

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Maddox Analyst: Darrine Distefano Bill Number: AB 1766

Related Bills: See Legislative History Telephone: 845-6458 Introduced Date: January 19, 2000

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exclusion/Earnings Received by Members of the California National Guard

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would exclude from gross income any earnings received by an individual for active service as a member of the California National Guard.

EFFECTIVE DATE

This bill would apply to taxable years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

Prior law (Ch. 147, Stats. 1943) allowed a deduction from gross income for all salary, 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). Ch. 12, Stats. 1952, reinstated the World War II exclusion but limited it to \$1,000 per year. In 1971, Ch. 1, Stats. 1971, Ex. Sess., further limited the exclusion to compensation (other than pensions and retirement pay) received for service on extended active duty. For taxable years commencing after December 31, 1972, Ch. 1359, Stats. 1972, added an annual \$1,000 exclusion from gross income for pensions and retirement pay as well as compensation for other than extended active duty. This exclusion, however, was limited to taxpayers with adjusted gross income of \$17,000 or less. AB 66 (Ch. 1461, Stats. 1985) increased the phase-out range to \$27,000, for taxable years beginning on or after January 1, 1985. AB 4419 (Ch. 779, Stats. 1986) excluded from gross income up to \$500 per month received for active duty service pursuant to a Governor-declared emergency. AB 53 (Ch. 1138, Stats. 1987) repealed each of these exclusions and established a tax credit, not to exceed \$40 in any taxable year, based on various types of military income. The credit was repealed by its own terms effective January 1, 1992.

SPECIFIC FINDINGS

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

Board Position:

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_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald H. Goldberg

3/9/00

Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received from certain death benefits, gifts and inheritances, compensation for injuries and sickness, qualified scholarships, educational assistance programs and foster care payments.

Under federal and state laws compensation received by a member of the Armed Forces is subject to income tax unless specifically excluded. Qualified military benefits are excludable from income. Qualified benefits include benefits paid by the Veterans Administration such as disability compensation, pensions, educational assistance, etc. In addition, medical benefits, military disability benefits, various travel allowances and other benefits provided by the military may be excludable. Dislocation allowances, temporary lodging allowances and move-in housing allowances provided for a permanent change of station also are excludable from gross income. Combat-zone compensation is excludable to a certain maximum amount.

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 would provide that gross income shall not include any earnings received for active service as a member of the California National Guard.

Policy Considerations

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

Under existing law, the organized militia of California consists of the National Guard, the State Military Reserve, and the Naval Militia, though no one is currently a member of the Naval Militia. In addition, members of the National Guard are in most cases members of the Armed Forces of the United States. The Armed Forces of the United States includes the Army, the Navy, the Air Force, the Marine Corps, and the Coast Guard. This bill would provide a tax benefit for a member of the California National Guard that would not be provided to other members of the militia or to other members of the Armed Forces.

Federal law (Public Salary Act of 1938) prohibits discriminatory state taxation of federal employees. As explained under Implementation Considerations below, it is unclear whether the exclusion provided by this bill extends to state and federal active service. If the exclusion provided by this bill is limited to earnings received for active state service, it could be held to violate this federal prohibition.

Implementation Considerations

The following implementation concerns have been identified. Department staff is available to assist the author in resolving these and other concerns that may arise.

The bill does not define the word "earnings." Prior exclusions from gross income used terms such as salary, wages, bonuses, allowances, pensions, retirement pay, and other compensation. Military pay is considered compensation. Compensation also includes bonuses, allowances, fringe benefits and similar items. It would be preferable if the author would define the term "earnings" or reference particular types of compensation or items of income described in existing law.

The bill does not define the term "active service." Under federal law, as applicable for purposes of the State Militia, active service means service on active duty (including full-time training duty, annual training duty, and attendance at a service school) or full-time National Guard duty (training or other duty, other than inactive duty, for which the member is entitled to pay from the United States). State law recognizes active federal service and active state service. In addition, the California National Guard can be called to active duty in state service by the Governor or to active duty in federal service by the federal government. Members of the National Guard performing active duty in state service are entitled to pay from the State, not the United States. It's unclear whether compensation for all such service is intended to be excluded under this bill.

FISCAL IMPACT

Departmental Costs

Once the implementation considerations are resolved, this bill is not expected to impact the department's costs significantly.

Tax Revenue Estimate

Based on the assumptions discussed below, the revenue loss from this proposal would be on the order of \$5 million annually.

Tax Revenue Discussion

According to data from California Military Department, gross income payments to members of the California National Guard exceeded \$111 million in fiscal year 1998/99 (\$109.9M from federal and estimated \$1.5M from state sources) for active duty which includes regular training, exercises, and schooling. A 20% reduction was applied to allow for certain payments that are not taxable under current law (long-term out-of-state assignments) and non-taxable filers. State income revenue losses are projected to be on the order of \$5 million per year ($\$111M \times 0.8 \times 6\%$ average tax rate).

BOARD POSITION

Pending.