



Legislative Council Staff *Nonpartisan Services for Colorado's Legislature*

Fiscal Note

Drafting Number: LLS 21-0343
Prime Sponsors: Rep. Bradfield

Date: February 18, 2021
Bill Status: House SCMVA
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Bill Topic: **INCOME TAX DEDUCTION FOR MILITARY RETIREMENT BENEFITS**

Summary of Fiscal Impact:

<input checked="" type="checkbox"/> State Revenue	<input type="checkbox"/> TABOR Refund
<input checked="" type="checkbox"/> State Expenditure (<i>minimal</i>)	<input type="checkbox"/> Local Government
<input type="checkbox"/> State Transfer	<input type="checkbox"/> Statutory Public Entity

The bill increases the amount of military retirement benefits that a taxpayer under age 55 may deduct in 2023, and extends the deduction through 2034. It decreases state revenue through FY 2034-35 and increases workload for administration.

Appropriation Summary: No appropriation is required.

Fiscal Note Status: This fiscal note reflects the introduced bill.

Table 1
State Fiscal Impacts Under HB 21-1113

		Budget Year FY 2021-22	Out Year FY 2022-23	Out Year FY 2023-24	Out Year FY 2024-25
Revenue	General Fund	-	(\$650,000)	(\$3,650,000)	(\$6,000,000)
Expenditures		-	-	-	-
Transfers		-	-	-	-
TABOR Refund		-	-	-	-

Summary of Legislation

The bill modifies and extends the state income tax deduction for military retirement benefits received by taxpayers under age 55. For tax year 2023, the maximum deduction amount is increased to \$20,000 from \$15,000 in current law. The bill extends the deduction for tax years 2024 through 2034, allowing taxpayers to deduct up to \$20,000 in these years.

Background

Pension and annuity deduction. Colorado allows taxpayers to deduct federally taxable pension and annuity income. The deduction is limited to \$24,000 annually for those age 65 and over, and to \$20,000 for taxpayers age 55 to 64.

Military retirement income deduction for taxpayers under 55. Military retirement income is taxable by default. Disabled veterans who receive disability payments pay tax on their military retirement benefits, but not their disability benefits.

House Bill 18-1060 created a state income tax deduction for military retirement income for tax years 2019 through 2023. The state deduction is allowed to taxpayers under age 55, as taxpayers who are 55 and over are eligible to claim the preexisting pension and annuity deduction. Under current law enacted in HB 18-1060, the state deduction is limited to the following annual amounts:

- \$4,500 for tax year 2019;
- \$7,500 for tax year 2020;
- \$10,000 for tax year 2021;
- \$15,000 for tax years 2022 and 2023.

The amounts listed above are the maximum amounts by which the deduction may reduce a taxpayer's taxable income. The actual tax benefit received by the taxpayer depends on their taxable income and the state income tax rate, which is 4.55 percent for 2020 and future years. For example, a taxpayer who takes the maximum \$10,000 deduction for tax year 2021 reduces their tax liability by \$455.

The Department of Revenue reports that about 7,000 taxpayers deducted a total of \$31.5 million from their 2019 tax returns under HB 18-1060, reducing their income tax due by about \$1.5 million.

State Revenue

The bill is expected to reduce General Fund revenue by \$650,000 in FY 2022-23, \$3,650,000 in FY 2023-24, and \$6,000,000 annually beginning in FY 2024-25. The bill will decrease state revenue through tax year 2034, resulting in a half-year revenue impact for FY 2034-35, after which the deduction expires. The bill reduces income tax revenue, which is subject to TABOR.

The estimate for FY 2022-23 represents a half-year impact for tax year 2023, for which the bill increases the maximum deduction amount from \$15,000 to \$20,000.

The estimate for FY 2023-24 represents a half-year impact for tax year 2023, for which the bill increases the maximum deduction amount, and a half-year impact for tax year 2024, for which no deduction is allowed under current law.

The estimate for FY 2024-25 and subsequent years reflects a full-year impact of extending the deduction at the \$20,000 cap amount. The bill's revenue impact may grow or decline in subsequent years depending on the number of veterans receiving military retirement income.

Assumptions. Estimates are based on the most recent Statistical Report on the Military Retirement System, prepared by the U.S. Department of Defense's Office of the Actuary and dated August 2020. Nearly 50,000 Colorado veterans received military retirement benefits in federal fiscal year 2019. Based on national shares for each age cohort, it is estimated that about 10,950 Colorado veterans receiving retirement benefits are age 54 or younger.

This fiscal note assumes that Colorado's veterans are distributed similarly across commissioned officer, warrant officer, and enlisted personnel ranks as national veterans of the same age. Following this assumption and the benefits paid to veterans of each rank, it is estimated that the bill could make up to \$204 million in retirement benefits tax deductible each year. However, actual deductions will be limited by retirees' taxable incomes after the application of the federal standard deduction or itemized deductions taken on federal returns. Based on actual deductions taken under HB 18-1060 for tax year 2019, it is assumed that actual deductions taken will be about 65 percent of the possible maximum, or about \$132.4 million each year. In future years, modest decreases in the population of eligible veterans are expected to offset the impact of inflation-driven cost of living adjustments.

State Expenditures

The bill minimally increases Department of Revenue workload to program and administer the deduction. The deduction was added to the department's GenTax software system following the passage of HB 18-1060, and costs to change the deduction amount and extend its applicability into future years are assessed as minimal. Workload in the department's taxpayer service section will increase to handle calls from taxpayers; however, the workload increase can be accomplished within the department's existing appropriations.

TABOR refund. The bill decreases income tax revenue, which is subject to TABOR. Under the December 2020 LCS forecast, state revenue is expected to remain below the TABOR limit through at least FY 2022-23, and no TABOR refunds are expected through at least FY 2023-24. The bill does not change these expectations concerning refunds to taxpayers. For future years in which state revenue exceeds the TABOR limit, the bill will decrease the amount to be refunded by about \$6.0 million per year.

Effective Date

The bill takes effect 90 days following adjournment of the General Assembly sine die, assuming no referendum petition is filed.

State and Local Government Contacts

Information Technology
Personnel

Military and Veterans Affairs
Revenue