

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Gray Analyst: Jessica Deitchman Bill Number: AB 528
Related Bills: See Legislative History Telephone: 845-6310 Introduced Date: February 13, 2017
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Exclusion/Military Retirement Pay

SUMMARY

The bill would, under the Personal Income Tax Law, exclude from gross income certain retirement pay received for military service.

RECOMMENDATION – NO POSITION

REASON FOR THE BILL

The reason for the bill is to provide tax relief for retired members of the United States Armed Forces.

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, 2018.

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 including, 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.

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.

For federal and state purposes, military retirement pay received by a taxpayer is generally taxable.

THIS BILL

For taxable years beginning on or after January 1, 2018, this bill would exclude from gross income qualified retirement pay received by a taxpayer from the federal government for military service performed in the Armed Forces of the United States, the reserve component of the Armed Forces of the United States, or the National Guard.

“Qualified retirement pay” means all of the following:

- 100 percent of retirement pay received in the first 12-month period after the taxpayer leaves military service. If the taxpayer subsequently performs military service, the 100 percent exclusion rule shall also apply to the first 12-month period after the taxpayer leaves that subsequent service;
- 80 percent of the retirement pay received in the 12-month period immediately following the first 12-month period described above;
- 60 percent of the retirement pay received in the 12-month period immediately following the first 24-month period described above;
- 40 percent of the retirement pay received in the 12-month period immediately following the first 36-month period described above; and
- 20 percent of the retirement pay received in the 12-month period immediately following the first 48-month period described above.

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 phrase, “performs military service.” Would the service need to be performed full time? Or would one day a month be enough to constitute “performs military services?” Further, if a taxpayer “performs military service,” it is unclear if the bill would allow the retirement pay to start over at the 12-month rate. For example, if a taxpayer retires from the Air Force and later joins and retires from the National Guard, would the retirement pay exclusion for both the Air Force service and the National Guard service be “reset” to the 12-month rate? The absence of definitions to clarify this term could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

Further, if a member of the Armed Forces retires, and delays their retirement pay until several years later, due to age or other circumstances, the bill would not allow a full exclusion of income. If this is contrary to the author’s intent, the bill should be amended.

LEGISLATIVE HISTORY

AB 1275 (Gray, 2015/2016), would have excluded 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. AB 1275 would have also excluded the gross income survivor benefits received by a taxpayer from the federal government. AB 1275 failed to pass out of the Assembly by the constitutional deadline.

AB 505 (Melendez, 2015/2016), would have excluded from gross income the additional retired pay to military retirees, known as concurrent retirement and disability pay payments. AB 505 failed to pass out of the Assembly by the constitutional deadline.

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 out of the Assembly 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, and tax laws.

Illinois, Massachusetts, Michigan, Minnesota and New York all allow an exclusion from gross income for retired pay received pursuant to a retirement plan for members of the U.S. Armed Forces.

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 AB 528 As Introduced February 13, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$5.3	- \$9.1	- \$9.2

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

Revenue Discussion

Based on U.S. Department of Defense (DOD) data, California military retirees received approximately \$350 million per month, or \$4.1 billion in retirement payments in 2015. DOD data also indicates that approximately 35,000 military members retired in 2015 with an estimated annual income of \$25,000. It is estimated that approximately 2,500 are California residents and would draw an estimated annual retirement income of \$64 million. Based on the observed growth rate for benefits from the three prior years, this amount was grown by 2 percent annually.

Beginning in tax year 2018, it is estimated that 15,000 California military retirees would qualify for the income exclusion for a total of \$200 million. This amount is multiplied by an estimated average tax rate for qualified taxpayers of 4.5 percent, resulting in an estimated revenue loss of \$9 million in tax year 2018.

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill would provide much needed tax relief for newly retired members of the United States Armed Forces.

Opponents: Some may argue that this bill would favor one group of taxpayers over another and would create inequity amongst taxpayers.

POLICY CONCERNS

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

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