Colorado Legislative Council Staff

SB17-075

REVISED FISCAL NOTE

(replaces fiscal note dated April 10, 2017)

FISCAL IMPACT: ☒ State ☐ Local ☐ Statutory Public Entity ☐ Conditional ☐ No Fiscal Impact

Drafting Number:	LLS 17-0015	**Date:**	April 27, 2017
Prime Sponsor(s):	Sen. Crowder Rep. Landgraf; Danielson	**Bill Status:** **Fiscal Analyst:**	House Appropriations Kate Watkins (303-866-3446)

BILL TOPIC: INCOME TAX DEDUCTION FOR MILITARY RETIREMENT BENEFITS

Fiscal Impact Summary	FY 2017-2018	FY 2018-2019	FY 2019-20	FY 2020-21
State Revenue	**($0.9 million)**	**($2.8 million)**	**($5.7 million)**	**($7.9 million)**
General Fund	(0.9 million)	(2.8 million)	(5.7 million)	(7.9 million)
State Expenditures		**$29,038**		
General Fund		29,038		
TABOR Impact	(0.9 million)	(2.8 million)	Not estimated	Not estimated
Appropriation Required: None.				
Future Year Impacts: Ongoing state revenue reduction.				

Summary of Legislation

Beginning in tax year 2018, this bill, ***as amended by the House Finance Committee***, allows an income tax deduction for annual military retirement benefits received by individuals under age 55. The deduction is capped at $20,000 per tax year and is phased-in over three years, as summarized in Table 1 by tax year.

Table 1. Military Retirement Income Tax Deduction under SB17-075			
Tax Year	**2018**	**2019**	**Beginning in 2020**
Deduction Amount	25% of up to $20,000	50% of up to $20,000	100% of up to $20,000

Background

Under current law, qualifying taxpayers aged 55 to 64 may deduct up to $20,000 in retirement income from their taxable income each year and qualifying taxpayers aged 65 and older may deduct up to $24,000 each year. The deduction is allowable for both military and non-military sources of income, including but not limited to Social Security income, pensions, and 401(k) retirement plan distributions.

State Revenue

This bill is estimated to **reduce General Fund revenue by $0.9 million in FY 2017-18 (half-year impact), $2.8 million in FY 2018-19, $5.7 million in FY 2019-20, and when fully phased-in $7.9 million in FY 2020-21.** In future fiscal years, the revenue impact is expected to grow with the military retirement population, cost of living adjustments, and changes in military retirement benefits.

To the extent that this bill induces nonresidents who receive military retirement benefits to move to Colorado who otherwise would not have moved, or induces current residents receiving such benefits to remain in Colorado who otherwise would have moved, the state and local governments may receive additional revenue through taxes and fees that may partially offset the revenue impact of this bill.

Military pension income. Based on data from the Department of Defense Office of the Actuary for the number of military retirees in Colorado and the national age distribution of retirees, an estimated 12,500 military retirees are expected to qualify for the deduction under SB17-075 beginning in 2018. This population excludes disabled retirees whose benefits are assumed to be excluded from federal taxable income. To arrive at revenue impact estimates for tax year 2018 and beyond, average estimated benefit amounts across age cohorts were grown by expectations for cost-of-living adjustments and growth in the military retirement population.

Based on national data for average retirement benefits by rank, this fiscal note assumes 34.7 percent of qualifying taxpayers will not reach the $20,000 cap. The average benefit for this population was reduced by 31.0 percent. Not all qualifying taxpayers will have a Colorado income tax liability large enough to experience savings from this bill because many taxpayers claim other tax deductions and credits that reduce the taxes they owe. To account for this consideration, the projected revenue impact was reduced by 28.2 percent, an adjustment based on a weighted average of the tax liability and share of taxpayers by adjusted gross income bracket using data from the 2013 Colorado Statistics of Income. Table 2 summarizes the maximum and estimated average taxpayer savings expected from the deduction under SB17-075 by tax year.

Table 2. Maximum and Estimated Average Taxpayers Savings from the Deduction under SB17-075*

Tax Year	2018	2019	2020
Maximum Taxpayer Savings	$232	$463	$926
Average Taxpayer Savings	$148	$298	$601

* *Calculated as the maximum and estimated average deduction multiplied by the 4.63 percent state income tax rate.*

Other military retirement benefits. Data are not available to quantify the revenue impact resulting from other military retirement benefits, such as the federal government's Thrift Savings Plan, which is similar to a defined contribution, or 401(k) plan. These additional sources of income are expected to result in additional General Fund revenue reductions that are minimal relative military pension income.

TABOR Impact

This bill reduces state revenue from the General Fund, which will reduce the amount of money required to be refunded under TABOR for FY 2017-18 and FY 2018-19. TABOR refunds are paid out of the General Fund. TABOR refund obligations are not expected for FY 2016-17. This bill is expected to reduce the TABOR surplus by $0.9 million in FY 2017-18 and $2.8 million in FY 2018-19, reducing the amount of revenue refunded through the Six Tier Sales Tax Refund by equal amounts. Since the bill reduces both revenue to the General Fund and the refund obligation by equal amounts, there is no net impact on the amount of money available in the General Fund for the budget. However, the bill will reduce money available for the General Fund budget in the future during years the state does not collect money above the TABOR limit.

State Expenditures

This bill will increase General Fund expenditures for the Department of Revenue by $29,038 in FY 2018-19. Costs include programming, testing, and form change costs, as summarized in Table 3.

Table 3. Expenditures Under SB17-075

Cost Components	**FY 2017-18**	**FY 2018-19**	**FY 2019-20**
GenTax Programming		$24,000	
GenTax Testing		3,838	
Form Change Costs		1,200	
TOTAL		**$29,038**	

Department of Revenue. This bill requires changes to the Department of Revenue's GenTax software system, which are programmed by a contractor at a rate of $200 per hour. These changes are expected to increase General Fund expenditures by $24,000, representing 120 hours of programming. All GenTax programming changes are tested by department staff, requiring expenditures for contract personnel totaling $3,838, representing 160 hours of testing at a rate of $24 per hour. Retirement income is reported on federal income tax returns, requiring minimal verification workload demands that can be accommodated within existing appropriations.

Department of Personnel and Administration. This bill requires programming and reconfiguring of the document imaging system to insert an additional line to capture the deduction value on individual income tax form 104CR. This will require one-time programming costs of $1,200 in FY 2018-19, which will be reappropriated from the Department of Revenue to the Department of Personnel and Administration.

Effective Date

The bill takes effect August 9, 2017, if the General Assembly adjourns on May 10, 2017, as scheduled, and no referendum petition is filed.

State and Local Government Contacts

Information Technology	Revenue	Personnel