



Options to Make Virginia's Individual Income Tax More Progressive (HJ 567)

HJ 567: Study increasing the progressivity of Virginia's income tax (2021, Watts)

- evaluate changes to tax brackets, tax rates, credits, deductions, and exemptions to make Virginia's individual income tax more progressive
- Research conducted late 2021 to summer 2022
- Final report released at October 2022 JLARC meeting

In brief

As directed, JLARC staff identified options to make the individual income tax more progressive:

- 7 would reduce taxes on low, lower-middle, and middle income filers; and
- 4 would raise taxes on high or very high income filers.

These options could increase progressivity by up to 115%, and are estimated to collect between 6% less and 6% more revenue than baseline projections.

In brief (continued)

	Change in progressivity		Income group primarily affected	Change in state revenue
	Progressivity index	High – low rate gap	L M H	
Create new brackets & new more progressive rates (Option 5)	+115%	+27%	\$\$\$	↓ -4%
Adj brackets for inflation & new progressive rates (Option 4)	+57%	+14%	\$\$\$	↓ -2%
Add new top 1% bracket with 9% rate (Option 10)	+38%	+27%	\$\$ \$	↑ +6%
Add new >\$1M bracket with 10% rate (Option 11)	+37%	+27%	\$\$ \$	↑ +6%
Increase standard deduction to the federal amount (Option 7)	+30%	+2%	\$\$\$	↓ -6%
Adjust income brackets for inflation since 1990 (Option 3)	+23%	+1%	\$\$\$	↓ -6%
Increase the tax filing threshold (Option 2)	+16%	+2%	\$\$\$	↓ -2%
Add new top 1% bracket with 7% rate (Option 9)	+15%	+11%	\$\$ \$	↑ +2%
Add new brackets with 6% & 6.75% rates (Option 8)	+13%	+8%	\$\$ \$	↑ +3%
Increase the personal exemption amount (Option 6)	+10%	+1%	\$\$\$	↓ -2%
Increase refundable portion of EITC (Option 1)	+2%	+8%	\$\$\$	↓ -0.2%

\$\$\$ Reduce taxes on lower income filers

\$\$\$ Reduce taxes on lower & middle income filers

\$\$ \$ Raise taxes on higher income filers

In this presentation

Background

Recent changes to individual income tax

Increasing progressivity

Maintaining progressivity over time

Virginia's individual income tax features four income brackets with higher rates for each bracket

Taxable Income	Rates
\$0 to \$3,000	2%
\$3,001 to \$5,000	3% <i>(plus \$60)</i>
\$5,001 to \$17,000	5% <i>(plus \$120)</i>
More than \$17,000	5.75% <i>(plus \$720)</i>

Single filing threshold = \$11,950

Married filing jointly threshold = \$23,900

A tax is progressive if the percentage of income paid in tax rises along with income

- Higher income filers pay a higher percentage of their income in taxes than lower income filers
- Basis for tax progressivity is higher ability to pay as income rises

	Bottom 20th	Second 20th	Middle 20th	Fourth 20th	Top 20th
Average Virginia income	\$5,400	\$24,500	\$50,700	\$95,000	\$287,000
Multiple of bottom 20th	-	4.5x	9x	18x	53x

Review used two measures of progressivity

- **Progressivity index** = relative tax burden of each income group
 - used the “Suits index”
 - focused equally on all income groups
- **High – low rate gap** = the difference in the effective tax rates of very high income and low income filers
 - effective tax rate of the *top 1%* of filers minus the *bottom 20%* of filers
 - larger difference indicates a more progressive tax system

Report used income quintiles to show effect of changes on differing levels of income

Income quintile	Income \$ range	Referred to as ...
Bottom 20%	Up to \$14,000	Low income
Second 20%	\$14,001 to \$35,999	Lower-middle income
Middle 20%	\$36,000 to \$67,999	Middle income
Fourth 20%	\$68,000 to \$128,999	Upper-middle income
Top 20%	Next 15%	\$129,000 to \$276,999
	Next 4%	\$277,000 to \$597,999
	Top 1%	\$598,000 or more
		High / Very high income

*Adjusted Gross Income

In this presentation

Background

2022 changes to individual income tax

Increasing progressivity

Maintaining progressivity over time

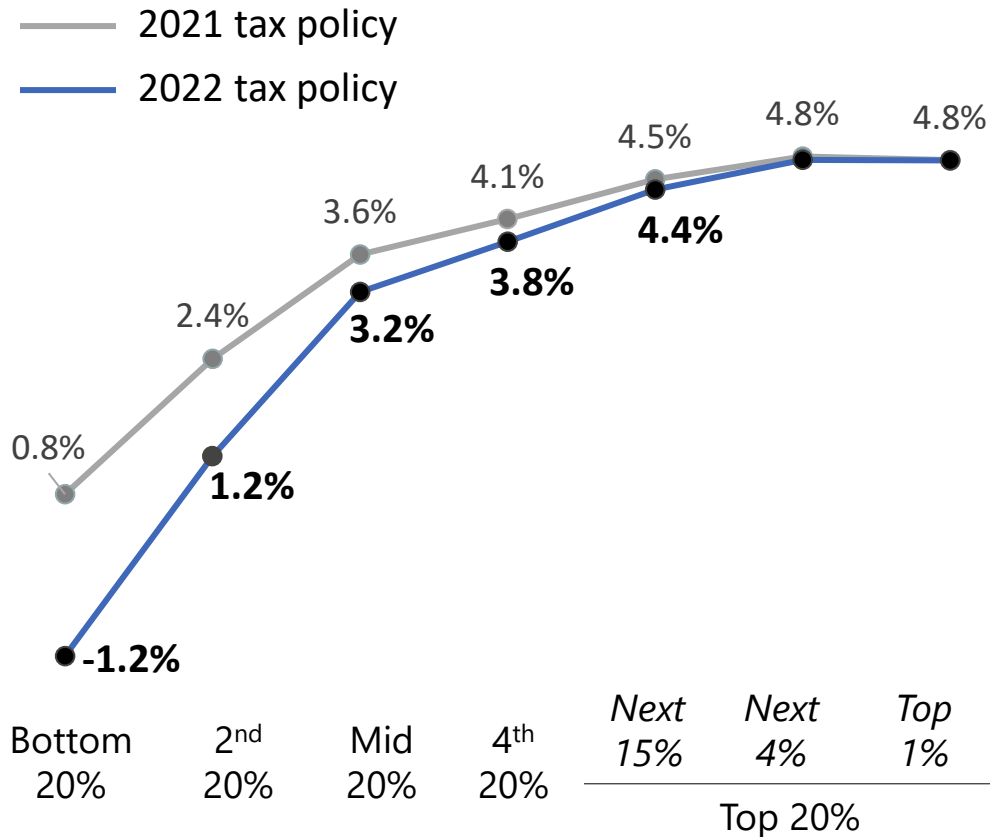
2022 General Assembly and governor made two changes to Virginia's individual income tax

- Standard deduction increased
 - Single filers: \$4,500 to \$8,000*
 - Married filers: \$9,000 to \$16,000*
- State earned income credit partially (75%) refundable
 - Refundability allows low income filers to receive a credit even if they do not have tax liability
 - Refundable credits are an important element of progressive income taxes, according to experts

*Dependent on state revenues

2022 changes were estimated make Virginia's individual income tax more progressive

Effective tax rates, by income group



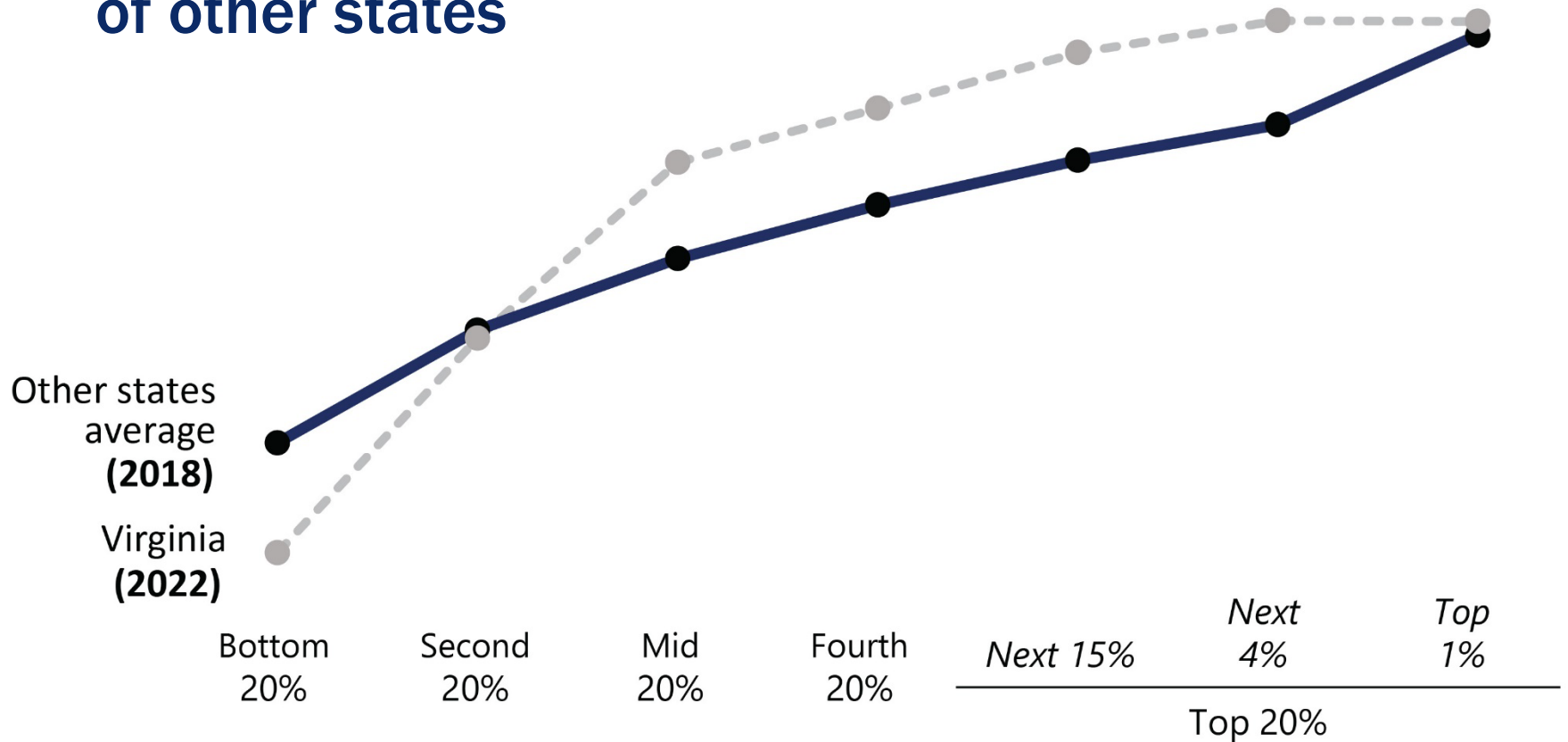
Progressivity index (% change)



High – low rate gap (% change)



2022 changes were estimated to make Virginia's individual income tax more progressive than average of other states



Source: Who Pays?, Institute on Taxation and Economic Policy (2018) using latest data available, and projections made using the Virginia Individual Income Tax Microsimulation Model.

In this presentation

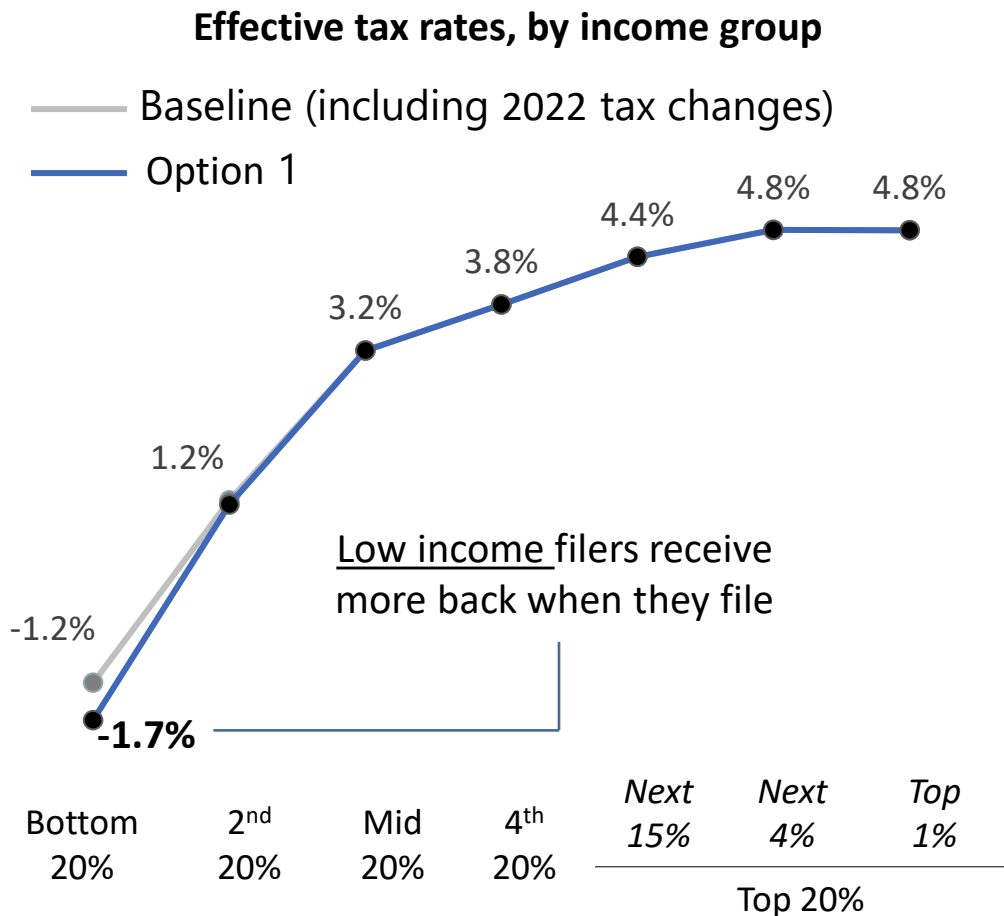
Background

Recent changes to individual income tax

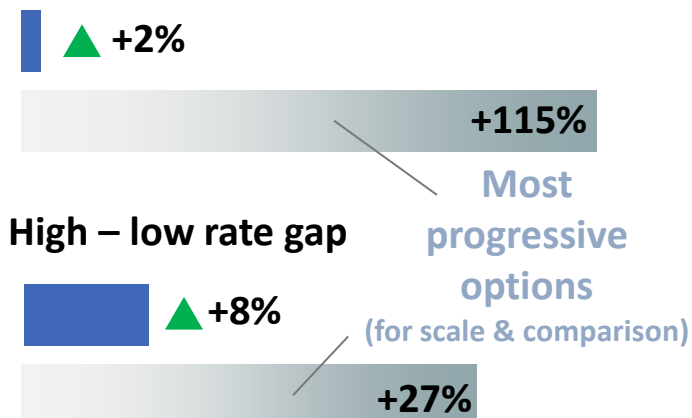
Increasing progressivity

Maintaining progressivity over time

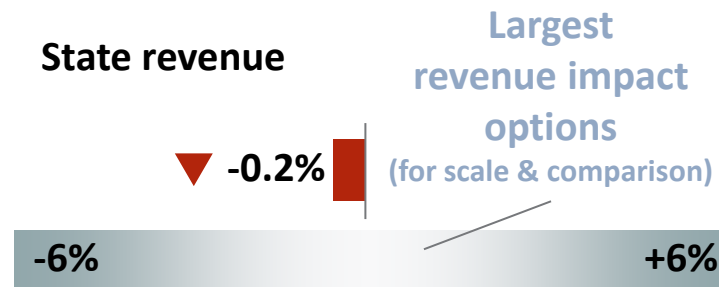
Option 1: Increase the refundable portion of the EITC from 75% to 100%



Progressivity index



State revenue



Not updating Virginia's income tax brackets since 1990 has steadily reduced progressivity over time

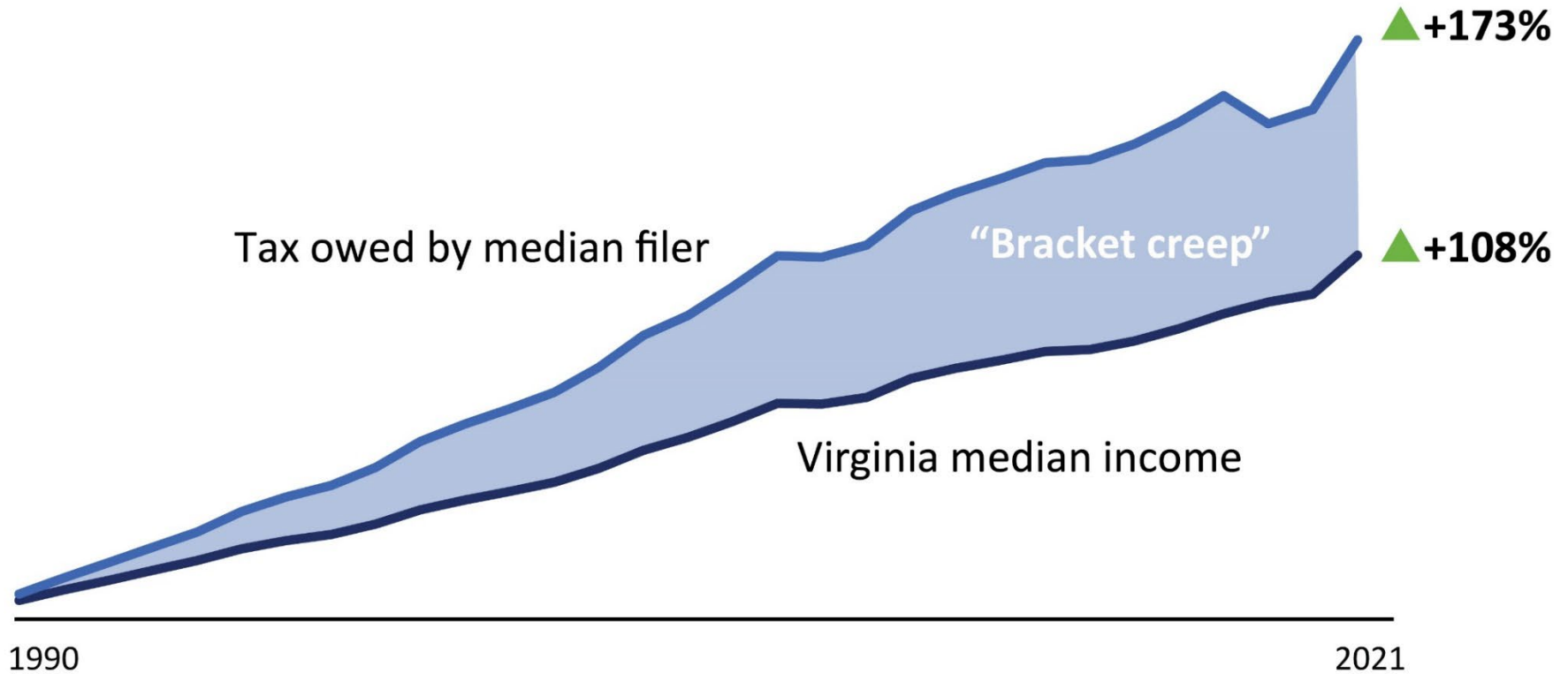
- Income brackets have remained the same since 1990
- Incomes have risen substantially, so a higher percentage of income is in the highest tax bracket*

	1990	2021
Taxable income of median single filer	\$14K	\$30K
% of median income in highest tax bracket	0%	47%

- “Bracket creep” has particularly affected lower-middle income households

*Highest tax bracket includes income of more than \$17,000 and is taxed at 5.75%.

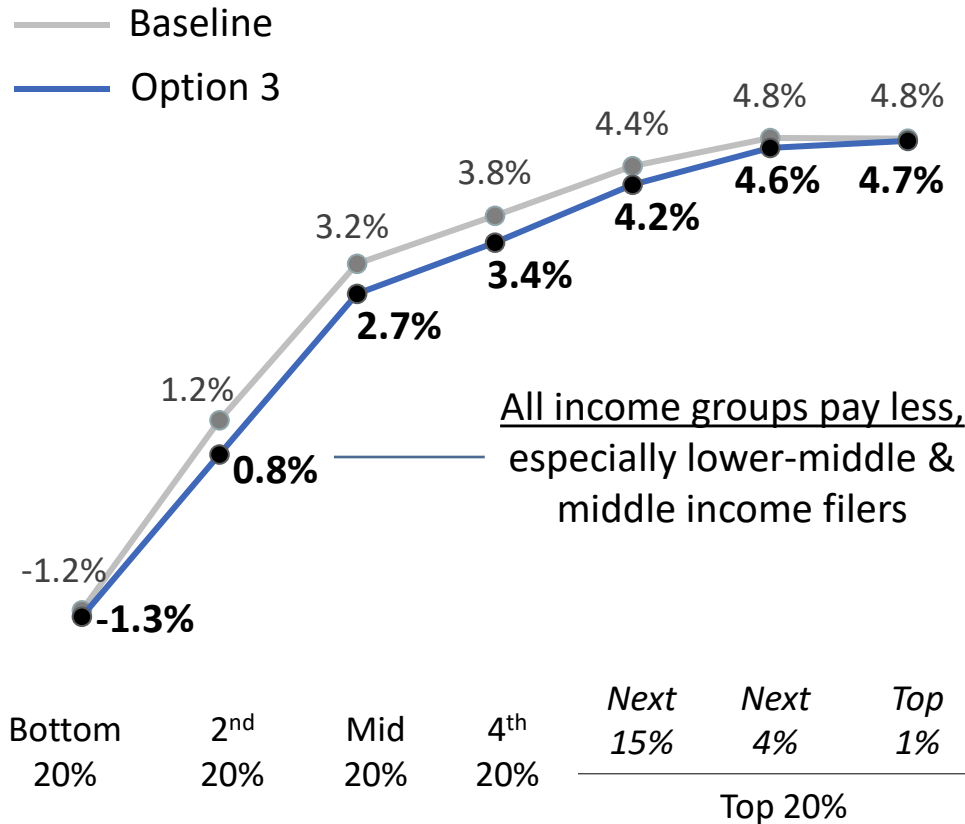
Taxes owed have risen faster than income because of “bracket creep”



Adjusted for inflation.

Option 3: Adjust income brackets based on inflation since 1990

Effective tax rates, by income group



Progressivity index



High – low rate gap



State revenue

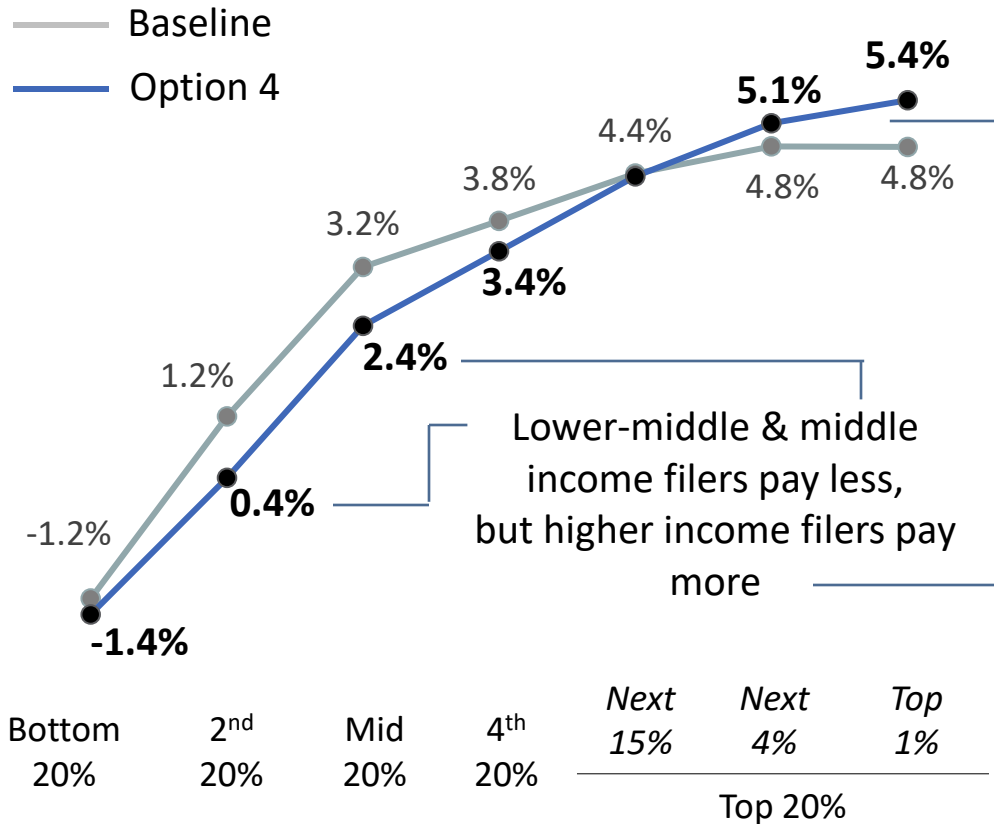


State could update brackets based on inflation since 1990 & adopt a more progressive rate structure

Current		New	
<i>Brackets</i>	<i>Rates</i>	<i>Brackets</i>	<i>Rates</i>
\$0 to \$3,000	2%	\$0 to \$6,237	1%
\$3,001 to \$5,000	3%	\$6,238 to \$10,395	2%
\$5,001 to \$17,000	5%	\$10,396 to \$35,347	4.5%
\$17,001+	5.75%	\$35,348+	6.5%

Option 4: Adjust brackets for inflation since 1990 & adopt moderately more progressive tax rates

Effective tax rates, by income group



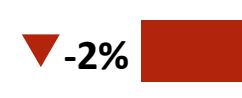
Progressivity index



High – low rate gap



State revenue



Virginia's top rate was less than the national average and substantially less than several states

- Virginia's top rate was below the average top rate of other states with graduated income taxes (5.75% vs. 6.5%)
- Virginia's top rate was substantially less than several other states with more progressive state income taxes
 - California – 13.3% for income above \$1 million
 - Hawaii – 11% for income above \$200,000
 - New Jersey – 10.75% for income above \$1 million
 - New York – 10.3% for income above \$5 million (and 10.9% for income above \$25 million)

Information latest available as of 2022.

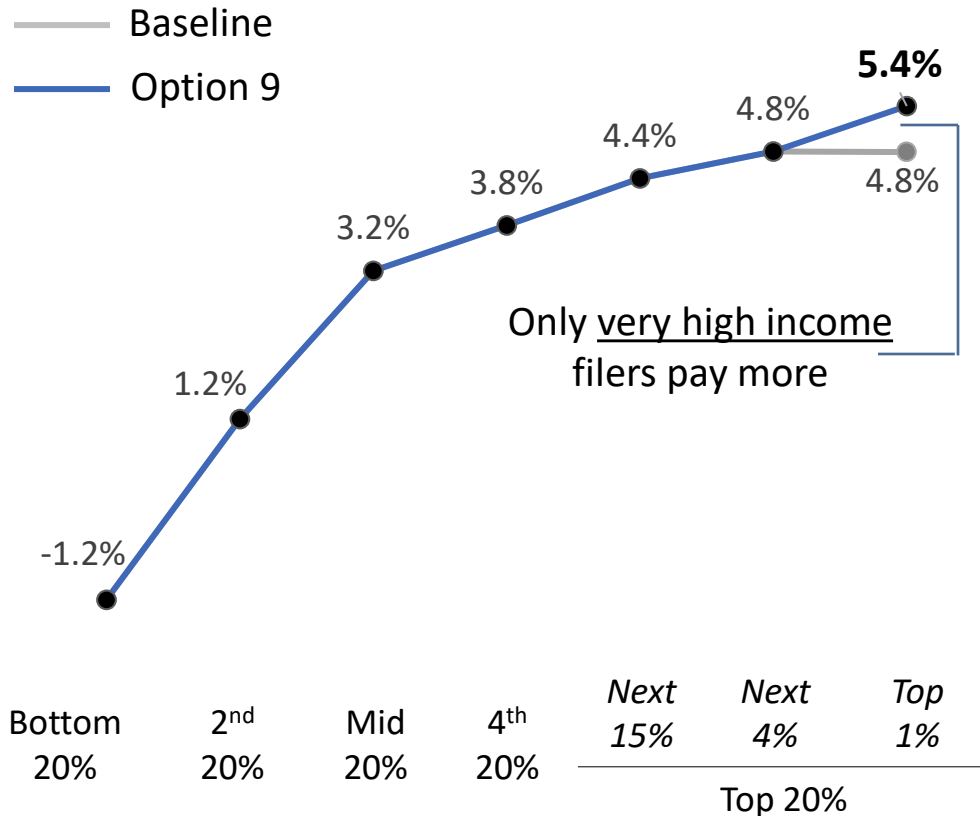
Regionally, highest income brackets and rates vary

- West Virginia - 6.5% for income above \$60,000
- Maryland - 5.75% for income above \$250,000
- D.C. – 10.75% for income above \$1 million
- North Carolina - 4.99% flat tax at all income levels (reduced in 2022 from 5.25%)

Information latest available as of 2022.

Option 9: Add new top 1% income bracket (\$600k+) with a 7% tax rate

Effective tax rates, by income group



Progressivity index



High - low rate gap

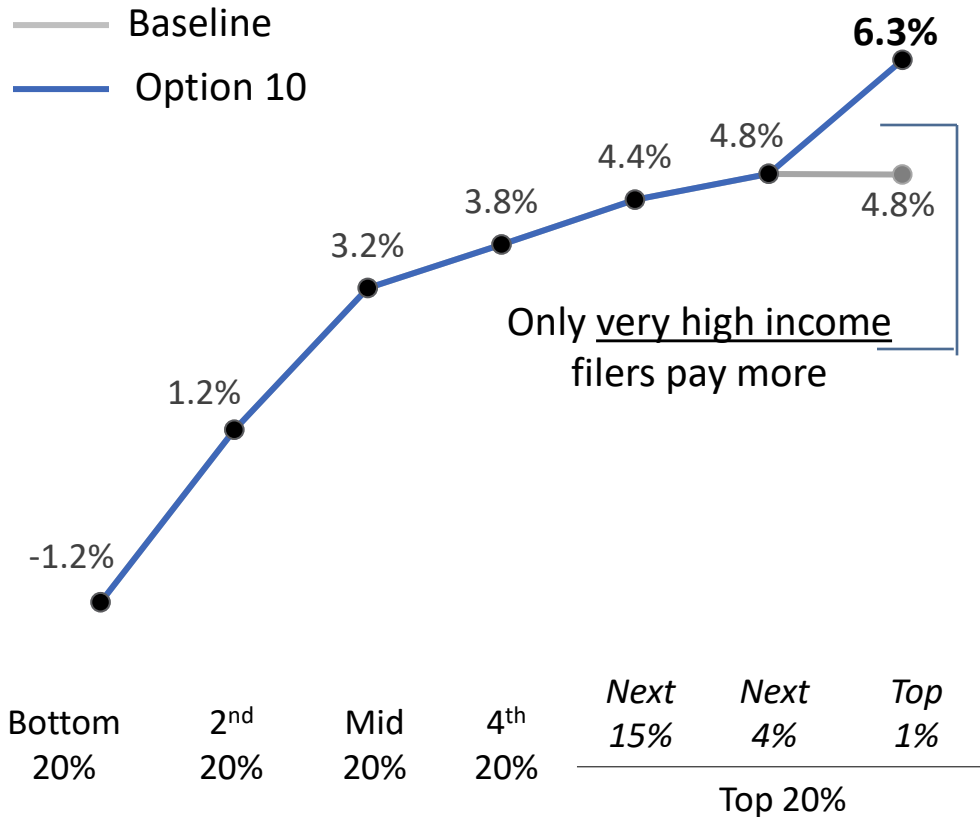


State revenue



Option 10: Add new top 1% income bracket (\$600k+) with a 9% tax rate

Effective tax rates, by income group



Progressivity index



High – low rate gap



State revenue



In this presentation

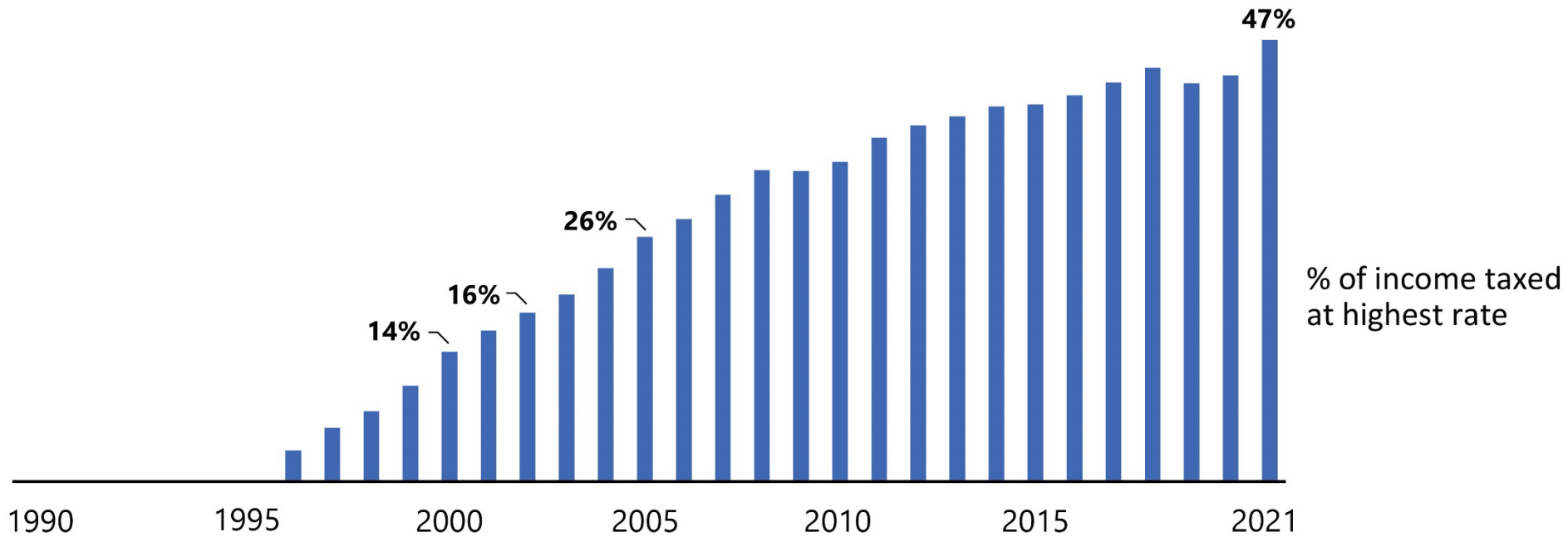
Background

Recent changes to individual income tax

Increasing progressivity

Maintaining progressivity over time

Higher percentage of median income has steadily been taxed at highest rate since 1990














Adjusting income brackets for inflation is progressive; used by federal gov't & many states

- Federal income tax brackets are regularly adjusted to account for inflation
- Majority (24) of states with graduated individual income taxes make some regular adjustments for inflation to brackets

Policy option

The General Assembly could preserve the progressivity of the individual income tax over time by indexing tax income brackets to inflation.

Key Findings

Option # and description	Change in progressivity		Change in state revenue
	Progressivity index*	High – low rate gap	
#5: New brackets & new more progressive rates**	+115%	+27%	 -4%
#4: Adj brackets for inflation & new progressive rates	+57%	+14%	 -2%
#10: New top 1% bracket with 9% rate	+38%	+27%	 +6%
#11: New >\$1M bracket with 10% rate**	+37%	+27%	 +6%
#7: Increase standard deduction to federal**	+30%	+2%	 -6%
#3: Adj income brackets for inflation since 1990	+23%	+1%	 -6%
#2: Increase the tax filing threshold**	+16%	+2%	 -2%
#9: New top 1% bracket with 7% rate	+15%	+11%	 +2%
#8: New brackets with 6% & 6.75% rates**	+13%	+8%	 +3%
#6: Increase the personal exemption amount**	+10%	+1%	 -2%
#1: Increase refundable portion of EITC	+2%	+8%	 -0.2%

*Options shown in order of largest to smallest increase in the progressivity index.

**Option not highlighted in presentation but included in written report.

JLARC staff for this report

Justin Brown, Associate Director

Erik Beecroft, PhD, Chief Methodologist

Ellen Miller, Chief Analyst