

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2017

Legislative Fiscal Note

BILL NUMBER: Senate Bill 153 (First Edition)
SHORT TITLE: Military State Income Tax Relief.
SPONSOR(S): Senators Rabin, Sanderson, and Britt

FISCAL IMPACT					
(\$ in millions)					
<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> No Estimate Available					
State Impact	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22
General Fund Revenues:					
Section 1: Active Duty Pay	(\$91.0)	(\$61.5)	(\$61.9)	(\$62.7)	(\$63.7)
Section 2: Retirement Pay	(\$22.7)	(\$24.8)	(\$27.1)	(\$29.6)	(\$32.2)
General Fund Expenditures:					
NET STATE IMPACT	(\$113.7)	(\$86.3)	(\$89.0)	(\$92.3)	(\$95.9)
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue					
EFFECTIVE DATE: Taxable Years beginning on or after January 1, 2017					
TECHNICAL CONSIDERATIONS: None					

BILL SUMMARY:

Section 1 provides that North Carolina taxable income does not include the military pay of an active service member of any branch of the Armed Forces of the United States for any period of time that the service member is not present in this State so long as the member is a North Carolina resident and the member is not present in North Carolina solely in compliance with military orders reassigning the member to a permanent duty station located outside of the state.

Section 2 allows a deduction for military retirement and survivorship benefits. Benefits paid to retirees who had earned five years of creditable service in the Military Retirement System as of August 12, 1989 and their survivor beneficiaries are already deductible and may not be deducted twice.

ASSUMPTIONS AND METHODOLOGY:

Section 1

Active duty members are considered North Carolina residents for tax purposes if North Carolina is indicated as the state of legal residence in the member’s military personnel record, regardless of whether or not the member spent any time in North Carolina during the taxable year. The state recorded by the military as the “home of record” when the individual was enlisted, appointed, commissioned, inducted or ordered in a tour of active duty remains the individual’s state of legal residence unless the service member takes action to change it.

Under current law, all military pay earned by enlisted personnel, warrant officers, and commissioned warrant officers is exempt from state income tax if the individual is either serving in a combat zone or is hospitalized as a result of serving in a combat zone. A similar exemption is applied to commissioned officers serving in a combat zone or hospitalized as a result of serving in a combat zone. However, the exemption is limited to the highest rate of enlisted pay plus imminent danger/hostile fire pay.

As a result, the legislation only affects military personnel who list North Carolina as their state of residence, are stationed outside North Carolina during the taxable year, and are not in a combat zone, or those officers whose current exemption is capped.

Fiscal Research obtained data from the Department of Defense (DOD) showing active duty enlisted members by “home of record” and duty location for FY 2001-02 to FY 2010-11. After excluding records missing “home of record”, the percentage of active duty enlisted members stationed outside of North Carolina who listed North Carolina as their home state ranged from 3.2 to 3.6 percent per year.

As of December 2016, there were 1,219,078 active duty personnel serving outside North Carolina. Approximately 2 percent of these individuals were serving in a combat zone. Based on the DOD data discussed above, Fiscal Research assumed that 3.4 percent of those serving outside North Carolina and not in a combat zone were residents of North Carolina. Personnel and pay projections for active duty military were obtained from the FY 2014 Valuation of the Military Retirement System. Multiplying average pay by the total number of personnel estimated to become eligible for the deduction under SB 153 provides an estimate the total amount of exempt income. To determine the fiscal impact, this amount is multiplied by an estimated effective income tax rate of 3.6 percent.

Because of the retroactive effective date, the impact for FY 2017-18 reflects the full-year impact of tax year 2017, plus a half-year impact for tax year 2018.

Section 2

Under the “Bailey Settlement,” military retirement income that is based on military service that includes at least five years of creditable service earned prior to August 1989 is exempt from North Carolina income tax. Senate Bill 153 exempts military retirement income that does not qualify for exemption under the “Bailey Settlement.”

To determine the amount of military retirement income that is not eligible for exemption, Fiscal Research obtained 2016 data on the total amount of military retirement benefits paid to North Carolina residents who first earned service after 1984 from DOD. This analysis assumes that all military retirement benefits based on service earned after 1984 are subject to taxation under current law. Projections of benefit payments were based on the growth predicted in the FY 2014 Valuation of the Military Retirement System.

The share of pension income that is subject to State income tax will increase each year because new retirees are less likely to meet the criteria required for exemption under the “Bailey Settlement.” To determine this share, Fiscal Research used data provided by DOD about retirees’

average years of service and year of retirement to approximate first year of employment for current retirees. This was used to approximate the share of benefit payments that would be eligible for the Bailey exemption each year, assuming no breaks in service during the first five years of employment. The share of benefits that would not be eligible for the Bailey exemption was multiplied by the total amount of benefits to determine the amount of income eligible for the tax deduction under Senate Bill 153. The fiscal impact was calculated by multiplying this amount by an estimated effective tax rate of 3.5 percent. Because the military retirement system does not automatically withhold state tax income, the impact for FY 2017-18 is assumed to equal the full-year impact of tax year 2017.

SOURCES OF DATA:

United States Department of Defense

- Data provided by the Office of the Actuary
- Data from the Office of the Secretary of Defense and the Joint Staff
- FY 2014 Valuation of the Military Retirement System
- FY 2001 – FY 2015 Military Retirement System Statistical Reports
- Defense Manpower Data Center December 2016 Report of Military and Civilian Personnel by Service/Agency by State/Country

TECHNICAL CONSIDERATIONS: None

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