

**EIGHTY-FIFTH GENERAL ASSEMBLY
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No amendments filed – see attached Fiscal Note.



SF 303 – Military Retirement Pay Tax Exemption (LSB 2169SV.1)
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Fiscal Note Version – As amended by S-5001

Description

Senate File 303, as amended by **S-5001** (Ways and Means Committee amendment), exempts all military retirement income from the State income tax, retroactive to January 1, 2014. The Bill with the amendment also excludes military retirement income from the calculation of the alternate tax and the calculation of the tax filing threshold.

Background

Iowa currently exempts the first \$6,000 (single) and \$12,000 (married) in qualified retirement income from the State income tax (applies to traditional pensions, annuities, and distributions from Individual Retirement Accounts (IRA) and deferred compensation plans). To qualify, the taxpayer or the taxpayer's spouse must be 55 years of age or older, disabled, or a surviving spouse or a survivor having an insurable interest in an individual that would have qualified for the exemption during that tax year.

Assumptions

- According to federal Defense Finance and Accounting Services data, pension income paid to 11,472 Iowans in 2012 totaled \$252.8 million.
- The Department of Revenue income tax micro model projects 7,765 income tax returns will experience an income tax reduction due to the changes in the Bill.
- The difference between the number of Iowans receiving military pensions (11,472) and the number of tax returns benefiting from the Bill (7,765), is explained by:
 - a. Taxpayers exempt from Iowa income tax due to the current Iowa income tax filing thresholds.
 - b. Tax situations where Iowa's current \$6,000/\$12,000 pension exemption fully covers an existing military pension.
 - c. Taxpayers with pension income, including military pension income, in excess of \$6,000/\$12,000, but for other reasons have zero or negative Iowa income tax liability.
 - d. Disability related pensions that are already exempt from State income tax.
 - e. Married taxpayers where both spouses are receiving military retirement income. In those instances, a tax return represents two military pensioners.
- Military pension payments were assumed to grow with inflation as forecasted by Moody's Analytics in November 2013.
- The tax liability impact was estimated for the 7,765 Iowa tax returns currently paying income tax on all or a portion of their military retirement income using the Department of Revenue's income tax micro model. The micro model uses tax return information to account for nontaxable military pension benefits, includes interactions with the current pension exclusion, alternate tax, and filing thresholds, and reflects an estimated increase in the number of military retirees living in the state over time. The model also translates tax year changes into fiscal year changes based on the observed streams by which the affected taxpayers met their tax liability historically.

- For those school districts that have a local option income surtax in place, the annual yield from that surtax depends on the lowa income tax owed by lowa taxpayers living within the school district. Law changes that impact lowa income tax, with the exception of changes impacting refundable tax credits, also change the amount of revenue generated by the local option income surtax.

Fiscal Impact

The following table provides the projected income tax reduction by tax year, along with the revenue impact on the State General Fund and on the local option income surtax for schools.

SF 303 with Amendment S-5001					
Income Tax Reduction and State/Local Revenue Reduction					
In millions					
<u>Tax Year</u>	<u>Income Tax Reduction</u>	<u>Fiscal Year</u>	<u>General Fund Revenue Reduction</u>	<u>Local Option Income Surtax Reduction</u>	
TY 2014	\$ 8.40	FY 2014	\$ 8.10	\$ 0.30	
TY 2015	8.70	FY 2015	8.40	0.30	
TY 2016	9.10	FY 2016	8.70	0.30	
TY 2017	9.40	FY 2017	9.10	0.30	
TY 2018	10.00	FY 2018	9.60	0.40	

Sources

Department of Revenue Individual Income Tax Micro Model
 Defense Finance and Accounting Services (DFAS)
 Moody's Analytics

/s/ Holly M. Lyons

January 27, 2014

The fiscal note for this bill was prepared pursuant to [Joint Rule 17](#) and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.
