Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Anderson	Analyst:	Matthew Cooling	Bill Number:	AB 1077
Related Bills:	See Legislative History	Telephone:	845-5983	Introduced Date:	February 27, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Military Benefits Exclusion from Gross Income

SUMMARY

This bill would allow an individual to exclude retired pay and survivor annuities received as a result of active service in the military from gross income.

PURPOSE OF THE BILL

According to the author's office, the intent of this bill is to minimize the tax burden for retired military personnel and for surviving dependents.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Under federal and state tax laws, gross income excludes certain types of income for an individual's active service in the Armed Forces of the United States. These laws exclude from gross income, but are not limited to: military death benefits paid to qualified survivors, military pay for time served in combat zones, and the premium paid into a survivor annuity account for the qualified survivors of military personnel.

Board Position:			Department Director	Date
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THIS BILL

This bill would allow an individual to exclude from gross income retired pay received as a result of active service of a member of the Armed Forces of the United States. This bill would also allow individuals to exclude from gross income survivor annuities received as a result of active service in the Armed Forces of the United States.

This bill would define "retired pay" by reference to a calculation based on years of service, rank, and final base salary as an active member of the Armed Forces, as calculated by the Armed Forces Code.[1]

This bill would define "survivor annuities" as annuities payable based on retired or retainer military pay, which defines individuals qualified to receive survivor annuities, as calculated by the Armed Forces Code.[2]

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not impact the department's programs or procedures.

LEGISLATIVE HISTORY

AB 2952 (Mountjoy, 2003/2004) would have exempted, from income taxes for the year of the member's death, the first $50,000 of income of a surviving spouse of a member of the Armed Forces who dies in a military combat or terrorist action. This bill failed passage in the Senate Revenue and Taxation Committee.

SB 948 (Morrow, 2003/2004) would have exempted from inclusion in income all income of a spouse of a member of the Armed Forces who dies as a result of certain military-type actions for the year of the member's death and the following three years. This bill failed passage in the Senate Appropriations Committee.

AB 294 (Zettel and Kehoe, 2001/2002) would have allowed qualified individuals to exclude from gross income the amount of survivor annuities received as a result of active service in the Armed Forces of the United States. This bill failed to pass out of the house of origin by the constitutional deadline.

AB 2168 (Bogh, 2001/2002) would have allowed qualified individuals to exclude from gross income up to $10,000 of retirement income and benefits received by qualified individuals. This bill failed to pass out of the Assembly Revenue and Taxation Committee.

AB 53 (Klehs, Stats. 1987, Ch. 1138) repealed the pension and retirement pay exclusions as a result of active duty in the Armed Forces.

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

[1] Chapter 71 of Title 10 of the US Code, the Armed Forces Code
[2] Chapter 73 of Title 10 of the US Code, the Armed Forces Code

AB 339 (Barnes, 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 for taxable years beginning after December 31, 1972. This exclusion was limited to taxpayers with adjusted gross income of less than $17,000.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. *Florida* does not have a personal income tax.

Illinois allows taxpayers to exclude military retired pay from gross income. *Massachusetts* allows taxpayers to exclude military retired pay and survivor annuities, received as a result of active service in the Armed Forces, from gross income.

Michigan, Minnesota, and *New York* do not provide any exclusion similar to the ones proposed by this bill.

FISCAL IMPACT

Implementing this bill would not significantly impact the department's costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB1077 Military Benefits Exclusion from Gross Income As Introduced 2/27/09, Enactment Assumed After 6/30/09 [$ In Millions]		
2009-10	2010-11	2011-12
-$300	-$300	-$310

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

<u>Revenue Discussion</u>

The revenue impact of this bill would be determined by the amount of retired military pay and survivor annuities received by California taxpayers and the marginal tax rates of those taxpayers.

Based on available data from the United States Military Department of Defense, qualified military retirement payments and survivor annuity payments to California residents were approximately $4 billion for 2007. Payments are projected to increase to approximately $4.4 billion for tax year 2009 assuming an increase of 5 percent annually ($4 billion x 5% per year x 2 years ≈ $4.4 billion).

Applying an average marginal tax rate of 6.25 percent to projected payments for tax year 2009 would result in a revenue loss of approximately $276 million ($4.4 billion x 6.25% ≈ $275 million). Taxable year estimates are converted to cash-flow fiscal year estimates above.

LEGISLATIVE STAFF CONTACT

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