STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

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Subject

Personal Income Tax Exclusion for Retirement Pay of Members of Uniformed Services

Summary

This bill would, under the Personal Income Tax Law (PITL), exclude from gross income a percentage of certain retirement pay received for military service.

Recommendation

No position.

Summary of Amendments

The January 6, 2020, amendments removed provisions of the bill related to the Education Code and replaced them with the provisions discussed in this analysis.

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 retired members of the uniformed services.

Effective/Operative Date

As a tax levy, the bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2030.

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 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 received by a taxpayer is generally taxable.

Existing state and federal laws provide various exclusions and deductions from gross income designed to provide tax relief for taxpayers who incur certain expenses or to influence behavior, including business practices and decisions. These deductions generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Under Revenue and Taxation Code (R&TC) section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit.

This Bill

This bill would, under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2030, allow an exclusion from gross income for retirement pay received by a taxpayer from the federal government for service in the uniformed services during the taxable year in the following amounts:

- 50 percent of the retirement pay received by a taxpayer during the first and second taxable years the exclusion applies to the taxpayer.
- 75 percent of the retirement pay received by a taxpayer during the third and fourth taxable years the exclusion applies to the taxpayer.
- 100 percent of the retirement pay received by a taxpayer during the fifth taxable years, and every year thereafter, the exclusion applies to the taxpayer.

[1] See R&TC section 17022.

“Armed Forces of the United States” has the same meaning as that term is defined in section 17022.

“Uniformed services” means Armed Forces of the United States, the Army National Guard and the Air National Guard when engaged in active duty for training, inactive duty for training or full-time National Guard duty, and the commissioned corps of the United States Public Health Service.

The exclusion would remain in effect until December 1, 2030, and be repealed as of that date.

This bill also contains uncodified language to comply with section 41. The bill states that the Legislative Analyst’s Office (LAO) shall provide a report to the legislature on or before December 1, 2029. The bill specifies that the LAO may request information from the Franchise Tax Board (FTB) and the Department of Veterans Affairs needed to complete the report, and that the FTB and the Department of Veterans Affairs would be required the provide the data requested. This bill would allow for the FTB to provide any data requested by the LAO and the LAO would be subject to the disclosure requirements of section 19542.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

To ensure that the FTB or any member thereof is not found guilty of a misdemeanor by providing the information related to this exclusion to the Legislative Analyst, it would be beneficial to add a section to Article 2 (commencing with Section 19542) of Chapter 7 of Part 10.2 of Division 2 of the R&TC authorizing the FTB to share this information.

For clarity and ease of administration, it is suggested that the bill be amended to specify the data that would be required to be provided by the department to the LAO, as well as the timing for the delivery of that data.

Technical Consideration

For clarity, on page 4, lines 17 and 23, it is recommended that the phrase “tax exclusion” be replaced with either “gross income exclusion” or “exclusion from gross income.”

Legislative History

AB 427 (Brough, 2019/2020) would have excluded from gross income a percentage of certain retirement pay received for military service 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 427 failed to pass out the Assembly Committee on Appropriations.

AB 1258 (Salas, 2019/2020), as amended, would have excluded active duty pay from gross income of active service members while on duty in this state and excluded military retirement pay from gross income after being honorably discharged. AB 1258 failed to pass out 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.

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 151 as Amended January 6, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	Revenue
2020-2021	-$70
2021-2022	-$60
2022-2023	-$70

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 from the United States Department of Defense, approximately 146,000 members of California's uniformed services retirees received approximately $340 million per month, or $4 billion per year, in retirement payments during 2018. This amount is grown by 1.5 percent annually based on the observed growth rate for retirement payments and cost of living adjustments over the last six years, resulting in retirement pay income subject to exclusion of $4.2 billion in the 2020 taxable year.

To calculate the amount of retirement pay eligible California uniformed services retirees are allowed to exclude, the specified exclusion rates are applied to each cohort through the fifth taxable year when the exclusion rate reaches 100 percent of retirement pay. In taxable year 2020, the first year in which the exclusion is allowed, it is assumed that 90 percent of eligible retirees will utilize the 50 percent exclusion rate resulting in a total income exclusion of $1.9 billion.

In taxable year 2022, the third year in which the exclusion is allowed at the 75 percent rate, $3.0 billion of income would be excluded. In taxable year 2024, the fifth year in which the exclusion is allowed at the 100 percent rate, $4.1 billion of income would be excluded. This amount would increase to $4.2 billion in the final year in which the exclusion is allowed. The annual amounts are then multiplied by an estimated average tax rate for qualified taxpayers of 2.3 percent, resulting in an estimated revenue loss of $42 million in the 2020 taxable year and peaking at $95 million in the 2029 taxable year.

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

Policy Concerns

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

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