STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Wilk, et al.	Sponsor:	Bill Number: SB 1071
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Attorney: Shane Hofeling	Related Bills: See Legislative History	

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 federal military service.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to provide tax relief for retired members of the uniformed services.

ANALYSIS

This bill would, under the PITL, for taxable years beginning on or after January 1, 2021, and before January 1, 2031, 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.

"Uniformed services" would mean Armed Forces of the United States (U.S.), the Army National Guard and the Air National Guard when engaged in active duty for training, inactive duty training, or full-time National Guard duty, and the commissioned corps of the U.S. Public Health Service.

"Armed Forces of the United States" would have the same meaning as that term is defined in Revenue and Taxation Code (R&TC) section 17022. That section generally defines "Armed Forces of the United States" as 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The exclusion would remain in effect until December 1, 2031, and be repealed as of that date.

Section 2 of this bill contains language to comply with R&TC section 41. This language would be excluded from the numbered sections of the R&TC. The bill would require that the Legislative Analyst's Office (LAO) provide a report to the Legislature on or before December 1, 2030. 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 to provide the data requested. This bill would provide an exception for the disclosure of data by the FTB to the LAO from the general disclosure requirements applicable to the FTB.

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, 2021, and before January 1, 2031.

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 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.

For federal and state purposes, military retirement pay (not including certain disability retirement pay) received by a taxpayer is generally taxable.

Under 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 expenditure.

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.

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 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 Considerations

For clarity, on page 3, line 24, it is recommended that the word "tax" be deleted.

Policy Concerns

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

LEGISLATIVE HISTORY

AB 151 (Voepel, 2019/2020) would have allowed an exclusion from gross income a percentage of retirement pay received by a taxpayer from the federal government for service in the uniformed services. AB 151 failed to pass out of the Assembly by the constitutional deadline.

AB 427 (Brough, 2019/2020) would have allowed an exclusion from gross income a percentage of retirement pay received by a taxpayer from the federal government for service in the uniformed services. AB 427 failed to pass out of the Assembly by the constitutional deadline.

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 by the constitutional deadline.

AB 2226 (Voepel et al., 2019/2020) would allow an exclusion from gross income a percentage of retirement pay received by a taxpayer from the federal government for service in the uniformed services. AB 2226 is pending in the Assembly Revenue and Taxation Committee.

SB 1007 (Hueso, 2019/2020) would allow an exclusion from gross income for retirement pay received by a taxpayer from the federal government for service in the uniformed services. SB 1007 is pending in the Senate Governance and Finance Committee and in the Senate Committee on Veterans Affairs.

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 by the constitutional deadline.

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

The bill states that for purposes of R&TC section 41, the goal, purpose, or objective of this credit is to honor the service of California veterans and provide fiscal relief so they will remain or retire in California, and to increase the number of highly skilled retired veterans in California's workforce. The Legislature's evaluation of the credit's success would be based on the number of veterans taking advantage of the tax exclusion, the economic security of veterans in California, and the number of retired veterans leaving California.

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1071 as Introduced February 18, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	**Revenue**
2020-2021	-$25
2021-2022	-$46
2022-2023	-$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 U.S. 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 2021 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 2021, 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 2023, 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 2025, 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 $4.3 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 2021 taxable year and peaking at $96 million in the 2030 taxable year.

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

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

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