

ANALYSIS OF ORIGINAL BILL

Author: Melendez Analyst: Jane Raboy Bill Number: AB 505
 See Legislative
 Related Bills: History Telephone: 845-5718 Introduced Date: February 23, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Exclusion/Military Concurrent Retirement and Disability Pay
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SUMMARY

This bill, under the Personal Income Tax Law, would exclude from gross income certain payments to eligible individuals.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to provide tax relief for California veterans receiving service-connected disability compensation.

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, 2016.

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.

Federal and state tax law excludes from gross income amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country. The exclusion is limited to amounts received for a combat-related injury, unless the individual was entitled to that payment before September 24, 1975, or the individual was a member of the armed forces on that date.

Federal and state law also exclude from gross income any veterans' benefits paid under any law, regulation, or administrative practice administered by Veteran Affairs (VA).

Before 2002, federal law prohibited the concurrent receipt of military retired pay and disability compensation from the VA for the same period of service. Consequently, the retired pay of a military retiree was reduced by the amount of disability compensation received from the VA.

Board Position:	Executive Officer	Date
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In 2002, federal law was amended to authorize the payment of additional compensation for a combat-related disability, known as Combat-Related Special Compensation to certain military retirees. This payment is authorized under Title 10, United States Code, section 1413a, and is considered disability compensation, which is excluded from gross income.

In 2003, federal law was further amended to authorize the payment of additional retired pay to military retirees whose retired pay was reduced because of receiving disability compensation from the VA. The additional retired pay, Concurrent Retirement of Disability Pay, authorized under Title 10, United States Code, section 1414, is subject to federal and state income tax.

There are currently no federal or state exclusion from gross income for Concurrent Retirement and Disability Pay payments. For federal and state purposes, Concurrent Retirement and Disability Pay is taxable.

THIS BILL

For taxable year beginning on or after January 1, 2016, this bill would exclude Concurrent Retirement and Disability Pay payments received by an eligible individual from gross income.

This bill would define the following:

- "Concurrent retirement and disability pay"¹ would mean payments received , as provided under law that a qualified retiree could be eligible for Concurrent Retirement and Disability Pay and Combat-Related Special Compensation payments; however, the retiree is prohibited against receiving both benefits simultaneously,²
- "Eligible individual" would mean an active, reserve, or retired member of the United States military who served in active duty.

Nothing in this bill would be construed to create any inference with respect to the proper tax treatment of any Disability Pay payments received before January 1, 2016.

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.

Because for federal purposes gross income includes both military retirement pay and Concurrent Retirement and Disability Pay, it is unclear how the department would be able to validate the Concurrent Retirement and Disability Pay exclusion for state purposes. The lack of guidance could cause disputes between taxpayers and the department and require the department to open up an audit in order to verify the amount of gross income reported by taxpayers.

¹ See 10 USC section 1414.

² Ibid.

TECHNICAL CONSIDERATIONS

This bill would allow Concurrent Retirement and Disability Pay payments received by an "eligible individual". For consistency with Title 10 of the United States Code section 1414, "eligible individual" should read "qualified retiree".

LEGISLATIVE HISTORY

AB 2329 (Melendez, 2013/2014), similar to this bill, would have among other things, allowed an exclusion from gross income for Concurrent Retirement and Disability Pay payments received by an eligible individual. AB 2329 was held in the Assembly Committee on Appropriations.

AB 2004 (Knight, 2011/2012) would have allowed an individual to exclude from gross income Combat-Related Special Compensation and Concurrent Retirement and Disability Pay. AB 2004 was held in the Assembly Committee on Appropriations.

SB 401 (Wolk, Chapter 14, Statutes of 2010) provided specified date conformity to the IRC, including the gross income exclusions for combat-related injury pay and Combat-Related Special Compensation.

AB 1077 (Anderson, 2009/2010) would have allowed 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 from the Assembly Revenue and Taxation Committee by the constitutional deadline.

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, Massachusetts, Michigan, Minnesota, and New York generally conform to federal rules for military combat-related pay.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB505 As Introduced February 23, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$14	- \$24	- \$24

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

Revenue Discussion

This bill would allow an exclusion from gross income for Concurrent Retirement and Disability Pay. The Department of Defense reports California military retirees received approximately \$43 million per month in Concurrent Retirement and Disability Pay during 2013. This amount was grown³ by 8 percent through 2016 and 4 percent each year thereafter. The growth rate was based on actual annual growth in the program of 22 percent from 2007 through 2011. A portion of this growth, however, reflects program changes in the federal retirement and disability programs for veterans; and thus, a lower growth rate was used. The amount was multiplied by the estimated average tax rate for qualified taxpayers of 3.5 percent. The estimates are converted to the fiscal year estimates, rounded, and are reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Supporters could argue that this bill would provide needed tax relief for certain California veterans who are disabled and taxed on a portion of their military retirement disability pay.

Opponents: Some could argue that this bill would create a federal and California difference in the tax treatment of military retired pay. The federal government treats this type of pay, like other non-disability retired pay, as taxable.

³ Indexed using Department of Finance forecasts.

POLICY CONCERNS

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

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