Date of Hearing: March 13, 2023

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Jacqui Irwin, Chair

AB 46 (Ramos) – As Introduced December 5, 2022

Majority vote. Tax levy. Fiscal committee.

SUBJECT: Personal income taxes: exclusion: Military Services Retirement and Surviving Spouse Benefit Payment Act

SUMMARY: Excludes, for taxable years beginning on or after January 1, 2024, and before January 1, 2034, uniformed services retirement pay and annuity payments from a United States Department of Defense Survivor Benefit Plan received by qualified taxpayers during the taxable year from gross income under the Personal Income Tax (PIT) Law. Specifically, **this bill**:

1) Contains the following legislative findings and declarations:

   a) Servicemembers are eligible to retire from the military after 20 years of service. These retirees devoted the prime years of their life to defending the freedom of all Americans;

   b) To preserve the current policy of an all-volunteer force while still maintaining critical skills and readiness requires the retention of qualified military personnel, both enlisted and officers. This retention of military professionals also saves the costs to the taxpayer associated with training replacement personnel in essential skills;

   c) Retired members of the nation's two nonarmed uniformed services, which consist of the commissioned corps of the United States Public Health Service and the National Oceanic and Atmospheric Administration Commissioned Officer Corps, also provide valuable service to the nation's health and environmental safety;

   d) Providing a state income tax exclusion to retirees of the uniformed services not only signifies the gratitude of Californians for these men and women who chose to serve our country, it also benefits the state and local economies by helping to retain skilled and motivated individuals in California;

   e) The number one issue for employers in California is attracting a qualified workforce. Approximately 60,000 high-tech jobs are unfilled. Uniformed service retirees are highly skilled, often in areas requiring technical and management expertise. These men and women often continue to be valuable assets to our schools, local charities, and nonprofit organizations;

   f) Substantial new federal funds are infused into the state and local economies not only from retirement pay, but also from the full taxation of their second careers. These retirees may also qualify for federal veterans' benefits, which further bring new monies into the state; and,

   g) The United States Department of Defense's Survivor Benefit Plan allows a retiree to ensure, after death, a continuous lifetime annuity for their dependents. The maximum annuity for a spouse is based on 55% of the member's retirement pay. Eligible children may also be beneficiaries. State income taxation of these funds, which are critical to the economic well-being of those who have suffered the loss of a husband, wife, father, or mother, can place the surviving family members in risk of falling into the state and local safety nets.

2) Excludes retirement pay received by a taxpayer from the federal government for service in the "uniformed services" during the taxable year from the gross income under the PIT Law for taxable years beginning on or after January 1, 2024, and before January 1, 2034.

3) Defines "uniformed services" for the retirement pay exclusion as:

   a) The "Armed Forces of the United States";

   b) 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;

   c) The commissioned corps of the United States Public Health Service; and,

   d) The National Oceanic and Atmospheric Administration Commissioned Officer Corps.

4) Provides that "Armed Forces of the United States" for the retirement pay exclusion includes:

   a) All regular and reserve components of the uniformed services which 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 and the United States Space Force; and,

   b) Commissioned officers and personnel below the grade of commissioned officers in such forces.

5) Excludes annuity payments received by a qualified taxpayer under the United States Department of Defense Survivor Benefit Plan during the taxable year from gross income for taxable years beginning on or after January 1, 2024, and before January 1, 2034.

6) Defines "United States Department of Defense Survivor Benefit Plan" or "plan" as a survivor benefit plan established under Sections 1447 to 1455, inclusive, of Title 10 of the United States Code.

7) Defines a "qualified taxpayer" for the annuity payments exclusion as the surviving spouse or other named beneficiary of a plan.

8) Repeals both gross income exclusion provisions on December 1, 2034.

9) Makes findings and declarations in compliance with Revenue and Taxation Code (R&TC) Section 41.

10) Declares that no reimbursement is required by this bill under Section 6 of Article XIIIB of the California Constitution for specified reasons.

11) Takes immediate effect as a tax levy.

EXISTING LAW:

1) Conforms to federal law, which provides that "gross income" includes all income from whatever source derived unless expressly excluded. (Internal Revenue Code (IRC) Section 61 and R&TC Section 17071.) Gross income includes compensation for services, business income, gain from selling property, interest, rents, royalties, dividends, and pensions. Military retirement pay of California residents is taxable.

2) Provides various exclusions from gross income in determining tax liability under the PIT Law. (R&TC Section 17131 *et seq.*)

3) Excludes from gross income, under state and federal law, certain types of income for an individual's active service in the Armed Forces, such as military pay for time served in combat zones, disability compensation, and death benefits paid to qualified survivors. (R&TC Section 17142.5.)

4) Excludes from gross income specified death benefits received by the surviving spouse or designated beneficiary of any member of the California National Guard, State Military Reserve, or Naval Militia who dies or is killed in the performance of duty, as specified. (R&TC Section 17132.4.)

5) Allows, under existing federal, members of uniformed services to elect to reduce their retirement pay pre-tax to provide an annuity to their survivors. In addition, under federal and state tax laws, the reduction is excluded from gross income.

6) Provides, under federal and state tax laws that certain annuities paid to survivors are in the survivors' gross income for tax purposes. Therefore, the annuities paid are taxable.

FISCAL EFFECT: The Franchise Tax Board (FTB) estimates General Fund revenue losses of $50 million for fiscal year (FY) 23-24, $85 million for FY 24-25, and $85 million for FY 25-26.

COMMENTS:

1) The author has provided the following statement in support of this bill:

> AB 46 recognizes members of the Armed Forces and their contribution to our nation and seeks to exempt their retirement pay once they retire after twenty years of service. This bill sunsets in 2034.
>
> The purpose of the bill is twofold; to honor those who dedicated their life to serving their country, and to retain and attract uniformed service retirees to California for the purposes of strengthening the state's skilled workforce, bringing stability to communities, and contributing to the state and local tax base.

2) This bill is supported by several veteran's organizations and sponsored by the California Council of Chapters Affiliated Military Officers Association of America (CALMOAA), who note, in part:

Between 2010 and 2020 the nation's population of military retirees has increased by 4%. California, during this period, was one of the few states that saw a reduction in the number of military retirees. California had a decline of 12% in the state's military retiree population. During the same period, Nevada showed a gain of 10% and Arizona a gain of 6%. Both Arizona and Nevada fully exempt military retirement from state taxes.

Recent studies conducted by the San Diego Military Advisory Council and others agree that retaining Uniformed Service retirees in California provide a valuable workforce and economic development tool for California. These studies also show that military retirees generate millions of dollars in general tax revenue for the state's economy from their 2nd careers.

3) Committee staff comments:

   a) *What would this bill do?* This bill excludes uniformed services retirement pay and annuity payments from the United States Department of Defense Survivor Benefit Plan from gross income for taxable years beginning on or after January 1, 2024, and before January 1, 2034. In other words, this bill provides that retirement pay for members of the uniformed services and survivor benefits paid to beneficiaries are not considered taxable income for the purposes of the PIT.

   b) *Who receives military retirement payments and survivor annuity payments*? As of December 31, 2021, 132,344 military retirees in California received total monthly payments of over $340 million or about $4.1 billion annually from the United States Department of Defense (DoD).[1] Generally, service members can retire from active duty at any age with at least 20 years of service. In addition, persons who meet retirement requirements partially or entirely through reserve or National Guard service receive retirement pay after age 59.

      Also, as of December 31, 2021, 27,060 survivors in California received total monthly payments of $34,593,000 or about $415 million annually.[2] The Survivor Benefit Plan allows a military retiree to ensure, after death, a continuous lifetime annuity for their dependents. A military retiree pays premiums for the Survivor Benefit Plan coverage upon retiring. Premiums are paid from gross retired pay and are not taxed at the federal level, and are also not taxed at the state level.

   c) *The population of California's military retirees and survivors receiving pay from the DoD has been steadily declining*: Committee staff analyzed the DoD Office of Actuary's data. The data show that the population of military retirees receiving pay from the DoD in California has been steadily declining by approximately 1% to 3% year-over-year (YOY) since 2013.[3] California experienced this YOY decline while the world and the

[1] Office of the Actuary, Department of Defense, *Military retirees and survivors by congressional district as of December 31, 2021 for the 117th congress* (CONGDIST 2021) (2022). https://actuary.defense.gov/Portals/15/CONGDIST%202021%20v999.pdf
[2] *Id*.
[3] *Id*.

U.S. generally had a slight YOY increase. (See "TOTAL MILITARY RETIREES RECEIVING PAY FROM DOD" table below.)

TOTAL MILITARY RETIREES RECEIVING PAY FROM DOD						
Year	**World Total**	**World YOY**	**U.S. Total**	**U.S. YOY**	**CA Total**	**CA YOY**
2021	2,008,403	-0.36%	1,985,852	-0.32%	132,344	-3.28%
2020	2,015,756	-0.22%	1,992,319	-0.18%	136,833	-2.27%
2019	2,020,175	0.09%	1,995,969	0.07%	140,015	-2.11%
2018	2,018,457	0.15%	1,994,526	0.16%	143,030	-2.09%
2017	2,015,423	0.14%	1,991,414	0.14%	146,088	-1.55%
2016	2,012,619	0.35%	1,988,655	0.35%	148,394	-1.48%
2015	2,005,526	0.50%	1,981,625	0.50%	150,628	-1.02%
2014	1,995,472	0.68%	1,971,829	0.67%	152,182	-0.72%
2013	1,981,999		1,958,673		153,280	

The population of survivors receiving pay from DoD in California has also experienced a persistent YOY decline, at a greater rate than in the world and the U.S. (See "TOTAL SURVIVORS RECEIVING PAY FROM DOD" table below.)

TOTAL SURVIVORS RECEIVING PAY FROM DOD						
Year	**World Total**	**World YOY**	**U.S. Total**	**U.S. YOY**	**CA Total**	**CA YOY**
2021	308,654	-1.02%	307,830	-1.03%	27,060	-4.04%
2020	311,825	1.00%	311,030	1.52%	28,199	-1.63%
2019	308,739	-0.49%	306,365	-0.50%	28,665	-2.91%
2018	310,272	-1.48%	307,904	-1.48%	29,523	-3.89%
2017	314,928	-1.28%	312,542	-1.28%	30,718	-3.48%
2016	319,012	-0.53%	316,599	-0.53%	31,825	-2.61%
2015	320,708	-1.80%	318,299	-0.65%	32,678	-2.71%
2014	326,583	-0.43%	320,397	-0.43%	33,587	-2.22%
2013	327,989		321,784		34,351	

d) *Need to improve California's attractiveness to veterans and discharging service members*: In a 2015 report to the Governor, the Governor's Military Council stated on page 70:

> At the same time, many veterans and discharging service members choose to move to other states. While some portion of these individuals are simply returning to their home state, others leave California based on concerns about our state's cost of living

or because they are attracted to incentives provided by other states for veterans. State leaders should explore appropriate ways to incentivize veterans to stay in California.[4]

e) *California previously offered military-specific income exclusions and later a targeted tax credit*: For taxable years beginning December 22, 1972 through January 1, 1986, California law provided taxpayers an annual $1,000 income exclusion for compensation received during active duty in the Armed Forces or State Military Reserve. State law also provided taxpayers an exclusion of up to $500 per month for any compensation received during active duty in the National Guard in connection with an emergency. Additionally, an income exclusion was applied to pensions or retirement pay received by an individual for their service in the Armed Forces, the State Military Reserve, or the National Guard. (See former R&TC Section 17146.)

For taxable years beginning January 1, 1987 through January 1, 1992, a member of the Armed Forces was allowed a credit, rather than an exclusion from gross income, in an amount equal to 4% of the eligible income received by an individual whose adjusted gross income was less than $27,000. Eligible income included salary, wages, bonuses, allowances, pensions, retirement pay, and other compensation received by an individual for their services on extended active duty as a member of the Armed Forces, including the California National Guard or the State Military Reserve. This law remained in effect until its January 1, 1992 sunset. (See former R&TC Section 17053.13.)

f) *Treatment of military retiree and survivor income by other states*: A significant number of states exclude military retirement pay from being taxed in the state, and California appears to be an outlier. For example, five states (Arizona, Utah, Indiana, Nebraska, and North Carolina) passed laws not to tax military retirement income starting for the 2021 or 2022 taxable year.[5]

Twenty-seven states do not tax military retirement pay: Alabama, Arizona, Arkansas, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Pennsylvania, Utah, West Virginia, and Wisconsin.

Nine states have no state income tax: Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming. New Hampshire taxes residents on interest and dividends but does not tax regular earned income or pension income.

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[4] Governor's Military Council, Office of Governor Edmund G. Brown Jr., *Maintaining and Expanding California's National Security Mission* (June 2015). https://militarycouncil.ca.gov/s_councilreport/

[5] Geier, Yahoo Smartasset. These five states just eliminated income tax on military retirement. (January 11, 2022.) https://www.yahoo.com/video/five-states-just-eliminated-income-203758421.html

Fourteen states tax military retirement income partially through income exemptions and exclusions: Colorado, Delaware, Georgia, Idaho, Kentucky, Maryland, Montana, New Mexico, Oklahoma, Oregon, Rhode Island, South Carolina, Vermont, and Virginia.[6]

Vermont and Virginia enacted legislation in 2022 exempting the first $10,000 in military retirement pay from state income taxation for qualifying taxpayers.[7,8] California appears to now be the only state that fully taxes military retirement pay.

A significant number of states are also not taxing annuity payments from the Survivor Benefit Plan.[9] For example, Arizona, North Carolina, and Utah passed legislation to not tax survivor annuity payments in 2021.[10]

g) *Taxation may not be the primary reason for the recent increase in migration out of California to other states*: According to the Public Policy Institute of California (PPIC), people who move to California are more likely to be working age, to be employed, and to earn high wages—and are less likely to be in poverty—than those who move away.[11] Moreover, a PPIC Statewide Survey found that one-third of Californians have seriously considered leaving the state because of housing costs.[12] PPIC notes that the state's high cost of living, driven almost solely by comparatively high housing costs, remains an ongoing public policy challenge—one that needs resolution if the state is to be a place of opportunity for all of its residents.[13]

Furthermore, lower income and middle-income taxpayers may be paying a higher percentage of total state and local taxes in other states than in California. For example, the Institute on Taxation and Economic Policy's study in 2018, based on one of the largest databases of tax returns and supplementary data, found that middle-income taxpayers in California pay 8.3% of total state and local taxes as a share of family income

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[6] Baumhover, The Military Wallet, *Military Retirement Income Taxes by State – Which States Don't Tax Military Retirement Pay?* (October 18, 2022). https://themilitarywallet.com/military-retirement-pay-tax-exempt/

[7] Hanley, Military Officers Association of America, *State Tax Update: Details on New Virginia Retiree Exemptions and Much More* (July 22, 2022). https://www.moaa.org/content/publications-and-media/news-articles/2022-news-articles/state-tax-update-details-on-the-new-virginia-law-and-much-more/

[8] Office of Veterans Affairs, State of Vermont, *Tax Exemptions for Veterans*. https://veterans.vermont.gov/benefits-and-services/veteran-benefits/tax-exemptions-veterans

[9] Absher, Military.com (January 10, 2022). States tax information for military members and retirees. https://www.military.com/money/personal-finance/state-tax-information.html

[10] Absher, Military.com (January 11, 2022). 5 more states make military retirement tax free. https://www.military.com/daily-news/2022/01/10/five-more-states-make-military-retirement-tax-free.html

[11] Johnson, Public Policy Institute of California, *Who's leaving California—and who's moving in?* (May 6, 2021). https://www.ppic.org/blog/whos-leaving-california-and-whos-moving-in/

[12] Baldassare, Bonner, Lawler, & Thomas, Public Policy Institute, *PPIC statewide survey: Californians and their government*. https://www.ppic.org/publication/ppic-statewide-survey-californians-and-their-government-february-2023/

[13] Johnson (2021).

compared to 9.7% in Texas or 8.5% in Arizona.[14] Therefore, legislative solutions that provide tax relief may not be as effective as those that decrease housing costs.

h) *Potential unintended consequences of this bill*: Generally, gross income exclusions in a progressive income tax system benefit higher income earners more than any other group. If high living costs persist in California, this bill may disproportionately attract wealthier military retirees and survivors to stay or come to California. In addition, over one million veterans in California who are not receiving military retirement benefits do not directly benefit from this bill.

   It should also be noted that California currently taxes the retirement benefits of teachers, first responders, and public service retirees. As a result, this Committee may face a slippery slope of choosing which groups should be rewarded and commended with similar income exclusions.

i) *Potential for double tax benefit*: Under existing federal law, members of the uniformed services may elect to reduce their retirement pay to provide an annuity to their survivors and families. This amount is generally excluded from gross income (front-end tax benefit). Under this bill, the survivors would also receive tax-free money (back-end tax benefit). Therefore, this bill results in a front-end and back-end tax benefit, a net loss for the state.

j) *Nonconformity to federal law*: This bill establishes exclusions for which federal law has no counterpart. Generally, nonconformity to federal law adds complexity and additional administrative burdens.

k) *Agency implementation concerns:* This bill requires the FTB to provide information to the Legislative Analyst's Office related to the exclusions; however, FTB is not clear on what specific information would be required. Additionally, FTB may not have information on the exclusions taken, the economic security of veterans or recipients of survivor benefit plans, or the number of veterans and beneficiaries leaving California.

l) *What is a "tax expenditure"?* Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these tax law features should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose, and there is a determinable cost associated with each (in the form of foregone revenues).

   As the Department of Finance notes in its annual Tax Expenditure Report, there are several critical differences between tax expenditures and direct expenditures. First, tax expenditures are reviewed less frequently than direct expenditures. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by a majority vote but cannot be rescinded, regardless of

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[14] Institute on Taxation and Economic Policy, *Who pays?* (6th Edition 2018). https://itep.sfo2.digitaloceanspaces.com/whopays-ITEP-2018.pdf

efficacy or cost, without a supermajority vote. This bill enacts a new tax expenditure program in the form of gross income exclusions for military retirement pay and annuity payments from the United States Department of Defense Survivor Benefit Plan.

m) *Committee's tax expenditure policy*: This bill complies with R&TC Section 41 because it outlines specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives.

In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals have an appropriate sunset provision to be eligible for a vote. Sunsets are required because eliminating a tax expenditure generally requires a two-thirds vote. Accordingly, this bill contains a sunset provision that states the income exclusions provided in this bill are repealed on December 1, 2034.

n) *Prior Legislation:*

i) AB 1623 (Ramos), of the 2021-22 Legislation Session, was substantially similar to this bill. AB 1623 was held on the Assembly Appropriations Committee's Suspense File.

ii) AB 1629 (Seyarto), of the 2021-22 Legislation Session, would have excluded from gross income survivor benefits or payments, not to exceed $20,000 per taxable year, received under the federal Survivor Benefit Plan for a period of five taxable years. AB 1629 was not heard by this Committee.

iii) AB 291 (Seyarto), of the 2021-22 Legislation Session, would have excluded from gross income survivor benefits and payments received under the federal Survivor Benefit Plan for five taxable years. AB 291 was not heard by this Committee.

iv) AB 151 (Voepel), of the 2019-20 Legislative Session, would have excluded from gross income specified amounts of military retirement pay for 10 taxable years. AB 151 was not heard by this Committee.

v) AB 427 (Brough), of the 2019-20 Legislative Session, would have excluded from gross income specified amounts of retirement pay for ten taxable years. AB 427 was held on the Assembly Appropriations Committee's Suspense File.

vi) AB 2380 (Choi), of the 2019-20 Legislative Session, would have excluded from gross income survivor benefits or payments received under the federal Survivor Benefit Plan for five taxable years. AB 2380 was not heard by this Committee.

vii) SB 1007 (Hueso), of the 2019-20 Legislative Session, would have excluded from gross income military retirement pay for 10 taxable years. SB 1007 was not heard due to the shortened 2020 Legislative Calendar as a result of the COVID-19 pandemic.

viii) SB 1071 (Wilk), of the 2019-20 Legislative Session, would have excluded from gross income a percentage of military retirement pay for 10 taxable years. SB 1071 was never heard due to the shortened 2020 Legislative Calendar as a result of the COVID-19 pandemic.

REGISTERED SUPPORT / OPPOSITION:

Support

American Legion, Department of California
AMVETS, Department of California
California Association of County Veterans Service Officers
California Council of Chapters Military Officers Association of America
California Enlisted Association of The National Guard of The United States (CAL-EANGUS)
California State Commanders Veterans Council
Howard Jarvis Taxpayers Association (HJTA)
Military Officers Association of America (MOAA)
Monterey County Board of Supervisors
Orange Empire Military Officers Club
San Bernardino County
San Diego County Taxpayers Association
San Diego Military Advisory Council (SDMAC)
Solano County Chapter, Military Officers Association of America
Ventura County Chapter of The Military Officers Association of America (VCC-MOAA)
Vietnam Veterans of America, California State Council
24 private individuals

Opposition

None on file

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