COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 0269-05
Bill No.: Truly Agreed To and Finally Passed SCS for HCS for HB 82
Subject: Military Affairs; Tax Credits; Retirement Systems and Benefits - General
Type: Original
Date: May 29, 2009

Bill Summary: Would authorize an individual income tax deduction for military retirement benefits.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2010	FY 2011	FY 2012
General Revenue	$0	(More than $127,811) *	(More than $208,593) *
Total Estimated Net Effect on General Revenue Fund	**$0**	**(More than $127,811) ***	**(More than $208,593) ***

* Expected to exceed $1 million.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2010	FY 2011	FY 2012
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 10 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2010	FY 2011	FY 2012
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2010	FY 2011	FY 2012
General Revenue	0	5	5
Total Estimated Net Effect on FTE	**0**	**5**	**5**

☐ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☒ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2010	FY 2011	FY 2012
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Provisions Exempting Military Retirement Benefits from State Income Tax

Officials from the **Department of Public Safety**, **Office of the Director** and **Missouri Veterans Commission** (VETS) assume this proposal would have no fiscal impact on their organizations.

Officials from the **University of Missouri, Economic and Policy Analysis Research Center** (EPARC) stated that their income tax database does not identify whether filers receive military retirement benefits. Accordingly, EPARC was not able to quantify the impact that this bill could have on Missouri's net general revenue.

Officials from the **Department of Revenue** (DOR) assume this proposal would create a tax deduction for military retirement benefits included in Federal Adjusted Gross Income for tax years beginning on or after January 1, 2010.

Beginning January 1, 2010, a percentage of military retirement benefits would be deducted from Missouri Adjusted Gross Income; the deduction would be increased each year until the subtraction is 100% for all taxable years beginning on or after January 1, 2016. DOR would promulgate rules for the program.

Personal Tax would require two FTE Temporary Tax Employees for key entry, one FTE Revenue Processing Technician I for every 19,000 returns verified, and one FTE Revenue Processing Technician I for every 2,400 additional pieces of correspondence. Collections and Tax Assistance would require one FTE Tax Collection Technician for every 24,000 contact annually to the non-delinquent tax line, one FTE Tax Collection Technician for every 15,000 contact annually to the delinquent tax line, and one FTE Revenue Processing Technician for every 4,800 contact annually to the field offices.

DOR provided an estimate of the cost to implement the proposal including five additional employee and the related equipment and expense costs totaling $206,460 for FY 2010, $221,978 for FY 2011, and $228,638 for FY 2012.

ASSUMPTION (continued)

Oversight assumes that these provisions would first impact individual income tax returns filed in January 2011, and will include six months of DOR cost for FY 2011 and twelve months cost for FY 2012.

Oversight has, for fiscal note purposes only, changed the starting salary for the additional positions to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees for a six month period and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research. Oversight has also adjusted the DOR equipment and expenditures estimate in accordance with OA budget guidelines, and Oversight assumes that one additional FTE could be accommodated in existing office space.

DOR also provided an estimate of the IT cost to implement the proposal.

Officials from the **Office of Administration**, **Information Technology Services Division** (ITSD/DOR) estimated that the IT portion of a previous version of this request could be implemented using two existing CIT III for 1 month for modifications to the MINITS system at a total cost of $8,882. ITSD/DOR assumes the proposal could be implemented with existing resources; however, if priorities shift, additional FTE or overtime would be needed.

Officials from the **Office of the Secretary of State** (SOS) provided this response to a similar proposal.

Many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the SOS for Administrative Rules is less than $2,500. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, we also recognize that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what our office can sustain with our core budget. Therefore, we reserve the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

ASSUMPTION (continued)

Officials from the **Office of Administration**, **Division of Budget and Planning** (BAP) assumed there would be no added cost to their organization as a result of a previous version of this proposal.

BAP officials provided an estimate of the fiscal impact of this proposal.

This proposal would phase in an income tax exemption on military retirement benefits received. According to the FY2007 Department of Defense Statistical Report on the Military Retirement System, during FFY07 there were 33,656 individuals receiving military pensions in Missouri, totaling $54.7 million monthly, or $656.7 million annually. Assuming a 4.5% average marginal tax rate, this proposal could reduce general and total state revenues $29.6 million annually when fully phased in.

This proposal is complicated by existing tax law, which provides that $6,000 per taxpayer income is exempt from income tax. Thus, total taxable military pension income would be ($656.7M - (33,656 * $6,000)) = $454.8 million. Assuming a 4.5% average marginal tax rate, total liability would be $454.8 million * 4.5% = $20.5 million. This proposal is further complicated by the concurrent phase-in of HB 444 (2007), which is also reducing taxes on retirement benefits.

As amended, this proposal would begin to phase-in with tax year 2010, so the first year of impact for general and total state revenues would be fiscal year 2011. At 15% of the amounts above, this proposal would reduce revenues $3.1 million to $4.4 million, increasing by similar amounts annually until FY 2017. These reductions would be mitigated by the implementation of HB 444.

Oversight assumes that the applicable Missouri income tax on gross military retirement income would be ($656,700,000 x 4.5%) = $29,551,500. The estimated tax reduction due to the current $6,000 exemption on retirement income would be ($6,000 x 33,656 x 4.5%) = $9,087,100. The net amount of tax after the application of the $6,000 exemption would be ($29,551,500 - $9,087,100) = $20,464,400.

ASSUMPTION (continued)

The impact of HB 444 (2007) would also be increasing each year. Oversight has calculated an average military retirement benefit of ($656,700,000/33,656) = $19,513. Oversight notes that HB 444 provides a tax reduction on otherwise taxable income which exceeds the $6,000 retirement income exemption; therefore, the HB 444 exclusion increases each year.

* For FY 2011, the HB 444 exclusion would be (65% x ($19,513 - $6,000)) = $2,783 and the tax at 4.5% would be ($2,783 x 4.5%) = $125. The total HB 444 tax reduction would be ($125 x 33,656) = $4,207,000. The remaining tax on military retirement income, exclusive of all other forms of exemption and deduction, would be ($20,464,400 - $4,207,000) = $16,257,400.

* For FY 2012, the HB 444 exclusion would be (80% x ($19,513 - $6,000)) = $10,810 and the tax at 4.5% would be ($10,810 x 4.5%) = $486. The total HB 444 tax reduction would be ($486 x 33,656) = $16,356,816. The remaining tax on military retirement income, exclusive of all other forms of exemption and deduction, would be ($20,464,400 - $16,356,816) = $4,107,584.

* For FY 2013 and subsequent years, the HB 444 exclusion would be 100% (100% x ($19,513 - $6,000) = $13,513 and the tax at 4.5% would be ($13,513 x 4.5%) = $608. The total HB 444 tax reduction would be ($608 x 33,656 = $20,462,848. The remaining tax on military retirement income, exclusive of all other forms of exemption and deduction, would be ($20,464,400 - $20,462,848) = $1,552.

ASSUMPTION (continued)

This proposal would provide deductions, or exemptions, for military pay - fifteen percent for FY 2011, thirty percent for FY 2012, forty-five percent for FY 2013, sixty percent for FY 2014, seventy-five percent for FY 2015, ninety percent for FY 2016, and one hundred percent for FY 2017.

Year	Implementation percent for this proposal	Tax Reduction for this proposal	Tax Remaining After Application of Other Exemptions
FY 2011	15%	$4,432,725	$16,257,400
FY 2012	30%	$8,865,450	$4,107,584
FY 2013	45%	$13,298,175	$1,552
FY 2014	60%	$17,730,900	$0
FY 2015	75%	$22,163,625	$0
FY 2016	90%	$26,596,350	$0
FY 2017	100%	$29,551,500	$0

Oversight notes that for FY 2012 and subsequent years, this provision would provide a tax reduction greater than the calculated remaining tax on retirement benefits after the application of the $6,000 exemption and the HB 444 exemption. Therefore, this provision would only provide a benefit for filers who have military retirement benefits in addition to other retirement benefits subject to the existing $6,000 exemption and the existing HB 444 exemption.

Oversight does not have information regarding the amounts of other income, deductions, exemptions, and tax credits for Missouri taxpayers who receive military retirement benefits. Accordingly, this estimate has not been adjusted for any of those items, nor for any potential cost of living increases in military retirement benefits. This estimate also can not account for demographic changes such as growth and migration of military retirees. Finally, Oversight is not able to determine the potential for any additional or offsetting revenue reductions due to the impact of this proposal on existing provisions such as the Circuit Breaker and Homestead Exemption programs. For fiscal note purposes, Oversight will indicate an unknown revenue reduction, expected to exceed $1 million.

ASSUMPTION (continued)

Maximum Social Security Benefit Provision

Officials from the **Department of Revenue** (DOR) assume these provisions would have no fiscal impact to DOR or to the state.

Officials from the **Office of Administration**, **Division of Budget and Planning** (BAP) assume these provisions would not result in additional costs or savings to their organization.

BAP officials stated that these provisions would set the maximum allowable Social Security Benefit at $32,500 for tax years beginning on or after January 1, 2007; with that amount to be raised by the growth in CPI each year thereafter. Because this raises the CPI limit for tax year 2008, it is possible that some persons could file amended returns.

Oversight assumes this provision would have no fiscal impact to the state.

Minimum Age Provision

Officials from the **Office of Administration**, **Division of Budget and Planning** (BAP) assume these provisions would not result in additional costs or savings to their organization.

These provisions would also eliminate the 62-year minimum age requirement for the phased reduction of taxation on retirement benefits. This provision would reduce general and total state revenues by an unknown amount.

Officials from the **Department of Revenue** stated that their understanding of the legislative intent of regarding Senate Substitute No. 2 for Senate Committee Substitute for House Committee Substitute for House Bill Nos. 444, 217, 225, 239, 243, 297, 402 & 172, 2007 was that the age 62 limit was to be disregarded. Accordingly, **Oversight** assumes this provision would enact current administrative practice and would have no fiscal impact.

FISCAL IMPACT - State Government	FY 2010 (10 Mo.)	FY 2011	FY 2012
GENERAL REVENUE FUND			
Cost - Department of Revenue			
Personal Service (5 FTE)	$0	($66,676)	($137,353)
Fringe Benefits	$0	($32,424)	($66,795)
Expense and Equipment	$0	($28,711)	($4,445)
Total	$0	($127,811)	($208,593)
Revenue reduction - pension exemption *	$0	(Unknown)	(Unknown)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND *	**$0**	**(More than $127,811)**	**(More than $208,593)**
* Expected to exceed $1 million.			
Estimated net FTE effect on General Revenue Fund	0	5	5

FISCAL IMPACT - Local Government	FY 2010 (10 Mo.)	FY 2011	FY 2012
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

This proposal would authorize an individual income tax deduction for military retirement benefits, would index the maximum Social Security benefit amount for purposes of computing nontaxable retirement income to the Consumer Price Index, and would eliminate the minimum age requirement for the phased reduction in taxation of retirement benefits.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Office of Administration
- Division of Budget and Planning

Department of Public Safety
- Missouri Veterans Commission

Department of Revenue

University of Missouri
- Economic and Policy Analysis Research Center

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Director
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