STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

Author: Brough, et al.	Sponsor:	Bill Number: AB 427
Analyst: Jessica Deitchman	Phone: (916) 845-6310	Amended: April 8, 2019
Attorney: Shane Hofeling	Related Bills: See Prior Analysis	

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 April 8, 2019, amendments added uncodified reporting requirement language to comply with the provisions of Revenue and Taxation Code (R&TC) section 41. As a result of the amendments, the "Federal/State Law" and "This Bill" sections of the departments analysis as amended March 11, 2019, has been revised and a new implementation consideration has been identified. The remainder of that analysis still applies. The "Fiscal Impact," "Economic Impact" and "Policy Concerns" sections have been restated for convenience.

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 resident taxpayer is generally taxable.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. Under R&TC section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the credit.

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.

[1] See R&TC 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 the FTB and the Department of Veterans Affairs would be required the provide the data requested.

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.

If requested, this bill would require the FTB to provide confidential taxpayer information to the LAO. However, the bill fails to allow the disclosure of such information or prohibit the LAO from further disclosure of confidential taxpayer information. An exception from the general disclosure provisions should be added to specifically allow the FTB to comply with the bill's provision on disclosure of tax information and apply the appropriate disclosure restrictions to the LAO.

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.

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 April 8, 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
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Jahna Carlson
Acting Legislative Director, FTB
(916) 845-5683
jahna.carlson@ftb.ca.gov