VIRGINIA HOUSE GOP

Middle Class Tax Relief for Virginia

Governor Ralph Northam's budget proposal includes $1.2 billion in higher taxes, including $975 million in higher taxes on the middle class directly. The tax increase is caused by a technical provision in the law requiring taxpayers to couple their state and federal tax returns. The federal tax cuts passed last year significantly increased the standard deduction, meaning more Virginia families will take this higher deduction rather than itemizing. However, this means instead of itemizing their state taxes and taking more than $12,700 in deductions, they will be stuck with Virginia's small standard deduction, creating a significantly higher state tax bill. The Tax department estimates over 600,000 tax filers will be hit with this hidden tax increase. Instead of fixing this problem, Governor Northam's budget collects this tax money and spends it.

House Republican Proposal

The proposal that Delegate Tim Hugo will introduce on behalf of House Republicans will responsibly protect the state's existing revenue streams and AAA bond rating while fully implementing the federal tax cuts and providing broad tax relief to middle- and low-income Virginians. The proposal includes five components:

1. **Allow taxpayers to itemize their state taxes regardless of how they file their federal return**. This will allow middle-class families to receive the maximum amount of tax relief at the federal and state level. This will protect over 600,000 middle-class tax filers from a hidden tax increase.
2. **Increase the state standard deduction from $3,000 to $4,000 for an individual and from $6,000 to $8,000 for a married couple.** This will provide broad tax relief for all Virginians, lowering an annual tax bill for a married couple by $115.
3. **Maintain the existing law for state and local tax (SALT) deduction** The federal tax law capped the amount of state and local taxes (SALT) that could be deducted from your taxes. At the state level, we can maintain the existing caps, protecting homeowners from another hidden tax increase.
4. **Create a one-time deduction for itemizers to be used in 2019 to offset 2018 tax hit due to the implementation timing.** Because we cannot make the changes for the 2018 tax year, we will allow itemizers to claim an additional deduction in 2019 to offset higher taxes paid in 2018 due to implementation timing.
5. **Sunset all state changes in 2024, in conjunction with federal law.** Recognizing the federal tax law is temporary, we will sunset all of our policy changes to protect our state's AAA bond rating.

Revenue Projections

Policy Component	Ongoing Revenue Impact
Additional Revenue from Individuals due to Federal Tax Changes	+ $443.8m
Protecting Itemizations	- $253m
Deconform SALT Cap	- $45m
Increasing the Standard Deduction	- $143m
Overall Impact	**+ $2.8m**

Additional Background on Itemization Decoupling

Each year, taxpayers are faced with choosing between whether to itemize deductions or claim the standard deduction. If a taxpayer's itemized deductions add up to less than the standard deduction, the taxpayer is incentivized to claim the standard deduction (ex. 1). On the other hand, if a taxpayer can claim deductions in excess of the standard deduction, the taxpayer will lower his/her tax liability through itemization (ex. 2).

Example 1: The Miller's, a married couple filing jointly, can claim $10,000 in deductions for tax year 2017 (prior to implementation of TCJA tax reform). Because the federal standard deduction for tax year 2017 is $12,700, the Miller's would pay less in taxes by claiming the standard deduction.

Example 2: The Johnson's, a married couple filing jointly, can claim $15,000 in deductions for tax year 2017 (prior to implementation of TCJA tax reform). Because the federal standard deduction for tax year 2017 is $12,700, the Johnson's would pay less in taxes by itemizing their deductions.

A core component of the federal tax cut was the increase of the standard deduction. The tax cuts increased the federal standard deduction from $12,700 for a married couple filing jointly to $24,000. This means that the Johnson's, who last year chose to itemize, would now save more by claiming the standard deduction.

While this is good news for the Johnson's federal tax bill, it's a different story at the state level...

Virginia law currently requires taxpayers who claim the standard deduction on their federal taxes to claim the standard deduction on their state taxes and likewise for those who itemized. Because Virginia's standard deduction did not change with the federal tax cuts (it remains at $6,000 for a married couple filing jointly), the disparity between the new federal standard deduction and the state standard deduction grew significantly.

Delegate Hugo's proposal would easily solve this problem by simply allowing for taxpayers, such as the Johnson's, to itemize at the state level even if they claimed the standard deduction at the federal level. This simple change in Virginia law would allow for the federaltax cuts to take full effect and ensure middle class Virginia taxpayers pay as little in taxes as possible.