DEPARTMENT OF TAXATION
2026 Fiscal Impact Statement

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

2. **Bill Number** HB 1351
House of Origin:
__X__ **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. **Committee** House Finance

4. **Title** Individual Income Tax; Civil Service Retirement System Benefit Subtraction

5. **Summary/Purpose:**

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

This bill would become effective for taxable years beginning on and after January 1, 2026.

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***
2026-27	($83.6 million)	GF
2027-28	($56.2 million)	GF
2028-29	($56.7 million)	GF
2029-30	($57.1 million)	GF
2030-31	($57.4 million)	GF
2031-32	($57.8 million)	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 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	*=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 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 two main federal retirement systems: the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System ("FERS"). CSRS covered most federal employees hired before 1984, while FERS, implemented in 1987, covers most employees hired after December 31, 1983, and all hired after December 31, 1986. Under transition rules, CSRS employees could make a one-time, irrevocable election to transfer to FERS. CSRS employees generally do not pay Social Security taxes on their federal earnings and, therefore, do not receive Social Security benefits. In contrast, FERS employees pay Social Security taxes, receive a smaller defined benefit pension than under CSRS, and usually qualify for Social Security benefits in addition to their FERS annuity.

Virginia Taxation of Retirement and Social Security Benefits

Virginia taxes federal CSRS pensions the same way it taxes all other pension income. Under current law, Virginia allows a subtraction for Social Security benefits, but CSRS retirees generally do not receive Social Security and therefore cannot use this subtraction. Because Virginia applies the same tax rules to all non-Social Security pension income, its treatment is considered nondiscriminatory. In 2015, this approach was challenged and upheld by a Virginia court in *Beisel v. Dep't of Taxation*, where the court found that Virginia's taxation of CSRS income complies with federal law because "[n]on-Social Security retirement income is taxed uniformly, regardless of whether it comes from state or federal sources."

Other Virginia Tax Benefits for Retirees

Taxpayers age 65 or older may claim an additional $800 personal exemption. Certain taxpayers may also qualify for an age deduction of up to $12,000. For those born on or before January 1, 1939, the full $12,000 deduction applies regardless of income, while for those born after that date, the deduction (up to $12,000) is reduced dollar-for-dollar once income exceeds $50,000 for single filers and $75,000 for married couples.

Other States

The National Active and Retired Federal Employees Association reports that, among the 41 states plus D.C. with an individual income tax, eight states (Alabama, Hawaii, Illinois, Louisiana, Massachusetts, Mississippi, New York, and Pennsylvania) fully exempt federal civil service annuities, including both CSRS and FERS pensions. In the remaining thirty-three jurisdictions, including Virginia, CSRS benefits are generally taxable, although some or all of those benefits may be exempt under certain state-specific rules or circumstances.

Proposal

This bill would establish a new individual income tax subtraction equal to 20 percent of the federal CSRS benefits a taxpayer receives each taxable year.

This bill would become effective for taxable years beginning on and after January 1, 2026.

Similar Bills

HB 959 is identical to this bill.

cc : Secretary of Finance

Date: 01/25/2026 JLOF
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