STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

Author: Brough, et al.	Sponsor:	Bill Number: AB 427
Analyst: Jessica Deitchman	Phone: (916) 845-6310	Introduced and Amended: February 7, 2019 & March 11, 2019
Attorney: Shane Hofeling	Related Bills: See Legislative History	

Subject: Exclusion/Military Retirement Income

Summary

The 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 March 11, 2019, amendments added a repeal date and restructured the amount of the exclusion. 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 United States Armed Forces.

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

"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.

[1] See Revenue and Taxation Code section 17022.

The exclusion would remain in effect until December 1, 2030, and be repealed as of that date.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Legislative History

AB 1258 (Salas, 2019/2020) would exclude all income from active service members while on duty in this state. AB 1258 was introduced on February 21, 2019.

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 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.

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 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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 427 as Amended March 11, 2019
Assumed Enactment after June 30, 2019

($ in Millions)

Fiscal Year	Revenue
2019-2020	-$25
2020-2021	-$46
2021-2022	-$60

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 149,000 members of California's uniformed services retirees received approximately $340 million per month, or $4 billion per year, in retirement payments during 2017. 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, $3.1 billion of income would be excluded. In taxable year 2024, the fifth year in which the exclusion is allowed at the 100 percent rate, $4.2 billion of income would be excluded. This amount would increase to $4.4 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 $43 million in the 2020 taxable year and peaking at $100 million in the 2029 taxable year.

The tax-year estimates are converted to fiscal-year estimates and then rounded to arrive at the amounts 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.

Legislative Staff Contact

Jessica Deitchman	Jame Eiserman	Jahna Carlson
Legislative Analyst, FTB	Revenue Manager, FTB	Acting Legislative Director, FTB
(916) 845-6310	(916) 845-7484	(916) 845-5683
jessica.deitchman@ftb.ca.gov	jame.eiserman@ftb.ca.gov	jahna.carlson@ftb.ca.gov