DEPARTMENT OF TAXATION
2026 Fiscal Impact Statement

1. **Patron** David A. Reid

2. **Bill Number** HB 47
House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. **Committee** House Finance

4. **Title** Income Tax Subtractions; Military Retirement Benefits; Uniformed Services.

5. **Summary/Purpose:**

This bill would expand the current military benefits income tax subtraction and establish a new income tax subtraction for individuals receiving Foreign Service retirement benefits.

The definition of "military benefits" would be expanded to include retirement income from a pension plan received for service in the uniformed services of the United States, which includes the United States Armed Forces, the commissioned corps of the National Oceanic and Atmospheric Administration, and the commissioned corps of the United States Public Health Service. Under current law, an up to $40,000 subtraction is allowed for retirement income received only for service in the United States Armed Forces.

The new individual income tax subtraction would be for up to $40,000 of Foreign Service retirement benefits.

This bill would be effective for taxable years beginning on and after January 1, 2027.

6. **Budget amendment necessary:** Yes.
Page 1, Revenue Estimates

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

Fiscal Year	***Dollars***	***Fund***
2027	($650,000)	GF
2028	($1,330,000)	GF
2029	($1,390,000)	GF
2030	($1,450,000)	GF
2031	($1,520,000)	GF
2032	($1,600,000)	GF

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation (“the Department”) considers this bill as routine and does not require additional funding.

This legislation does not require significant changes to the Department’s systems and is not impacted by the first phase of the Integrated Revenue Management System (IRMS) replacement project. No resource constraints or implementation considerations are anticipated.

Revenue Impact

This bill would modify the existing military benefits subtraction and create a new subtraction for U.S. Foreign Service retirement benefits. As a result, the revenue impact of this bill is the sum of two separate estimates—one for each subtraction. A detailed breakdown of the revenue impact into these two components is summarized in the following table:

Fiscal Year	***Total***	***Foreign Service***	***Uniformed Services***
2027	($650,000)	($190,000)	($460,000)
2028	($1,330,000)	($380,000)	($950,000)
2029	($1,390,000)	($390,000)	($1,000,000)
2030	($1,450,000)	($390,000)	($1,060,000)
2031	($1,520,000)	($400,000)	($1,120,000)
2032	($1,600,000)	($410,000)	($1,190,000)

9. **Specific agency or political subdivisions affected:**

Department of Taxation

10. **Technical amendment necessary:** No

11. **Other comments:**

Background on the Uniformed Services and the Foreign Service

The Uniformed Services include the six branches of the U.S. Military (Army, Navy, Air Force, Marine Corps, Coast Guard, and Space Force), as well as certain other federal services such as the Commissioned Corps of the Public Health Service (“PHS”) and the National Oceanic and Atmospheric Administration (“NOAA”). These individuals are officers and enlisted members who serve under a military-style rank structure and are eligible for retirement after 20 years of active service.

The Foreign Service comprises the diplomatic and consular officers and specialists who represent U.S. interests abroad, including employees of the Department of State, the Foreign Agricultural Service, and the Foreign Commercial Service. They are civilians but operate under a distinct statutory personnel system established by the Foreign Service Act of 1980, which includes unique rules for worldwide availability, service at hardship posts (including combat zones), danger pay, and a separate retirement structure.

Foreign Service Retirement Systems: FSRDS and FSPS

The Foreign Service Retirement and Disability System ("FSRDS") is the older, stand-alone retirement system that covered Foreign Service employees who entered service before 1984. It is similar in structure to the Civil Service Retirement System and generally provides a defined benefit pension with relatively higher contribution rates and more generous accrual formulas. The Foreign Service Pension System ("FSPS") was created after the federal government moved toward a three-tier retirement structure in the 1980s, parallel to the Federal Employees Retirement System for civil servants. FSPS applies mainly to Foreign Service employees hired in 1984 or later. It also provides a defined benefit pension, but with different accrual rates, eligibility rules, and integration with Social Security and the Thrift Savings Plan compared to FSRDS.

Virginia Military Tax Preferences

Taxpayers may subtract the following military-related items for the purposes of computing Virginia taxable income:

- Wages or salaries received for service in the Virginia National Guard, not exceeding income for thirty-nine days of service or $5,500, whichever is less. This subtraction only applies to persons in the ranks of O6 and below.
- All military pay and allowances earned while serving in a combat zone or qualified hazardous duty area, to the extent they were included in federal adjusted gross income.
- $15,000 of military basic pay for military personnel on extended active duty for periods in excess of ninety days. The subtraction amount is reduced dollar-for-dollar by the amount which the taxpayer's military basic pay exceeds $15,000 and will be reduced to zero if such pay is equal to or exceeds $30,000.
- The amount of military death gratuity payments received after September 11, 2001, by survivors of military personnel who are killed in the line of duty. This subtraction amount must be reduced dollar-for-dollar by the amount that is allowed as an exclusion from federal adjusted gross income to the survivor on his or her federal income tax return.
- Any amount received as military retirement income by an individual awarded the Congressional Medal of Honor.
- Up to $40,000 of military benefits in Taxable Year 2025 and each taxable year thereafter.

For taxable years beginning on or after January 1, 2011, Virginia exempts from taxation the real property, including the joint real property of a husband and wife, and the land, not exceeding one acre, upon which the real property is situated of any military veteran who has been rated by the VA to have a 100 percent service-connected, permanent, and total disability, and who occupies the real property as his or her principal place of residence. The surviving spouse of a veteran may also qualify for this exemption, so long as the following conditions are met: the veteran's death occurred on or after January 1, 2011; the surviving spouse does not remarry; and the surviving spouse continues to occupy such real property as his or her principal place of residence.

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	*=Federal Adjusted Gross Income ("FAGI")*
+Federal Adjustments	+Virginia Additions (only if not included in FAGI)
-Federal Adjustments	-Virginia Subtractions (only if not excluded from FAGI)
=Federal Adjusted Gross Income ("FAGI")	=*Virginia Adjusted Gross Income ("VAGI")*
-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 expand the military benefits income tax subtraction and create a new income tax subtraction, the amounts allowed under this bill could be taken whether the taxpayer chooses to take the Virginia standard deduction or itemize their deductions.

Proposal

This bill would expand the current military benefits income tax subtraction and establish a new income tax subtraction for individuals receiving Foreign Service retirement benefits.

The definition of "military benefits" would be expanded to include retirement income from a pension plan received for service in the uniformed services of the United States, which includes the United States Armed Forces, the commissioned corps of the National Oceanic and Atmospheric Administration, and the commissioned corps of the United States Public Health Service. Under current law, an up to $40,000 subtraction is allowed for retirement income received only for service in the United States Armed Forces.

The new individual income tax subtraction would be for up to $40,000 of Foreign Service retirement benefits.

"Foreign Service retirement benefits" means any retirement income received from a foreign service member's pension plan in the Foreign Service Retirement and Disability System or the Foreign Service Pension System.

No Foreign Service retirement benefits subtraction would be allowed if a credit, exemption, subtraction, or deduction is claimed for the same income pursuant to any other provision of Virginia or federal law.

This bill would be effective for taxable years beginning on and after January 1, 2027.

Similar Bills

HB 137 would incrementally eliminate the cap on the military benefits subtraction, reaching full subtraction by Taxable Year 2030.

HB 588 would eliminate the cap on the military benefits subtraction, allowing the full subtraction beginning in 2026.

HB 697 would provide a nonrefundable tax credit, for taxable years 2026-2030, for qualifying real property taxes paid by certain surviving spouses of disabled veterans, subject to $5 million annual cap.

SB 148 is substantially similar to this bill, except that it would only expand the military retirement subtraction to include uniformed service.

cc : Secretary of Finance

Date: 01/18/2026 SJH
HB47F161