THE JEFFERSON JOURNAL

…a commentary from

THE THOMAS JEFFERSON INSTITUTE FOR PUBLIC POLICY

Best Tax Reform Idea? Raise the Standard Deduction

By Stephen D. Haner

Most Virginia taxpayers, and by far the highest percentage of those who live outside the prosperous urban areas, use the standard deduction when calculating their annual income tax. It is a small portion of their income which is free from tax, a recognition that they do not have as many of the expenses which wealthier taxpayers can deduct from their income at tax time.

Those include mortgage interest payments, on one or more loans, real estate taxes, on one or more properties, personal property taxes on expensive cars (again, they may have several of them), and medical expenses. If you have enough of those costs, you itemize your annual deductions and greatly reduce your tax bill. If you do not have enough of those, Virginia gives you a basic $3,000 per person or $6,000 per couple as a standardized amount to remove from taxable income.

The comparison between itemized deductions and standard deductions may be at the heart of a debate coming to the 2019 General Assembly. Congress made major changes to both at the federal level, and the amount of taxable income you show to the Internal Revenue Service is also the starting point for Virginia taxes. Virginia now has decisions to make.

If Virginia conforms to all those federal rule changes but does not change its standard deduction or tax rates or does not make it easier to itemize on a state tax return, the result will be a major state tax increase of about $600 million per year. Should the General Assembly take steps to prevent that increase, at least in the aggregate? Yes.

On behalf of the individual taxpayer, as opposed to companies filing a corporate return, the best step Virginia can take is to at least double that standard deduction. Congress doubled the federal standard deduction to $24,000 for a couple, and Virginia should double its to $12,000 for that same couple. That step would qualify as meaningful tax reform.

There is a strong geographic element to this. In several large urban areas more than half of Virginia taxpayers use itemized deductions. Many of them will look at that new $24,000 federal deduction and switch to the standard amount, but that means they must do the same at the state level (with only $6,000 to deduct). Because of that many legislators want to give them the option of taking the standard deduction on their federal return but continuing to itemize on their state return.

Here are some reasons why the higher standard deduction is the better route.

- Surrounding states are already there, offering their citizens higher standard deductions. North Carolina, South Carolina, Maryland and the District of Columbia have substantially higher standard deductions, some as high as the federal $24,000.

Tennessee, of course, has no income tax. Only West Virginia has an equally low standard deduction.

- The tax reform philosophy behind Congressional actions was to move people away from making decisions based on tax benefits and to stop subsidizing of high local and state taxes. If state and local taxes are fully deductible, the resulting tax break is a subsidy and rest of the cost is shared by other taxpayers in other jurisdictions.
- It reaches the highest number of Virginians, as many as 2.8 million tax returns out of the total 4 million. An increase in the standard deduction lowers the tax bill for all of them, far more people than would benefit from allowing state-only itemized deductions.
- It will lower the withholding tables used to calculate paychecks, meaning slightly more take home pay each cycle.

In the western part of the state there are no localities at all where people who itemize are the majority. In the deep southwestern counties close to 90 percent of taxpayers used the standard deduction, according to 2015 Department of Taxation data. In Roanoke City it was 76 percent, in Salem 68 percent, and in Montgomery County 69 percent. Even in suburban Roanoke County 63 percent used the standard deduction in 2015.

The state tax revenue, which is a side effect of federal tax reform, is viewed by some as a windfall of new dollars for the state to spend. Others see a problem that needs to be corrected by protecting each individual taxpayer from paying higher taxes, a hard goal to hit when things are this complicated.

It is best viewed as an opportunity to reform Virginia's tax system, which is why this step should be taken. Virginia also needs to lower its corporate tax rate because of the changes on the business side and should finally index its tax brackets and standard deduction to inflation, something the Congress did long ago. If more windfall dollars are produced by federal conformity, as expected, Virginia should look again at an even higher standard deduction.

-30-

A version of this commentary first appeared in the Roanoke Times *on December 3, 2018.* *Steve Haner is Senior Fellow for State and Local Tax Policy for the Thomas Jefferson Institute. He may be reached at blackwalnut140@live.com*