

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Soto Analyst: Colin Stevens Bill Number: AB 1664

Related Bills: See Legislative History Telephone: 845-3036 Amended Date: 4/14/99

Attorney: Pat Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Exclusion/Armed Forces Hazardous Duty Pay Area Compensation/Yugoslavia

## SUMMARY OF BILL

Under this bill, Yugoslavia (Serbia/Montenegro) would be added, as of an unspecified date in March 1999, to the definition of a qualified hazardous duty area for state income tax purposes, thereby providing combat zone tax relief to members of the armed forces performing services in Yugoslavia.

## SUMMARY OF AMENDMENT

The April 14, 1999, amendments remove the provisions of the bill as introduced March 11, 1999, and insert the provisions discussed in this analysis.

## EFFECTIVE DATE

This bill would take effect immediately and would apply as of an unspecified date in March, 1999. However, since the President has signed an Executive Order designating the Federal Republic of Yugoslavia, Albania, the Adriatic Sea and the Ionian Sea north of the 39<sup>th</sup> parallel as a combat zone, the changes contemplated by this bill are already in effect.

## LEGISLATIVE HISTORY

AB 1636 (Stats. 1996, Ch. 723) conformed to federal law providing combat zone tax relief to members of the armed forces in a "qualified hazardous duty area" (Bosnia-Herzegovina, Croatia and Macedonia) and combat zone tax postponements to individuals outside the United States performing services as part of Operation Joint Endeavor (Public Law 104-117).

## BACKGROUND

Both **federal and California laws** provide tax relief to members of the armed forces performing services in a combat zone and certain individuals serving in support of these members.

Service is performed in a "combat zone" only if performed on or after the date designated by the President by executive order as the date of the commencing of combatant activities in that zone.

On April 13, 1999, President Clinton signed an Executive Order (E.O. 13119) designating the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea and the Ionian Sea north of the 39<sup>th</sup> parallel as a combat zone. The order designated March 24, 1999, as the date of commencement of combatant activities in the zone.

Board Position:

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Department Director

Date

**Gerald Goldberg**

**5/12/1999**

On April 19, 1999, federal law was enacted to provide combat zone tax relief to members of the armed forces in a "qualified hazardous duty area" (Federal Republic of Yugoslavia [Serbia/Montenegro], Albania, the Adriatic Sea, and the northern Ionian Sea [above the 39<sup>th</sup> parallel]) and combat zone tax postponements to individuals outside the United States performing services as part of Operation Allied Force, effective March 24, 1999 (Public Law 106-21).

#### SPECIFIC FINDINGS

**State and federal laws** provide various tax benefits for members of the armed forces serving in a combat zone and for their spouses in the event the member in the armed forces dies or is missing in action. The provisions applicable to this bill will be discussed separately.

##### A. EXCLUSION FOR COMBAT PAY

**Federal law and state laws** exclude from income compensation received for active service by enlisted personnel in the U.S. Armed Forces for any month during which the member served in a combat zone or was hospitalized as a result of wounds, disease or injury incurred while serving in the combat zone. Combat zone compensation for commissioned officers is similarly excluded, to the maximum monthly amount allowed to enlisted personnel.

Service is performed in a "combat zone" only if performed on or after the date designated by the President by Executive Order as the date of the commencing of combatant activities in that zone.

##### B. WITHHOLDING

**Federal law** provides that for wage withholding purposes, compensation excluded from gross income as a result of service in a combat zone is excluded from wages subject to withholding of income tax.

**California** wage withholding is administered by the Employment Development Department and is governed by the provisions of the Unemployment Insurance Code (UIC) and federal law. The UIC provides that the term "wages" does not include remuneration paid to an employee to the extent not included in "gross income," as defined under the relevant provisions of the Personal Income Tax Law. Thus, if compensation received for active service by personnel in the U.S. Armed Forces is excluded from income for income tax purposes, no withholding on the excluded amount will be required under the UIC.

##### C. OTHER COMBAT ZONE PROVISIONS

###### 1. INCOME TAX EXEMPTION ON DEATH

**Federal and state laws** exempt from taxation all otherwise taxable income of: (a) active members of the U.S. Armed Forces who die while serving in a combat zone or as a result of wounds, disease, or injury incurred while serving in a combat zone; (b) certain individuals in missing status; and (c) military or civilian employees of the U.S. who die as a result of wounds or injury incurred outside the U.S. in terroristic or military action.

The above-described exemption applies for the taxable year in which the date of death falls and every preceding taxable year including the year the member first served in a combat zone, or in the event the member dies as a result of military or terroristic action, the forgiveness applies to the year injuries were incurred and the preceding taxable year.

2. SURVIVING SPOUSE TAX RATE WHERE DECEASED SPOUSE WAS IN MISSING STATUS

**Federal and state laws** provide several special rules relating to a surviving spouse and permit the surviving spouse, under certain conditions, to continue to file a joint return for the two years immediately following the tax year in which the military spouse died.

When an individual in missing status (MIA or POW) is officially declared dead and is removed from the missing status rolls, surviving spouse status does not depend on the actual date of death. The relevant date is the date of the official determination or, if earlier, the date that is two years after the date of official termination of combatant activities in that zone. If a later actual death is established, that date will control.

3. TIME FOR PERFORMING CERTAIN ACTS POSTPONED BY REASON OF SERVICE IN COMBAT ZONES

**Federal and state laws** extend the time for performing certain acts by reason of service in a combat zone by the period of service in the combat zone plus 180 days thereafter. That entire time period is disregarded in determining the amount of any credit or refund and whether various acts were timely. These acts include the filing or payment of any return of income, estate, or gift tax, filing a petition with the Tax Court for redetermination of a deficiency, or the review of a prior decision, allowance of or a suit for a credit or refund of any tax, assessment of any tax, notice and demand for the payment of any tax, collection of the amount of any liability with respect to any tax, bringing suit by the United States for any liability with respect to any tax, and any other act required or permitted as specified in regulations.

In addition, this provision specifies that the rules for earning interest on refunds still apply when the amount of interest to which an individual is entitled is calculated. This section also applies to the individual's spouse. Certain exceptions are provided for when tax is in jeopardy or for bankruptcy, receivership or certain transferred assets.

**By action of federal and state law,** the combat zone postponement is extended to individuals performing services as a part of Operation Joint Endeavor outside the United States while deployed from the individual's permanent duty station. (Operation Joint Endeavor is a military operation directed toward circumstances in Bosnia and Herzegovina, Croatia, and Macedonia).

In addition to conforming to these federal postponement provisions, **California law** contains an additional provision that specifies that an individual serving in the armed forces of the United States outside of the United States, even if not in a combat zone, is granted an automatic extension for filing a return and paying tax (except withheld income tax) until 180 days after returning to the United States. This unique California provision also applies to the individual's spouse.

Also, under this California provision, the period for performing the following acts is automatically extended for 180 days after the return to the United States of an individual serving in the armed forces outside of the United States:

- Filing a protest to a notice of proposed assessment issued by the Franchise Tax Board (FTB);
- Appealing the FTB's action on a protest to the State Board of Equalization;
- Filing a claim for credit or refund;
- Appealing the FTB's denial of a claim for credit or refund; and
- Filing an appeal if the FTB fails to act within six months of filing a claim for credit or refund.

#### 4. JOINT RETURN WHERE INDIVIDUAL IS IN MISSING STATUS

**Federal law** provides that a spouse of an individual in a missing status as a result of service in a combat zone may elect to file a joint return until two years after the termination of the combat zone designation.

**California** has not adopted this provision. Instead, California law, in general, requires that an individual use the same filing status that was used in the federal income tax return filed for the same taxable year. An exception to this rule is provided when either spouse was an active member of the armed forces, in which case they may file separate returns for California even though filing jointly on the federal return for the same taxable year. If separate federal returns are filed, a joint California return may not be filed.

Since the President has declared a combat zone in Yugoslavia, Albania and the airspace above and waters adjacent, the provisions described above apply on and after March 24, 1999.

While **this bill** would, for California purposes, declare Yugoslavia a qualified hazardous duty area as of an unspecified date in March, the changes contemplated by this bill are already in effect.

#### Implementation Considerations

Implementing this bill would not impact the department's programs and operations.

#### FISCAL IMPACT

##### Departmental Costs

This bill would not result in costs to the department.

##### Tax Revenue Estimate

Revenue losses associated with this bill are considered baseline since the changes are automatically in force with the Presidential action.

Information is not currently available to determine baseline revenue losses. However, it is projected to be minor (less than \$250,000).

#### BOARD POSITION

Pending.