Colorado Legislative Council Staff

SB17-075

REVISED FISCAL NOTE

(replaces fiscal note dated January 20, 2017)

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

Drafting Number:	LLS 17-0015	**Date:**	April 10, 2017
Prime Sponsor(s):	Sen. Crowder Rep. Landgraf	**Bill Status:**	Senate Second Reading
		Fiscal Analyst:	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 2027-28
State Revenue	**(At least $2.0 million)**	**(At least $6.0 million)**	**(At least $10.6 million)**	**(At least $49.6 million)**
General Fund	(At least 2.0 million)	(At least 6.0 million)	(At least 10.6 million)	(At least 49.6 million)
State Expenditures		**$29,038**		
General Fund		29,038		
TABOR Impact	(At least $2.0 million)	(At least $6.0 million)	Not estimated	Not estimated
Appropriation Required: None.				
Future Year Impacts: Ongoing state revenue reduction.				

Summary of Legislation

Under current law, qualifying taxpayers ages 55 to 64 may deduct up to $20,000 in retirement income from their taxable income each year and qualifying taxpayers ages 65 and older may deduct up to $24,000 each year. ***As amended by the Senate Appropriations Committee***, this bill allows an additional income tax deduction for all annual military retirement benefits received by individuals of all ages beginning in tax year 2018. The deduction is phased-in over ten years in 10 percent increments, as summarized in Table 1 by tax year. Other retirement income is still subject to the existing deduction limits.

Table 1. Share of Military Retirement Income Deductible from Taxable Income under SB17-075

2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
10%	20%	30%	40%	50%	60%	70%	80%	90%	100%

State Revenue

This bill is estimated to **reduce General Fund revenue by at least $2.0 million in FY 2017-18 (half-year impact), at least $6.0 million in FY 2018-19, at least $10.6 million in FY 2019-20, and when fully phased-in at least $49.6 million in FY 2027-28.** 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. Data from the Department of Defense Office of the Actuary indicate that in federal fiscal year 2015, 46,131 individuals in Colorado claimed an average estimated annual military retirement benefit of $31,713. This population excludes disabled retirees whose benefits are assumed to be excluded from federal taxable income and includes only those receiving benefits greater than $0. To arrive at 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. The share of the deduction that may be claimed was then applied to these projections.

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 16.7 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 compares the estimated income tax liability reduction for taxpayers who claim the maximum deduction under current law and the projected average deduction under SB17-75 for their military retirement pensions when the deduction is fully phased-in in tax year 2027.

Table 2. Estimated Tax Year Income Tax Savings from Military Pensions when Fully Phased-In in 2027
(Calculated as the deduction amount multiplied by the state income tax rate of 4.63%)

Qualifying Taxpayers by Age	**Under Current Law** *Maximum Deduction*	**Under SB17-075** *Average Deduction*	**Savings* Under SB17-075**
14,381 under age 55	$0	$38,171 × 4.63% = $1,797	$1,797
15,644 ages 55 to 64	$20,000 × 4.63% = $926	$31,171 × 4.63% = $1,797	$841
25,760 ages 65+	$24,000 × 4.63% = $1,111	$40,562 × 4.63% = $1,878	$767

**Assumes that the taxpayer has a large enough tax liability to receive additional savings.*

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.

Non-military retirement income. Many military retirees are expected to claim non-military retirement income, including Social Security income, non-military pensions, and 401(k) retirement plan distributions for non-military employment. For some qualifying taxpayers, this bill is expected to allow additional amounts of non-military retirement income to be claimed that otherwise would have been limited by the $20,000 and $24,000 caps under the current law deduction. Data are available to quantify the potential impact from Social Security income deductions, but data are not available to quantify the full revenue impact of other additional non-military retirement income deductions resulting from this bill.

Based on Social Security Administration data, Social Security benefits averaged an estimated $16,176 annually in 2016. This fiscal note assumes that at least 50 percent of military retirees ages 65 and older will have military benefits that exceed $24,000 and will claim additional Social Security income under the current law deduction. Table 3 summarizes the projected taxpayer savings and General Fund revenue reduction for tax year 2027 resulting from additional allowable Social Security benefit deductions as a result of SB17-075. To arrive at the estimates in Table 3, average 2016 Social Security benefits were grown by projections for inflation and military retiree population growth.

Table 3. Estimated Tax Savings and General Fund Impact from Deducting Additional Social Security Income under SB17-075 when Fully Phased-In in 2027	
Average Social Security Income Deducted	$20,073
Average Taxpayer Savings Calculated as the average deduction amount multiplied by the state income tax rate of 4.63%.	$929
Number of Taxpayers 50 percent of the military retiree population ages 65 and older.	At least 12,880
General Fund Revenue Reduction	(At least $12.0 million)

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 $2.0 million in FY 2017-18 and $6.0 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 4.

Table 4. 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

Research Note Available

An LCS Research Note for SB17-075 is available online and through the iLegislate app. Research notes provide additional policy and background information about the bill and summarize action taken by the General Assembly concerning the bill.