
SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair

2025 - 2026 Regular

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Author: Archuleta
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Consultant: Summers

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Tax Levy: Yes
Fiscal: Yes

***PERSONAL INCOME TAX LAW: EXCLUSIONS: MILITARY RETIREMENT PAY:
SURVIVOR BENEFIT PAY***

Expands the Military Services Retirement and Surviving Spouse Benefit Payment Act by eliminating the adjusted gross income limits and the \$20,000 maximum exclusion cap and extending the exclusion to tax year 2036.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives 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 to annually publish a list of tax expenditures, which currently total around \$94.2 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 specified amounts received as gifts or by 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 other things.

Military retirement income. Generally, military service members can retire from active duty at any age after 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 and pay for time served in combat zones.

The Survivor Benefit Plan (SBP) 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 the gross income calculation for those beneficiaries.

According to the most recent publicly available data from the DOD, as of September 30, 2022, there were 1,998,452 military retirees; the average gross monthly military retirement pay was \$2,823 (\$33,876 annually).¹

All Federal Military Retirees Retired as of September 30, 2022, and Receiving Retired Pay by Rank			
<i>Sorted Lowest to Highest by Average Gross Pay</i>			
RANK/ GROUPING	NUMBER ALL RETIRES	GROSS Monthly Average	GROSS Annual Average
E-2	1,510	\$702	\$ 8,424
E-1	581	\$734	\$ 8,808
E-3	5,681	\$832	\$ 9,984
UNKNOWN RANK	21	\$973	\$ 11,676
E-4	25,205	\$1,037	\$ 12,444
E-5	96,221	\$1,248	\$ 14,976
O-1	502	\$1,545	\$ 18,540
E-6	396,636	\$1,658	\$ 19,896
W-1	277	\$1,959	\$ 23,508
O-2	3,333	\$2,210	\$ 26,520
E-7	570,949	\$2,231	\$ 26,772
W-2	10,188	\$2,536	\$ 30,432
E-8	247,649	\$2,715	\$ 32,580
W-3	22,461	\$3,088	\$ 37,056
O-3	42,281	\$3,257	\$ 39,084
O-4	127,571	\$3,675	\$ 44,100
W-4	25,774	\$3,887	\$ 46,644
E-9	105,376	\$3,959	\$ 47,508
O-5	192,699	\$4,417	\$ 53,004
W-5	5,467	\$5,811	\$ 69,732
O-6	110,518	\$6,355	\$ 76,260
O-7	3,321	\$7,500	\$ 90,000
O-8	2,998	\$9,793	\$ 117,516
O-9	970	\$14,408	\$ 172,896
O-10	263	\$17,020	\$ 204,240
All Commissioned	484,456	\$4,625	\$ 55,500
All Warrant	64,167	\$3,549	\$ 42,588
All Officers	548,623	\$4,499	\$ 53,988
All Enlisted	1,449,808	\$2,189	\$ 26,268
All retirees	1,998,452	\$2,823	\$ 33,876

¹ <https://media.defense.gov/2023/Oct/06/2003315292/-1/-1/0/MRS%20STATRPT%202022%20V999.PDF>

Military Services Retirement and Surviving Spouse Benefit Payment Act. Governor Newsom's 2025-26 Proposed Budget proposed to exclude up to \$20,000 of military retirement pay and survivor benefit pay for taxpayers with an adjusted gross income (AGI) of:

- \$250,000 or less, in the case of a surviving spouse or spouses filing a joint return, and
- \$125,000 or less, for any other individual.

The Legislature subsequently enacted the proposal as the Military Services Retirement and Surviving Spouse Benefit Payment Act as part of the 2025 Budget Act (SB 132, Committee on Budget & Fiscal Review, 2025). The exclusion commenced in the 2025 taxable year and is set to end after the 2029 taxable year.

Economic impact of the exodus of military retirees and survivors. Comparing US Census reports with DoD data for 2021 to 2024, California is losing military retirees at a rate forty times greater than its overall population decline. Since 2016, California has slipped from 3rd to 4th in terms of the largest population of military retirees, with a median annual loss rate of 2,698 and a loss of \$472.9 million in taxable income from retirement pay from 2016 to 2022. Since 2016, California has gone from having the highest population of survivors in the country to just the third highest, with a median loss rate of 1,078 per year and a loss of \$86 million in taxable income from survivor benefits from 2016 to 2022. According to the DoD, as of December 31, 2022, the 127,657 military retirees in California received a combined total of monthly payments over \$333.7 million, or about \$4.0 billion annually from the United States DoD. In addition, as of December 31, 2022, the 26,036 survivors in California received total monthly Survivor Benefit Plan payments of \$35.8 million or about \$429 million annually.

Seeking to honor veterans and create incentives for military retirees to reside in the state, the author wants to exclude all military retirement and survivor benefit payments from state income tax by eliminating the AGI limits and the \$20,000 maximum exclusion cap.

Proposed Law

Senate Bill 1407 expands the Military Services Retirement and Surviving Spouse Benefit Payment Act by eliminating the AGI limits and the \$20,000 maximum exclusion cap from the state income tax exclusion for:

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

SB 1407 also extends the exclusion seven more years through the 2036 taxable year. The bill also defines several terms and complies with Section 41 of the Revenue and Taxation Code.

State Revenue Impact

According to the Franchise Tax Board, SB 1407 would result in a revenue loss of \$100 million in FYs 2026-27, \$65 million in 2027-28, and \$65 million in 2028-29.

Comments

1. Purpose of the bill. According to the author, “For too long our veterans have been faced with a difficult decision: stay in this beautiful state while struggling to make ends meet with rising costs of living or move to a state that financially incentivizes them to join their labor force and feed federal dollars into their economy. I’ve heard from far too many of my brothers and sisters who say California has become too expensive for them to live and say a tax exemption on their retirement pay would be the determining factor on whether they stay or leave. California's current tax structure discourages long-term service and drives away mid-career leaders, weakening our state's ability to meet homeland defense, wildfire, disaster response, and civil support missions. As retention challenges grow, we must recognize that fiscal policy plays a role in long-term enlistment decisions. SB 1407 is crucial in strengthening California’s commitment to supporting its veterans. Veterans staying in California will pay sales, property, and use taxes, benefiting local governments. By exempting military retirement pay for retirees, SB 1407 will ensure California retains these highly skilled professionals and keeps the reinvestment of federal dollars and wages from second careers.”

2. “Windfall” or “but for” tax benefit? Tax expenditures produce two different outcomes. The first outcome is a “windfall,” in which the tax expenditure rewards behavior that would have occurred regardless of the tax benefit. The second outcome is a “but for tax benefit,” where a particular activity would not have occurred without the incentive created by the tax expenditure. Here, military personnel, like other public servants, agree to serve in exchange for predetermined benefits. In California, income exclusion for retirement income was not an anticipated benefit. Therefore, this would be a windfall for those retirees and their beneficiary survivors. On the other hand, California is losing military retirees at a disproportionate rate compared to other states. Therefore, this exclusion may serve as a “but for” incentive to retain veterans, who would otherwise have relocated to a state with more favorable tax policy.

3. Revenue loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for certain taxpayers, including SB 132’s partial exclusion for military retirement pay and survivor benefit pay. According to the Senate Floor Analysis of SB 132, the bill’s provisions related to the military retirement pay exclusion were estimated to reduce revenues by \$130 million in FY 2025-26 and by \$80 million annually thereafter. The Legislative Analyst’s Office stated the exclusion would reduce state taxes for 130,000 veterans in the state and would equate to a \$600 tax reduction for the average military retiree.² By excluding all military retirement and surviving spouse benefit pay from gross income, SB 1407 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. Additionally, its benefits would accrue solely to veterans with income above SB 132’s AGI threshold, and its benefit to veterans would increase the more retirement income they receive. The Committee may wish to consider amending SB 1407 to increase the current exclusion amount rather than eliminating it, and to index the AGI thresholds to inflation rather than striking them.

4. Precedent. Income is generally taxable, regardless of the source from which it is derived. If the Legislature exempts retirement income for one line of work that provides a direct benefit to the public, why should it not extend the same treatment for other commendable professions, such as teachers, firefighters, or police officers? This may lead to a slippery slope where retirement

² <https://lao.ca.gov/LAOEconTax/Article/Detail/820>

income from other professions is excluded from gross income, thereby eroding the income tax base.

5. Equity. Veterans face a variety of hardships, including mental health issues, financial challenges, and difficulties transitioning to civilian life. Financial insecurity and uncertainty, especially around retirement pay or survivor benefits, can exacerbate these stressors. SB 1407 reduces the economic burden on veterans and their families, which can help reduce overall stress. Additionally, surviving spouses are more vulnerable to financial hardship following the death of a loved one. State income tax on survivor benefits can threaten the economic security of a family after the death of a service member. SB 1407 will help surviving spouses maintain financial stability by reducing state income taxes on survivor benefits.

6. 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 others; a taxpayer whose income from other sources puts them in the 12.3% bracket has a higher dollar benefit from SB 1407's exclusion than a taxpayer in the 4% bracket.

7. Conformity. SB 1407 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 when filing their taxes.

8. 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). A bill that would authorize a new gross income exclusion is exempt from the requirement that the bill contain detailed performance indicators and data collection reporting if the Legislature determines there is no available data to collect and report (AB 3289, Committee on Revenue and Taxation, 2024). To satisfy these requirements, SB 1407 states that its specific goals are to recognize the loss and sacrifice of military families, give them the support that our community owes them, and to provide some financial relief to families that have experienced not only the loss of a loved one, but also often the loss of the sole income of the family, who are now trying to make ends meet on a portion of that original income. The bill also states that there is no available data to collect or report with respect to the exclusions.

9. Related legislation. AB 2016 (Jeff Gonzalez, 2026) is substantially similar to SB 1407. The bill excludes from gross income all retirement pay received for service in the uniformed services and annuity payments received from a Survivor Benefit Plan for taxable years beginning on or after January 1, 2025, and before January 1, 2030. This bill is currently pending in the Assembly Committee on Revenue & Taxation.

10. Double-referred. The Senate Rules Committee ordered a double referral for SB 1407: first to the Committee on Revenue and Taxation, and second to the Committee on Military and Veterans Affairs.

Support: California State Treasurer Fiona Ma (Sponsor)
Veterans of Foreign Wars (Co-Sponsor)
American Legion, Department of California
AMVETS, Department of California
Armed Services YMCA San Diego
Burnham Center for Community Advancement
Cal Fire Local 2881
California Association of County Veterans Service Officers
California Association of Highway Patrolmen
California Hispanic Chambers of Commerce
California State Commanders Veterans Council
China Lake Alliance
General Atomics Electromagnetic Systems
Military Officers Association of America, California Council of Chapters
National University
Peace Officers Research Association of California
San Diego Regional Chamber of Commerce
Schneider Electric
The Veterans Beer Club
Veterans Village of San Diego
VetFund Foundation
Vietnam Veterans of America, California State Council
Western States Regional Council of Carpenters
Workshops for Warriors
YMCA of San Diego County

Opposition: California Tax Reform Association
California Teachers Association

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