



2019 Virginia Tax Reform Legislation

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Prepared by Connor Garstka, Attorney, and Josh Kaplan, Attorney
Division of Legislative Services

Introduction

During the 2019 Session, the General Assembly enacted major legislation regarding income tax conformity and income tax reform in response to the federal Tax Cuts and Jobs Act (TCJA).¹ For more information on ways the TCJA impacts Virginia, see [Issue Brief Number 59](#).

The TCJA was a significant overhaul of federal tax policy, which in turn impacted Virginia's tax system by complicating the issue of income tax conformity. "Conformity" refers to legislation in which a state adopts federal income tax definitions for use in administering its own income tax laws. Each year, Virginia passes conformity legislation to conform the definitions of its tax code to those of federal law. Conformity legislation greatly reduces a state's burden in determining the amount of tax owed by individuals and businesses. Without conformity, a state would have to develop its own method of defining income and tax liability, which would greatly increase the cost, time, and number of personnel required to process each taxpayer's tax return.

In a typical year, conformity legislation is straightforward and uncontroversial.² However, due to the TCJA, a simple conformity bill (one without additional changes to Virginia tax policy) would have resulted in higher state tax bills for certain Virginians. As a result, the General Assembly passed Chapters 17 and 18 of the Acts of Assembly of 2019 (hereinafter referred to as "the legislation"),³ that not only conformed Virginia's tax code to federal law as of December 31, 2018, but also included the following reforms to mitigate the concern about increased tax liability:

- A one-time \$110 refund for individual taxpayers (\$220 for married filers);
- A \$1,500 standard deduction increase for individual taxpayers (\$3,000 for married filers);
- Deconformity from the TCJA's limit on state and local tax deductions (the "SALT deduction");
- Deconformity from the TCJA's suspension of the overall limit on itemized deductions (the "Pease limitation");
- Allowance of a partial deduction of business interest that is disallowed by the TCJA;

¹ Pub. L. 115-97 (2017).

² See, e.g., Chapters 1 and 2 of the Acts of Assembly of 2017.

³ HB 2529 (2019), enacted as Chapter 17 of the Acts of Assembly of 2019; SB 1372 (2019), enacted as Chapter 18 of the Acts of Assembly of 2019. See also HB 1700, enacted as Chapter 854 of the Acts of Assembly of 2019 (Item 266 and § 3-5.21 included provisions related to federal tax law).

- Allowance of a subtraction for certain foreign source income that is taxed by the TCJA; and
- Creation of a Taxpayer Relief Fund from surplus revenues obtained as a result of the TCJA.

As in previous years, this year's conformity legislation contained an emergency clause, so it became effective when the Governor signed it on February 15, 2019.

The TCJA and Its Impact on Virginia Income Taxes

Specifically, the TCJA contained two provisions that complicated the issue of conformity. The law (i) increased the federal standard deduction to \$12,000 for individuals and \$24,000 for married persons⁴ and (ii) placed a \$10,000 limit on the amount of state and local taxes that a taxpayer could deduct from his federal taxable income.

By increasing the federal standard deduction, it is likely that a greater number of taxpayers will take the standard deduction in lieu of itemization. This has implications for Virginia taxes because Virginia law requires taxpayers to make the same election on their state taxes as they do on their federal return.⁵ Therefore, if a taxpayer chooses to itemize deductions for his federal return, he also must itemize deductions on his state return, and vice versa for the standard deduction.

Consider a taxpayer with \$10,000 in potential itemized deductions. Under the TCJA, the taxpayer likely would choose the \$12,000 federal standard deduction and, therefore, would be required to take the standard deduction at the state level. Prior to the TCJA, the taxpayer would have itemized both federally and at the state level, and would have received a \$10,000 deduction on both returns. Under the TCJA, if the taxpayer were to choose the federal standard deduction, the taxpayer would receive \$12,000 in federal deductions and \$3,000 in state deductions, thereby resulting in a lower federal tax bill, but a higher state tax bill.

The TCJA also placed a limit of \$10,000 on the amount of state and local taxes that can be deducted on a federal return. For Virginia taxpayers with more than \$10,000 of state and local tax liability, this limit reduced the amount of deductions available to them, thereby possibly increasing their federal and, in some cases, state tax liability.

It should be noted that state law does not allow taxpayers to claim the SALT deduction for income taxes paid. For Virginia income tax purposes, the \$10,000 cap only affects taxpayers who claim the SALT deduction for non-income taxes, such as property taxes.

In order to offset the impact of these federal changes, the General Assembly enacted the reforms described in the sections below as part of its conformity package.

⁴ The TCJA nearly doubled the standard deduction. In 2017, it was \$6,350 for an individual and \$12,700 for a married couple filing jointly.

⁵ VA. CODE § 58.1-322.03(1).



Individual Tax Policy Changes

\$1,500 Standard Deduction Increase

The legislation increased the standard deduction from \$3,000 to \$4,500 (or from \$6,000 to \$9,000 for married taxpayers filing jointly). The increase is effective for tax years 2019 through 2025, which corresponds to the duration of the TCJA's changes to federal individual income taxation.

One-time \$110 Refund

For tax year 2018, the legislation established a one-time refund of \$110 (or \$220 for married taxpayers filing jointly) to be issued to taxpayers in October 2019.⁶ It will be available only to taxpayers who file their final return before July 2019. The refund is issued after accounting for a taxpayer's deductions, subtractions, and credits. If his tax liability is less than \$110 after those reductions, he may receive a refund only up to his remaining tax liability.

Deconforming from the TCJA's Limit on the State and Local Tax Deduction

Prior to the enactment of the TCJA, federal law provided a deduction for state and local taxes paid by a taxpayer. The TCJA established a \$10,000 cap on the amount allowed to be deducted.⁷ The legislation deconformed from the \$10,000 cap; therefore, for Virginia tax purposes, a taxpayer can still deduct the full amount of state and local taxes. However, Virginia's deconformity from the SALT limit does not apply to tax year 2018 and is only effective beginning in tax year 2019.

Deconforming from the TCJA's Suspension of the Overall Limit on Itemized Deductions

Federal law allows taxpayers to claim a variety of itemized deductions—mortgage interest and charitable contributions are two of the most common. Before the TCJA, there was an overall limit, referred to as the Pease limitation, on the amount of itemized deductions a taxpayer could claim per year.⁸ The threshold was about \$260,000 per tax year.⁹ If a taxpayer's total deductions were over the threshold, his over-the-threshold deductions would be reduced by up to 80 percent.¹⁰

The TCJA suspended the Pease limitation, making itemized deductions no longer subject to an overall limit. However, the legislation deconformed from this federal tax change, and the Pease limitation remains operative for Virginia tax purposes. Like deconformity from the SALT

⁶ The legislation required the refund to be prorated if there are insufficient funds to cover the cost.

⁷ The cap applies only to taxes that are *not* "paid or accrued in carrying on a trade or business." § 11042 of Pub. L. 115-97 (2017) (codified at I.R.C. § 164). Business taxes remain fully deductible.

⁸ The limit is known as the "Pease limitation" for Donald Pease, the Ohio congressman who introduced the law creating it.

⁹ The threshold was \$261,500 for an individual filer in 2017, but it increased every year.

¹⁰ The 80 percent was measured against the entire amount of the taxpayer's itemized deductions.



limit, the provision deconforming from the suspension of the Pease limitation applies only to tax years 2019 and after.

Business Tax Policy Changes

Partial Deduction of Disallowed Business Interest

Prior to the enactment of the TCJA, federal law allowed certain businesses to deduct 100 percent of certain types of business interest. The TCJA changed the rules for this deduction, allowing more types of businesses to claim the deduction, but also imposing a cap on the deduction.¹¹ The legislation provides partial relief from the cap by allowing taxpayers to deduct, for Virginia tax purposes, 20 percent of business interest disallowed by the cap's operation. This deduction is available starting in tax year 2018.

Subtraction for Certain Foreign Source Income

The TCJA made major changes to the taxation of foreign source income. One such change created a new category of income called Global Intangible Low-Taxed Income (GILTI), which became subject to federal taxation starting in tax year 2018. The legislation establishes an income tax subtraction for GILTI; therefore GILTI is not taxable for Virginia tax purposes.¹²

Taxpayer Relief Fund

The legislation estimates that, for tax years 2019 through 2025, extra revenues resulting from the TCJA will be approximately \$450 million per year. After subtracting the amount of revenue required to finance the tax policy changes of the legislation described in this Note, the legislation provides that any additional revenue accrues to the Taxpayer Relief Fund. Each year, by September 1, the Governor will certify the deposit to the Fund. The legislation provides that the General Assembly shall appropriate the money for "permanent or temporary tax reform measures."

For more information, contact the Division of Legislative Services staff:

Connor Garstka, Attorney, DLS
cgarstka@dls.virginia.gov
804-698-1869

Josh Kaplan, Attorney, DLS
jkaplan@dls.virginia.gov
804-698-1817

¹¹ In its simplest form, the cap equals the sum of the taxpayer's (i) income from business interest plus (ii) 30 percent of adjusted taxable income plus (iii) interest from floor plan financing. § 13301 of Pub. L. 115-97 (2017) (codified at I.R.C. § 163(j)).

¹² Before the TCJA, foreign source income generally was not taxed under Virginia law. *See* VA. CODE § 58.1-402(C)(7).

