



SOUTH CAROLINA REVENUE AND FISCAL AFFAIRS OFFICE
STATEMENT OF ESTIMATED FISCAL IMPACT
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Bill Number: H. 5119 As amended by the Senate Finance Committee on May 17, 2016
Author: Goldfinch
Subject: State Guard
Requestor: House Ways and Means
RFA Analyst(s): Shuford
Impact Date: May 18, 2016

Estimate of Fiscal Impact

	FY 2016-17	FY 2017-18
State Expenditure		
General Fund	\$0	\$0
Other and Federal	\$0	\$0
Full-Time Equivalent Position(s)	0.00	0.00
State Revenue		
General Fund	(\$17,837,310)	\$0
Other and Federal	\$0	\$0
Local Expenditure	\$0	\$0
Local Revenue	\$0	\$0

Fiscal Impact Summary

This bill as amended will have no expenditure impact on the General Fund, Federal Funds, or Other Funds. The bill as amended will decrease General Fund individual income tax revenue by \$17,837,310 in FY 2016-17.

Explanation of Fiscal Impact

Explanation of Amendment by the Senate Finance Committee on May 17, 2016

State Expenditure

This amendment provides an individual income tax deduction from South Carolina taxable income for retirement benefits attributable to service on active duty in the Armed Forces of the United States. The Department of Revenue estimates that this legislation will increase General Fund expenditures by a minimal amount that can be absorbed within current funding.

State Revenue

This amendment adds Section 12-6-1171 to provide an individual income tax deduction of up to \$17,500 of earned income for taxpayers under age 65 that receive military retirement income. The deduction is equal to the amount of military retirement income, not to exceed \$17,500. When a taxpayer reaches age 65, the taxpayer may deduct up to \$30,000 of military retirement income. The amendment specifies also that in the case of married taxpayers who file a joint return, the deduction shall be calculated separately as though they had not filed a joint return. This would allow each individual's deduction to be based on the same individual's retirement income and earned income. These additional deductions begin in tax year 2016. Any amount

claimed as a deduction in Section 12-6-1171 will reduce the deduction claimed in Section 12-6-1170. This RFA analysis utilizes updated South Carolina specific military retiree data for 2012 through 2015 provided by staff of the Department of Defense, Office of the Actuary and a 2013 tax year sample of federal and state income tax returns that is adjusted to tax year 2016.

Since Section 12-6-1171 allows different amounts of retirement income deductions by taxpayers depending on their age, we use Department of Defense data to segregate these taxpayers with military retirement income into two categories: under age 65 and age 65 and older. Taxpayers under age 65 may deduct earned income equal to their military retirement income up to a maximum of \$17,500 per year. Taxpayers age 65 and older may deduct military retirement income of up to \$30,000 per year.

In FY 2016-17, we anticipate 19,338 taxpayers under age 65 with military retirement income. We can estimate earned income eligible for the proposed deduction for these taxpayers from a survey of 2013 tax year data adjusted to tax year 2016. We identified all income tax returns where retirees currently claim the \$3,000 deduction. We then recalculated these returns by subtracting up to the proposed maximum \$17,500 deduction based on the earned income reported on the return. This recalculation accounts for returns with no earned income or an amount of earned income less than the proposed maximum \$17,500 deduction. We found that taxpayer returns claiming the current \$3,000 deduction can also deduct an average of \$16,185 in earned income under the proposed deduction. Using these taxpayers as a proxy for military retirees under age 65, we estimate that tax returns of the anticipated 19,338 military retirees under age 65 in tax year 2016 will deduct an additional \$16,185 in earned income. At an average tax rate of 2.9%, we expect this proposed deduction would reduce General Fund individual income tax revenue by \$9,076,580 in FY 2016-17.

The average tax rate and the amount of earned income available for the proposed deduction are based on a recalculation of the income tax for each return after the proposed deduction is applied. This method takes into account the taxpayers with no earned income to claim the deduction, the large number of returns that have zero taxable income, returns that are reduced to zero taxable income by the deduction, and returns that do not benefit from the full amount of the proposed deduction.

This analysis is based on total taxable income by tax return, which may include more than one taxpayer reporting retirement and earned incomes. We must rely on this approach because taxpayer data is not individually specified on jointly filed South Carolina income tax returns, and we have no other data to disaggregate the income of married taxpayers as if they filed single returns. Since we are limited to total taxable income reported on tax returns, our methodology is less precise than specified by the amendment by assuming all earned income on a jointly filed return is eligible for the deduction, regardless of which taxpayer may have earned the income. This may lead to an overestimation of the revenue reduction for taxpayers under age 65 with military retirement income. Without data that disaggregates joint return income by individual taxpayers, we are unable to determine the potential overestimation amount. Finally, since we have no way to identify military retirees on the federal or state income tax returns, this analysis relies on the premise that the amount of earned income by military retirees under age 65 is similar to the amount claimed by all taxpayers claiming the current \$3,000 retirement deduction.

The revenue impact of the amendment for military retirees age 65 and older is unchanged from the bill as amended by the Senate Finance Sales and Income Tax Subcommittee on March 15, 2015. We expect 17,874 active duty military retirees age 65 or older in FY 2016-17 with military retirement income totaling \$556,478,000. This results in a \$31,133 average annual military retirement benefit. After accounting for the proposed \$30,000 deduction, we estimate that the remaining \$20,255,000 in taxable retirement benefits at an average tax rate of 2.47 percent would generate \$500,299 in individual income tax revenue in FY 2016-17. This amount is \$8,035,350 less than the \$8,535,648 in estimated tax for this age group under the current maximum \$15,000 deduction.

In addition, we anticipate that 11,154 South Carolina taxpayers age 65 and older will receive \$187,963,000 in military retirement from the National Guard and Reserves, for an annual average retirement benefit of \$16,852 in FY 2016-17. While National Guard or Reserve retirement income is not generally taxed in South Carolina, National Guard and Reserve retirement attributable to active duty service is taxable. This adjustment is made by taxpayers on line 3v of the SC 1040 income tax form. Based on an analysis of taxpayers claiming a retirement deduction and having an adjustment on line 3v of the income tax returns, we estimate that approximately 13 percent of this retirement income is from active duty service. Multiplying the \$187,963,000 by 13 percent and applying an average tax rate of 2.96 percent results in an estimated \$723,280 tax liability for taxpayers aged 65 and older. This amount of income tax revenue would be eliminated under the proposed \$30,000 maximum military retirement income deduction.

Combining the revenue impacts of the earned income tax deduction for military retirees under age 65 and the military retirement income deduction for taxpayers age 65 and older results in an estimated reduction in General Fund individual income tax revenue of \$17,835,210 in FY 2016-17.

The revenue impact of the bill filed on March 16, 2016, is unchanged. We estimate that simplifying the training and drill requirement for State Guard members for the \$3,000 deduction from South Carolina taxable income to 192 hours in a year rather than 16 hours per month will increase the number of State Guard members receiving the deduction by 20 per year. These 20 additional members with the \$3,000 deduction at an average tax rate of 3.5 percent results in an estimated \$2,100 reduction in General Fund individual income tax liability for these State Guard taxpayers. This revision to the \$3,000 deduction for State Guard members and the military retiree deduction analyzed above would reduce General Fund individual income tax revenue by a combined total of \$17,837,310 in FY 2016-17.

Local Expenditure

N/A

Local Revenue

N/A

Explanation of Bill Filed on March 16, 2016

State Expenditure

N/A

State Revenue

This bill amends various sections relating to the South Carolina State Guard. The following is an analysis of the bill by section.

Section 1. This section allows a member of the State Guard to claim a \$3,000 deduction from South Carolina taxable income when the member completes a minimum of 192 hours of training or drill a year. Current law requires the member complete a minimum of 16 hours each month, equating to 192 hours a year. State Guard officials indicate that training and drill are currently averaging 240 hours per year. In tax year 2014, 233 State Guard members were eligible for the \$3,000 deduction. We estimate that simplifying the training and drill requirement to 192 hours a year will increase the number of State Guard members receiving the deduction by 20 per year. These 20 additional members with the \$3,000 deduction at an average tax rate of 3.5 percent results in an estimated \$2,100 reduction in tax liability for these State Guard taxpayers. The average tax rates used in this analysis are based on a re-calculation of the income tax for each return after the proposed deduction is applied. This method takes into account the large number of returns that have zero taxable income, returns that are reduced to zero taxable income by the deduction, and returns that do not benefit from the full amount of the proposed deduction.

Sections 2. This section adds South Carolina State Guard judge advocates to the list of legal assistance attorneys who may provide premobilization legal assistance and counseling to national guard personnel, immediate family members, and dependents.

Section 3. This section adds South Carolina State Guard judge advocates to the list of personnel that are exempt from personal liability for alleged negligent or wrongful acts when providing legal assistance.

Sections 4 and 5. These sections provide the Governor more flexibility in calling the State Guard into state duty when the National Guard is otherwise tasked with duties that cause the State to be without sufficient military resources. The State Guard may be ordered into service for a breach, natural or manmade disaster, or local emergency when the lives and property of the state's citizens are threatened.

Section 6. This amendment to Section 25-3-140 permits members of the State Guard, when ordered to active duty, to receive a daily stipend or a per diem for reasonable expenses, or both, if approved by the Adjutant General. We expect that sections two through six of this bill will not have any expenditure or revenue effect on the General Fund, Federal Funds, or Other Funds.

Local Expenditure and Local Revenue

N/A



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