

ANALYSIS OF AMENDED BILL

Author: Chávez Analyst: Jane Raboy Bill Number: AB 321
 See Legislative
 Related Bills: History Telephone: 845-5718 Amended Date: March 12, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Exclusion/Military Servicemember Income
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SUMMARY

This bill would, under the Personal Income Tax Law, allow an exclusion from gross income for certain types of servicemember income.

RECOMMENDATION

No position.

Summary of Amendments

The March 12, 2015, amendments replaced language that would have made a nonsubstantive change to the Revenue and Taxation Code with the provisions discussed in this analysis.

This is the department’s first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to provide tax benefits for California resident military personnel stationed in California and allow them an opportunity to securely transition into civilian life.

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, 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.¹

Additionally, federal and state laws exclude from gross income amounts received by members of the United States (U.S.) Armed Forces as disability income from combat-related injuries. Combat-related injuries are defined as injuries that were incurred as a direct result of armed conflict, while engaged in extra-hazardous service, or in the performance of duty under conditions simulating war.

¹ See "Publication 3, Armed Forces Tax Guide", Table 2. Excluded Items, at < <http://www.irs.gov/pub/irs-pdf/p3.pdf>>, for details.

Board Position:	Executive Officer	Date
_____ S _____ NA _____ X _____ NP	Selvi Stanislaus	5/6/15
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Gross income excludes compensation received for active service as a member of the U.S. Armed Forces below the grade of a commissioned officer for any month the individual was serving in a combat zone or hospitalized as a result of wounds, disease, or injury incurred in a combat zone. Commissioned officers are allowed to exclude similar pay up to the maximum level received by enlisted personnel.

Under federal law, the Servicemembers Civil Relief Act² provides protections for military members as they enter active duty, including provisions prescribing rules for determining the residence of a servicemember and the source of military compensation for state income tax purposes. The Military Spouses Residency Relief Act is a federal law that amended the Servicemembers Civil Relief Act with respect to the state income tax obligations of the spouses of a servicemember.

There are currently no federal or state exclusions from gross income similar to the exclusions this bill would allow.

THIS BILL

This bill would exclude from gross income any income received by a servicemember:

- In the U.S. Armed Forces, in the reserve component of the U.S. Armed Forces, or in the National Guard, derived from his or her position as a servicemember, while serving his or her active duty in the state.
- Separated from the U.S. Armed Forces, the reserve components of the U.S. Armed Forces, or the National Guard, for 12 calendar months from the date he or she is honorably discharged, derived from his or her position as a servicemember while located in the state.
- Hospitalized within the state for an injury received while on active duty in the U.S. Armed Forces, in the reserve components of the U. S. Armed Forces, or in the National Guard, during the period of hospitalization.

The exclusions allowed under this bill would be allowed cumulatively.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

This bill would allow an exclusion from gross income for basic pay, bonus pay, special pay, other pay, and incentive pay (see Appendix A for details). If this is broader than the author's intent, the author may wish to amend the bill.

² See 50 U.S. Code Appendix Sections 501-593.

TECHNICAL CONSIDERATIONS

For grammatical consistency, the phrase "reserve component", on page 2 line 5, should read "reserve components." On page 2, lines 10 to 11, the phrase "the reserve components" should read "in the reserve components" and the phrase "or the National Guard", should read "or in the National Guard".

LEGISLATIVE HISTORY

AB 505 (Melendez, 2015/2016) would exclude Concurrent Receipts of Disability Pay payments from gross income for active, reserve, or retired member of the U.S. military who served on active duty. AB 505 is currently in the Assembly Revenue & Taxation Committee.

AB 2329 (Melendez, 2013/2014) would have excluded from gross income specific retirement and disability payments to an active, reserve, or retired member of the U.S. military who served on active duty. AB 2329 failed to pass out of the Assembly Appropriations Committee.

AB 2004 (Knight, 2011/2012) would have excluded from gross income the first \$60,000 of Combat-Related Special Compensation and Concurrent Receipt of Disability Pay to an active, reserve, or retired member of the U.S. military who served on active duty. AB 2004 failed to pass out of the Assembly Appropriations Committee.

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).

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 impose an individual 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 because of active service in the U.S. Armed Forces, from gross income.

Michigan excludes active duty pay, and pension and retirement benefits from gross income because of active service in the U.S. Armed Forces.

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

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 AB 321 As Amended March 12, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$170	- \$110	- \$110

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

Revenue Discussion

Using data published by the U.S. Census Bureau and Military One Source it is estimated that in 2015 there would be 160,000 active duty servicemembers, servicemembers separated for 12 calendar months from the date they were honorably discharged while located in California, and servicemembers hospitalized (within this state) for an injury received while on active duty, collectively referred to for purposes of this discussion as "servicemembers".

U.S. military pay charts were used to determine the average military pay of \$25,000 for all servicemembers. The estimated average California tax rate for the above servicemembers is 2.68 percent. Using this data, the estimated loss from the gross income exclusion results in \$107 million, \$110 million, and \$112 million in years 2015 through 2017, respectively. The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts shown in the above table.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Supporters could argue that this bill would provide needed tax relief for military families by allowing them an opportunity to securely transition to civilian life.

Opponents: Some could argue that this bill may be overly generous for military families.

POLICY CONCERNS

This bill would establish an exclusion from gross income for which federal law has no counterpart, thus increasing nonconformity.

LEGISLATIVE STAFF CONTACT

Jane Raboy
Legislative Analyst, FTB
(916) 845-5718
jane.raboy@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov

Appendix A – Military Pay Currently Includible In Gross Income – Unless a Combat Zone.

Basic pay	Special pay	Other pay
<p>Active duty</p> <p>Attendance at a designated service school</p> <p>Back wages</p> <p>CONUS COLA</p> <p>Drills</p> <p>Reserve training</p> <p>Training duty</p>	<p>Aviation career incentives</p> <p>Career sea</p> <p>Diving duty</p> <p>Foreign duty</p> <p>Foreign language proficiency</p> <p>Hardship duty</p> <p>Hostile fire or imminent danger</p> <p>Medical and dental officers</p> <p>Nuclear-qualified officers</p> <p>Optometry</p> <p>Pharmacy</p> <p>Special compensation for assistance with activities of daily living</p> <p>Special duty assignment pay</p> <p>Veterinarian Voluntary Separation Incentive</p>	<p>Accrued leave</p> <p>High deployment per diem</p> <p>Personal money allowances paid to high-ranking officers</p> <p>Student loan repayment from programs</p>
Bonus pay		Incentive pay
<p>Career status</p> <p>Enlistment</p> <p>Officer</p> <p>Overseas extension</p> <p>Reenlistment</p>		<p>Submarine</p> <p>Flight</p> <p>Hazardous duty</p> <p>High altitude/Low Opening (HALO)</p>