

DEPARTMENT OF TAXATION

2022 Fiscal Impact Statement

1. **Patron** Aijalon Cordoza

3. **Committee** House Finance

4. **Title** Individual Income Tax; Subtraction for
Veteran Retirement Income

2. **Bill Number** HB 1069

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide an individual income tax subtraction of up to \$40,000 of the annual retirement compensation received by a veteran for service as a member of the United States Armed Forces, reservist in the United States Armed Forces, or member of the Virginia National Guard.

This bill would be effective for taxable years beginning on or after January 1, 2022.

6. **Budget amendment necessary:** Yes.

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7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

7b. **Revenue Impact:**

| <i>Fiscal Year</i> | <i>Dollars</i> | <i>Fund</i> |
|---------------------------|-----------------------|--------------------|
| 2022-23 | (\$313 million) | GF |
| 2023-24 | (\$218 million) | GF |
| 2024-25 | (\$226 million) | GF |
| 2025-26 | (\$234 million) | GF |
| 2026-27 | (\$242 million) | GF |
| 2027-28 | (\$251 million) | GF |

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have an estimated negative General Fund revenue impact of \$313 million in Fiscal Year 2023, \$218 million in Fiscal Year 2024, \$226 million in Fiscal Year 2025,

\$234 million in Fiscal Year 2026, \$242 million in Fiscal Year 2027, and \$251 million in Fiscal Year 2028. According to data from the U.S. Department of Defense, there were 149,848 retired military veterans receiving benefits and living in Virginia during 2020.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Military Retirement Pay and Veterans Disability Compensation

A military retiree (generally, a service member who serves 20 years or more in the military) typically qualifies for military retirement pay and certain other veterans benefits. The amount of military retirement pay a military retiree receives is based on a formula or scale that factors in the person's military rank at retirement and the person's length of military service. Military retirement pay is determined and paid by the U.S. Defense Finance and Accounting Service ("DFAS"). DFAS is an agency of the United States Department of Defense.

A disabled veteran may apply for disability compensation from the Department of Veterans Affairs ("VA"). The VA can approve veterans as eligible for veteran's disability compensation for one or more documented service-connected injuries or illnesses that continue to affect the person's health or abilities following separation from the military. The VA calculates the amount to be paid to a veteran based on a formula that factors in the person's service-connected disability rating and the person's number of dependents. Service-connected disability ratings are made in 10 percent increments from 0 percent to 100 percent.

"Concurrent receipt" refers to a veteran's eligibility to receive both military retirement pay and VA disability compensation. Until 2004, concurrent receipt was prohibited by federal law, so a person receiving military retirement pay was required to waive some or all of that pay in order to receive VA disability compensation. This waiver of retirement pay for disability compensation would cause a dollar-for-dollar offset. As a result, a military retiree subject to the federal ban on concurrent receipt was limited to the higher of: (1) the person's military retirement pay; or (2) the person's veteran's disability compensation, but not to the sum of the two.

Federal law was changed as of January 1, 2004, so that certain military retirees are eligible for full concurrent receipt of military retirement pay and veterans disability compensation. This is referred to as Concurrent Receipt of Retirement Pay and Disability Compensation ("CRDP"). To be eligible claimants for CRDP, a veteran must show that he or she has a service-connected disability and:

- Is a regular retiree with a VA disability rating of 50 percent or greater;
- Is a reserve retiree with 20 qualifying years of service, who has a VA disability rating of 50 percent or greater and who has reached retirement age. (In most cases the retirement age for reservists is 60, but certain reserve retirees may be eligible before they turn 60. If he or she is a member of the Ready Reserve, his or her retirement age can be reduced below age 60 by three months for each 90 days of active service they have performed during a fiscal year.);
- Is retired under Temporary Early Retirement Act and have a VA disability rating of 50 percent or greater; or
- Is a disability retiree who earned entitlement to retired pay under any provision of law other than solely by disability, and they have a VA disability rating of 50 percent or greater.

CRDP was a "phase in" of benefits that gradually restored a military retiree's VA disability offset from January 2004 to January 2014. This meant that an eligible retiree's retirement pay gradually increased each year until the phase in was complete effective January 2014. Once the phase in was complete, eligible retirees received both halves—their military retirement pay and their disability compensation—automatically without being required to use a complicated phase-in formula.

While CRDP has helped some disabled military retirees, many retirees did not qualify because they had less than a 50 percent disability rating. Such retirees continued to be subject to the ban on concurrent receipt, which required them to reduce their retirement pay dollar-for-dollar by the amount of disability compensation they were receiving. In 2008, Congress enacted a program called Combat-Related Special Compensation ("CRSC"), which allows military retirees to receive monthly compensation to replace some or all of their VA disability offset, even if they do not have a disability rating of a 50 percent or more. To be eligible claimants for CRSC, a veteran must show that he or she has a combat-related disability and:

- Is entitled to and/or receiving military retired pay with 20 or more years of service;
- Is rated at least 10 percent disabled by the VA, or a disability directly related to a Purple Heart.

Military retirees cannot receive both CRSC and CRDP. If a retiree qualifies for both, DFAS will automatically apply the entitlement that is most advantageous to him or her. Every year, a military retiree has the opportunity to change his or her election.

Federal Taxation

As a general rule, pension income is taxable. Therefore, military retirement pay received from DFAS that is based on age, length of service, or rank is taxable under federal law, regardless of whether a military retiree is disabled. CRDP payments received from DFAS

are also taxable pursuant to federal law, because such payments are intended to recover the retirement pay that military retirees waive to receive VA disability compensation.

In contrast, federal law exempts from taxation certain benefit or compensation received under any law administered by the VA. VA disability compensation received from the VA by any veteran—including a military retiree—is exempt from taxation under federal law.

Federal law also exempts from taxation any pension income, annuities, or similar allowances for personal injuries or sickness resulting from active service in the armed forces of any country. Except for taxpayers who were entitled to receive pension income, annuities, or similar allowances for personal injuries or sickness on or before September 24, 1975, or who were members of the armed forces of any country (or a reserve component thereof) or under a binding written commitment to become such a member on September 24, 1975, such exemption is only allowed to the extent that:

- The taxpayer received such income by reason of a combat-related injury;
- The taxpayer would be entitled to receive disability compensation from the Department of Veterans Affairs if they applied; or
- The taxpayer received such income on account of personal physical injuries or physical sickness.

CRSC payments received from DFAS are exempt under federal law, because military retirees receive such payments by reason of their combat-related injuries. Military retirement pay received from DFAS that is based on a disability is not taxable to the extent that such pay meets one of the tests above.

Military retirement pay received from DFAS based on disability is generally taxable unless the taxpayer received such income by reason of a combat-related injury; the taxpayer would be entitled to receive disability compensation from the Department of Veterans Affairs if he applied; or the taxpayer received such income on account of personal physical injuries or physical sickness.

These rules are illustrated in the chart below.

| Military Income | Taxable | Tax-Exempt |
|---|----------------|-------------------|
| Military Retirement Pay Received from DFAS Based on Age, Length of Service, and/or Rank | X | |
| Military Retirement Pay Received from DFAS Based on Disability | X | |
| Disability Compensation Received from the VA | | X |
| CRDP Payments Received from DFAS | X | |
| CRSC Payments Received from DFAS | | X |

Virginia Military Tax Preferences

Since the starting point for determining an individual's Virginia income tax is federal adjusted gross income, any income exempt for federal income tax purposes, such as disability compensation from the VA or SRSC payments from DFAS, is generally exempt for Virginia income tax purposes.

In addition, taxpayers may subtract the following military-related items for the purposes of computing Virginia taxable income:

- Wages or salaries received for service in the Virginia National Guard, not exceeding income for thirty-nine days of service or \$3,000, whichever is less. This subtraction only applies to persons in the ranks of O3 and below.
- All military pay and allowances earned while serving in a combat zone or qualified hazardous duty area, to the extent they were included in federal adjusted gross income.
- \$15,000 of military basic pay for military personnel on extended active duty for periods in excess of ninety days. The subtraction amount is reduced dollar-for-dollar by the amount which the taxpayer's military basic pay exceeds \$15,000 and will be reduced to zero if such pay is equal to or exceeds \$30,000.
- Any amount received as military retirement income by an individual awarded the Congressional Medal of Honor.
- The amount of military death gratuity payments received after September 11, 2001, by survivors of military personnel who are killed in the line of duty. This subtraction amount must be reduced dollar-for-dollar by the amount that is allowed as an exclusion from federal adjusted gross income to the survivor on his or her federal income tax return.

For taxable years beginning on or after January 1, 2011, Virginia exempts from taxation the real property, including the joint real property of a husband and wife, and the land, not exceeding one acre, upon which the real property is situated of any military veteran who has been rated by the VA to have a 100 percent service-connected, permanent, and total disability, and who occupies the real property as his or her principal place of residence. The surviving spouse of a veteran may also qualify for this exemption, so long as the following conditions are met: the veteran's death occurred on or after January 1, 2011; the surviving spouse does not remarry; and the surviving spouse continues to occupy such real property as his or her principal place of residence.

Virginia Study Regarding Exempting Military Retirement Income

During the 2019 Session, the General Assembly enacted House Joint Resolution 674, which required the Department of Veterans Services and the Department to study the feasibility of exempting military retirement income from taxation and publish a report regarding their findings and recommendations. Throughout 2019, the agencies

completed this study and published the “Feasibility Study of Exempting Military Retirement Income from Taxation” on November 25, 2019. The report focused on the revenue impact of excluding all military retirement income and several other alternatives for consideration by the General Assembly.

Virginia’s Age and Disability Tax Preferences

Taxpayers age 65 and older may claim an additional \$800 personal exemption. Certain taxpayers may also qualify for an age deduction of up to \$12,000. For taxpayers born on or before January 1, 1939, the amount of the age deduction is \$12,000. For taxpayers born after January 1, 1939, who have attained the age of 65, the amount of the age deduction is means-tested. Accordingly, the \$12,000 age deduction is reduced dollar-for-dollar for single taxpayers whose income exceeds \$50,000 and for married taxpayers whose combined income exceeds \$75,000.

Taxpayers who are totally and permanently disabled may exclude up to \$20,000 of disability income, as defined under federal law, in calculating Virginia taxable income. Taxpayers may claim either an age deduction or a disability deduction, but not both.

Proposed Legislation

This bill would provide an individual income tax subtraction of up to \$40,000 of the annual retirement compensation received by a veteran for service as a member of the United States Armed Forces, reservist in the United States Armed Forces, or member of the Virginia National Guard. To the extent an eligible individual claims another Virginia subtraction or deduction for annual retirement compensation for such service, they would be ineligible to claim the subtraction that this bill would provide.

This bill would be effective for taxable years beginning on or after January 1, 2022.

Similar Bills

Senate Bill 528, Senate Bill 586, and House Bill 1128 would provide an individual income tax subtraction for up to \$20,000 of military benefits in Taxable Year 2021, up to \$30,000 in Taxable Year 2022, and up to \$40,000 in Taxable Year 2023 and each year thereafter.

House Bill 1045 would provide an individual income tax subtraction of up to \$10,000 in annual retirement compensation for Taxable Year 2022, \$20,000 in Taxable Year 2023, \$30,000 in Taxable Year 2024, and \$40,000 for Taxable Year 2025 and thereafter for veterans of the United States Armed Forces who are at least 65 years old.

Senate Bill 381 would provide an individual income tax subtraction of up to \$40,000 of military retirement income received by a veteran who is 55 years of age or older and who was honorably discharged after active duty service in the United States Armed Forces, the reserve components of the United States Armed Forces, or the National Guard of Virginia or any other state.

House Bill 233 would increase the income tax subtraction for wages or salaries of a member of the National Guard of the Commonwealth from \$3,000 to \$5,000, and expand the military ranks that qualify for the subtraction from O3 and below to O6 and below.

cc : Secretary of Finance

Date: 1/23/2022 RWC
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