



NORTH CAROLINA GENERAL ASSEMBLY

Session 2021

Legislative Fiscal Note

Short Title: Military Retiree State Income Tax Relief. |
Bill Number: Senate Bill 12 (First Edition) |
Sponsor(s): Senator Clark |

SUMMARY TABLE

	FISCAL IMPACT OF S.B. 12, V.1 (\$ in millions)				
	<u>FY 2021-22</u>	<u>FY 2022-23</u>	<u>FY 2023-24</u>	<u>FY 2024-25</u>	<u>FY 2025-26</u>
State Impact					
General Fund Revenue	-	(6.5)	(8.1)	(10.2)	(12.5)
Less Expenditures	-	-	-	-	-
General Fund Impact	-	(6.5)	(8.1)	(10.2)	(12.5)
NET STATE IMPACT	-	(\$6.5)	(\$8.1)	(\$10.2)	(\$12.5)

FISCAL IMPACT SUMMARY

This bill allows an income tax deduction for military retirement benefits for retirees over age 55 who meet certain residency requirements. Military retirement benefits paid to those who had earned five years of creditable service in the military retirement system as of August 12, 1989 are already deductible and may not be deducted twice.

The deduction would be effective for taxable years beginning on or after January 1, 2022.

FISCAL ANALYSIS

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. This bill exempts military retirement income that does not qualify for exemption under the “Bailey Settlement” for retirees age 55 and over. To qualify for the deduction, the taxpayer must establish residency in North Carolina within two years of retirement or by December 31, 2023, whichever is later, and must continue to reside in North Carolina once residency is established.

To determine the amount of military retirement income that is not eligible for exemption under the “Bailey Settlement,” Fiscal Research obtained 2016-2020 data on the total amount of military retirement benefits paid to North Carolina residents who first earned service after 1984 from the U.S. Department of Defense (DOD). This analysis assumes that all military retirement benefits based on service earned after 1984 are subject to taxation under current law. We used 2020 data

from the DOD on the number of military retirees in North Carolina who first earned service after 1984 and were age 55 or higher to estimate the share of taxable benefits that would be eligible for the tax deduction. Projections of benefit payments were based on the growth predicted in the FY 2018 Valuation of the Military Retirement System.

The share of pension income that is subject to State income tax under current law 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 taxable under current law each year, assuming no breaks in service during the first five years of employment. Similarly, due to aging, the share of taxable military retirement benefits paid to retirees age 55 and over is expected to increase. To determine this share, Fiscal Research used retiree age distribution data from DOD. No adjustments were made to account for the residency restrictions in the bill or for the possibility that the tax incentive induces retirees to relocate to North Carolina.

The fiscal impact was calculated by multiplying the estimated amount of retirement pay that would be eligible for the deduction by the estimated average effective tax rate applicable to filers age 55 and up who received income from the military retirement system. Because the military retirement system does not automatically withhold state income tax, the impact for each fiscal year is assumed to equal the impact of the tax year ending in December.

DATA SOURCES

U.S. Department of Defense Office of the Actuary, FRD Individual Income Tax Microsimulation Model

LEGISLATIVE FISCAL NOTE – PURPOSE AND LIMITATIONS

This document is an official fiscal analysis prepared pursuant to Chapter 120 of the General Statutes and rules adopted by the Senate and House of Representatives. The estimates in this analysis are based on the data, assumptions, and methodology described in the Fiscal Analysis section of this document. This document only addresses sections of the bill that have projected direct fiscal impacts on State or local governments and does not address sections that have no projected fiscal impacts.

CONTACT INFORMATION

Questions on this analysis should be directed to the Fiscal Research Division at (919) 733-4910.

ESTIMATE PREPARED BY

Emma Turner and Rodney Bizzell



ESTIMATE APPROVED BY

Mark Trogdon, Director of Fiscal Research
Fiscal Research Division
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