



## Analysis of Original Bill

Author: Chen	Sponsor:	Bill Number: AB 2590
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Attorney: Bruce Langston	Related Bills: See Legislative History	

**Subject:** Exclusion/Military Servicemember Income

### 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.**

### Reason for the Bill

The reason for this bill is to provide tax benefits for California resident military personnel stationed in California.

### 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, 2018.

### Program Background

Military pay includes several categories of pay, including Basic Pay, Bonus Pay, Special Pay, and Incentive Pay. Examples of the types of pay in each of these categories is provided in Appendix A.

### Federal/State Law

Existing federal and state laws provide that gross income includes all income from whatever source derived unless specifically excluded.<sup>1</sup>

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

Under federal and state law, members of the United States (U.S.) Armed Forces are eligible to exclude from gross income:

- 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.
- amounts received 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.

Under federal law, the Servicemembers Civil Relief Act<sup>2</sup> 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 exclusion this bill would allow.

### **This Bill**

This bill would exclude from gross income any basic pay received by a servicemember on active duty in the U.S. Armed Forces, in the reserve component of the U.S. Armed Forces, or in the National Guard, that is derived from their position as a servicemember while on military orders for 90 or more consecutive days.

### **Implementation Considerations**

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

This bill uses the undefined term, "military orders." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clearly define the term.

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<sup>2</sup> See 50 U.S. Code Appendix Sections 501-593.

If the author intends for the term “active duty” to apply to servicemembers in the reserve component of the U.S. Armed Forces, the National Guard, or both, this bill should be amended.

It is unclear how the Franchise Tax Board (FTB) would be able to determine that a servicemember had served on military orders for the 90 day minimum period needed to trigger the exclusion.

It is unclear whether and how the exclusion would apply to a servicemember who served the minimum 90 days on military orders over two taxable years but less than the 90 day period in each taxable year. Would the exclusion apply to both taxable years? Be prorated based on the days served in each taxable year?

### **Technical Considerations**

For grammatical consistency, the phrase “reserve component”, on page 2, line 3, should read “reserve components.”

### **Legislative History**

SB 924 (Morrell, 2017/2018) would allow an exclusion from gross income for certain income earned by an active duty servicemember in the National Guard derived from their position as a servicemember while on active duty in this state. SB 924 is pending before the Senate Committee on Governance and Finance.

AB 321 (Chávez, 2015/2016) would have excluded from gross income all of the 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, received (1) while on active duty, (2) during the 12 calendar months since the date of honorable discharge separation, and (3) during the period of hospitalization within the state for an injury received while on active duty. AB 321 failed to pass out of the Assembly Revenue & Taxation Committee by the constitutional deadline.

AB 505 (Melendez, 2015/2016) would have excluded 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 failed to pass out of the Assembly Revenue & Taxation Committee by the constitutional deadline.

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 by the constitutional deadline.

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 by the constitutional deadline.

### Other States' Information

The states surveyed include *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.

*Illinois* allows pay for service in the U.S. Armed Forces Reserves to be excluded from gross income.

*Massachusetts* law excludes from gross income compensation earned by members of the armed forces for service in a combat zone to the extent the income is excluded under federal law.

*Michigan* law excludes active duty military pay from gross income.

*Minnesota* law allows residents to subtract federally taxable active-duty military pay when determining their Minnesota tax. Members of the Minnesota National Guard members may subtract pay for service as specified.

*New York* law allows resident servicemembers, including members of the New York State organized militia (which includes the New York Army National Guard, the New York Air National Guard, the New York Naval Militia, and the New York Guard) to subtract federally taxable pay received while on state or federal active duty orders from New York adjusted gross income.

### 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 2590 as Introduced February 15, 2018  
For Taxable Years Beginning On or After January 1, 2018  
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$190
2019-2020	- \$130
2020-2021	- \$130

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

## Revenue Discussion

This bill would allow a gross income exclusion for any basic pay received by a servicemember on active duty 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 he or she is on military orders for 90 or more consecutive days.

Based on data published by the Department of Defense, it is estimated that there would be 95,000 active duty servicemembers in the Armed Forces domiciled in California in 2018. It is assumed that all active servicemembers in the U.S. Armed Forces would serve on military orders for 90 or more consecutive days. Based on federal recruitment data, it is estimated that there would be 10,000 servicemembers in the Reserves and National Guard who would serve on military orders for 90 or more consecutive days in 2018.

According to U.S. military pay charts, active duty servicemembers earn an average military pay of \$41,000. This results in an estimated \$4.3 billion in qualified income exclusions. This amount is multiplied by an estimated average tax rate for qualified taxpayers of 2.77 percent, for an estimated revenue loss of \$120 million in the 2018 taxable year.

The tax-year estimates were 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: Some may argue that this bill would provide needed tax relief to California's active duty servicemembers and their families.

Opponents: Some could argue that this bill may be overly generous for active duty servicemembers and their families.

## Policy Concerns

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a tax benefit by the Legislature.

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

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

Source: <https://www.irs.gov/pub/irs-pdf/p3.pdf>

Pay	Description
Basic pay	<ul style="list-style-type: none"> <li>• Active Duty</li> <li>• Attendance at a designated service school</li> <li>• Back wages</li> <li>• CONUS COLA</li> <li>• Drills</li> <li>• Reserve training</li> <li>• Training duty</li> </ul>
Special pay	<ul style="list-style-type: none"> <li>• Aviation career incentives</li> <li>• Career sea</li> <li>• Diving duty</li> <li>• Foreign duty</li> <li>• Foreign language proficiency</li> <li>• Hardship duty</li> <li>• Hostile fire or imminent danger</li> <li>• Medical and dental officers</li> <li>• Nuclear-qualified officers</li> <li>• Optometry</li> <li>• Other Health Professional Special Pays (for example, nurse, physician assistant, social work, etc.)</li> <li>• Pharmacy</li> <li>• Special compensation for assistance with activities of daily living</li> <li>• Special duty assignment pay</li> <li>• Veterinarian</li> <li>• Voluntary Separation Incentive</li> </ul>
Bonus pay	<ul style="list-style-type: none"> <li>• Career status</li> <li>• Continuation pay</li> <li>• Enlistment</li> <li>• Officer</li> <li>• Overseas extension</li> <li>• Reenlistment</li> </ul>
Incentive pay	<ul style="list-style-type: none"> <li>• Submarine</li> <li>• Flight</li> <li>• Hazardous duty</li> <li>• High altitude/Low Opening (HALO)</li> </ul>
Other pay	<ul style="list-style-type: none"> <li>• Accrued leave</li> <li>• High deployment per diem</li> <li>• Personal money allowances paid to high-ranking officers</li> <li>• Student loan repayment from programs</li> </ul>
In-kind military benefits	<ul style="list-style-type: none"> <li>• Personal use of a government-provided vehicle</li> </ul>