

Date of State Budget Office Approval:

Date Requested: Friday, January 29, 2016

Date Due: Monday, February 08, 2016

<i>Impact on Expenditures</i>		<i>Impact on Revenues</i>	
FY 2016	n/a	FY 2016	\$(2,929,312)
FY 2017	n/a	FY 2017	\$(5,970,946)
FY 2018	n/a	FY 2018	\$(6,237,093)

Explanation by State Budget Office:

This bill would amend Rhode Island General Law Chapter 44-30 entitled "Personal Income Tax" and allow a taxpayer to take a modification reducing federal Adjusted Gross Income (AGI) under Rhode Island General Law Section 44-30-12(e) titled "Rhode Island income of a resident individual - Partners" for the amount of a military pension received that is included in federal AGI.

Under current law, the amount of a military pension, no matter how it is defined, is subject to Rhode Island income tax to the extent that the amount of military pension is included in federal AGI.

Comments on Sources of Funds:

All personal income taxes are considered to be general revenues.

Summary of Facts and Assumptions:

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 places the language that would allow the amount of a military pension included in federal Adjusted Gross Income (AGI) as a modification reducing federal AGI in Rhode Island General Law subsection 44-30-12(e) titled "Rhode Island income of a resident individual – Partners". The proper placement of the modification should be in Rhode Island General Law subsection 44-30-12(c) titled "Rhode Island income of a resident individual – Modifications reducing federal adjusted gross income".

It should be noted that, although this modification reducing federal AGI is provided for in Rhode Island General Law Section 44-30-12 titled "Rhode Island income of a resident individual", said modification reducing federal AGI is extended to non-resident taxpayers via subsection (c) of Rhode Island General Law Section 44-30-32 titled "Rhode Island income of a nonresident individual – Income and deductions partly from Rhode Island sources".

The bill specifies that the amount of military pension included in federal AGI shall be deducted from federal AGI prior to the computation of Rhode Island taxable

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income. ORA assumed that the term "military pension" meant 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.

According to the United States Department of Defense (DoD), Office of the Actuary a total of 5,453 military retirees and 1,183 military survivors lived in Rhode Island during Federal Fiscal Year (FFY) 2014 (i.e., October 1, 2013 through September 30, 2014). Of those military retirees and military survivors, 5,071 military retirees and 1,183 military survivors received monthly military pension payments from DoD in FFY 2014. The monthly payments received by military retirees in Rhode Island totaled \$10,913,000 and the monthly payments received by Rhode Island military survivors were \$1,160,000. Annualized total pension income received by DoD military retirees was \$130,956,000 (i.e., \$10,913,000 * 12) and annualized total pension income received by DoD military survivors was \$13,920,000 (i.e., \$1,160,000 * 12).

The Coast Guard falls under the United States Department of Homeland Security (DHS). The Office of Revenue Analysis (ORA) was unable to find reliable data on the monthly payments of Coast Guard retirees and Coast Guard survivors. However, the ORA was able to ascertain the number of Coast Guard retirees and Coast Guard survivors, as well as the number of Coast Guard retirees and Coast Guard survivors who received monthly military pension payments from DHS. According to DoD, Office of the Actuary, based on data received from DHS, a total of 238 Coast Guard retirees and 33 Coast Guard survivors lived in Rhode Island during FFY 2014. Of these Coast Guard retirees and Coast Guard survivors, 224 retirees and 33 survivors collected a monthly military pension payment during FFY 2014. The Office of Revenue Analysis assumed the monthly payments for Coast Guard retirees and Coast Guard survivors were similar to those of the other military branches. Coast Guard retiree monthly payments were estimated by taking the total amount of monthly payments divided by the number of military retirees paid by the Department of Defense to obtain an average monthly payment of \$2,152 (i.e., \$10,913,000 / 5,071). This average monthly payment was then multiplied by the number of Coast Guard retirees paid by DHS to obtain a total monthly payment for Coast Guard retirees of \$482,057 (i.e., \$2,152 * 224). This same method was applied to obtain an estimate of the total monthly payments paid to Coast Guard survivors of \$32,358 (i.e., (\$1,160,000 / 1,183) * 33). Annualized total pension income received by Coast Guard retirees was \$5,784,686 (i.e., \$482,057 * 12) and annualized total pension income received by Coast Guard survivors was \$388,301 (i.e., \$32,358 * 12).

ORA estimates that the effective tax rate for Rhode Island residents based on the TY 2013 personal income tax file adjusted to current law as of TY 2016 is 2.7247 percent. ORA assumed that the effective tax rate for military retirees and military survivors in FFY 2014 is also 2.7247 percent. Application of this effective tax rate to the estimated military pension income noted above yields total tax collections of \$4,115,576 from these two groups of Rhode Island residents (i.e., (\$130,956,000 + \$13,920,000 + \$5,784,686 + \$388,301) * .027247).

Rhode Island resident personal income tax collections estimated from the TY 2013 personal income tax file adjusted to TY 2016 law were \$805,193,626. Thus, income

taxes from all military retirees and military survivors are estimated to comprise 0.51113 percent of resident personal income taxes collected (i.e., \$4,115,576 / \$805,193,626). ORA could not directly estimate nonresident taxable income from military retirees and military survivors, including Coast Guard retirees and survivors, which would be exempt from Rhode Island personal income taxes under the bill. As a result, ORA applied the same percentage comprising resident TY 2013 returns to the nonresident personal income tax collections for TY 2013 of \$176,106,895 to arrive at a TY 2013 estimate of \$900,133 in personal income tax revenues from the inclusion of income from military retirees and military survivors in Rhode Island taxable income (i.e., $0.0051113 * \$176,106,895$). Therefore, if the bill had been in effect in TY 2013, ORA estimates that total foregone revenues from exempting income received by military retirees and military survivors would have been \$5,015,709 (i.e., $\$4,115,576 + \$900,133$).

ORA estimated that resident and nonresident TY 2013 personal income tax collections based on 2013 tax law were \$1,006,843,088. This amount solely represents payments made by taxpayers for that particular tax year. It is important to distinguish between a particular tax year's collections 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 resident and nonresident TY 2013 personal income tax collections to total personal income tax collections received in calendar year 2013 of \$1,111,538,070 to arrive at an estimate of the ratio of total calendar year personal income tax collections that TY 2013 payments comprise of 90.5811 percent (i.e., $\$1,006,843,088 / \$1,111,538,070$).

The ratio of TY 2013 personal income tax collections to CY 2013 personal income tax revenues was applied to the November 2015 Revenue Estimating Conference's personal income tax estimate for FY 2017 of \$1,265,400,000 to yield TY 2016 personal income tax payments of \$1,146,212,872 realized in FY 2017 (i.e., $\$1,265,400,000 * 0.905811$). The percentage of 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 \$5,858,624 in TY 2016 personal income tax revenues attributable to taxable military retirement payments (i.e., $0.0051113 * \$1,146,212,872$).

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 of \$1,313,920,805 to yield an estimated \$6,083,268 in Rhode Island personal income tax revenue received from the inclusion of military retirement payments in Rhode Island taxable income for TY 2017 (i.e., $(0.905811 * \$1,313,920,805) * 0.0051113$). Similarly for FY 2019, the Office of Management and Budget projects personal income tax revenues of \$1,380,369,710 to yield an estimated \$6,390,917 in Rhode Island personal income taxable income received from the inclusion of military retirement payments in Rhode Island for TY 2018 (i.e., $(0.905811 * \$1,380,369,710) * 0.0051113$).

Employing the Office of Accounts and Controls accrual methodology yields budgetary revenue losses for FY 2016 of \$2,929,312 (i.e., $0.5 * \$5,858,624$), for FY 2017 of \$5,970,946 (i.e., $0.5 * \$5,858,624 + 0.5 * \$6,083,268$) and for FY 2018 of \$6,237,093 (i.e., $0.5 * \$6,083,268 + 0.5 * \$6,390,917$) from passage of the bill.

The Governor's FY 2017 Recommended Budget projects a closing surplus of \$81.7 million in FY 2016 and \$519,565 in FY 2017. Passage of this bill would reduce the FY 2016 closing surplus and put the Governor's FY 2017 Recommended Budget out of balance.

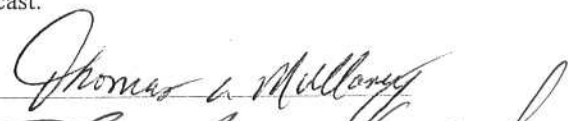
*Summary of Fiscal
Impact:*

FY 2016: A revenue loss of \$2,929,312 is forecast.

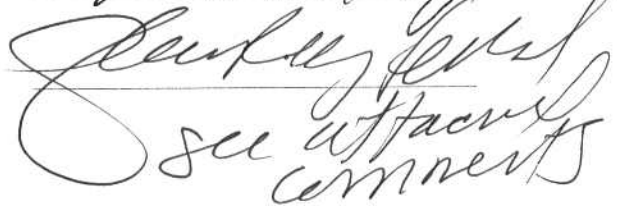
FY 2017: A revenue loss of \$5,970,946 is forecast.

FY 2018: A revenue loss of \$6,237,093 is forecast.

Budget Office Signature:



Fiscal Advisor Signature:



House Fiscal Advisor Comments H 7112:

As presented, the Fiscal Note does not identify potential issues with change in tax rate after the tax year has begun. In the past such changes have applied to the upcoming tax year, in this case beginning January 1, 2017. The impacts would be similar to those reported, but shift one year.