What Conformity Means for Virginia

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This is an Opportunity
Virginia May Miss It
Conformity

- 2018 Session failed to act, with discussions of a special session.
- Special session never materialized.
- Conformity with no policy changes produces a major tax increase, especially for corporate income tax (40 percent).
- Could turn out to be one of three recent tax increases:
  1. 2018 Medicaid hospital levies.
  2. 2018 conformity windfall tax.
  3. 2019 sales tax expansion due to Wayfair ruling.
## Tax Impact on Virginia

### Table 1
Estimated Virginia Revenue Impact of the TCJA
Fiscal Years 2019 to 2024

<table>
<thead>
<tr>
<th></th>
<th>2019*</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Provisions</td>
<td>532.1</td>
<td>443.8</td>
<td>466.7</td>
<td>492.5</td>
<td>520.0</td>
<td>546.1</td>
<td>3,001.3</td>
</tr>
<tr>
<td>Business Provisions</td>
<td>29.4</td>
<td>114.6</td>
<td>181.5</td>
<td>300.3</td>
<td>417.2</td>
<td>398.2</td>
<td>1,441.3</td>
</tr>
<tr>
<td>International Provisions</td>
<td>32.6</td>
<td>52.7</td>
<td>5.5</td>
<td>5.8</td>
<td>6.0</td>
<td>6.3</td>
<td>108.8</td>
</tr>
<tr>
<td><strong>Total, All Provisions</strong></td>
<td><strong>594.2</strong></td>
<td><strong>611.1</strong></td>
<td><strong>653.7</strong></td>
<td><strong>798.7</strong></td>
<td><strong>943.2</strong></td>
<td><strong>950.6</strong></td>
<td><strong>4,551.4</strong></td>
</tr>
</tbody>
</table>

* Due to the likely timing of Virginia’s conformity to the federal provisions, the full revenue impact for Taxable Year 2018 is recognized in FY 2019.
Early Positions

• Governor Northam favors full conformity, with a refundable EITC the only policy change.

• House Republicans leaning to state-only itemized deductions.

• Senate Republicans have no public position.

• Virginia CPA’s pushing full conformity, hold windfall revenue for later action on policy changes.

• No firm consensus from business community, which may ask for selective de-conformity (GILTI, interest provisions).
Approach We Are Exploring

• Similar to Virginia response to 1986 – do not try to make individuals whole but improve tax policy overall.

• Full conformity with policy changes effective tax year 2018.

• Double the standard deduction from $6 to $12K per couple

• Consider eliminating one or two of bottom tax brackets.

• Index brackets and standard deduction to inflation.

• Lower the corporate income tax rate, perhaps in phases.

• Capture and segregate any additional windfall revenue.
Benefits of That Approach

• Like federal reform, moves away from deductions.

• Aligns with neighboring states’ standard deductions.

• Helps same people targeted by the EITC.

• Reduces Virginia’s nameplate corporate tax rate.

• Simple and easy to explain.

• Good match with conformity revenue; no budget issue.
Problem:
Not Real Virginia Tax Reform

Which Would:

• Reduce reliance on individual income tax (70% of general fund now).

• Broaden sales tax base to more services, reflecting current economy.

• Rebalance state and local funding relationships.

• Reform various local business taxes.

• Revisit and re-justify all tax preferences.
Why It’s *Really* Bad Timing
Tax Impact on Virginia

$ Millions

<table>
<thead>
<tr>
<th>Year</th>
<th>Individual &amp; Pass-Throughs</th>
<th>Corporate</th>
<th>International</th>
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</thead>
<tbody>
<tr>
<td>2019</td>
<td>$532.1</td>
<td>$29.4</td>
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<td>$600</td>
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</table>
Recent Economic Drivers

• **Tax Cut and Jobs Act of 2017**
  
  o Business Investment up
  
  o Labor productivity up
  
  o Employment growth accelerated, reversing decelerating trend since 2015
  
  o GDP growth accelerated from 2.1% during the 2010-16 “Recovery” to 3.2% so far in 2018

• **Increases in Defense Spending**
VA Construction up 8,300 Jobs y-o-y in September
VA Manufacturing up 9,400 Jobs y-o-y in September
VA Leisure & Hospitality up 15,700 Jobs y-o-y in September
VA Education & Health up 16,100 Jobs y-o-y in September
VA Professional & Business Services up 17,000 Jobs y-o-y in September
VA Total Nonfarm Employment in September

- 81%: Everything Else
- 19%: Professional and Business Services
Y-o-Y Change in Federal Government Expenditures

Defense vs. NonDefense

Diagram showing the comparison of defense and non-defense expenditures from 2008:Q1 to 2017:Q4.
VA Professional & Business Services up 17,000 Jobs y-o-y in September
Annual Interest Payment on Federal Debt as % of Total Tax Revenue
Tax Foundation’s 2019 State Business Tax Climate Rankings

• Virginia #22
• Maryland #40
• North Carolina #12
YoY Change in Total Nonfarm Employment

- US
- NC
- VA
- MD
Additional Information

• Governor’s Report on Conformity Revenue Impacts

Technical-Appendix.pdf

• Virginia Department of Taxation Annual Reports

https://tax.virginia.gov/annual-reports

• Thomas Jefferson Institute Articles


www.thomasjeffersoninst.org