



State Fiscal Note for Bill Number: 2015-H-5325

Date of State Budget Office Approval: Tuesday, March 10, 2015

Date Requested: Thursday, March 05, 2015

Date Due: Sunday, March 15, 2015

Impact on Expenditures

FY 2015 n.a.

FY 2016 n.a.

FY 2017 n.a.

Impact on Revenues

FY 2015 n.a.

FY 2016 \$(2,949,369)

FY 2017 \$(6,004,600)

*Explanation by State
Budget Office:*

This bill would amend Rhode Island General Law Chapter 44-30 entitled "Personal Income Tax" by adding to Rhode Island General Law Section 44-30-12 titled "Rhode Island income of a resident individual" modifications reducing federal Adjusted Gross Income (AGI) for the amount of military retirement pension income, including any survivorship annuities received, that is included in federal AGI. Eligible military retirement pension income is pension income received from service in the regular armed forces, reserves, and National Guard and paid by the United States or the State of Rhode Island.

Under current law, all military retirement income is subject to the tax imposed by Rhode Island General Law Chapter 44-30 to the extent that such income is subject to federal income tax.

*Comments on
Sources of Funds:*

All personal income taxes are considered to be general revenues.

*Summary of Facts
and Assumptions:*

***** REVISED MARCH 18, 2015

The bill takes effect upon passage. For simplicity, the Office of Revenue Analysis (ORA) assumed the bill would be applicable to tax years beginning on or after January 1, 2016. Based upon the accrual methodology employed by the Office of Accounts and Controls, tax law changes that take effect in the middle of a fiscal year have a current fiscal year revenue impact equal to one-half of the succeeding fiscal year's revenue impact. The Office of Revenue Analysis has used this accrual based methodology to provide the budgetary revenue impacts contained in this fiscal note.

The bill as drafted only allows a subtraction from federal AGI for military retirement income received by a Rhode Island resident. Based on the Privileges and Immunities Clause of the United States Constitution restricting this modification to only Rhode Island residents is very likely unconstitutional. The Office of Revenue Analysis developed the revenue impacts of the bill under the assumption that such a modification would be made available to both resident and nonresident taxpayers.

The Office of Revenue Analysis (ORA) utilized data from the Department of Defense, Office of the Actuary. According to the Department of Defense, Office of the Actuary a total of 5,457 military retirees and 1,207 military survivors lived in Rhode Island and received a military pension during Federal Fiscal Year (FFY) 2013 (i.e., October 1, 2012 through September 30, 2013). Of the 5,457 military retirees it

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was determined that 1,850 were officers while 3,607 were enlisted. The monthly payments received by military retirees in Rhode Island totaled \$10,767,000. Part of this monthly payment included Combat Related Special Compensation (CRSC) of \$129,000 which was deemed to be non-taxable. This amount was subtracted from the total monthly payment amount to arrive at a taxable monthly payment amount of \$10,638,000 (i.e. \$10,767,000 - \$129,000). The monthly payments received by Rhode Island military survivors were \$1,159,000. Annualized total pension income received by Rhode Island military retirees was \$127,656,000 (i.e., \$10,638,000 * 12) and annualized total pension income received by Rhode Island military survivors was \$13,908,000 (i.e., \$1,159,000 * 12).

ORA estimated the effective tax rate for Rhode Island residents based on current personal income tax law to be 2.87 percent. The effective tax rate was determined from the personal income tax simulation model developed by the Office of Revenue Analysis using TY 2012 data. ORA assumed that the effective tax rate for Rhode Island military retirees in FFY 2013 is also 2.87 percent. Application of this effective tax rate to the estimated military retirement pension income figures noted above yields total tax collections of \$4,069,799 from these two groups.

Rhode Island resident personal income tax receipts for TY 2012 were \$837,026,612. Thus, income taxes from military retirees and military survivors are estimated to comprise 0.49 percent of resident personal income taxes received in Tax Year 2012 (i.e. \$4,069,799 / \$837,026,612). ORA could not directly estimate non-resident taxable military retirees and military survivors pension income which would be exempt from Rhode Island personal income taxes under the bill. As a result, ORA applied the same percentage derived from Rhode Island resident TY 2012 returns to the non-resident personal income tax collections for TY 2012 of \$190,094,661 to arrive at a TY 2012 estimate of \$924,280 in personal income tax revenues from the inclusion of military pension income from military retirees and military survivors in Rhode Island taxable income (i.e., 0.00486 * \$190,094,661). Therefore, if the bill had been in effect in TY 2012, ORA estimates that total foregone revenues from exempting income received by military retirees and military survivors would have been \$5.0 million.

ORA estimated that resident and non-resident TY 2012 personal income tax receipts were \$1,027,121,273. This amount solely represents payments made by taxpayers for that particular tax year. It is important to distinguish between a particular tax year's revenues and total personal income taxes received in a given calendar year. Total personal income tax payments received in a given calendar year may include tax payments that are associated with prior tax year liabilities or estimated payments for future tax year liabilities as well as tax payments that are related to current tax year liabilities. To account for the receipt of tax payments not associated with the current tax year, ORA compared the TY 2012 personal income tax receipts to total personal income tax revenues received in calendar year 2012 of \$1,076,888,992 to arrive at an estimate of the ratio of total calendar year personal income tax receipts that TY 2012 payments comprise of 95.38 percent (i.e., \$1,027,121,273 / \$1,076,888,992).

The ratio of TY 2012 personal income tax receipts to CY 2012 personal income tax

revenues was applied to the Budget Office's projection of personal income tax revenues for FY 2017 of \$1,271,963,320 to arrive at TY 2016 estimated personal income tax revenues of \$1,213,803,369 (i.e., $0.9538 * \$1,271,963,320$). The percentage of personal income tax revenues received from the inclusion of taxable income from military retirees and military survivors in Rhode Island personal income tax revenue was applied to the FY 2017 estimate of TY 2016 personal income tax revenues to arrive at an estimate of \$5.9 million in TY 2016 personal income tax revenues attributable to taxable military retirement payments (i.e. $0.00486 * \$1,213,180,369$). Similarly, the two percentages described above were also applied to the Office of Management and Budget's projection of personal income tax revenues for FY 2018. The Office of Management and Budget projects personal income tax revenues of \$1,317,618,366 for FY 2018 which results in estimated foregone personal income tax revenues from allowing the subtraction of military retirement income from federal AGI prior to the determination of Rhode Island personal income tax liability for TY 2017 of \$6.1 million (i.e., $(0.9538 * \$1,317,618,366 * 0.00486)$).

Employing the Office of Accounts and Controls accrual methodology yields budgetary revenue losses for FY 2016 of \$2,949,369 (i.e., $0.5 * \$5,898,737$) and for FY 2017 of \$6,004,600 (i.e., $0.5 * \$5,898,737 + 0.5 * \$6,110,462$).

According to the Office of Management and Budget, the FY 2015 Enacted Budget projects an ending balance of \$600,000 in FY 2015 and deficits of \$172.9 million in FY 2016 and \$296.3 million in FY 2017. Passage of the bill would ~~put the FY 2017 budget out of balance and~~ increase the FY 2016 and FY 2017 projected deficits.

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Summary of Fiscal Impact:

***** REVISED MARCH 18, 2015 *****

FY 2015: No fiscal impact given the assumed implementation date of the act.

FY 2016: A revenue loss of \$2,949,369 is forecast.

FY 2017: A revenue loss of \$6,004,600 is forecast.

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Fiscal Advisor Signature: *Stanley...*
Not corrections to last paragraph

