

DEPARTMENT OF TAXATION

2025 Fiscal Impact Statement

1. **Patron** James A. 'Jay' Leftwich

3. **Committee** House Finance

4. **Title** Individual Income Tax: Subtraction for retirement income of certain federal employees

2. **Bill Number** HB 2575

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide an individual income tax subtraction equal to 20 percent of the federal Civil Service Retirement System ("CSRS") benefits received by a taxpayer each taxable year.

This bill would become effective for taxable years beginning on and after January 1, 2025.

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

Item(s): Page 1. Revenue Estimates

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

7b. **Revenue Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2025-26	(\$75.2 million)	GF
2026-27	(\$51.4 million)	GF
2027-28	(\$52.5 million)	GF
2028-29	(\$53.6 million)	GF
2029-30	(\$54.6 million)	GF
2030-31	(\$55.7 million)	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 an estimated negative General Fund revenue impact as shown on Line 7b. The above estimate is based on the number of CSRS retirees receiving annuity benefits in Virginia.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Virginia's Individual Income Tax Modifications

Federal Adjusted Gross Income

Virginia's Individual Income Tax substantially conforms to federal income tax law by using federal adjusted gross income ("FAGI") as the starting point for computing Virginia income taxes. Virginia law then provides various modifications to FAGI that must be taken into account that figure in determining Virginia taxable income.

Virginia Adjusted Gross Income

When completing a Virginia individual income tax return, a taxpayer starts with the amount of FAGI reported on his federal return. A taxpayer then calculates Virginia adjusted gross income by making two types of adjustments: (1) "additions" which increase the amount of income taxable by Virginia and (2) "subtractions" which reduce such amount. These adjustments are made only to the extent that they have not already been included or excluded from FAGI.

Virginia Taxable Income

The taxpayer calculates his Virginia taxable income by making another type of modification referred to as "deductions," which further reduce the amount of income taxable by Virginia. These modifications are made regardless of federal treatment unless specifically stated otherwise in the provision.

Please find below an illustration of how taxable income is computed for federal and Virginia income tax purposes and how they interrelate:

Federal Income Tax	Virginia Income Tax
+Wages and Other Income	= <i>Federal Adjusted Gross Income ("FAGI")</i>
+Federal Adjustments	+Virginia Additions (only if not included in FAGI)
-Federal Adjustments	-Virginia Subtractions (only if not excluded from FAGI)
= <i>Federal Adjusted Gross Income ("FAGI")</i>	= <i>Virginia Adjusted Gross Income ("VAGI")</i>
-Federal Standard Deduction or Itemized Deductions	-Virginia Standard Deduction or Federal Itemized Deductions

	(depends on federal election)
-QBI Deduction	-Deduction for Virginia Exemptions
	-Virginia Deductions (regardless of federal treatment)
=Federal Taxable Income	=Virginia Taxable Income

Because this bill would establish a new Virginia subtraction, the amount allowed under this bill could be taken whether the taxpayer chooses to take the Virginia standard deduction or itemize their deductions.

Federal Retirement System

There are currently two separate retirement systems for federal employees, CSRS, and the Federal Employees Retirement System ("FERS"). From 1920 through 1986, CSRS was the only retirement system available to federal employees. Beginning in 1987, FERS replaced CSRS as the federal retirement system. Most employees hired after December 31, 1983 and all employees hired after December 31, 1986 are covered by FERS. Federal employees in CSRS were given the option to either stay in CSRS or join FERS. If employees opted to switch to FERS, this choice was irrevocable. Federal employees that are covered by CSRS are not required to pay Social Security taxes and, therefore, are not eligible to receive Social Security benefits. In contrast, because employees under FERS are required to pay Social Security taxes and FERS pension benefit is generally smaller when compared to the benefit under CSRS, FERS retirees generally qualify for Social Security.

Virginia Taxation of Retirement and Social Security Benefits

Virginia taxes federal CSRS income in the same manner as all other pension plan income. Under current law, Virginia provides a subtraction for Social Security income. As CSRS retirees do not receive Social Security, they do not benefit from the Virginia subtraction for Social Security income. Because Virginia taxes pension plan income uniformly, regardless of the source, this treatment is nondiscriminatory. During 2015, the taxation of CSRS income was litigated and upheld by a Virginia court in *Beisel v. Dep't of Taxation*. Specifically, the court in *Beisel* held that Virginia's taxation of CSRS income does not violate federal law because "[n]on-Social Security retirement income is taxed in the same manner, regardless of its state or federal source."

Other Virginia Tax Benefits for Retirees

Taxpayers age 65 and older may claim an additional \$800 personal exemption. Certain taxpayers may also qualify for an age deduction of up to \$12,000. For taxpayers born on or before January 1, 1939, the amount of the age deduction is \$12,000. For taxpayers born after January 1, 1939, who have attained the age of 65, the amount of the age deduction is means-tested. Accordingly, the \$12,000 age deduction is reduced dollar-for-dollar for single taxpayers whose income exceeds \$50,000 and for married taxpayers whose combined income exceeds \$75,000.

Other States

According to the National Active and Retired Federal Employees Association, of the 41 states and DC that impose an individual income tax, eight states (Alabama, Hawaii, Illinois, Louisiana, Massachusetts, Mississippi, New York, and Pennsylvania) completely exempt civil service annuities (which includes both CSRS and FERS pension amounts). Generally, the other thirty-three jurisdictions, including Virginia, tax CSRS benefits received. However, depending on the jurisdiction, some or all of CSRS benefits may be exempt under specific circumstances.

Proposal

This bill would provide an individual income tax subtraction equal to 20 percent of the federal CSRS benefits received by a taxpayer each taxable year.

This bill would become effective for taxable years beginning on and after January 1, 2025.

Similar Bills

SB 943 is identical to this bill.

cc : Secretary of Finance

Date: 01/22/2025 AO
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