

HJ674 Study - Requesting the Department of Veterans Services and the Department of Taxation to study the feasibility of exempting military retirement income from taxation.

EXECUTIVE SUMMARY

BACKGROUND

In 2017, a study by The Matrix Group and The Roosevelt Group examined the impact of exempting military retirement income from state taxation. The 2017 Matix/Roosevelt study concluded that:

- “By exempting all military retiree pensions from state income tax, the Commonwealth would incur nearly \$145 million in foregone tax revenue during the first year... – almost twice as much as the Secretary of Veterans and Defense Affairs FY 2017 budget;” and
- Additionally, the study found that “implementing a tax exemption on military pensions as a means of attracting military retirees has not proven to be effective in states with large populations.

In 2019, Delegate Luke Torian introduced the resolution HJ674, which requested that the Virginia Department of Veterans Services (DVS) and the Virginia Department of Taxation (TAX) jointly study the feasibility of exempting military retirement income from taxation, in response to a request by the JLC (Joint Leadership Council of Veterans Service Organizations) to reexamine and build upon the 2017 Matrix/Roosevelt report.

HJ674 STUDY – AGENCY ROLES

DVS and TAX formed a joint workgroup (see *Appendix B* for list of members). As part of the HJ647 study:

DVS studied the costs and benefits across states affecting veterans and retirees (*see detail in PowerPoint report*) that:

- Consider all tax types (e.g., income, sales, and property taxes) across all states (& Washington DC);
- Consider tax exemptions specific to military retirees across all states—plus services and programs offered;
- Focus on 12 states with the most military retirees;
- Show a slightly rising population of military retirees in Virginia, which suggest the state remains an attractive destination for retirees; and
- Compare two case studies of a “typical” Virginia military retiree and how the various tax exemptions and structures would affect him or her in: Alexandria, VA; Houston, TX; Raleigh-Durham, NC; or Jacksonville, FL.

TAX estimated the fiscal impact on Virginia’s tax revenue of a range of options for an income tax exemption (*see detail in PowerPoint report*) that:

- Account for Virginia-specific conditions—notably the means-tested exemption available to all retirees age 65 and older (despite no exemption for military retirees specifically);

- Rely heavily on data/forecasts from the U.S. Departments of Defense and Veterans Affairs; and
- Outline five potential courses of action the General Assembly could take (a full exemption, and four other options)

HJ674 STUDY – STATE COMPARISONS

A majority of states exclude all or a portion of retirement pay from taxable income, according to sources including the National Conference of State Legislatures (NCSL). Depending on the state, the retirees eligible for these exemptions can range from military-only to all retirees. Eligibility also can be limited to age 65 and older or extend to retirees age 64 and younger.

For example, 20 states provide a full military retirement pay exemption and another nine states do not tax state income.¹ Among the remaining states, Virginia is among 19 that offer a partial exemption to retirees age 65 and older.² Virginia also is among nine states (including Washington D.C.) that offer no exemption to retirees age 64 and younger.³

It is important to note that categorizing states by exemption status does not provide a complete picture. For example, a report from the financial company Kiplinger found that 10 states with a full military retiree tax exemption are “not tax-friendly” or are “least tax-friendly” to all retirees or all residents. Kiplinger’s rates Virginia as “tax-friendly” for all retirees and says, “The Old Dominion offers some tax breaks to retirees. It does not tax Social Security benefits, and residents 65 and older can deduct up to \$12,000 per person of income, which may be subject to income-eligibility limits. Virginia’s property taxes are modest (with breaks for seniors available), and its sales tax low.” Meanwhile, CNBC, the financial cable network, named Virginia the top state for business.⁴

SUMMARY OF THE FIVE POLICY OPTIONS

Five policy options for an exemption were estimated for the House Appropriations and Senate Finance Committees to consider. Our research does not include a cost-benefit analysis of each of these options to consider. What this study did find is that:

- Although Virginia offers no income tax exemption specific to military retirees, the state is “tax friendly” to retirees in part because it offers an exemption to those age 65 and older that is means-tested for certain taxpayers.
- Virginia is attractive to military retirees because it has built many unique assets through the strong support from the General Assembly and several Governors, including the V3 program, world-class educational institutions, wrap-around supportive services led by the

¹ Full-exemption states: AL, AR, CT, HI, IL, IA, KS, LA, ME, MA, MI, MN, MS, MO, NJ, NY, OH, PA, WV, WI;
No-tax states: AK, FL, NV, NH, SD, TN, TX, WA, WY

² Partial exemption to age 65 and older: AZ, CO, DE, GA, ID, IN, KY, MD, MT, NE, NM, NC, OK, OR, RI, SC, UT, VT, VA.

³ No exemption to age 64 and younger: CA, ID, NM, ND, RI, UT, VT, VA, DC.

⁴ Source: <https://www.cnbc.com/2019/07/09/virginia-is-americas-top-state-for-business-in-2019.html>

DVS Virginia Veteran and Family Support service line and a state-wide appreciation for our military and the valuable leadership skills and abilities they bring to our communities.

Below are five options estimated by TAX, (*see detail in PowerPoint report*) chosen from among a range of policy options available in other states, and have been brought up by retirees to DVS:

- A full military retirement income tax exemption in Virginia = -\$295 million revenue loss by 2027
- Other policy options include:
 - Refundable tax credit of \$5,000 = -\$783 million loss by 2027
 - Fixed subtraction of \$40,000 = -\$247 million
 - Full exemption for retirees age 65 and older only = -\$112 million
 - Phased-in fixed subtraction rising from \$10,000 to \$40,000 over four years for retirees age 65 and older only = -\$97 million

Comparison of Policy Options for Exempting Military Retirement Pay

Cost of other policy options as share of baseline full exemption

Virginia FY	Baseline Full Exemption Cost (\$M)*	Number of Retirees	Refundable tax credit ¹	Fixed subtraction ²	Exemption for Age 65+ only ³	Phased-in Fixed subtraction for Age 65+ only ⁴
2020	-\$112.6	152,005	338%	85%	33%	15%
2021	-\$229.7	152,682	332%	85%	33%	21%
2022	-\$239.2	153,290	320%	85%	34%	28%
2023	-\$249.4	153,909	309%	85%	35%	30%
2024	-\$260.4	156,010	298%	84%	36%	32%
2025	-\$272.0	156,330	287%	84%	36%	32%
2026	-\$283.6	156,540	276%	84%	37%	32%
2027	-\$295.2	156,642	265%	84%	38%	33%

* Assumes 1/1/2020 effective date and no adjustment for timing of passage; For a normal revenue impact, FY 2020 impact would be shifted to FY 2021

¹ Tax credit of \$5,000

² Fixed subtraction of \$40,000

³ Full exemption only if age 65 & older; no exemption for younger age groups

⁴ Fixed subtraction rising from \$10,000 to \$40,000 over four years for age 65 and older

CONCLUSION

The General Assembly tasked DVS and TAX to convene a joint working group to study the feasibility of exempting military retirement income from taxation and evaluate the effects of phasing in a full exemption of military retirement income over a four-year, five-year, or six-year period or any other time period the Agencies deem appropriate. DVS and TAX considered the impact of fully exempting military retirement income of Virginia’s current population of veterans, the projected effect of such an exemption of Virginia’s competitiveness as a desirable state of residence and the revenue losses associated with fully exempting military retirement income (HJ674, Appendix A).

DVS and TAX are thankful to all staff who contributed to this report and for all their hard work and due diligence to consider all options (Appendix B). We hope the General Assembly finds this report helpful.

SUMMARY OF APPENDICES AND ATTACHMENTS

Appendix A: House Joint Resolution 674 (HJ674), 2019 General Assembly

Appendix B: Work Group Team

Attachment 1: Formal report (as a PowerPoint presentation) with all the above information in text and charts.

Appendix 2: two case studies examined the competitiveness issue, and is also presented as a PowerPoint presentation

All raw data was compiled in Excel spreadsheets, and is available upon request.

APPENDIX A

HJ674

2019 SESSION

ENROLLED

HOUSE JOINT RESOLUTION NO. 674

Requesting the Department of Veterans Services and the Department of Taxation to study the feasibility of exempting military retirement income from taxation. Report.

Agreed to by the House of Delegates, February 4, 2019

Agreed to by the Senate, February 20, 2019

WHEREAS, over half of the states exempt military retirement income or a portion thereof from taxation; and

WHEREAS, Maryland, North Carolina, and West Virginia, which share a border with Virginia, either partially or fully exempt military retirement income from taxation; and

WHEREAS, Virginia currently exempts military retirement income from taxation only if the taxpayer is a recipient of the Congressional Medal of Honor; and

WHEREAS, Virginia should strive to maintain its reputation as a veteran-friendly state and, more importantly, strive to reward veterans for their service to Virginia and the United States by fully exempting military retirement income from state income tax; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Department of Veterans Services and the Department of Taxation (the Agencies) be requested to convene a joint working group to study the feasibility of exempting military retirement income from taxation.

In conducting their study, the Agencies shall evaluate the effects of phasing in a full exemption of military retirement income over a four-year, five-year, or six-year period or any other time period the Agencies deem appropriate. The Agencies shall consider (i) the impact of fully exempting military retirement income on Virginia's current population of veterans, (ii) the projected effect of such exemption on Virginia's competitiveness as a desirable state of residence for veterans in comparison with other states, (iii) the revenue losses associated with fully exempting military retirement income from state income tax, and (iv) any other factors the Agencies deem relevant. The Agencies shall review any other issues and make recommendations as appropriate.

All agencies of the Commonwealth shall provide assistance to the Agencies for this study upon request.

The Agencies shall complete their meetings by November 30, 2019, and shall submit to the Governor and the General Assembly an executive summary and a report of their findings and recommendations for publication as a House or Senate document. The executive summary and report shall be submitted as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents and reports no later than the first day of the 2020 Regular Session of the General Assembly and shall be posted on the General Assembly's website.

ENROLLED

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APPENDIX B

WORK GROUP TEAM

Veterans and Defense Affairs/ Virginia Department of Veterans Services

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*Deputy Secretary
Veterans and Defense Affairs*

Steven J. Combs
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Carrie Ann Alford
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