



Legislative Council Staff
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Final Fiscal Note

Drafting Number: LLS 23-0780
Prime Sponsors: Sen. Gardner
Rep. Bradfield

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Bill Status: Postponed Indefinitely
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Bill Topic: INCOME TAX DEDUCTION FOR MILITARY RETIREMENT BENEFITS

Summary of Fiscal Impact:

- State Revenue
- State Expenditure
- State Transfer
- TABOR Refund
- Local Government
- Statutory Public Entity

The bill would have indefinitely extended the military retirement benefits deduction for taxpayers under age 55, which is currently set to expire after 2023 and annually adjusted the deduction's \$15,000 cap for inflation starting in tax year 2024. The bill would have decreased state revenue on an ongoing basis.

Appropriation Summary:

For FY 2023-24, the bill would have required an appropriation of \$16,197 to the Department of Revenue.

Fiscal Note Status:

The fiscal note reflects the introduced bill. This bill was postponed indefinitely by the Senate State, Veterans, and Military Affairs Committee on February 9, 2023; therefore, the impacts identified in this analysis do not take effect.

Table 1
State Fiscal Impacts Under SB 23-106

		Budget Year FY 2023-24	Out Year FY 2024-25
Revenue	General Fund	(\$2.3 million)	(\$4.7 million)
Expenditures	General Fund	\$16,197	\$16,133
Transfers			
Other Budget Impacts	TABOR Refund	(\$2.3 million)	(\$4.7 million)
	General Fund Reserve	\$2,430	\$2,420

Summary of Legislation

Under current law, the state income tax deduction for military retirement benefits received by taxpayers under age 55 is scheduled to expire after tax year 2023. The bill extends the deduction indefinitely, and requires that the maximum deduction amount of \$15,000 be annually adjusted for inflation, starting in tax year 2024

Background

Pension and annuity deduction. Colorado allows taxpayers to deduct federally taxable pension and annuity income from their taxable 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. Veterans who receive disability payments pay tax on their military retirement benefits, but not their disability payments. 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 for taxpayers under age 55, as taxpayers who are 55 and over are eligible to claim the preexisting pension and annuity deduction. After phasing in for several years pursuant to HB 18-1060, the state deduction reached its maximum amount, \$15,000, for tax years 2022 and 2023.

The actual tax benefit received by the taxpayer depends on their taxable income and the state income tax rate, which is 4.40 percent for 2022 and future years. For example, a taxpayer who takes the maximum \$15,000 deduction for tax year 2022 reduces their tax liability by \$660.

The Department of Revenue reports that about 7,000 taxpayers deducted a total of \$49.2 million from their 2020 tax returns under HB 18-1060, reducing their income tax due by \$2.2 million at a tax rate of 4.55 percent. The deduction in 2020 was limited to \$7,500 per taxpayer.

Assumptions

The fiscal note assumes that the distribution of retirees across ages and ranks in Colorado is stable and reflects historical distributions, with a population of military retirees receiving military retirement benefits in Colorado of about 50,000, of whom 20 percent are aged 19 to 54. Following this assumption and the benefits paid to veterans of each rank, it is estimated that the bill will make up to \$150 million in military retirement benefits tax deductible in tax year 2024, with actual deductions limited by retirees' taxable incomes after the application of the federal standard deduction or itemized deductions taken on federal returns.

Further, the estimates are consistent with the December 2022 Legislative Council Staff economic forecast for inflation. Finally, these estimates assume that not all eligible military retirees will claim the exemption, either because of lack of awareness or insufficient taxable income, with 70 percent of military retirees under age 55 claiming the exemption.

State Revenue

The bill is expected to reduce General Fund revenue by \$2.3 million in FY 2023-24, a half-year impact, by \$4.7 million in FY 2024-25, by \$4.8 million in FY 2025-26, and by increasing amounts in future years depending on the rate of inflation. The bill reduces income tax revenue, which is subject to TABOR.

The estimate for FY 2024-25 and subsequent years reflects a full-year impact of extending the deduction at the \$15,000 cap adjusted for inflation. The revenue impact may grow or decline in subsequent years depending on the number of veterans receiving military retirement income as well as the rate of inflation.

State Expenditures

The bill increases workload and expenditures in the Department of Revenue to administer the inflation adjustment for the tax deduction by about \$16,000 annually starting in FY 2023-24, paid from the General Fund. Expenditures are shown in Table 2 and detailed below.

Table 2
Expenditures Under SB 23-106

	FY 2023-24	FY 2024-25
Department of Revenue		
Computer Programming	\$1,125	\$1,125
User Acceptance Testing	\$7,680	\$7,680
Research and Analysis	\$7,392	\$7,328
Total Cost	\$16,197	\$16,133

Computer programming, testing, and data reporting. The DOR will have ongoing costs of \$1,125 annually, representing 5 hours of contract programming at a rate of \$225 per hour, starting in FY 2023-24 to program, test, and update database fields in its GenTax software system. Workload and costs for testing will also increase. The workload increase in the Systems Support Office can be accomplished with existing resources. Costs for contract testing at the department are estimated at \$7,680, representing 240 hours at a rate of \$32 per hour. Expenditures in the Office of Research and Analysis are required for data management and reporting.

Other Budget Impacts

TABOR refunds. The bill is expected to decrease the amount of state revenue required to be refunded to taxpayers by the amounts shown in the State Revenue section above. This estimate assumes the December 2022 LCS revenue forecast. A forecast of state revenue subject to TABOR is not available beyond FY 2024-25. Because TABOR refunds are paid from the General Fund, decreased General Fund revenue will lower the TABOR refund obligation, but result in no net change to the amount of General Fund otherwise available to spend or save.

General Fund reserve. Under current law, an amount equal to 15 percent of General Fund appropriations must be set aside in the General Fund statutory reserve. Based on this fiscal note, the bill is expected to increase the amount of General Fund held in reserve by the amounts shown in Table 1, decreasing the amount of General Fund available for other purposes.

Effective Date

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

State Appropriations

For FY 2023-24, the bill requires a General Fund appropriation of \$16,197 to the Department of Revenue.

State and Local Government Contacts

Information Technology
Revenue

Military Affairs

Personnel