TOWARD A SIMPLIFIED INCOME TAX SYSTEM FOR VIRGINIA TAXPAYERS

REPORT OF THE

VIRGINIA INCOME TAX STUDY COMMISSION

To

THE GOVERNOR

And

THE GENERAL ASSEMBLY OF VIRGINIA

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TOWARD A SIMPLIFIED INCOME TAX SYSTEM FOR VIRGINIA TAXPAYERS

REPORT OF THE VIRGINIA INCOME TAX STUDY COMMISSION

Richmond, Virginia, January 2, 1968

To:

HONORABLE MILLS E. GODWIN, JR., *Governor of Virginia*

and

THE GENERAL ASSEMBLY OF VIRGINIA

The present Virginia income tax law differs from the corresponding federal law in many significant respects. As a result taxpayers in Virginia must comply simultaneously with two different sets of rules in preparing their annual income tax returns and determining their tax liability.

Many other states, faced with a similar situation, have revised their state income tax laws to conform to the federal law. The list of conforming states has grown rapidly in the past few years until at present about half the states with income tax laws conform to the federal rules for determining taxable income.

The convenience to taxpayers that might stem from the coordinating of state and federal income tax laws led the 1966 General Assembly to call for an independent commission study of the matter. The possibility of constitutional problems in the enactment of such a conforming state law also required thorough consideration.

House Joint Resolution No. 64, which created this Commission and specified its duties, reads as follows:

HOUSE JOINT RESOLUTION NO. 64

Creating a Commission to study the desirability of conforming the income tax laws of the Commonwealth with those of the United States, and appropriating funds.

Whereas, twenty of the thirty-nine states which today impose state income taxes had adopted statutory and administrative provisions conforming to those now used in the Internal Revenue Code of 1954, as amended; and

Whereas, the Committee on the Judiciary of the United States House of Representatives has recommended the adoption of legislation which would require states imposing net income taxes on corporations to adopt the standard of "taxable income" as provided under the Internal Revenue Code of 1954, as now or hereafter amended, and its Chairman has introduced H.R. 11798 to effect such purpose; and

Whereas, the adoption of federal income tax standards may provide many desirable features, but serious constitutional and policy questions arise under Virginia law that must be carefully studied and first resolved; now, therefore, be it

Resolved, by the House of Delegates of Virginia, the Senate concurring, That a commission is hereby created to study and report to the Governor and General Assembly as to the desirability or need by the State to adopt basic federal income tax concepts, especially the definition of taxable income, for the taxation of individuals, fiduciaries and corporations, including estimates of the effect on revenues, consideration of constitutional questions as to incorporation by reference of federal tax legislation and the incorporation of future federal legislation, appropriate adjustments to be made to any federal definition and all related matters. The Commission shall also study and report to the Governor and General Assembly on such other tax matters as may be referred to it by the Governor.

The Commission shall be comprised of eleven members, two of whom shall be appointed by the President of the Senate from the membership thereof, three of whom shall be appointed by the Speaker of the House of Delegates from the membership thereof, and six of whom shall be appointed by the Governor from the State at large. The Governor shall appoint the Chairman. Members of the Commission shall receive no compensation for their services but shall be reimbursed for their actual and necessary expenses for which, and for the other expenses of the Commission including consultants and secretarial help, there is hereby appropriated from the contingent fund of the General Assembly the sum of ten thousand dollars.

All agencies of the State shall assist the Commission in its study. The Commission shall complete its study and submit its report and recommendations to the Governor and General Assembly not later than October one, nineteen hundred sixty-seven.

Acting pursuant to the Resolution, the President of the Senate appointed Robert C. Fitzgerald, member of the Senate, Fairfax, and Garland Gray, member of the Senate, Waverly, to serve on the Commission; the Speaker of the House of Delegates appointed John Warren Cooke, Delegate, Mathews, L. E. Putney, Delegate, Bedford, and D. French Slaughter, Jr., Delegate, Culpeper, to serve on the Commission. The Governor appointed Carle E. Davis, Attorney at Law, Richmond; George D. Fischer, Commissioner of the Revenue, Arlington; Gilbert W. Francis, Attorney at Law, Boykins; Roy C. Herrenkohl, President of the Colonial-American National Bank, Roanoke; R. Braxton Hill, Jr., Certified Public Accountant, Norfolk; and C. H. Morrissett, State Tax Commissioner, Richmond.

The Governor appointed Mr. Slaughter to serve as Chairman of the Commission, and the Commission elected Robert C. Fitzgerald to serve as Vice-Chairman. G. M. Lapsley and Mary R. Spain served as Secretary and Recording Secretary, respectively.

The Commission secured the services of Edwin S. Cohen, Professor at the University of Virginia Law School, to act as consultant to the Commission during the course of its study.

The Commission, near the outset of its work, held a public hearing to which all interested parties were invited. Representatives of the Virginia State Bar and Virginia State Bar Association, the Virginia State Chamber of Commerce, the Virginia Society of Certified Public Accountants and the Accountants' Society of Virginia were among those who presented their views and suggestions to the Commission at this hearing. Numerous meetings have been held by the Commission with Mr. Cohen to review various facets of the subject as the work has progressed. The Commission has endeavored to give careful consideration to the overall fairness of the state income tax law, to the convenience of taxpayers in keeping records and filing income tax returns, to the need for effective administration of the law and to the requirements of the state for revenue.

RECOMMENDATIONS AND REASONING

After much study and deliberation the Commission has concluded, and recommends to the Governor and the General Assembly, that the Virginia income tax law should be revised so that, with the few exceptions mentioned below and without altering our present income tax rates, it would be brought into conformity with the federal law, particularly in the determination of net income subject to tax.

Advantages for taxpayers. The Commission has reached this conclusion primarily because of the simplification and convenience it believes will result for the taxpayers of Virginia in fulfilling their responsibilities under two income tax systems simultaneously, including the preparation of income tax returns for both the federal and Virginia authorities.

In its detailed comparison of the Virginia and federal laws the Commission found a long list of items of income, deductions and personal exemptions that are treated differently under the two laws. Among these are the following items frequently encountered on returns of individuals:

- Sick pay
- Pensions and annuities
- Dividends
- Scholarships and fellowships
- Alimony
- Life insurance payments
- Income of trusts and estates
- Capital gains and losses
- Tax basis of property received by gift or inheritance
- Child care expense
- Medical expenses
- Charitable contributions
- Education expense
- Automobile mileage allowances
- Excise and license tax deductions
- Standard deduction
- Personal exemptions

Businesses are faced with a bewildering series of differences between the two laws in connection with the organization, reorganization or liquidation of corporations, as well as in other significant areas. Frequently the difference in tax result stems from a slight difference in wording of the two laws that is not obvious to the casual reader, or is due to an omission from the state law of provisions found in the federal. The lack of conformity is of concern in business transactions in which income tax consequences are significant. Since the federal tax rate is far higher, business transactions will be planned in the light of federal tax law, but the state law may produce state income tax consequences substantially different from the federal.

Moreover, neither the Virginia statute, the income tax return forms nor the accompanying instructions point out to the taxpayer the major differences between the Virginia law and the federal. The individual who has filled out his federal return must begin afresh with the state return and study the state instructions or seek advice as though the federal return did not exist.

In reviewing the principal points of difference between the two laws, the Commission concluded that in a number of instances the Virginia rule is preferable, and that in other respects the federal law is more desirable. In certain cases the Virginia rule is simpler than the federal, and perhaps for that reason preferable in an income tax system with a substantially lower rate, even though the simpler rule may not be as equitable as a more complex one. From its study, however, the Commission concluded that the overriding consideration is the present complexity for the taxpayers of the state in their effort to comprehend and comply with two different systems simultaneously. In the main, even where the present Virginia income tax rule might appear more desirable than the federal, the advantages of the Virginia rule do not seem to the Commission to outweigh the simplification that would flow from having consistent provisions in the two laws.

An important effect of enacting a conforming statute would be to permit the use of a shortened and simplified state income tax return which should be filed accompanied by a copy of the taxpayer's return when needed to furnish full information to the state's tax administrators. Generally the state return would merely reflect summary figures taken directly from the federal return. This type of simplified state return has been used with considerable success and approval in other states.

Advantages in administration. The Commission believes the Commonwealth and its citizens have been fortunate in having dedicated, highly competent and experienced administrative officials in charge of the income tax system. They make available prompt and thoughtful interpretations of the state law upon request of taxpayers seeking advice, and they have administered the law with courtesy and fairness. But their discretion is limited by the state statute; and the statute forces taxpayers to cope simultaneously with two significantly different sets of rules in preparing tax returns, handling withholding of income tax on salaries and wages, keeping records of income and deductions, understanding the tax effects of business or investment transactions and dealing with government audits of returns.

As the number of taxpayers and volume of taxable income in the state steadily mounts, the need for conformity of state and federal law grows greater, not only for the convenience of the taxpayers but also as a means of meeting the ever increasing administrative burden of the Department of Taxation in auditing returns. For some years the Department has had an agreement with the Internal Revenue Service for interchange of information on the audit of returns. The introduction of computers both by the Department and the Service provides an opportunity for efficient exchange of data on magnetic tape not possible until 1967.

As a result of negotiations between the National Association of Tax Administrators and the Internal Revenue Service, the Service will now supply to any state on magnetic tape data regarding federal income returns filed by individuals residing in that state. When that data is introduced via the tapes into the state's computer for comparison with state return data, the state is provided with a most efficient tool for auditing returns filed and checking against failure to file returns. It is estimated that the cost to the state of Virginia of obtaining such a tape would be as little as $3,000.

A substantial number of states have ordered these tapes. At the present time, however, the tape would be of relatively little use to the state of Virginia because of the differences between the federal and the state law and the necessary differences between the federal and state tax return forms. Accordingly, the Commission understands, the Virginia Department of Taxation is not planning to obtain the federal tape. If the Virginia income tax statute and the return forms were brought into general conformity with the federal counterparts, the tapes could be used and this valuable administrative device would be available.

Moreover, the Department now exchanges information with the federal government regarding the results of audits of income tax returns.

As a part of this program, the state is generally given access to the results of adjustments made by the Internal Revenue Service on the audit of federal returns. In addition, the state income tax return forms require the taxpayer to report any adjustments made by federal tax authorities to net income for any prior year. Nevertheless, the Virginia law makes no provision for keeping open the statute of limitations for adjustment of the Virginia tax liability, either by way of additional assessment or refund, that might be indicated by reason of the federal audit.

In a number of other states, the state statute of limitations is held open until a period of time, such as a year, has elapsed after the final determination of federal liability, thus permitting the appropriate state adjustment consistent with the federal. The Commission recommends that, as a part of conforming generally the Virginia law to the federal, the Virginia statute of limitations be made to correspond generally to the federal, except that in any event an additional year would be allowed for collection of additional Virginia tax, or for a refund of Virginia tax, solely to reflect any adjustment made on audit of the federal income tax return.

In addition, further administrative advantages would seem to flow from increasing the standard deduction from the present 5% on the state returns to 10% by conforming to the federal rule. The increase should tend to reduce the number of individual state returns in which nonbusiness deductions (such as taxes, interest, contributions, medical expense) must be itemized and audited.

Again, provision for the filing of a single combined return by husband and wife, as explained further below, should reduce the number of returns to be prepared, filed, processed and audited.

Experience in other states. Thirty-six of the fifty states have broad based income taxes on individuals.[1] Of these, the following nineteen states conform generally to the federal rules for determining taxable income:

Alaska
Colorado
Hawaii
Idaho
Indiana
Iowa
Kansas
Kentucky
Maryland
Michigan
Minnesota
Montana
Nebraska[2]
New Mexico
New York
North Dakota
Vermont
West Virginia
Wisconsin

The above list has grown substantially in the past ten years, for at the beginning of 1958 only four states (Kentucky, Iowa, Montana and Vermont) conformed generally to the federal rules.[3] The movement was given impetus in 1960 when the State of New York, after a lengthy study, converted its personal income tax to this system. During the year 1967 four states joined the rapidly expanding list, including Kansas and Maryland by revising their existing law and Michigan and Nebraska upon enacting personal income taxes for the first time.

With respect to taxes on corporations, forty-one states now impose on corporations either an income tax or a franchise tax measured by income.[4]

[1] CCH State Tax Handbook, 652 (Oct. 1, 1967)
[2] The Nebraska tax goes into effect January 1, 1968.
[3] Miller, *Proposal for a Federally-Based New York Personal Income Tax,* 13 Tax L. Rev. 183, 193 (1958)
[4] CCH State Tax Handbook 652 (Oct. 1, 1967)

Of these, twenty-three states base the tax in general by reference to the federal Internal Revenue Code.[5] This list has also been steadily expanding.

So far as is known, within the past decade no state after conforming generally to the federal law has abandoned such a system. Inquiries by the Commission as to the experience in the conforming states have produced only favorable responses, as the trend of legislation clearly indicates would be the case. In general the administrators of the income tax laws in the conforming states seem enthusiastic about the superiority of the system to that of an independent state law.

Recommended variance from the federal law. The Commission would have preferred to recommend a complete conformity to the federal law in determining net income subject to tax. Complete conformity would permit maximum simplification of tax return forms in all cases and minimize the time necessitated in complying with the state law. With respect to a few items, however, the Commission has concluded that the state law should differ from the federal. The principal items which, in the Commission's judgment, call for different treatment in the state law are listed below, with a brief indication of the pertinent considerations.

1. *Government bond interest.* Because of the serious policy and constitutional questions involved in any change, the Commission recommends that the state law continue to exempt from income tax the interest on obligations of the federal government and of the Commonwealth of Virginia and its political subdivisions, and that it continue to include in income interest on obligations of other states and their political subdivisions. This will require an adjustment to the income reported on the federal income tax return to subtract federal bond interest and to add interest on obligations of other states and their subdivisions.

2. *Deduction for state income tax.* The federal law allows a deduction for income taxes paid to the states. Permitting a deduction in computing state income tax for the tax itself produces complex calculations under certain conditions. The present Virginia law does not allow such a deduction and permitting the deduction would cause a significant loss of revenue. Many of the conforming states eliminate deductions for state income tax. Accordingly, the Commission recommends that in computing income subject to the state tax the amount of federal net income be adjusted to exclude a deduction for income tax paid to states or localities.

3. *Dividends on stocks of national and state banks.* The National Banking Act[6] limits the types of taxes that may be imposed by the states upon national banks and their shareholders. The Virginia tax law for many years has imposed a tax upon the stockholders on the value of the shares of stock of national and state banks owned by them on January 1 of each year.[7] The tax is at the rate of 1% and is customarily paid by the bank itself rather than by the shareholders.[8] The revenue from this tax is in effect shared by the state with the localities in which the banks are situated, since the state law permits cities, towns and counties to impose a similar tax at lower rates and

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[5] Included are Connecticut, Delaware, Massachusetts, New Jersey, Pennsylvania, and Rhode Island, which either have no broad-based income tax on individuals or have one that does not conform to the federal. Minnesota and Wisconsin conform with respect to individual tax but not with respect to corporate tax. See 31 Tax Administrators News, No. 6 (June, 1967).

[6] 12 U.S.C. § 548.

[7] Va. Code § 58-466.

[8] Va. Code §§ 58-473, 58-480.

permits the bank to credit the amount paid to the locality against the tax paid to the state.[9]

A tax of this type on shares of national banks is permitted under the National Banking Act, but so long as such a tax is imposed that Act prohibits the state from imposing income tax either upon the income of the national bank or upon the dividends paid by the bank to its shareholders. The present state income tax law complies with this prohibition by allowing deduction in determining taxable net income for dividends received on stocks of national banks and state banks and trust companies,[10] and by exempting banks and trust companies from state corporate income tax.[1]

While the National Banking Act specifically applies only to national banks, obviously the tax on state banks and trust companies and their shareholders should be the same as in the case of the national banks.

A change from the present bank stock tax to an income tax would substantially affect the present tax structure applicable to banks and their stockholders and the allocation of revenue between the state and the localities.

The Commission did not consider it appropriate to consider a revision of the bank tax system as a part of its study of conformity of the state and federal income tax laws. Accordingly, the Commission recommends that for the present, in view of the bank stock tax, the state statute should continue to exclude from income subject to state income tax dividends on stocks of national banks and of state banks and trust companies, and that the companies continue to be exempt from corporate income tax.

4. *Dividends received from corporations subject to Virginia corporate income tax.* The present Virginia income tax law allows a deduction in computing net taxable income for dividends received from any corporation, the income of which was assessable for the preceding year for Virginia corporate income tax purposes; and when only a part of the corporate income is so assessable, only a corresponding part of the dividend received from the corporation is deductible.[2]

The present federal income tax law contains no such provision, but permits each individual taxpayer to exclude from income dividends received from domestic corporations up to $100.00 in any year.[3]

Thus the present Virginia law avoids the imposition of a double Virginia income tax on both the corporation and the shareholder where income is earned by the corporation and distributed to its shareholders, whereas the federal law eliminates a double federal income tax only with respect to amounts up to $100.00 of dividends distributed to each individual shareholder.

Because of the sudden adverse effect which adoption of the federal rule would create for shareholders of corporations doing business in Virginia, the Commission recommends in general that the Virginia rule with respect to deduction for dividends on stocks of such corporations be continued for the present except with respect to dividends from corporations which have less than half their income from sources

[9] Va. Code §§ 58-476 et seq., 58-481.
[10] Va. Code § 58-81(K).
[1] Va. Code § 58-128.
[2] Va. Code § 58-81(1).
[3] Int. Rev. Code § 116.

within the State of Virginia. The $100.00 exclusion of the federal law would be allowed under the state law as well, but to avoid duplication of the exclusions the $100.00 allowance would be reduced by any amounts excluded from income by reason of the source of the corporate income being from within the state of Virginia. Thus when the taxpayer has reflected on his Virginia income tax return his income reported on the federal return, he would make an adjustment to take an additional deduction for the excess of (a) the dividends he received out of Virginia corporate income, over (b) his allowable dividend inclusion on his federal return.[4]

The Commission believes that in view of the above recommended conformity of Virginia law to the federal $100 exclusion, a further simplification can be achieved if the deduction for dividends received out of income subjected to Virginia corporate income tax is confined to cases in which more than 50% of the income of the corporation is subject to Virginia income tax. At present the Department of Taxation publishes a list of some 600 dividend-paying corporations together with the applicable percentages of their dividends that are subject to Virginia income tax. About 60% of these corporations derive less than 10% of their income from within the state of Virginia, and accordingly more than 90% of their dividends are subject to Virginia income tax in the hands of their shareholders. About 77% of the corporations listed derive less than 50% of their income from within the state.

The present Virginia dividend deduction rule, while having the strength of considerable logic when the corporation pays Virginia income tax on substantially all its income, requires a mathematical calculation that must be made and audited with respect to each affected dividend received by the taxpayer. Where the corporation derives less than half of its income from within the state, the Commission believes that the advantages of the rule are outweighed by the complexities it produces. In these circumstances and in view of the recommended conformity with the federal $100 exclusion, the Commission recommends that the additional deduction for dividends received out of Virginia corporate income be limited to dividends from corporations which are subject to Virginia corporate income tax on more than half their income. The effect would be to confine the special Virginia deduction to dividends from less than one-fourth of the companies now affected, and yet preserve the deduction for the shareholders of those companies doing a majority of their business within the state, where the duplication of Virginia income tax would be of most concern.

5. *Virginia governmental retirement benefits.* Although the income tax provisions of the Virginia Code do not reflect the rule, the

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[4] For example, assume a taxpayer receives $300 of dividends from a Virginia corporation all of whose income is subject to Virginia corporate income tax and $150 of dividends from corporations which pay no Virginia income tax. His total dividends received are $450, but on his federal return he excludes $100, leaving $350 in federal net taxable income. On his Virginia return, after setting forth income as reflected on his federal return ($350), he would make an adjustment to deduct an additional $200, representing the excess of (a) the dividends out of Virginia corporate income ($300), over (b) the dividend exclusion taken on the federal return ($100). Thus the income subject to Virginia tax would be $150, as at present.

If, however, the taxpayer received only the $150 dividends from corporations paying no Virginia income tax, he would be subject to federal tax on only $50 (after the federal $100 exclusion) and he would make no adjustment on his Virginia tax return. Hence under the proposed revision he would pay Virginia income tax on $50 of dividend income.

statutes relating to the Virginia Supplemental Retirement System and county, city and town retirement system benefits provide an exemption from state income tax for retirement benefits received thereunder. Since the state income tax exemption granted by those statutes has obviously been taken into account in fixing the benefits, the Commission did not consider that the exemption should be disturbed by reason of the revision of the state income tax law to conform it generally to the federal. So long as the exemption remains, recipients of such benefits must be permitted to adjust the amount of income brought over from the federal return to their state return by subtracting the amount of these supplemental retirement benefits. Similar adjustments for such governmental retirement benefits are now made under several state income tax laws which conform generally to the federal Internal Revenue Code.[5]

6. *Joint returns of husband and wife.* The federal law permits a husband and wife either to file separate income tax returns or to file a joint return in which the income tax is "twice the tax which would be imposed if the taxable income is cut in half."[6] Sometimes referred to as "split income", the system was adopted in the federal law in 1948 primarily to accomplish for married persons residing in common law states the income tax results that had been reached by court decision for married persons residing in community property states.[7] Whatever the merits of such a system, such data as are available indicate that its introduction in Virginia would create a significant loss in revenue and that much of this loss would occur in the upper income brackets.

The present Virginia income tax rate structure is:

2% on the first $3,000 of taxable income;
3% on the next $2,000 of taxable income; and
5% on the balance.

Under present law if a man has $10,000 of taxable income (i.e., after deductions and personal exemptions) and his wife has no income, his state income tax is $370. If the "split income" provisions of the federal law were made applicable, he and his wife would pay on a joint return twice the $120 tax that is due on an income of $5,000, or a total state tax of $240. Thus there would be a saving of $130 in tax. This is the maximum saving that could be obtained from "split income" under the present Virginia tax rates by a married couple, since the tax on any income above $5,000 is at the maximum rate of 5%.

If the combined taxable income of husband and wife were $ 3,000 or less, no tax reduction would flow from "split income" since the entire income would be taxable at the rate of 2%, whether received by one spouse or the other. With combined income between $3,000 and $10,000, some tax would be saved, in amounts ranging up to $130 per couple, unless in fact their separate incomes were identical in amount.

Of course, if both husband and wife have separate income of at least $5,000, no reduction in tax would result from enactment of "split income", since by filing separate returns each spouse would have the full benefit of the lower rates on the first $5,000 of income.

[5] The Commission also believes it would be appropriate to provide in the new law a credit patterned after the federal retirement income credit contained in Internal Revenue Code § 37.

[6] Int. Rev. Code § 2

[7] Poe v. Seaborn, 282 U.S. 101

It is not possible to determine accurately from available data the effect that "split income" would have had on the Virginia income tax revenue if it had been in effect in recent years. To make such a calculation one must know how much of family income is derived by one spouse and how much by the other. The present computer and other records maintained by the Department of Taxation do not permit of ready association of separate income tax returns of husband and wife, which are now processed and recorded separately. Available federal statistical data based upon joint federal income tax returns cannot be used without adjustment because it does not show the separate taxable income for each of the spouses.

The Commission was able, however, to obtain data from New York State income tax authorities as to the division of income between spouses in that state since New York permits married couples to file a so-called "combined" return, reporting their separate incomes and making their separate tax calculations on a single form. Using a combination of that data and other data obtained from the Internal Revenue Service regarding federal returns filed in Virginia, computer calculations were made as to the estimated loss in revenue that would have resulted had "split income" been in effect for Virginia income tax purposes in 1964, the latest year for which the data was available. Compared with actual Virginia personal income tax revenue of $129 million for 1964, the estimated loss for that year would have been more than $10 million, or in excess of 7% of the revenue. Based upon estimated income levels for 1968, the indicated revenue loss would increase to more than $15 million in 1968.

Because of the size of the indicated loss from enactment of "split income" and the state's present need for revenue, the Commission concluded that it could not recommend adoption of the split income concept in the state law at this time if the present rates of income tax are to be retained. However, if a conforming state income tax law is enacted without the split income provision, the income tax returns for the first year of its operation should provide more reliable data from which the potential loss of revenue that would stem from split income could be more accurately predicted. The Commission recommends that the matter of split income be reconsidered when such data is available.

Although the Commission does not recommend the adoption at present of the split income rule of the federal law, the Commission does recommend changes which will permit the use of a simplified Virginia income tax return for a married couple filing a joint federal return.

At present it is to the advantage of a married couple, after preparing a joint federal return,[8] to file two separate returns in Virginia if their aggregate taxable income exceeds $3,000 and if each of them has more than $1,000 of income. This will frequently be the case where the wife is employed or has more than $1,000 of investment income.

The Commission recommends that the Virginia law permit husband and wife to file a single return, to be called a "combined return",

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[8]Husbands and wives filed 39.3 million joint federal income tax returns for the year 1965 throughout the United States, as compared with only 2.9 million separate returns. 1965 Internal Revenue Service Statistics of Income, Individual Income Tax Returns, p. 2. For the state of Virginia 810,538 joint federal returns were filed out of a total of 1,415,831, but the latter figure includes returns of unmarried persons as well. *Id.* at 102.

in which their separate incomes would be stated in parallel columns, but either spouse would be permitted to claim all or any part of the nonbusiness deductions to which either is entitled. Thus it would not be necessary to determine whether husband or wife paid such deductible nonbusiness items as contributions, interest, taxes, medical expenses, etc.; if the husband's income is the higher he could deduct in his column all of such items, whether they were paid by his wife or by himself. Generally these items would merely be transferred from the federal joint return onto the state combined return in the column for the spouse having the higher income.

Similarly, either spouse would be allowed to claim the personal exemptions for dependents, regardless of which spouse furnished the support.

The income tax of each spouse would be calculated separately in the two columns. Any overpayment by one spouse, whether because of withholding or estimated tax payments, could be applied to the tax liability of the other spouse, if both of them so desired.

Payments of estimated tax, whether made in joint or separate declarations of estimated tax, could be applied as the spouses wished on a joint or combined return or on separate returns.

More than 800,000 joint federal returns were filed by married persons in Virginia for the year 1965. Not only would the combined state return form be more convenient for married taxpayers filing joint federal returns than two separate state returns, but from an administrative standpoint there would be a reduction in the number of returns of married persons to be processed, audited and assessed and a reduction in mailing of forms, notices of payments due, receipts and other correspondence.

The combined return for married persons has been used successfully in New York and in Wisconsin, both of which have conformed their state income tax laws generally to the federal in recent years without enacting split income. It has recently been adopted in Maryland and Kentucky for returns due in 1968 on 1967 income.

The combined return ordinarily would be used only if the married couple (1) has net taxable income (after all deductions and personal exemptions) above $3,000 and (2) each spouse has income exceeding his own exemption of $600. If their joint net taxable income is less than $3,000, or if one spouse has income of less than $600, they ordinarily would pay no greater tax if they filed a joint return. In that event they could merely transfer their net figures from the federal return to the state return without separating their gross income figures into two columns and without making separate tax calculations.[9]

7. *Transitional items*. Provisions would be made in the new law for adjustments to prevent the inclusion in income after the effective date of the new law of any items which were required to be included in income for an earlier period under the present Virginia law; and, similarly, provision would be made to prohibit deduction of any item under the new law which was deductible in a prior period under the

[9] The report of the Department of Taxation for the fiscal year ended June 30, 1967 shows that approximately 58% of Virginia individual and fiduciary income tax returns filed for the year 1965 showed taxable income of less than $3,000 (calculated under present law). This included 209,906 nontaxable returns and 600,818 returns with net taxable incomes less than $3,000, out of a total of 1,404,272 returns.

present Virginia law.[10] These provisions would merely avoid taxing under the new law income that has been taxed earlier under the old law, or giving a deduction a second time for the same item, due to a difference between the time of inclusion of income or the time for taking a deduction under the present state law as compared with the federal law.

Other possible variances from the federal law considered by the Commission but not recommended. The Commission gave considerable study to other items of income and deduction which are handled in the federal law in a different manner from the state law. Among the items to which the Commission gave particular consideration were personal exemptions, standard deductions, capital gains and losses, net operating loss carry-backs and carry-overs, small business corporations and tax bases of assets.

In general, the Commission believes that the number of adjustments to be made to the federal calculation of net income should be held to a minimum, because the simplicity of the recommended new tax return form and the ease of compliance and administration is reduced to the extent that adjustments are needed to convert federal net income to state net income. The advantages of a conforming state law would disappear rapidly if it were to require numerous adjustments to the federal return.

1. *Personal exemptions and standard deductions.* In general, the state law allows a personal exemption of $1,000 for the taxpayer and if he is married, another exemption of $1,000 for his wife if she has no gross income or if a joint return is filed. It also allows an additional exemption of $600 if the taxpayer is over age 65 or blind, and allows a similar increase in the exemption for a spouse who is over age 65 or blind. In addition, an exemption of $200 for each dependent is allowed; and commencing January 1, 1968 this exemption will be increased from $200 to $300.

The federal law, on the other hand, allows a personal exemption of $600 per person, with an additional exemption of $600 for a person over age 65 or blind and an additional $600 in respect of a spouse over age 65 or blind. It makes no distinction between the exemption for dependents and that for the taxpayer or his spouse. There are certain other differences in particular cases between the federal and state laws in respect of personal exemptions for dependents.

In essence conformity to the federal rules regarding personal exemptions will produce a reduction in the personal exemption for the individual and his spouse but an increase in the personal exemption for dependents. The net effect of the change would be to reduce somewhat the personal exemption for an unmarried person without dependents, and for married persons with one dependent, but to increase them for married persons with three or more dependents. The differences in personal exemptions are shown below (assuming all individuals are neither over 65 nor blind).

Status	Present State Law	State Law Effective Jan. 1, 1968	Proposed Conforming Law
Single person, no dependents	$1000.00	$1000.00	$ 600.00
Married couple, no dependents	2000.00	2000.00	1200.00
Married couple, one dependent	2200.00	2300.00	1800.00
Married couple, two dependents	2400.00	2600.00	2400.00
Married couple, three dependents	2600.00	2900.00	3000.00
Married couple, four dependents	2800.00	3200.00	3600.00

[10] For example, deductions for net capital losses are limited to $1,000 under federal law with a carry-over to subsequent years of the unused portion. Under present state law they are allowable in full in the year realized. Net capital losses allowed on state returns under present law should not again be allowed as carry-overs under the conforming law in a later year.

In weighing the advantages of a conforming law against the continuation of the present Virginia personal exemption schedule the Commission took into account the fact that the conforming law would simultaneously liberalize various other deductions, particularly in the low to middle income brackets. In particular, although personal exemptions would be decreased for single persons or smaller families, the standard deduction, which is used primarily in the low and middle income brackets, would be doubled from 5% of adjusted gross income to 10% of adjusted gross income. Moreover, the maximum standard deduction, now $500 under the state law, would be increased to $1,000.[1] For example, a single person, without dependents, who has an adjusted gross income of $4,000 would have his personal exemption reduced by $400, but would obtain an increase in the standard deduction from $200 to $400; his net additional tax would be $4. A married couple with two dependents and an adjusted gross income of $6,000 would have the same personal exemptions as under present 1967 law and an increased standard deduction of $300, resulting in a tax reduction of $9.[2]

Moreover, there would be introduced into the state law the federal provisions for a "minimum standard deduction", under which the standard deduction cannot be less than $200 plus $100 for each $600 exemption allowable on the return. Thus a single person, without dependents, would pay no tax under the proposed conforming law unless he has at least $900 of income ($600 personal exemption plus $300 minimum standard deduction). In addition, there would be further liberalization by allowance of exclusion for "sick pay", allowance of moving expenses of employees, increases in medical expense deductions through lowering the "floor" for medical expense deductions from 5% to 3% and other changes.

Necessarily a change in the personal exemption structure and the standard deduction structure will cause some increase in the tax of certain taxpayers and decrease in the tax of others. The Commission's studies indicate that in net effect there will be a relatively small reduction in income taxes, but that it will not have a material effect upon the revenue of the state.

2. *Capital gains and losses.* The present state law makes no distinction between capital gains and ordinary income, nor between capital losses and ordinary losses. Thus capital gains, whether long-term or short-term, are taxable in full, and capital losses are allowable in full as deductions. Federal law, on the other hand, takes into income only half of net long-term capital gains (with a maximum tax of 25%) and limits the deduction for net capital losses to $1,000 with a carry-over of unused capital losses to subsequent years.

The present Virginia rule regarding capital gains and losses is simpler than the federal rule, for it eliminates the need for distinguishing between capital gains and losses on the one hand and ordinary income and deductions on the other. Especially since the maximum state income tax rate is 5%, the simpler state rule might seem preferable.

Nevertheless, every taxpayer in the state must make these distinctions for purposes of his federal income tax, and then make separate calculations for state purposes. To the extent his investment decisions are affected by income tax considerations they are made primarily with the

[1] In the case of married persons filing separate returns, the maximum standard deduction for each spouse is $250 under present state law. This figure would be raised to $500.

[2] Under the law enacted in the 1966 General Assembly to take effect in 1968 and thereafter, the personal exemption for the two dependents would be increased a total of $200. The conforming law would produce a net reduction of $3 for this couple in relation to their 1968 tax.

federal tax in mind because of its higher rate structure, despite the different result under the state tax.

The Commission concluded that overall the greater simplification for taxpayers would flow from conforming the state rules for capital gains and losses to the federal. Not only would this be so, but use by the state of federal audit and enforcement information with regard to capital gains and losses would be greatly improved if the state rules were brought into conformity with the federal.

Net capital gains reported on Virginia individual income tax returns in recent years appear to have been below those reflected on federal returns, after allowance for the differences in the rules under the two laws.[3]

In addition, conformity to the federal rules as to tax basis of assets will eliminate the differences between federal and state rules regarding property received by gift or bequest. As an illustration, at present if father buys stock for $10, gives it to his daughter when it has a value of $15 and the daughter later sells it for $18, the daughter has $8 of gain for federal tax purposes but only $3 for state purposes. Yet if the stock had a value of $6 instead of $10 when the gift was made her gain for state purposes on the sale would be $12 as contrasted with the $8 gain for federal purposes. The Commission believes that minor differences of this type are confusing to taxpayers, who must contend with both calculations, and should be eliminated.[4]

Effect of conformity on state income tax revenue. The state income tax now produces almost two-thirds of the general fund revenues of the Commonwealth. The estimates of revenue published at the close of the 1966 General Assembly showed that of an estimated $436 million of general fund revenues for the current fiscal year ending June 30, 1968, $215.5 million (49.4%) was estimated to be derived from income tax on individuals and fiduciaries and $60 million (13.8%) from income tax on corporations.[5]

The state income tax revenues have been increasing rapidly.[6] The steady growth may be seen in receipts as reflected in the Reports of the Department of Taxation for the past three years:

[3] Thus for the year 1965 net capital gains on state income tax returns aggregated $255 million, while those on federal returns filed in Virginia aggregated $184 million (after reducing net long-term capital gains by 50%). If the $184 net gains reported on the federal returns are adjusted to the Virginia rules, indications are that substantial additional net capital gains should have appeared on the Virginia returns.

[4] The recommended new law would also conform to the federal rules regarding carry-back and carry-over of net operating losses, except that there would be no carry-backs to years before the effective date of the new law and no carry-forward of losses incurred before that date. The new law would also conform to the federal rules regarding income and loss of "Subchapter S corporations."

[5] The budget figures are based upon revenues for the state's fiscal year ended June 30. The revenues for recent fiscal years, stated at the time of the 1966 General Assembly, were as follows (in millions of dollars):

	Income Tax on Individuals and Fiduciaries	Income Tax on Corporations
June 30, 1964 (actual)	$127.8	$34.2
June 30, 1965 (actual)	141.6	39.8
June 30, 1966 (estimated)	163.0	46.2
June 30, 1967 (estimated)	187.5	52.5
June 30, 1968 (estimated)	215.5	60.0

The fiscal year revenues from individuals embrace taxes on income received by the individuals in two calendar years. For example, withholding taxes and estimated tax payments for income of a particular calendar year will generally be paid in part in the first six months of the calendar year.

[6] Per capita income in Virginia increased from $1,841 in 1960 to $2,419 in 1965 and a preliminary estimate of $2,581 in 1966. Statistical Abstract of the United States, 1967, p. 327.

Income Tax on Individuals and Fiduciaries		Income Tax on Corporations	
Returns filed for Income Year:	Taxes Assessed (Millions)	Assessments For Year Ended June 30:	Taxes Assessed (Millions)
1963	$113.4	1965	$40.1
1964	129.4	1966	48.2
1965	148.8	1967	49.6

The Commission has given extensive consideration to the effect upon the state income tax laws of conforming the Virginia income tax system generally to the federal rules. With respect to the individual income tax, the Commission was able to compare statistical data taken from Virginia personal income tax returns with those taken from federal individual income tax returns filed in the state of Virginia.[7] The data from returns for the calendar year 1965, the latest year for which it is available, is as follows (dollar figures are stated in millions):

	Virginia Returns[8]	Federal Returns in Virginia[9]
Number of returns filed	1,372,497	1,415,831
Salaries and wages	$6,590	$7,174
Business profit and loss (net)	322	388
Farm profit and loss (net)	15	159
Capital gain and loss (net)	255	184[10]
Other income	773	737
Adjusted gross income	$7,955	$8,498
Nonbusiness deductions	$ 909	*[1]
Personal exemptions	2,333	2,428
Taxable income	4,877	4,979

As will be noted from the last line above, the net taxable income on 1965 federal returns filed by individuals in Virginia was slightly more than $100 million in excess of the taxable income reported on Virginia state income tax returns. Similarly, the federal taxable income exceeded the state taxable income for the year 1964 by $84 million and for the year

[7] The Virginia return data was furnished by the Department of Taxation from its computer records; the federal data is published in the Internal Revenue Service Statistics of Income for Individual Income Tax Returns.

[8] The Virginia figures include returns of fiduciaries as well as individuals. The latest available federal statistics for federal fiduciary income tax returns filed in Virginia are for the year 1962. They show 9,858 fiduciary returns reporting $59 million of total gross income and $11 million of taxable income. Internal Revenue Service Statistics of Income, 1962, Fiduciary, Gift and Estate Tax Returns, p. 30.

[9] Internal Revenue Service Statistics of Income for 1965—Individual Income Tax Returns, pp. 89, 90 and 102.

[10] The federal figure is stated after reduction for 50% of net long-term capital gains.

[1] Federal total of nonbusiness deductions not available.

1963 by $48 million. The excess in each of the three years 1963-1965 amounted to about 1% to 2% of the total.[2]

Conforming to federal dates of payment of withholding taxes on salaries and wages. Until January 1, 1963 Virginia did not require withholding by employers of income tax at the source on salaries and wages or require advance payment of estimated income tax by individuals. The 1962 General Assembly instituted withholding and estimated tax payments for individuals in a manner quite similar to the then federal rules.[3]

With respect to payments of estimated tax by individuals, the requirement that the individuals pay one-quarter of their estimated tax on or before May 1, and another quarter by June 15, results in one-half of estimated tax revenues being received in the fiscal year of the Commonwealth ending shortly thereafter on June 30. The remaining two installments of estimated tax, and the final adjustment on the tax return, will fall in the following fiscal year of the Commonwealth. Thus, with respect to payments of estimated tax on income received in 1968 by an individual on a calendar year basis, two-fourths of his estimated tax payments will be received by the Commonwealth in its fiscal year ended June 30, 1968, and the balance in the fiscal year ended June 30, 1969—in the next biennium.

With respect to tax withheld on salary and wages, the employer is not required to pay over to the Commonwealth the withheld amounts until the close of the calendar month following the calendar quarter in which the salary and wage payments are made.[4] Thus the state withholding tax on wages and salaries paid during January, February and March in 1968 calendar year will be paid over to the state on or before April 30, 1968 and will go into the fiscal year of the Commonwealth ending June 30, 1968. However, tax withheld on salary and wages paid in April, May and June, 1968 will not have to be paid over to the state until July 31, 1968 and hence unless voluntarily paid earlier will not go into revenue of the state until the next fiscal year, which will end June 30, 1969, in the 1968-1970 biennium. As a result, one-quarter of the withholding tax revenue in Virginia is now deferred from the fiscal year of the Commonwealth in which the tax is withheld from employees until the Commonwealth's following fiscal year, in which the employer pays over the withheld amounts to the Commonwealth.

Since the time when this withholding system was enacted in 1962 to correspond with the then federal system, the federal government has modified the requirements as to the time in which many employers must pay over the withheld tax to the government. The federal Treasury Department, by regulation under a general authorization in the Internal Revenue

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[2] Through the use of computer tapes made available for research purposes by the Internal Revenue Service, an effort has been made to determine the Virginia income tax that would have been payable at Virginia personal income tax rates under a Virginia law conforming to the federal determination of net income. No such determination can be made with accuracy because as noted earlier, the federal law permits married couples filing joint returns to compute their tax on a "split income" basis, whereas the Commission recommends that "split income" not be allowed under a Virginia conforming law and the federal returns do not show the actual separate income of husband and wife. The calculations indicated for the year 1964 that as compared with state income tax revenue of about $124 million on resident individuals, the revenue from individuals under a conforming law without "split income" would have amounted to a figure between $113 million and $135 million, depending upon the assumption made as to the division of joint return income between husband and wife. (The actual income tax revenue from all individuals and fiduciaries for 1964 amounted to $129 million, but some $1 million tax was obtained from nonresident individuals and an estimated $3 million from fiduciaries, leaving an estimated revenue of $124 million from resident individuals only.)

[3] Va. Code § 58-151.1 *et seq.*

[4] Va. Code § 58-151.13(a).

Code.[5] now requires that any employer who owes to the federal government, in respect of salaries or wages paid to his employees in any calendar month, more than $100 for income tax withheld from the employees and certain Social Security taxes, must remit those amounts to a bank depositary for the account of the federal Treasury by the fifteenth day of the following month.

The effect of this change in the federal system is to expedite the flow of withholding tax monies into the government, and as a part thereof to bring the withholding tax amounts for the months of April and May into the revenue of the government for its current fiscal year by requiring payment by May 15 and June 15 instead of deferring the receipt of such money until July, after the start of the next fiscal year of the government. In essence, two-twelfths of the withholding tax revenues are advanced to an earlier fiscal year. Moreover, beyond the matter of fiscal year revenue calculations, the withholding tax amounts for the first month of each calendar quarter are advanced in payment date by two and a half months and the amounts withheld in the second month of each calendar quarter are advanced in payment by one and a half months.

Within recent months the federal government has further advanced the payment dates for employers who withhold from employees more than $2,500 monthly by requiring payment over of the withheld taxes to be made twice each month. This will bring into revenue in the month of June taxes withheld by large employers in the first half of June.

For calendar year 1965 income tax returns the total individual income tax revenue derived by the Commonwealth from resident individuals and fiduciaries was $149 million,[6] of which $118 million,[7] or about 80%,[8] was withheld by employers from salary and wages. The taxes withheld in the months of April and May, 1965, assuming those amounts to have been about two-twelfths of the total withheld for the entire year 1965, would have amounted to some $19.7 million. Except for amounts due from employers withholding less than $100 of federal tax monthly, if the federal payment dates had been in effect for state withholding purposes, that amount of $19.7 million would have been received by the Commonwealth in its fiscal year ended June 30, 1965 rather than in its fiscal year ended June 30, 1966.

In addition, those employers withholding more than $2,500 in federal taxes monthly would have paid over to the Commonwealth in its fiscal year ended June 30, 1965 the tax withheld from employees in the period June 1 to June 15, 1965. It would seem likely that those amounts would exceed the amount of taxes withheld in April and May by employers withholding less than $100 monthly.

In the budget for the current 1966-1968 biennium the projected income tax revenue from individuals and fiduciaries for the fiscal year ended June 30, 1968 is estimated at $215.5 as compared with some $149 million for the calendar year 1965. With such an increase in revenue it may be estimated that the amount of withholding tax revenue that would be advanced into an earlier fiscal year would be some $28.5 million if the federal payment dates were adopted in 1968. If the steady increase in revenues from individual income tax continues, some $2 million or $3 million of additional withholding tax from increased salaries and wages would be advanced in payment each year from July to May and June. There would be a continuing benefit to the state throughout the year in the earlier receipt of revenue.

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[5] Internal Revenue Code, § 6302 (c).

[6] Report of Department of Taxation, Year Ending June 30, 1967, p. 21.

[7] Data supplied from Department of Taxation computer print-outs.

[8] Federal budget data also shows that about 80% of federal individual income tax revenue is derived from withholding.

The Commission recommends that, as a part of the program of conforming the state law to the federal, employers be required to pay over to the state government state income taxes withheld from employees at the same time as they are required to pay to the federal government federal income taxes withheld from employees. As a part of the conforming law, employers will benefit from elimination of administrative problems in withholding under different sets of personal exemptions and other rules for federal and state taxes. The amounts involved represent monies withheld from the earnings of employees, and properly should be paid over promptly to the state government, for whose benefit they have been withheld.

Advance payments of estimated state corporate income tax. For some years the federal government has required corporations with more than $100,000 of federal income tax to file estimated tax returns in advance and to make four quarterly payments on the estimated tax during the year in which the income is derived.[9] The federal estimated tax payment system for corporations is similar in general to that for individuals, except that it is required only with respect to estimated corporate income tax in excess of $100,000. Corporations filing returns on a calendar year basis and estimating tax liability above that amount file an estimated income tax return on April 15 of the year in which the income is derived, and pay one-fourth of the estimated tax on the 15th day of April, June, September and December; and their final return is due on March 15 of the following year, at which time they make whatever additional payment is finally determined to be due or become entitled to a refund of any excessive advance payment.

The Virginia income tax law requires a corporation which prepares its returns on the basis of a calendar year to file its Virginia income tax return by April 15 of the following year[10] (unless an extension is granted), and provides that the entire tax shall be paid to the state Treasurer within 30 days after the Department of Taxation has audited the return and mailed a bill therefor to the corporation; but the law further provides that no tax on a calendar year return shall be due before June 1 following its close.[1] The returns of fiscal year corporations are due on the 15th day of the fourth month following the end of their income year, and the entire tax is payable within 30 days after the return has been audited and a bill sent to them.[2]

Thus large corporations subject both to the federal and Virginia income tax are now paying their federal income tax primarily in the year in which the income is earned but are paying their Virginia income tax in the following year. A large corporation filing a return on a calendar year basis for the income year 1967, for example, is paying two quarterly installments of federal estimated income tax for 1967 on April 15 and June 15, 1967, these revenues being includible in the fiscal year of the federal government ended June 30, 1967. However, none of its Virginia income tax on 1967 income is payable to the state until after June 1, 1968, and hence its entire tax on 1967 income is includible in the fiscal year of the state ended June 30, 1968.

Most corporations keep their books and file their returns on the basis of an accrual method of accounting. Such corporations will accrue as a deduction in determining their federal income tax for 1967 the tax payable to the state of Virginia on their 1967 income, and thus reduce their federal income tax payments of estimated tax made in 1967, even though they are not paying the state tax until June, 1968.

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[9] Internal Revenue Code, §§ 6016, 6074, 6154 and 6655.
[10] Va. Code, § 58-134.
[1] Va. Code, § 58-151.
[2] Va. Code, §§ 58-135 and 58-151.

The Commission recommends that corporations which are required to make payments of estimated income tax to the federal government be required similarly to make current payments of estimated Virginia income tax.

Under federal law only corporations estimating a federal income tax liability in excess of $100,000 are required to pay their federal corporate income tax on an estimated basis in advance. Under the present federal corporate income tax rate structure corporations must generally have taxable income above $221,875 in order to have a federal income tax liability above $100,000.[3]

The report of the Virginia Department of Taxation for the fiscal year ended June 30, 1967 shows that 18,098 corporations filed Virginia corporate income tax returns during that period.[4] Of these, 16,973 corporations had income of less than $100,000 and would not have been required to pay estimated federal tax. Of the remaining 1,125 corporations, 897 reported net income between $100,000 and $500,000 and paid aggregate Virginia income tax of $9.1 million; but the report does not indicate how many of such corporations would have been obligated to pay estimated federal tax. The balance of 228 corporations reported net income in excess of $500,000, and doubtless were required to pay estimated federal tax; these latter corporations paid more than $27.4 million in Virginia income tax, approximately 57% of the total corporate income tax revenue of the state.

Federal statistical data indicate that for the year 1966 less than 2% of corporations filing federal income tax returns paid estimated tax.[5] A similar ratio in Virginia would indicate that only about 360 corporations of the 18,098 now filing Virginia returns would have to pay Virginia estimated tax, but the data indicate that they would account for more than two-thirds of the corporate income tax revenue of $48.3 million[5a] received on filing of returns in the fiscal year ended June 30, 1967.

If corporations required to file federal estimated tax returns were required to file Virginia estimated tax returns also, and other rules were comparable to the federal law, they would pay in advance only to the extent that the estimated Virginia tax would exceed $10,000. A federal tax level of $100,000 for corporations would correspond roughly to a Virginia tax level of about $10,000.

At current levels of Virginia corporate income tax revenue, it is estimated that amendment of the Virginia law to require advance payment of estimated Virginia tax by corporations now required to pay estimated federal tax would advance to an earlier fiscal year returns of about $12 million.

In addition, as Virginia corporate income levels increase in the future a requirement of payment of estimated corporate income tax will continue to direct a substantial part of the increase in revenue into an earlier fiscal year of the Commonwealth.

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[3] In general, the present federal corporate income tax rates are 22% on the first $25,000 of taxable income and 48% on the balance. Int. Rev. Code § 11. Certain tax credits and adjustments can affect the net amount of federal tax.

[4] Report, p. 7.

[5] Annual Report of Commissioner of Internal Revenue, 1966, p. 14.

[5a] A further amount of $1.2 million was assessed on audit additions made by the Department of Taxation. Report of the Department of Taxation for the Fiscal Year ending June 30, 1967, p. 7.

The amount of revenue accelerated through institution of estimated corporate tax payments on a basis similar to the federal will depend not only on the level of Virginia corporate income at the time, but upon possible future changes in the federal rules. The President has asked the Congress to require estimated returns for the entire corporate tax and not merely the portion above $100,000; and has also asked that the estimated tax be at least 80% of the final tax instead of the present 70%.[6] These changes are designed to make estimated federal tax rules for corporations comparable to those for individuals. The Congress has not yet acted on the President's proposal. While the state's requirements for estimates need not be identical with the federal, the Commission considered that such conformity is desirable because the estimated returns would be required only from those corporations which must in any event carry out the estimating procedures for federal purposes.

A survey of requirements in other states indicates that eighteen states require payment of estimated corporate income taxes and that eleven states require monthly payment of taxes withheld on salaries and wages. While some of the states conform fully to the federal rules, others require accelerated payments under different rules.

The Commission's studies indicate that as a result of both of these recommended changes to conform to federal payment dates on withholding and corporate tax payments the amount of revenue that would be advanced to an earlier fiscal year would be some $40 million, consisting of an estimated $28 million with respect to withholding and $12 million with respect to corporate tax.

The Commission recommends no change in the present dates for filing final Virginia individual and corporate income tax returns. The Virginia individual returns are now due May 1 as compared with a federal filing date of April 15; and the Virginia corporate returns are due April 15 as compared with a federal date of March 15, if the taxpayer is on a calendar year basis. The added time for final state returns is a convenience to which taxpayers are accustomed and the Commission believes it should be preserved.

Type of conformity statute and constitutional issues. Most of the state income tax laws that conform to the federal law provide for the calculation of state taxable income by reference to the federal statutory rules for determining income, and then apply state income tax rates to the taxable income so determined. Some of the states, however, such as Alaska, Nebraska and Vermont, provide that the state income tax on individuals shall be a specified percentage of their federal income tax. While such a system at first blush would seem to achieve maximum simplicity in preparation of state returns, each of these states provides for adjustments to federal taxable income in certain cases; and where the adjustments are applicable the system requires an artificial calculation of federal tax to which the state percentage is applied.

Moreover, the state tax liability and state revenues would be affected by increases or decreases in federal tax rates.[7] This might create difficul-

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[6] Budget of the United States, 1968, p. 61; see Int. Rev. Code § 6655.

[7] The Alaska individual tax is 16% of the federal tax calculated at the federal rates existing on December 31, 1963. This eliminates the effect of the 1964 federal rate reductions, but detracts substantially from simplicity. Alaska Statutes, § 43.20.010. The Nebraska law provides that the applicable percentage of the federal tax is to be fixed each year by a state board. Nebraska Revenue Act of 1967, § 15(1). The Vermont law enacted recently defines the federal tax so as to exclude any "surtax" upon the federal tax, doubtless having in mind the current uncertainty as to the imposition of a federal surcharge. Vermont Statues, § 5811(4).

ties if federal rate changes occurred between biennial sessions of the legislature, and it is eliminated as a factor if state tax rates are applied to federal income.

In addition, fixing the state tax as a percentage of the federal tax makes the progression of the federal tax rate structure applicable for state purposes.

For these and other reasons, the Commission recommends that the current Virginia income tax rates continue to be applied, and that general conformity to the federal law be achieved by applying those rates to the taxable income as determined under the Internal Revenue Code, subject to the few adjustments noted earlier.

As to the method of accomplishing this result in the Virginia law, it would be possible, of course, to enact a Virginia statute that sets out verbatim the income tax provisions of the federal Internal Revenue Code. The Commission recommends, however, that the state law be framed by referring in the state law to the applicable provisions of the federal Internal Revenue Code for the determination of net taxable income, and specifying the few adjustments to be made to convert the federal net income to Virginia net income. This would eliminate the need for enacting a lengthy and bulky addition to the Virginia Code to set out the federal Code word for word.[8] With minor exceptions every taxpayer in the state who would owe Virginia income tax under the recommended state law would already be subject to the income tax provisions of the federal Internal Revenue Code, has ready access to the federal law and is as familiar with its terms as if it were set forth verbatim in the Virginia Code.

The Constitution of Virginia contains a sentence in Section 50, prescribing the requirements for enactment of laws by the General Assembly, that

> "Every law imposing, continuing or reviving a tax shall specifically state such tax, and no law shall be construed as so stating such tax, which requires a reference to any other law or any other tax."

The consultant to the Commission has advised that, in his opinion, in the light of the history and purpose of this sentence and pertinent precedents, a Virginia income tax law conforming to the federal income tax law in the manner recommended herein by reference to the determination of taxable income in the federal law would not violate this constitutional provision. The Consultant's memorandum reviewing the constitutional aspects and setting forth his opinion will be submitted to accompany this report.

In view of the importance of the income tax revenues to the general fund of the state, it is apparent that no risk may be incurred of possible unconstitutionality of the recommended law. Accordingly, as the opinion of the consultant advises, the Commission recommends that a test case be brought before the Supreme Court of Appeals of Virginia in advance of the effective date of the recommended new state income tax law to obtain a judicial decision as to its constitutionality.

The Commission has considered carefully the further question whether the recommended conforming state income tax law should refer to the provisions of the federal income tax law as they exist on a specified date prior to the enactment of the new Virginia law (a "fixed base"), or

[8] The New York City personal income tax law does contain the income tax provisions of the Internal Revenue Code as an appendix.

whether it should refer to the federal law as it may be amended from time to time by the Congress (a "moving base"). A state law that conforms to the federal law as to a specified date (herein referred to as a "fixed base") has the advantage of certainty and eliminates any risk of change by the Congress that might affect the income tax revenue of the state or alter the state tax of any taxpayer. On the other hand, it has the disadvantage that as amendments to the federal law for calculation of net income are inevitably made from time to time by the Congress, the adjustments that must be made on the state return increase in number and extent, the state law becomes outmoded and the advantages of conformity are eroded. About half of the nineteen states having conforming income tax laws have adopted a "fixed base" and the other half have adopted a "moving base".[9] Those states which have adopted the "fixed base" have periodically updated the state law through action by the legislature to conform the state law to the federal law as of a more recent date.

The Commission has reviewed the federal amendments to the Internal Revenue Code back to 1960 and has found no evidence of serious dislocations to the revenue of the State or Virginia taxpayers that would have occurred if Virginia had conformed to the federal definition of income on a "moving base" during that time. During that period serveral major federal income tax laws were enacted as amendments to the Internal Revenue Code, including the Revenue Acts of 1962 and 1964, as well as a number of minor laws. The Commission believes that the advantages to taxpayers and to the Commonwealth of a steadily conforming law outweigh the risk of possible dislocations that might occur as a result of future federal changes in the definition of taxable income. If a serious change should occur, the General Assembly can eliminate the effect of the federal change by amending the Virginia law to require an offsetting adjustment to federal taxable income.

As the memorandum from the Commission's consultant discusses, there is a possible constitutional question whether, assuming that the adoption of a "fixed base" is constitutional, the adoption of a "moving base" in a conforming Virginia income tax law would constitute an unlawful delegation of legislative power by the General Assembly. The memorandum notes that precedents in Virginia case law on this issue are few, but the consultant expresses the view that such a provision is constitutional.

This constitutional question, the Commission believes, should also be resolved by a test case in the courts before the new law becomes effective.

If the "moving base" provision were held unconstitutional the Commission would nevertheless recommend the adoption of a "fixed base" law that conformed to the federal law as it exists on December 31, 1967. Hence the Commission recommends that the Virginia law contain provisions such that if the incorporation of future federal amendments to the definition of taxable income were held unconstitutional, the federal law existing on December 31, 1967 would be applicable. The General Assembly could then update the Virginia law from time to time to incorporate federal amendments so as to accomplish substantially the same result.

Effective date. The Commission recommends that the new conforming law be made effective with respect to the income of taxable years beginning after December 31, 1969 (calendar years 1970 and thereafter).

[9] Two states, Wisconsin and Vermont, permit a taxpayer in effect to calculate his state tax by reference to the "fixed base" if subsequent amendments by Congress would cause him to pay a greater state tax.

Postponing the effective date until that time should provide adequate time for the constitutional tests mentioned above, for the orderly preparation of new forms and instructions and the institution of new withholding rules and other administrative procedures.

ACKNOWLEDGMENTS

The Commission wishes to express its appreciation to Mr. Cohen, to those of his students who developed much background material for the Commission, to those groups who presented their suggestions and views at the hearing and in writing and to the State Department of Taxation for their time and efforts spent on behalf of the Commission. Without the cooperation and advice of all these groups, the Commission would have been unable to conduct its study with the thoroughness necessary to permit the development of this Report.

Respectfully submitted,

D. French Slaughter, Jr., *Chairman*
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DISSENTING STATEMENT BY C. H. MORRISSETT AND GEORGE D. FISCHER

The Commission, by a majority vote, is recommending that Virginia net taxable income be made the same as Federal net taxable income computable under the income tax provisions of the Internal Revenue Code as it may be amended from time to time, with various additions to, and subtractions from, Federal net taxable income in order to arrive at Virginia net taxable income.

The adoption of this starting point in ascertaining Virginia net taxable income would be accomplished by references in the Virginia law to the Internal Revenue Code. In our opinion, this would be in plain contravention of the following sentence of Sec. 50 of the Constitution of Virginia: "Every law imposing, continuing or reviving a tax shall specifically state such tax, and no law shall be construed as so stating such tax, which requires a reference to any other law or any other tax."

The General Assembly, at its session of 1966, in recognition of the constitutional barrier, proposed an amendment to this section of the Constitution. (Acts 1966, p. 1576). The proposed amendment, however, merely eliminates the quoted sentence, with the result that, if the proposed amendment be concurred in at the session of 1968, and ratified in the November, 1968 general election, there would still remain the grave question of the unconstitutional delegation of legislative power to the Congress of the United States.

The State of New York was confronted with the same constitutional questions, and in order to pave the way for the legislature of that State to adopt "conformity", amended Sec. 22 of its Constitution on November 3, 1959, effective January 1, 1960. For convenience the section as so amended is quoted below:

> "Sec. 22. Every law which imposes, continues or revives a tax shall distinctly state the tax and the object to which it is to be applied, and it shall not be sufficient to refer to any other law to fix such tax or object.
>
> "Notwithstanding the foregoing or any other provision of this constitution, the legislature, in any law imposing a tax or taxes on, in respect to or measured by income, may define the income on, in respect to or by which such tax or taxes are imposed or measured, by reference to any provision of the law of the United States as the same may be or become effective at any time or from time to time, and may prescribe exceptions or modifications to any such provision."

The amendment added the second paragraph. It was thus in the affirmative and adequately covers both the reference question and the question of the unconstitutional delegation of legislative power.

From the foregoing it is quite apparent that the General Assembly of 1968 may desire to give consideration to non-concurrence in the amendment now pending and to propose another amendment similar to the New York amendment above quoted. This would clear the way for consideration of the policy question of "conformity" at the appropriate time, if the amendment is eventually ratified.

The policy of Virginia has been to parallel various acceptable provisions of the Federal income tax law, especially some provisions which were thought to have earned stability, and this policy, in our opinion, is wise and proper. We would hope for its continuance. This policy does not involve any abdication by the General Assembly of its law-making power over this major subject of State taxation, whereas a policy of blind "conformity" under a moving base would mean, in effect, that the Congress of the United States and not the Virginia General Assembly, would legislate for Virginia in the matter of State income taxation.

If there were no constitutional barrier to the adoption of "conformity" at this time, we would entertain grave doubt as to the net result, that is to say, whether the advantages would outweigh the disadvantages. The Federal income tax law is probably the most complicated tax law in the world. Conforming to it as the starting point in computing Virginia net taxable income would certainly promote more uniformity than now exists, but just as certainly it would not promote simplicity.

The vast majority of Virginia individual income taxpayers file simple returns at this time, and "conformity" would not make them any simpler. The same is generally true as to fiduciary returns, although naturally to a lesser extent. Corporations, whenever they so desire, file their State income tax returns with Federal net taxable income as the starting point (computed in detail on the State return or attachments) and make the necessary adjustments, up and down; and in the case of corporations engaged in multi-State operations, before allocating and apportioning net income to Virginia.

Thousands of individual income taxpayers, especially those of means, do have complicated problems from time to time, and many of these seek advice and help from attorneys or accountants respecting their State returns the same as they do respecting their Federal returns. These taxpayers would need this professional help under "conformity" the same as now.

"Conformity," if ultimately adopted, would not in any way lessen the cost of State income tax administration nor simplify the same.

For the reasons hereinbefore set out, we cannot conscientiously sign the Report, and we regret our inability to concur in the views of the majority on the principal question.

Apart from the principal question, however, we look with favor on changes in the Virginia law to provide for monthly payments of the withheld State income tax by the larger employers, and a current income tax payment plan under which corporations having substantial net income would file declarations of estimated State income tax and pay the estimated tax in installments.

Respectfully submitted,

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George D. Fischer