



SOUTH CAROLINA REVENUE AND FISCAL AFFAIRS OFFICE
STATEMENT OF ESTIMATED FISCAL IMPACT
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Bill Number: H. 3147 As amended by Senate Finance Sales and Income Tax Subcommittee on March 15, 2016
Author: G.M. Smith
Subject: Taxable Income Deductions
Requestor: Senate Finance
RFA Analyst(s): Shuford
Impact Date: March 17, 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	(\$18,568,690)	\$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 \$18,568,690 in FY 2016-17.

Explanation of Fiscal Impact

Explanation of Amendment by Senate Finance Sales and Income Tax Subcommittee on March 15, 2015

State Expenditure

This amendment provides a deduction from South Carolina taxable income of individuals 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 strikes all after the enacting words of the bill and adds an individual income tax deduction of up to \$15,000 of military retirement income for taxpayers under age 65 and up to \$30,000 of military retirement income for taxpayers age 65 or older for 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.

Generally, retirement income from active duty military service is taxable in South Carolina, while National Guard or Reserve retirement income is not taxed. However, Guard and Reserve retirement attributable to active duty service is taxable and is one of the adjustments made on line 3v of the SC 1040 income tax form. Also, any retirement income based on disability is excluded from federal and South Carolina income tax. The taxability of the remaining active duty, Reserve, and Guard military retirement income is discussed below.

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 into two categories: age 65 and older and under age 65. Taxpayers age 65 and older may deduct income of up to \$30,000 per year, while taxpayers under age 65 may deduct retirement income up to \$15,000 per year.

For example, 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 FY 2016-17, we anticipate 19,338 taxpayers under age 65 with military retirement income of \$531,856,000 resulting in an average \$27,503 annual military retirement benefit. After accounting for the proposed \$15,000 deduction, we estimate that the remaining \$241,781,000 in taxable retirement benefits multiplied by an average tax rate of 2.96 percent will generate \$7,156,718 in individual income tax revenue in FY 2016-17. This amount is \$9,427,720 less than the \$16,584,435 in estimated tax for this age group under the current maximum \$3,000 deduction.

As stated earlier, the active duty portion of National Guard and Reserve retirement income is taxable in South Carolina. We anticipate that 11,154 South Carolina taxpayers age 65 and older will receive \$187,963,000 in military retirement, an annual average retirement benefit of \$16,852 in FY 2016-17. 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.

We estimate further that the 5,212 taxpayers under age 65 with National Guard and Reserve retirement income totaling \$116,093,000 results in a \$22,274 average annual benefit. These taxpayers will remit an estimated \$528,220 in tax under current statutes after applying an average tax rate of 3.5 percent to the \$116,093,000 of retirement income. After accounting for the proposed \$15,000 deduction, we estimate that these taxpayers would remit \$145,880 in tax, or \$382,340 less in tax compared to current statutes.

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. The tax rates for the two age groups are different because the larger deduction for age 65 and older further reduces remaining South Carolina income subject to tax.

Combining the revenue impacts of the military retirement deduction for both age groups and different types of military retirement income results in an estimated reduction in General Fund individual income tax revenue of \$18,568,690 in FY 2016-17.

Local Expenditure

N/A

Local Revenue

N/A

Explanation of Bill Filed on January 13, 2015

State Expenditure

This bill provides a deduction from South Carolina taxable income of individuals 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 have a minimal expenditure impact on the department from revising forms and instructions. The department will have some additional General Fund expenditures that can be absorbed within their current funding.

State Revenue

Updated on May 14, 2015 to Include Revised Analysis and Additional Revenue Impact

Sections 2 and 4 of this bill allow a deduction of military retirement benefits attributable to service on active duty in the Armed Forces of the United States for taxable years beginning after 2014 from South Carolina taxable income. This deduction is phased-in over three years, with the deduction being 33.33 percent in tax year 2015. The deduction increases to 66.66 percent in tax year 2016 and reaches 100 percent in tax year 2017.

Based on the latest data from the U.S. Department of Defense, Office of the Actuary, there were 57,755 military retirees in South Carolina as of September 2013 receiving \$1,361,388,000 in annual military retirement benefits. This equates to an average annual retirement benefit of \$23,572 for each retiree in South Carolina.

Since Section 12-6-1170 allows different amounts of retirement income deductions by taxpayers depending on their age, we use Department of Defense data to segregate these taxpayers into two categories: age 65 and older and under age 65. Taxpayers age 65 and older may deduct retirement income of up to \$15,000 per year, while taxpayers under age 65 may deduct retirement income up to \$3,000 per year.

Adjusting the number of South Carolina military retirees and their retirement income in tax year 2013 to tax year 2015, or FY 2015-16, we anticipate 30,450 taxpayers age 65 or older with military retirement income totaling \$798,214,000. This results in an average \$26,214 annual military retirement benefit. After accounting for the current \$15,000 deduction and any non-taxable retirement income such as disability payments, we estimate that the remaining \$323,210,000 in taxable retirement benefits at an average tax rate of 2.9 percent would generate \$9,373,090 in individual income tax revenue in FY 2015-16. Adjusting this amount for the 33.33 percent deduction allowed in tax year 2015 results in an estimated \$3,124,051 reduction in General Fund individual income tax revenue in FY 2015-16.

We also anticipate 28,717 taxpayers under age 65 with military retirement income totaling \$665,618,000, resulting in an average \$23,179 annual military retirement benefit. After accounting for the current \$3,000 deduction and any non-taxable retirement income such as disability payments, we estimate that the remaining \$557,536,000 in taxable retirement benefits multiplied by an average tax rate of 3.4 percent will generate \$18,956,224 in individual income tax revenue in FY 2015-16. Adjusting this amount for the 33.33 percent deduction allowed in tax year 2015 results in an estimated \$6,318,109 reduction in General Fund individual income tax revenue in FY 2015-16.

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. The tax rates for the two age groups are different because the larger deduction for age 65 and older further reduces remaining South Carolina income subject to tax.

Combining the revenue impact for these two age groups results in an estimated \$9,442,160 reduction in General Fund individual income tax revenue in FY 2015-16, the first year of the three-year phase-in. The total reduction in General Fund individual income tax revenue in FY 2016-17 with the 66.66 percent deduction is an estimated \$19,698,280. In the final year with the 100 percent deduction, the total reduction in General Fund individual income tax revenue is an estimated \$30,832,254 for FY 2017-18.

The revised analysis and additional revenue impact in this updated fiscal impact statement is from our reexamination of Section 3 that amends Section 12-6-1170(A)(2) for taxable years after 2016 to exclude military retirement income for purposes of the deduction allowed by this section. Section 12-6-1170 allows different amounts of retirement income deductions by taxpayers depending on their age. Significant to this analysis is Section 12-6-1170(B), which states that a taxpayer aged 65 and older is allowed a \$15,000 deduction from South Carolina taxable income reduced by the \$10,000 retirement income deduction. This proposed amendment in Section 12-6-1170(A)(2) would allow taxpayers aged 65 and older to deduct up to the \$15,000 amount allowed without subtracting \$10,000 of military retirement income that will no longer be taxable. This results in an increase in the revenue impact of this bill from our original estimate. Based on data compiled by the Revenue and Fiscal Affairs Office from a Department of Revenue sample of 2012 federal and state matched returns, we estimate that the 30,450 taxpayers age 65 or older with military retirement income in tax year 2016 would be allowed to deduct an

additional \$186,088,000 of South Carolina taxable income compared to the current statute. At an average tax rate of 2.9 percent, this would reduce General Fund individual income tax revenue by \$5,397,000. Adjusting this amount for the 33.33 percent deduction allowed in tax year 2015 results in an estimated \$1,799,000 reduction in General Fund individual income tax revenue in FY 2015-16. By FY 2017-18, these additional deductions are expected to total \$202,064,413 and reduce General Fund individual income tax revenue by \$5,860,000 when the deduction reaches 100 percent.

Combining the revenue impacts of the military retirement deduction and the revision to the maximum \$15,000 deduction allowed in Section 3 of the bill results in an estimated \$11,241,160 reduction in General Fund individual income tax revenue in FY 2015-16, the first year of the three-year phase-in. The total reduction in General Fund individual income tax revenue in FY 2016-17 with the 66.66 percent deduction is an estimated \$23,447,280. In the final year with the 100 percent deduction, the total reduction in General Fund individual income tax revenue is an estimated \$36,692,254 for FY 2017-18.

Local Expenditure

N/A

Local Revenue

N/A



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