

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington St., Suite 301
Indianapolis, IN 46204
(317) 233-0696
iga.in.gov

FISCAL IMPACT STATEMENT

LS 6038

BILL NUMBER: HB 1034

NOTE PREPARED: Apr 13, 2023

BILL AMENDED: Apr 11, 2023

SUBJECT: Income Tax Exemption for Military Pay.

FIRST AUTHOR: Rep. Frye R

FIRST SPONSOR: Sen. Baldwin

BILL STATUS: 2nd Reading - 2nd House

FUNDS AFFECTED: X **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill exempts military pay for members of a reserve component of the armed forces of the United States or the national guard from the individual income tax. (Current law provides an individual income tax exemption for members of a reserve component of the armed forces of the United States or the national guard for the period the member is mobilized and deployed.) It exempts military pay earned by members of an active component of the armed forces of the United States from the individual income tax. (Current law exempts from the Individual Income Tax the military pay earned by members of the National Guard and reserve components of the armed forces of the United States while serving on active duty.)

Effective Date: July 1, 2023.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and software to reflect the changes to the military income deduction. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Active Duty Military Income:* The bill increases the active duty military income tax deduction from a maximum of \$5,000 to a full exemption. These changes would be effective beginning in tax year 2024. The revenue loss is estimated to be \$20 M in FY 2025. The revenue loss could potentially grow by 3% to 5% annually thereafter. To the extent that taxpayers adjust their income tax withholding, the fiscal impact would begin in FY 2024. [Individual Adjusted Gross Income (AGI) Tax revenue is deposited in the General Fund.]

Reserves and National Guard: The bill increases the reserves and National Guard military income tax deduction from \$5,000 under current law to a full exemption for military income. The provision would result in significant reduction in state individual income tax. This provision is effective July 1, 2023, so the fiscal impact for at least six months will occur in FY 2024. To the extent that taxpayers adjust their income tax withholding, the full year fiscal impact could begin in FY 2024. The revenue loss could potentially grow by 3% to 5% annually thereafter. The fiscal impact from this provision is indeterminable.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the changes to the military income deduction will decrease taxable income, counties imposing a local income tax (LIT) could potentially experience a decrease in revenue from this tax.

Active Duty Military Income: Based on the current weighted average LIT rate of 1.64%, the revenue loss is estimated to be \$10.4 M in FY 2025. The revenue loss could potentially grow by 3% to 5% annually thereafter.

Reserves and National Guard: Exempting military income to members of the reserves and National Guard would have a substantial impact on LIT revenues.

Additional Information - The estimates are based on pay and benefit information and personnel counts provided by the U.S. Department of Defense's Defense Manpower Data Center (DMDC). These data provide counts of active duty, Armed Forces Reserve, and National Guard personnel reporting Indiana as their state of legal residence and annualized taxable pay to those individuals.

The estimates assume that active duty, Armed Forces Reserve, and National Guard personnel are already claiming the current military income deduction. It also accounts for Armed Forces Reserve and National Guard personnel who claim the current full deduction for active duty pay they may earn. The estimate does not include active duty personnel reported with an Indiana duty location who are not Indiana residents.

Current statute provides an AGI Tax deduction for the first \$5,000 of income earned by an individual for his or her service in an active or reserve component of the U.S. armed forces, including the National Guard. Also, current statute provides a full deduction for active duty pay earned by members of the Armed Forces Reserve or National Guard in lieu of the deduction for military service income described above. (Note: Combat pay is already excluded from federal gross income and, as a result, is excluded from Indiana AGI.)

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: U.S. Department of Defense, Defense Manpower Data Center; OFMA Income Tax database.

Fiscal Analyst: Randhir Jha, 317-232 9566.