

**DEPARTMENT OF TAXATION
2025 Fiscal Impact Statement**

1. **Patron** Joseph P. McNamara

2. **Bill Number** HB 2728

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Virginia Income Tax; Personal Exemptions;
Child Tax Credit

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would remove the two percent and three percent individual income tax brackets and reduce from 5.75 percent to 5.6 percent the tax imposed on incomes in excess of \$17,000. Such percentage would be further reduced by one-tenth of a percent for each taxable year between 2025 and 2029 that the Department of Taxation (“the Department”) certifies annual revenue growth of at least five percent, adjusted for the impact of tax policy changes.

This bill would repeal the Virginia personal exemption.

This bill would provide a \$250 per dependent refundable individual income tax credit for each dependent seventeen and younger. Such amount would increase by \$50 for each taxable year that the Department certifies annual revenue growth for the prior year of at least five percent, adjusted for the impact of tax policy changes. The credit would only be allowed for an individual or married persons filing a joint return whose family Virginia adjusted gross income does not exceed \$100,000.

The portions of this bill that would make changes to Virginia’s individual income tax brackets and repeal the Virginia personal exemption would be effective for taxable years beginning on and after January 1, 2025. The portion of this bill that would provide a Child Tax Credit would be effective for taxable years beginning on and after January 1, 2025, but before January 1, 2030.

6. Budget amendment necessary: Yes.

Item(s): 258 and 260, Department of Taxation

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

7a. Expenditure Impact:

| <i>Fiscal Year</i> | <i>Dollars</i> | <i>Positions</i> | <i>Fund</i> |
|--------------------|----------------|------------------|-------------|
| 2025-26 | \$345,670 | 0 | GF |
| 2026-27 | \$151,500 | 0 | GF |
| 2027-28 | \$78,000 | 0 | GF |
| 2028-29 | \$53,000 | 0 | GF |

8. Fiscal implications:

Administrative Costs

The Department would incur estimated expenditures, as shown on Line 7a. Such costs would primarily consist of implementation of the new tax credit program, including updating technology, forms, and systems. The Department considers implementation of the remaining provisions of this bill as routine and does not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2026 and each year thereafter. The revenue impact is unknown because it is unknown if the revenue growth triggers in the bill will be met. In addition, the revenue impact of the Virginia Child Tax Credit portion of the bill is unknown, but based upon data from the US Census and American Community Survey ("ACS"), the revenue impact of such credit could be approximately \$258.21 million.

The following table shows the potential negative General Fund revenue impact of this bill if it is assumed that the 5 percent growth threshold is not met during any of the years from TY 2025 through 2029:

| Potential Revenue Impact Assuming 5 Percent Annual Growth Rate <u>Not Met</u> (in millions) | | | | | |
|--|---------------------------|-------------------------|-------------------------|---------------------------|---------------------------|
| Provision | FY 2026 | FY 2027 | FY 2028 | FY 2029 | FY 2030 |
| Personal Exemptions | \$486.14 | \$368.97 | \$374.40 | \$380.04 | \$385.68 |
| Rate Reductions | (\$1,368.23) | (\$1,061.34) | (\$1,098.77) | (\$1,137.27) | (\$1,176.74) |
| Child Tax Credit | (up to \$258.21) | (up to \$259.00) | (up to \$259.79) | (up to \$260.58) | (up to \$261.38) |
| TOTAL | (up to \$1,140.30) | (up to \$951.37) | (up to \$984.16) | (up to \$1,017.81) | (up to \$1,052.44) |

However, because it is unknown whether and during which years the revenue triggers proposed by this bill would be met, the actual negative General Fund revenue impact could be greater than the above by an unknown amount.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

The Department does not track revenues on a taxable year basis but instead tracks them on a fiscal year basis. To allow this bill's revenue triggers to align with how revenues are tracked, the following technical amendments are suggested:

Line 47
 After in the
 Strike: preceding taxable year.
 Insert: most recently completed fiscal year for which complete data is available

Line 204
 After in the
 Strike: preceding taxable year.
 Insert: most recently completed fiscal year for which complete data is available

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 only 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.

| Year | Taxable Income Subject to 5.75 percent Tax Rate |
|--------------|--|
| 1972—1986 | \$12,001 or more |
| 1987 | \$14,001 or more |
| 1988 | \$15,001 or more |
| 1989 | \$16,001 or more |
| 1990—Present | \$17,001 or more |

Since the changes adopted during the 1987 Session adjusting the top bracket to the current income level for Taxable Year 1990 and thereafter, the General Assembly has not enacted any legislation affecting Virginia individual income tax rates or brackets and the brackets are not currently indexed for inflation. The federal individual income tax rate brackets are indexed for inflation.

Virginia Personal Exemption

Currently, a \$930 personal exemption may be claimed for each person filing a return (for married couples, each spouse is entitled to an exemption) and for each dependent. In 1971, when Virginia studied conforming to federal income tax law, Virginia's personal exemptions were originally intended to be the same as the federal personal exemptions. However, by 1972, when Virginia voted to conform to federal income tax law, Virginia's personal exemption amount was less than the federal amount because Virginia did not conform to the 1972 federal increase. Virginia's personal exemption amounts have changed over the years, as shown below:

| Year(s) | Virginia Personal Exemption |
|----------------|------------------------------------|
| 1972 | \$600 |
| 1973-1986 | \$600 |
| 1987 | \$700 |
| 1988-2005 | \$800 |
| 2006-2007 | \$900 |
| 2008-present | \$930 |

For Taxable Years 2018 through 2025, the TCJA effectively eliminated the federal personal exemption by making the amount of the exemption equal to \$0. However, the TCJA did not remove the statutory language in the IRC granting personal exemptions. Therefore, federal law still contains a provision allowing personal exemptions, but the amount of such exemption is \$0. Because Virginia's personal exemption deduction is based on the number of personal exemptions allowable for federal income tax purposes and not on the amount of such exemptions, the TCJA has no effect on Virginia's personal exemption.

The amounts of the Virginia personal exemption are not currently indexed for inflation. Before it was temporarily suspended, the federal personal exemption was indexed for inflation.

Federal Child Tax Credit

Under federal law, a taxpayer may claim a \$2,000 child tax credit against the individual income tax for each qualifying child for whom the taxpayer is allowed a dependency deduction. For purposes of the child tax credit, the term "qualifying child" is defined the same as that for claiming a dependency exemption except that the child must not have attained age 17 by the end of the taxable year. Generally, a "qualifying child" is the taxpayer's child, stepchild, adopted child, eligible foster child, sibling, step sibling, or a descendant of any such individual, who lives with the taxpayer for more than half of the taxable year and does not provide more than half of his own support.

For taxpayers with modified adjusted gross income ("MAGI") above certain thresholds, the otherwise allowable child tax credit is phased out. Specifically, the amount of the credit is reduced by \$50 for each \$1,000, or fraction thereof, by which the taxpayer's MAGI

exceeds the applicable threshold amount. The threshold amounts are \$400,000 for married taxpayers filing a joint return, and \$200,000 for all other filers.

Federal Credit for Child and Dependent Care Expenses

Under federal law, a nonrefundable credit is allowed for a portion of qualifying child and dependent care expenses paid for the purpose of allowing the taxpayer to be gainfully employed. To be eligible for the credit, the taxpayer must incur employment-related expenses in providing care for one or more qualified individuals.

For purposes of this credit, the term “qualifying individual” means a dependent of the taxpayer who has not attained age 13; a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than half of the taxable year; or the taxpayer’s spouse, if the spouse is incapable of caring for himself or herself and has the same principal place of abode as the taxpayer for more than half of the taxable year.

Qualifying employment-related expenses include expenses paid for household services and for the care of a qualifying individual that allow the taxpayer to work or look for work. Services rendered outside the home qualify if they involve the care of a qualified individual who regularly spends at least eight hours per day in the taxpayer’s home.

The maximum amount of employment-related expenses to which the credit may be applied is \$3,000 for one qualifying individual or \$6,000 for two or more qualifying individuals, less the amount excludable by the taxpayer for any employer-provided dependent care assistance. The amount of the credit is equal to the amount of qualified expenses multiplied by the applicable percentage, as determined by the taxpayer’s adjusted gross income (“AGI”). Taxpayers with an AGI of \$15,000 or less use the highest applicable percentage of 35 percent. For taxpayers with an AGI over \$15,000, the credit is reduced by one percentage point for each \$2,000 of AGI, or fraction thereof, in excess of \$15,000. The minimum applicable percentage of 20 percent is used by taxpayers with an AGI greater than \$43,000. Thus, the maximum dependent care credit amount is \$1,050 for one qualifying individual and \$2,100 for two or more qualifying individuals.

Virginia Deduction for Child and Dependent Care Expenses

In Virginia, taxpayers may deduct the amount of employment-related expenses on which the federal child and dependent care credit is based. The amount of employment-related expenses that may be deducted is limited to the amount actually used in computing the federal child and dependent care credit. As a general rule, taxpayers are limited to a maximum deduction of \$3,000 for one child and \$6,000 for two or more dependents, or the earned income of the spouse having the lowest income, whichever is less.

Proposal

This bill would remove the two percent and three percent individual income tax brackets and reduce from 5.75 percent to 5.6 percent the tax imposed on incomes in excess of \$17,000. Such percentage would be further reduced by one-tenth of a percent for each

taxable year between 2025 and 2029 that the Department certifies annual revenue growth of at least five percent, adjusted for the impact of tax policy changes.

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The Department would be required to develop guidelines implementing this credit.

The portions of this bill that would make changes to Virginia's individual income tax brackets and repeal the Virginia personal exemption would be effective for taxable years beginning on and after January 1, 2025. The portion of this bill that would provide a Child Tax Credit would be effective for taxable years beginning on and after January 1, 2025, but before January 1, 2030.

Similar Bills

HB 2180 and **SB 1378** would provide a one-time \$300 per dependent individual income tax credit for certain dependents.

cc : Secretary of Finance

Date: 01/26/2025 JLOF
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