



Analysis of Amended Bill

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Sponsor:

Bill Number: AB 1258

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Introduced and Amended:

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Related Bills: See Prior Analysis

February 21, 2019 & March 25,
2019

Subject: Exclusion/Military Servicemember Income

Summary

This bill would, under the Personal Income Tax Law (PITL), exclude from gross income all income earned by a member of the United States Armed Forces while on active duty in this state. Additionally this bill would provide an exclusion for a specified time period, to members of the United States Armed Forces that have been honorably discharged.

Recommendation – No position.

Summary of Amendments

The March 25, 2019, amendments made technical changes to the bill.

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

Reason for the Bill

The reason for the bill is to provide tax relief for active duty and 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, 2020.

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.

Introduced February 21, 2019 and Amended March 25, 2019

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

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

This Bill

This bill would, under the PITL, for taxable years beginning on or after January 1, 2020, exclude from gross income any income from any source received by a servicemember:

- in the United State Armed Forces, in the reserve components of the United States Armed Forces, or in the National Guard while on active duty in this state,
- who has been honorably discharged from the United States Armed Forces, the reserve components of the United States Armed Forces, or the National Guard during the applicable time period.

"Applicable time period" would mean the period of time beginning on the date a servicemember in the United States Armed Forces, in the reserve components of the United States Armed Forces, or the National Guard is honorably discharged and ends after a period of time equal to that of the servicemember's cumulative days on active duty service prior to the honorable discharge.

The Secretary of Veterans Affairs would be required to confirm the applicable time period and the Department of Veterans Affairs would be allowed to adopt rules and regulations for the purpose of confirming the applicable time period.

¹ See Revenue and Taxation Code section 17022.

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.

The bill would exclude from gross income "all income from any source received by a servicemember." Because California is a community property state, all income earned by each spouse in a marriage is considered to be split equally. Therefore, it could be interpreted that the exclusion would apply to 50 percent of the servicemember's spouse's income. If this is contrary to the author's intent, the bill should be amended.

Legislative History

AB 427 (Brough, et al., 2019/2020) would exclude from gross income a percentage of certain retirement pay received for military service. AB 427 is currently in the Assembly Revenue and Taxation Committee.

AB 528 (Gray, 2017/2018) would have excluded from gross income a percentage of 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. AB 528 failed to pass out of the Assembly by the constitutional deadline.

AB 2394 (Brough, et al. 2017/2018) would have excluded any retirement pay received by a taxpayer from the federal government for service in the uniformed services from gross income. AB 2394 failed to pass out the Assembly Revenue and Taxation Committee.

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 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.

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 retirement pay received pursuant to a retirement plan for members of the United States Armed Forces. However, these states lack an exclusion for members of the United States Armed Forces for all income from any source, as provided in this bill.

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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1258 as Amended March 25, 2019
For Taxable Years Beginning On or After January 1, 2020

Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$700
2020-2021	-\$1,200
2021-2022	-\$1,100

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

Based on data published by the Department of Defense, it is estimated that of the active duty servicemembers in the United States Armed Forces, in the reserve components of the United States Armed Forces, or in the National Guard, 170,000 would be domiciled in California in 2020. Based on discharged veteran data published by the Department of Veterans Affairs (VA), it is estimated that 1.5 million veterans would be living in California in 2020. Based on data from the California Department of Veterans Affairs it is estimated that 95 percent, or 1.4 million, would be considered honorably discharged from military service.

Based on United States military pay charts for active duty servicemembers in the United States Armed Forces, in the reserve components of the United States Armed Forces, or in the National Guard it is estimated servicemembers will earn a combined average military pay of \$35,000 in 2020. This average was then adjusted for those servicemembers receiving additional pay in the form of bonuses, incentives, special pay, and additional household income in the form of spousal and secondary civilian employment. This results in total combined annual income of \$45,000 and an estimated \$7.6 billion in qualified income exclusions in tax year 2020. This amount is multiplied by an estimated average tax rate for active duty servicemembers of 1.6 percent, resulting in an estimated revenue loss of \$120 million in taxable year 2020.

Research on the average civilian income received by the 1.4 million servicemembers who have received a veteran discharge status of Honorable Discharge, indicates that this population would earn an estimated average income of \$50,000 in tax year 2020. This amount includes assumed additional household income that this population could receive in the form of civilian and spousal employment. This results in an estimated \$70 billion in additional qualified income exclusions in tax year 2020. This amount is multiplied by a combined estimated average tax rate for qualified taxpayers of 1.6 percent, for an estimated revenue loss of \$1.1 billion in tax year 2020.

Net revenue loss for the combined income exclusions would reach approximately \$1.2 billion in 2020.

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

Policy Concerns

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

This bill would provide an exclusion for all income received (including unrelated to military service) by a servicemember, and honorably discharged servicemembers, in certain circumstances, for a specified period of time. This may be a broader exclusion than the author intends.

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