$6,000 (twice the amount of the deduction for single persons) has a \$21 million annual fiscal impact.

Personal Exemptions

- Virginia allows a personal deduction of \$800 for each person in the household. Individuals over 65 and blind persons are allowed an additional \$800 deduction.
 - The personal exemption amount last changed in 1988 when it increased from \$700 to \$800.
 - Each \$100 of the personal exemption amount has an annual fiscal impact of approximately \$28 million.

Tax Rates

- Virginia's individual income tax rates are:
 - 2% on income up to \$3,000
 - 3% on income between \$3,001 and \$5,000
 - 5% on income between \$5,001 and \$17,000
 - 5.75% on income over \$17,000

- The 5.75% tax rate first became effective in 1986 on any income in excess of \$12,000. Beginning in 1990, the 5.75% tax kicked in for income over \$17,000, where it stands today.
- Inflation and wage growth has resulted in more Virginians having annual income in excess of \$17,000.

As a result, the average income tax paid by Virginians on taxable income in 2000 was 5.13%.

Tax Deductions, Exclusions, and Credits

- Tax deductions, exclusions, and credits reduce the tax base and income tax liability.
- Examples¹ of some of the top deductions, exclusions, and credits in terms of annual fiscal impact are (excluding itemized deductions or personal exemptions):

	<u>Annual Impact (millions)</u>
Tax credit for individuals and families below the poverty level	\$17.5
Subtraction for social security benefits (2002 estimate)	104.7
Subtraction for those aged 65 or older and 62-64	304.2

Conformity with Federal Tax Code

- 2003 legislation conformed Virginia's tax laws with federal tax laws as they existed on December 31, 2002.
 - The two exceptions were for special depreciation allowances for certain property and the carry-back of certain net operating losses that were part of the Job Creation & Worker Assistance Act of 2002.
 - "Fixed-date" conformity means Virginia will not automatically adopt changes in federal tax law enacted after December 31, 2002.

¹ These examples are illustrative of the top deductions, exclusions, and credits, but do not necessarily represent the top three deductions, exclusions, and credits. More detailed analysis would be required to rank the top deductions, exclusions, and credits.

Therefore, federal tax law changes enacted after such date will not automatically impact revenues generated from Virginia's individual income tax.

- Fixed-date conformity over time can result in a state tax system that is largely independent from the federal tax system.