

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Maddox Analyst: Darrine Distefano Bill Number: AB 2699

Related Bills: See Legislative History Telephone: 845-6458 Amended Date: 04-29-2002

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exclusion/\$5,000 of Military Pay

SUMMARY

This bill would exclude from taxation, up to a specific amount, military pay received by a member of the Armed Forces of the United States or the California National Guard.

SUMMARY OF AMENDMENTS

The April 29th amendments deleted all language regarding the definition of adjusted gross income and added the language discussed in this analysis.

PURPOSE OF THE BILL

The author's staff indicated the purpose of this bill is to provide a tax benefit to active members of the Armed Forces and the National Guard for their service to their country.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy. It would be effective immediately upon enactment and apply to taxable years beginning on or after January 1, 2002.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under federal and state laws, compensation received by a member of the Armed Forces is subject to income tax unless specifically excluded. Compensation received for any month while serving in a combat zone or qualified hazardous duty area is excludable. Other qualified military benefits that are excludable from income include:

- benefits paid by the Veterans Administration, such as disability compensation, pensions, educational assistance, etc.;
- certain medical benefits, military disability benefits, and various travel allowances; and
- dislocation allowances, temporary lodging allowances, and move-in housing allowances provided for a permanent change of station.

Board Position:

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Department Director

Date

Alan Hunter for GHG

5/9/02

Under current state and federal laws, a member of the Armed Forces of any country and the uniformed services of the United States may exclude from gross income amounts received as a pension, annuity, or similar allowance for personal injury or sickness resulting from active service.

THIS BILL

This bill would allow any member of the Armed Forces of the United States or the California National Guard or reserve unit within either of those organizations to exclude from gross income an amount not to exceed \$5,000 for any military pay received.

IMPLEMENTATION CONSIDERATIONS

This bill does not define the word "military pay." Military pay as used in this bill could include basic pay, special duty pay, retirement pay, bonuses, other types of compensation, and similar items. The author's staff has indicated that the intent of this bill is to limit the exclusion to military pay for active service and duty as a member of the National Guard or the Armed Forces. The language as drafted could be interpreted to include members who are retired.

Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

LEGISLATIVE HISTORY

Prior law (Stats. 1943, Ch. 147) allowed a deduction from gross income for all salaries, wages, bonuses, allowances, and other compensation received for service as a member of the Armed Forces for taxable years 1943 through 1948 (World War II). Stats. 1952, Ch. 12, reinstated the World War II exclusion but limited it to \$1,000 per year.

In 1971, another law (Stats. 1971, Ch. 1, Extraordinary Session) further limited the exclusion to compensation (other than pensions and retirement pay) received for service on extended active duty. For taxable years beginning on or after January 1, 1973, Stats. 1972, Ch. 1359, added an annual \$1,000 exclusion from gross income for pensions and retirement pay as well as for compensation for other than extended active duty. However, this exclusion was limited to taxpayers with adjusted gross income of \$17,000 or less.

AB 66 (Stats. 1985, Ch. 1461) increased the phase-out range to \$27,000 for taxable years beginning on or after January 1, 1985.

AB 4419 (Stats. 1986, Ch. 779) excluded from gross income up to \$500 per month received for active duty service pursuant to a Governor-declared emergency.

AB 53 (Stats. 1987, Ch. 1138) repealed each of these exclusions and established a tax credit, not to exceed \$40 in any taxable year, based on various types of military income. The credit was repealed by its own terms effective January 1, 1992.

AB 1365 (Oller, 1999/2000) would have excluded from gross income any military retirement pay, military disability pay, or any other benefits received by a person retired from the armed forces. This bill failed passage in the Assembly Revenue and Taxation Committee.

AB 2561 (Zettel, 1999/2000), and AB 1222 (Rod Pacheco 2001/2002) would have allowed a credit for taxpayers who received retirement pay as a result of active duty in the armed forces. AB 2561 died in Assembly Revenue and Taxation Committee while AB 1222 was amended to increase the dependent credit.

SB 1725 (Haynes, 1999/2000) and AB 294 (Zettel and Kehoe, 2001/2002) would have both provided that gross income would not include benefits and payments received under the federal Retired Serviceman's Family Protection Plan, the Survivor Benefit Plan, and the Supplemental Survivor Benefit Plan. SB 1725 died in the Senate Revenue and Taxation Committee, while AB 294 died in the Assembly Revenue and Taxation Committee.

AB 1766 (Maddox, 1999/2000) would have excluded from gross income any earnings received by an individual for active service as a member of the California National Guard. AB 1766 died in Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

New York and *Massachusetts* tax their residents for any military pay received during the taxable year. However, *New York* does not tax its residents for any tuition payments, subsistence allowances or any other benefits paid to a veteran or beneficiary that are excluded from federal gross income.

Research of *Illinois*, *Michigan*, and *Minnesota* laws found that these states do not tax their residents for any military pay, including any retired pay, received during the taxable year.

The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

If this bill is amended to resolve the implementation considerations addressed in this analysis, the bill would not impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, potential revenue losses are projected to be on the order of \$110 million per year beginning in 2002-3.

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

Revenue Discussion

The revenue impact of this proposal would be determined by the number of qualified taxpayers claiming this exclusion, the total exclusion amount, and the applicable state marginal tax rate.

According to the U.S. Statistical Abstract 2001, there were over 146,300 active duty military personnel in California in year 2000 (about 11% of the Department of Defense manpower in total). The number of CA military reserves was nearly 140,500 (by applying the same 11% to federal numbers). The number of enlisted California National Guard members was 21,000 of which over 5,000 were recently placed on active duty. As regarding retirees, U.S. Department of Defense reported 192,535 California military retirees on the 2001 payroll.

The total number of qualified individuals exceeds 500,000. This number was reduced by 25% (about 125,000 cases) to allow for non-taxable individuals.

If all the remaining 375,000 qualified taxpayers deduct the maximum \$5,000 from gross income and a 6% average marginal tax rate is applied, the potential revenue loss would be on the order of \$110 million per year.

ARGUMENTS/POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

LEGISLATIVE STAFF CONTACT

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