
SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Anna M. Caballero, Chair

2023 - 2024 Regular

Bill No: AB 46
Author: Ramos
Version: 12/5/22
Consultant: Grinnell

Hearing Date: 6/14/23
Tax Levy: Yes
Fiscal: Yes

PERSONAL INCOME TAXES: EXCLUSION: MILITARY SERVICES RETIREMENT AND SURVIVING SPOUSE BENEFIT PAYMENT ACT

Enacts the Military Services Retirement and Surviving Spouse Benefit Payment Act, which excludes two forms of military retirement income from state income tax.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives either to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something they would otherwise not do, but for the tax credit. The Department of Finance is required annually to publish a list of tax expenditures, which currently total around \$87 billion per year.

Income. Existing federal and state laws provide that gross income includes all income from any source, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Existing federal and state laws exclude certain types of income from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations, among others.

Military retirement income. Generally, military 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. Military retirement pay received by a taxpayer is usually taxable for federal and state purposes. However, federal and state law exclude certain types of military income from tax, including military death benefits paid to qualified survivors, military pay for time serviced in combat zones, and the premium paid into a survivor annuity account for qualified survivors of military personnel.

The Survivor Benefit Plan is a United States Department of Defense (DoD) sponsored and subsidized program that allows a military retiree to ensure, after death, a continuous lifetime annuity for their dependents. Under existing federal law, members of the uniformed services may elect to reduce their retirement pay to provide an annuity to their survivors, and the reduction is excluded from gross income. However, payments received by beneficiaries of the survivor annuity accounts, are included in gross income calculation for those beneficiaries.

According to DoD, 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). Also, as of December 31, 2021, 27,060 survivors in California received total monthly Survivor Benefit Plan payments of \$34,593,000 or about \$415 million annually.

Seeking to reward military veterans for their service, and provide an incentive for military retirees to reside in the state, the author wants to exclude military retirement and survivor benefit payments from state income tax.

Proposed Law

Assembly Bill 46 enacts the Military Services Retirement and Surviving Spouse Benefit Payment Act, which excludes from income for state tax purposes:

- Retirement pay received by a taxpayer from the federal government for services in the uniformed services, and
- Annuity payments received by a qualified taxpayer pursuant to a DoD Survivor Benefit Plan.

AB 46 applies beginning in the 2024 taxable year, and ends after the 2033 taxable year. The bill defines several terms, and makes legislative findings and declarations supporting its purposes, as well as to comply with Section 41 of the Revenue and Taxation Code.

State Revenue Impact

According to the Franchise Tax Board (FTB), AB 46 results in state revenue losses of \$50 million in 2023-24, and \$85 million in 2024-25 and 2025-26.

Comments

1. Purpose of the bill. According to the author, “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. 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. AB 46 has received unanimous Bi-partisan support through the process.”

2. Revenue loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for certain taxpayers. By excluding a form of income that is currently included for tax purposes, AB 46 will result in the State General fund receiving less revenue. As a result, the state will have to reduce spending or increase taxes to account for the loss.

3. Precedent. Income is generally taxable, regardless of the source derived. If the Legislature exempts retirement income for one line of work that provides a direct benefit to the public, why shouldn’t it extend the same treatment for other commendable professions, such as teachers, fire fighters, police officers, or health providers? Additionally, military personnel, like other public servants, agree to enter into service in exchange for a salary, benefits, and other considerations;

AB 46 would provide an unexpected windfall benefit after their service is complete. Why should retired military not have to pay tax on retirement income, when retirees of other worthy jobs have to?

4. Who benefits? California's progressive income tax system applies higher marginal rates as annual taxable income grows above certain thresholds. As a result, enacting a gross income exclusion benefits higher income earners more than any other group; a taxpayer whose income from other sources puts them in the 12.3% bracket has a higher dollar benefit from AB 46's exclusion than a taxpayer in the 4% one. In comparison, a capped exclusion or a fixed amount tax credit similar to the personal or dependent exemption credit helps all taxpayers equally. The Committee may wish to consider whether enacting a fixed credit amount for military retirees would be more equitable.

5. Conformity. AB 46 would exempt certain military retirement benefits for state tax purposes that are taxable under federal law unless and until Congress adopts similar treatment. While the bill would provide a financial benefit to military retirees, taxpayers often find different treatment between state and federal taxes for the same item of income confusing and frustrating.

6. Section 41. Section 41 of the Revenue and Taxation Code requires any bill enacting a new tax expenditure to contain, among other things, specific goals, purposes, and objectives that the tax expenditure will achieve and detailed performance indicators, along with data collection and reporting requirements (SB 1335, Leno, 2014). To satisfy these requirements, AB 46 states that its purpose is to honor the service of California veterans and provide fiscal relief so they and their families will remain or retire in California, and to increase the number of highly skilled retired veterans in California's workforce. The bill identifies the following performance indicators:

- The number of veterans and survivor benefit plan beneficiaries taking advantage of the tax exclusions.
- The economic security of veterans and survivor benefit plan beneficiaries in California.
- The number of retired veterans and survivor benefit plan beneficiaries leaving California.

The bill then directs the Legislative Analyst's Office (LAO) in collaboration with the Department of Veterans Affairs to submit a report to the Legislature on the effectiveness of the exclusion. The report must include an analysis of the number of veterans and survivor benefit plan beneficiaries taking advantage of the exclusions, the impact of the exclusions on the economic security of veterans and survivor benefit plan beneficiaries in California, and the number of retired veterans and survivor benefit plan beneficiaries leaving California. AB 46 provides that FTB, the California Department of Tax and Fee Administration, and the Department of Veterans Affairs must provide any information necessary requested by LAO, and subjects the information to existing confidentiality requirements and sanctions for unlawful disclosure.

Assembly Actions

Assembly Revenue and Taxation Committee:	11-0
Assembly Appropriations Committee:	15-0
Assembly Floor:	77-0

Support and Opposition (6/9/23)

Support:

Military Officers Association of America, California Council of Chapters (Sponsor)
Aerospace and Defense Alliance of California
American Legion, Department of California
Amvets, Department of California
Association of The U.s. Army, Northern & Southern California Chapters
California Association of County Veteran Services Officers
California Association of County Veterans Service Officers
California Association of Highway Patrolmen
California Enlisted Association of The National Guard of The United States
California Manufacturers and Technology Association
California State Commanders Veterans Council
City of Fairfield
County of Monterey
Howard Jarvis Taxpayers Association
Military Officers Association of America - Alameda Chapter
Military Officers Association of America - Alta CA Chapter
Military Officers Association of America - California Council of Chapters
Military Officers Association of America - Miramar Chapter
Military Officers Association of America - Redwood Empire Chapter
Military Officers Association of America - Sacramento Chapter
Military Officers Association of America - Solano County
Military Officers Association of America - Ventura County Chapter
Peace Officers Research Association of California
San Diego Military Advisory Council
San Diego Regional Chamber of Commerce
Scottish-american Military Society
Vietnam Veterans of America, California State Council
41 Individuals

OPPOSITION

Opposition:

California Federation of Teachers Afl-cio

-- END --