Franchise Tax Board **ANALYSIS OF ORIGINAL BILL**

Author:	Gray	Analyst:	Jane Raboy	Bill Number:	AB 1275
Related Bills:	See Legislative History	Telephone:	845-5718	Introduced Date:	February 27, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Exclusion/Military Retirement and Survivor Income

SUMMARY

This bill, under the Personal Income Tax Law, would exclude military retirement pay and survivor benefits from gross income.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for 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 specifically operative for taxable years beginning on or after January 1, 2015.

FEDERAL/STATE LAW

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 United States (U.S.) Armed Forces. 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.

Under existing federal law, members of the U.S. Armed Forces may elect to reduce their retired pay to provide an annuity to their survivors and the reduction is excluded from gross income.

The term "U.S. Armed Forces", includes all regular and reserve components of the uniformed services that are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and each term also includes the Coast Guard. The members of such forces include commissioned officers and personnel below the grade of commissioned officers in such forces.[1]

[1] See Revenue and Taxation Code section 17022.

Board Position:						Executive Officer	Date
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For federal and state purposes, military retirement pay and survivor benefits received by a taxpayer are generally taxable.

THIS BILL

This bill would exclude from gross income the retirement pay received by a taxpayer from the federal government for military service performed in the U.S. Armed Forces, the reserve component of the U.S. Armed Forces, or the National Guard.

Similarly, this bill would also exclude from gross income survivor benefits received by a taxpayer from the federal government.[2]

IMPLEMENTATION CONSIDERATIONS

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

LEGISLATIVE HISTORY

AB 505 (Melendez, 2015/2016), would exclude from gross income, the additional retired pay to military retirees, known as concurrent retirement and disability pay payments. AB 505 has been referred to the Assembly Revenue and Taxation Committee.

AB 1077 (Anderson, 2009/2010), a similar bill, would allow an individual to exclude retirement pay and survivor annuities received as a result of active service in the military from gross income. AB 1077 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

PROGRAM BACKGROUND

For taxable years beginning December 22, 1972, through January 1, 1986, California law provided a taxpayer an annual $1,000 income exclusion for salary, wages, bonuses, allowances and other compensation received during active duty in the U.S. Armed Forces or the State Military Reserve. California law also provided a taxpayer an exclusion of up to $500 a month for any compensation received during active duty in the National Guard in connection with an emergency. Also, an income exclusion applied to pensions or retirement pay received by an individual for his or her service in the U.S. Armed Forces, the State Military Reserve or the National Guard. (Former Revenue and Taxation Code section 17146).

For taxable years beginning on or after January 1, 1987, and before January 1, 1992, a member of the U.S. Armed Forces was allowed a credit, rather than an exclusion from gross income, in an amount equal to 4 percent of the eligible income received by an individual whose adjusted gross income was less than $27,000. Eligible income included: salary, wages, bonuses, allowances, pensions, retirement pay, and other compensation received by an individual for his or her services on extended active duty as a member of the U. S. Armed Forces, including the California National Guard, or the State Military Reserve. This law remained in effect until January 1, 1992, and was repealed by its own terms as of that date. (Former Revenue and Taxation Code section 17053.13).

[2] Pursuant to Chapter 73 of line 12 Title 10 of the United States Code.

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 an individual income tax. Thus, military retirement pay and survivor benefits are not taxed.

Illinois allows an exclusion from gross income for retired and annuity pay received pursuant to a retirement plan for members of the U.S. Armed Forces.

Massachusetts allows taxpayers to exclude military retired pay and survivor annuities, received because of active service in the U.S. Armed Forces, from gross income. However, survivor benefit plan benefits are taxed.

Michigan allows an exemption for retired pay and survivor benefits. However, survivor benefit plan benefits are exempt if the benefits are also exempt from federal taxes.

Minnesota does not provide any exclusion similar to the exclusions proposed by this bill.

New York allows an exclusion for retired pay and SBP benefits.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB1275 As Introduced February 27, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16[3]	2016-17	2017-18
- $330	- $210	- $210

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

[3] The fiscal year 2015-16 estimated loss covers the first 6 months from January 1, 2015, through June 30, 2015, along with the 12 months from July 1, 2015, through June 30, 2016.

Revenue Discussion

Based on Department of Defense data, California military retirees and their survivors received approximately $367 million per month, or $4.4 billion per year in benefits during 2013. These amounts were grown by 2 percent annually. The growth rate was based on observed growth for benefits paid from 2008 through 2013. This amount was multiplied by the estimated average tax rate for qualified taxpayers of 4.5 percent, resulting in an estimated revenue loss of $200 million for tax year 2015.

The estimates are converted to fiscal year estimates and then rounded, to arrive at the amounts shown in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Those in support of this bill may argue that the personal sacrifices made by members of the military should be recognized and rewarded by creating an income exclusion.

Opponents: Those who oppose this bill may argue that this bill would favor one group of taxpayers over another and would create a precedent for an income exclusion for pensions received by other residents of California whose service the state wishes to recognize (e.g., police, firemen, teachers).

POLICY CONCERNS

This bill would allow an exclusion from gross income for military retirement pay and survivor annuities for which federal law has no counterpart, thus increasing nonconformity.

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