

The top left corner of the cover features a stylized, semi-transparent American flag with its stars and stripes. The rest of the background is a solid dark blue.

May 2018

# ENDING TAXATION OF MILITARY RETIREE PAY IN CALIFORNIA

AN ANALYSIS OF THE COSTS AND BENEFITS

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## EXECUTIVE SUMMARY

California currently is one of only nine states that fully tax the pay of its 146,000 military retirees. Many factors affect the decision of members of the Armed Forces regarding where they will live after retirement. Climate, housing costs, where they have been based, and employment opportunities are important. Whether or not a state taxes their military pension benefits is also a factor.

Between 2000 and 2016, the nation's population of military retirees increased by 17%. California, which was one of only five states that saw a reduction in the number of its military retirees, saw a decline of 17%.

This study analyzed what the impact would be of fully exempting retired military pay from taxes. By 2025, after ten years of implementation, the economic gains for California would be substantial:

- 12,600 more jobs
- \$830 million added to total personal income
- \$1.27 billion added to GSP
- \$2.0 billion added to total business sales

The net fiscal impacts on state and local finances would also be substantially positive after factoring in all of the ripple effects through the different revenue channels. By 2025, the results would be:

- \$28.4 million in net state tax revenues
- \$56.3 million in net state and local tax revenues combined

The impact of California's military retirees extends beyond the numbers. These individuals represent some of the state's best and brightest. They bring key resources, skills, and values to their jobs and communities. They are individuals that the state should strive to attract and retain.

## INTRODUCTION AND STUDY PURPOSE

States differ widely in their tax policies, regarding both how much they tax and who pays. While the benefits of state-financed spending, such as for infrastructure and education, can be important offsets, tax policies can affect the location decisions of individuals and businesses.

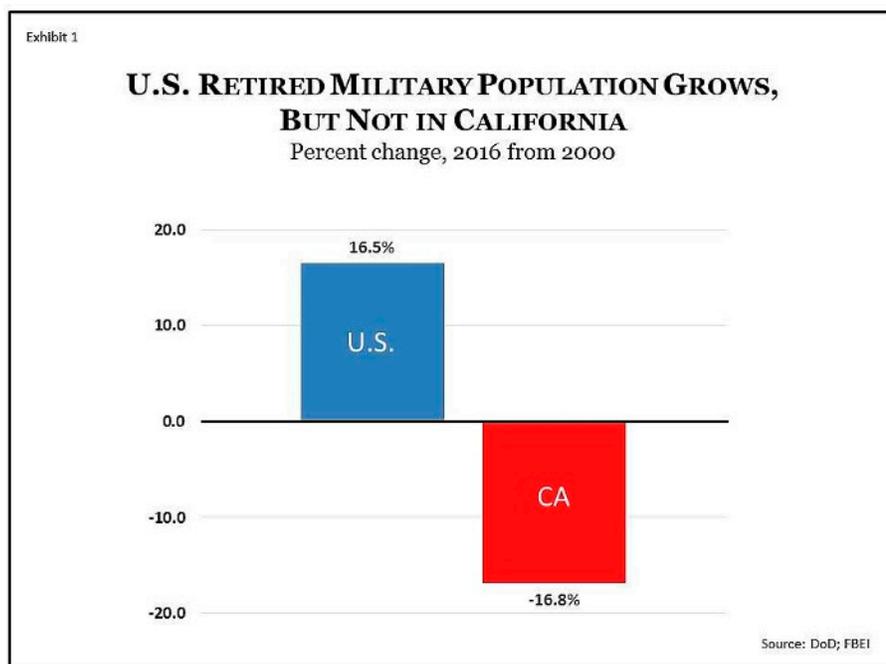
The decision to tax or not tax the pensions of military retirees has been an issue facing many states. Currently, California is one of only nine states that fully tax such pay. This study assesses the impact of current policy and explores the potential impact of eliminating the taxation of military retiree pay. Such effects are

analyzed in terms of the implications for the in-migration or out-migration of military retirees, the economic impact in terms of jobs, income, gross state product (GSP) and business sales, and the net implications for state and local tax revenues.

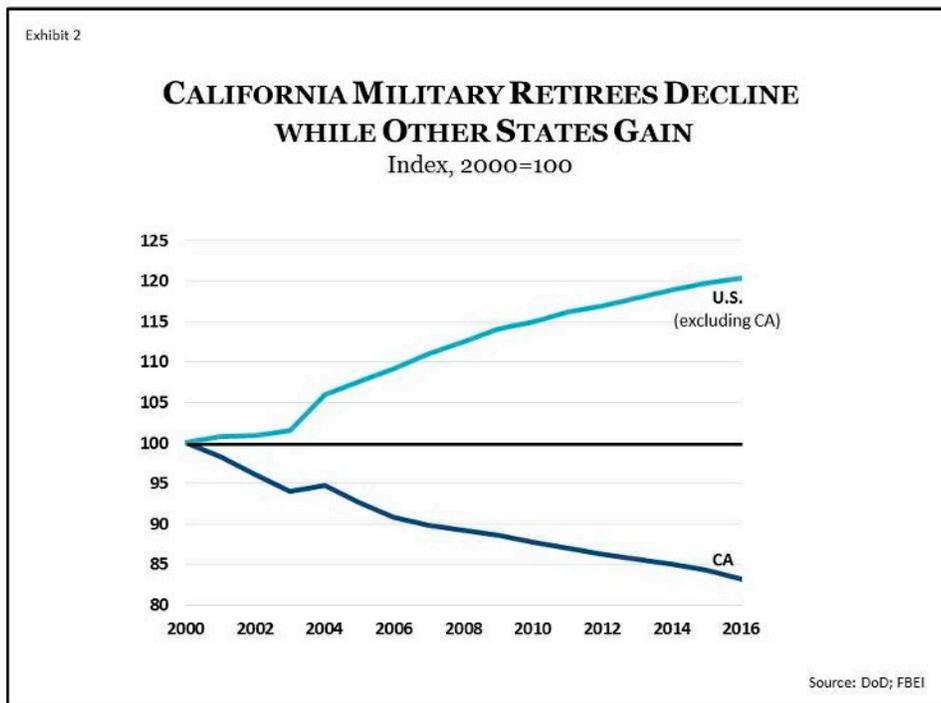
The report is organized as follows. Section I shows the trends of California’s military retiree population over time and compares it to other states. Section II discusses the differences in military retiree taxation across states. The various factors affecting military retiree location decisions are statistically modeled in Section III. This section also shows the effect of ending military pay taxation in California on the potential number and growth of military retirees. Section IV quantifies the economic implications and Section V quantifies the potential impact on state and local tax revenues. Section VI discusses some of the qualitative effects of the impact of military retirees. The study’s conclusions and recommendations for policy leaders are then presented in Section VII.

### I. MIGRATION TRENDS OF MILITARY RETIREES IN AND OUT OF CALIFORNIA

The nation’s military retired population has continued to grow with former Active Duty members of the Armed Forces moving to nearly all but a handful of states. California is one of those. The number of retired military increased by about 276,000, or 16.5%, from 2000 to 2016 in the U.S. In contrast, the number dropped by nearly 30,000, or 16.8%, in California over this same period of time. (See Exhibit 1.) As a result, California’s share of the nation’s retired military population has fallen from 10.5% to 7.5%.



California is the largest of the five states losing military retirees. The others are Connecticut, Massachusetts, New Jersey and Rhode Island. These other states largely reflect the pattern of retiring and moving from the Northeast to warmer climates in the South and West. California’s loss of military retirees reflects both the impact of current residents leaving the state as well as its difficulty in attracting new retirees. Its steady and continued loss of military retirees since 2000 contrasts with a consistent rise in military retiree counts in the rest of the nation. (See Exhibit 2.) While base closings in the 1990s might have impacted California more in earlier years, the continued widening in the gap vis-à-vis other states would appear to have other causes.

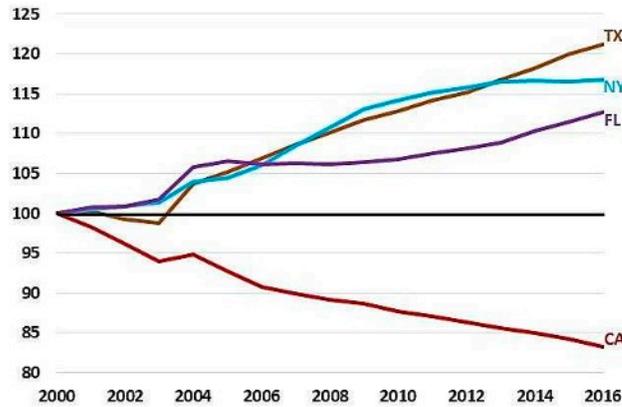


Many factors impact where military retirees choose to live, but taxes are one element. While other large states, such as Texas, Florida, and New York, which exempt military retiree pay from taxes, have seen their retired military populations grow, California’s count has dropped. (See Exhibit 3.) As of 2016, a total of just 146,000 military retirees called California their home. California’s 7.5% share of the nation’s military population contrasts to its 12% share of the overall U.S. population.

Exhibit 3

### MILITARY RETIREES RISE IN OTHER LARGE STATES WITH NO TAXATION OF MILITARY PAY

Index, 2000=100



Source: DoD; FBFI

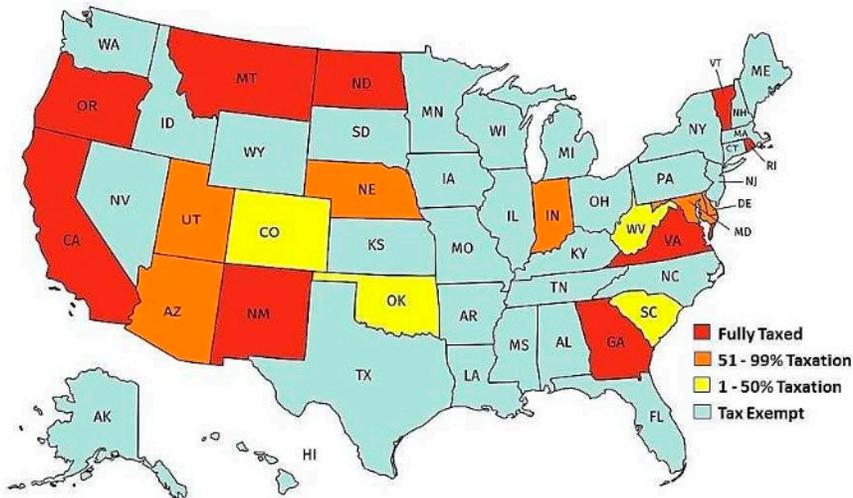
## II. DIFFERENCES IN TAXATION ACROSS STATES

A total of 31 states do not tax military pensions. A total of 9 states, including California, fully tax military retiree compensation: California, Georgia, Montana, New Mexico, North Dakota, Oregon, Rhode Island, Vermont, and Virginia. The remaining 10 states have various special exemptions depending on the state. (See Exhibit 4.)

Exhibit 4

### ONLY 9 STATES FULLY TAX MILITARY RETIREE PAY

Levels of taxation



Created with mapchart.net

Source: [themilitarywallet.com/military-retirement-pay-tax-exempt/](http://themilitarywallet.com/military-retirement-pay-tax-exempt/)

The various exemptions for the ten states partially taxing military retiree pay are outlined below together with an estimate of the average share of military retiree pay which is taxed.

- Arizona allows a \$2,500 tax exemption. (90.7%)
- Colorado allows a \$20,000 tax exemption for individuals under the age of 65 and a \$24,000 tax exemption for individuals over the age of 65. (30.8%)
- Delaware allows a \$2000 tax exemption for individuals under the age of 65 and a \$12,500 tax exemption for individuals over the age of 65. (69.2%)
- Indiana allows a \$5,000 tax exemption. (76.7%)
- Maryland allows a \$5,000 tax exemption for individuals under the age of 65 and a \$10,000 tax exemption for individuals over the age of 65. (77.1%)
- Nebraska allows two options. An individual can exclude 40% of retirement income for seven consecutive taxable years beginning with the year in which the election is made; or an individual can exclude 15% of military retirement income for all taxable years beginning with the year in which the individual turns 67 years of age. (71.5%)
- Oklahoma exempts the greater of \$10,000 or 75% of military retiree pay. (25%)
- South Carolina allows a \$17,000 tax exemption for individuals under the age of 65 and a \$30,000 tax exemption for individuals over the age of 65. (7.9%)
- Utah allows a tax exemption for individuals over 65. If they are single, the exemption is \$450 and if they are married and file jointly, the exemption is \$900. (96.7%)
- West Virginia allows for an exemption of \$20,000. (10.4%)

Excluding the states that totally or effectively tax large amounts of military retiree pay, a clear majority of states have chosen to exempt all or most of the pensions of military retirees from their tax coffers.

### **III. THE FACTORS DETERMINING LOCATION DECISIONS AND THE IMPACT OF ENDING MILITARY RETIREE PAY TAXATION IN CALIFORNIA**

#### Factors Driving the Number of Military Retirees in Each State and Growth

The decision of military retirees on where to live depends on many economic and other factors. This study investigated and modeled those considered most relevant. It then statistically tested them using data from the years, 2014-2016 for all fifty states. The most important indicators of the number of military retirees residing in each state, identified through econometric/statistically modeling, were determined to be the following:

- Size of Active Duty installations
- Home prices
- Share of military retiree pay taxed

- Average temperature
- Job opportunities
- Unemployment rate

Size of Active Duty installations. States with large numbers of military personnel tend to also have a large number of military retirees. These individuals may have been stationed at those installations either at the end of their military careers or at some point during their time with the military.

Home prices. Housing costs are a major consideration in determining where all individuals, including military retirees, choose to live. This is particularly true where home prices vary widely across states, such as is the case in the U.S.

Share of military retiree pay taxed. The share of military retirement pay that is taxed, ranging from 0% to 100%, is a significant factor in the location decision.

Average temperature. Retirees typically prefer warmer climates, particularly if they have more leisure time.

Job opportunities. Since Active Duty members can typically retire after 20 years of service with full retirement benefits, most are likely to be 40-50 and thus may opt for a second career in the private, non-profit, or government sector. The employment opportunities, measured as the increase in new jobs, can be an important element in determining where military retirees choose to live.

Unemployment rate. The unemployment rate is another indicator of the job market in a given state as well as a barometer of a state's overall economic health.

The model and factors listed above were used to predict the level or number of military retirees residing in each state. It is also important to understand what might determine the growth of this number over time. Testing of different models showed the following factors as important in determining the year-to-year percentage changes experienced in the military retiree populations of various states.

- Size of Active Duty installations
- Home prices
- Share of military retiree pay taxed
- Percent change in employment
- Unemployment rate

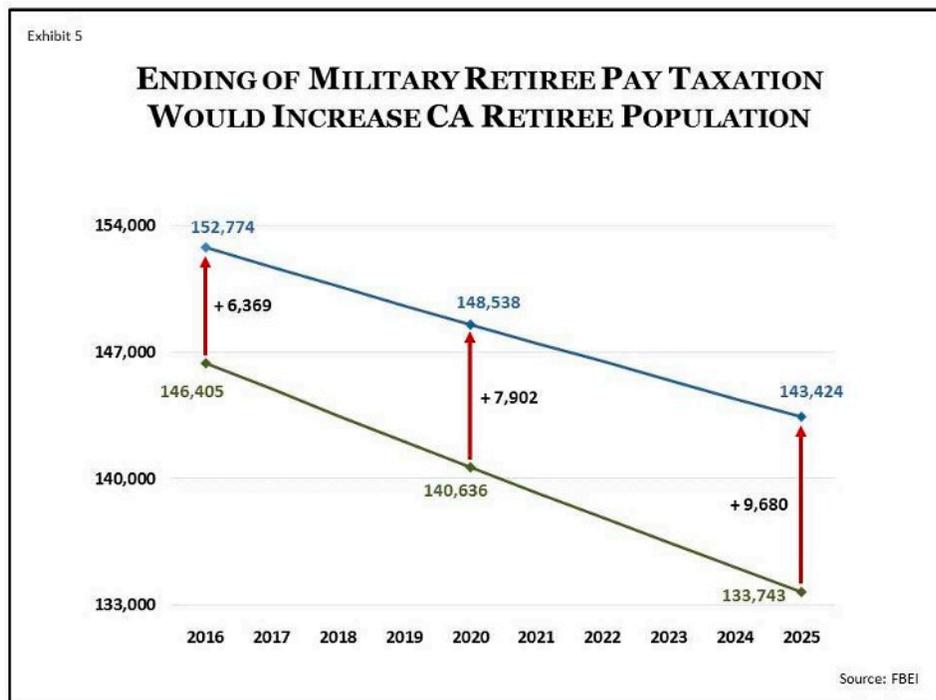
## Impact of Ending Military Retiree Pay Taxation in California

The above models were used to determine what would be the impact on the number of military retirees who would reside in California if their pensions were totally exempt from state taxes. The results indicated that there would initially be about 6,400, or 4.4%, more military retirees if they were not taxed on their pension pay.

The military retiree population in California declined by 1.2% in 2016 and shows a trend of dropping by about 1.0% per year, driven significantly by the relatively high level of home prices. The modeling conducted in this study showed that fully exempting military retirement pay from taxation could ease that decline by 0.3 percentage point a year.

These models are consistent with survey results found by California's Department of Finance indicating that housing, jobs, and family are the most important factors affecting location decisions by military retirees. However, our model indicates that taxes are also statistically significant.

As a result, an ending of pension taxation would have raised the number of military retirees by about 6,400 in 2016 over what existed. The difference could grow to nearly 8,000 in 2020 and 10,000 by 2025. (See Exhibit 5.) These effects might not be achieved immediately, but would grow over time.



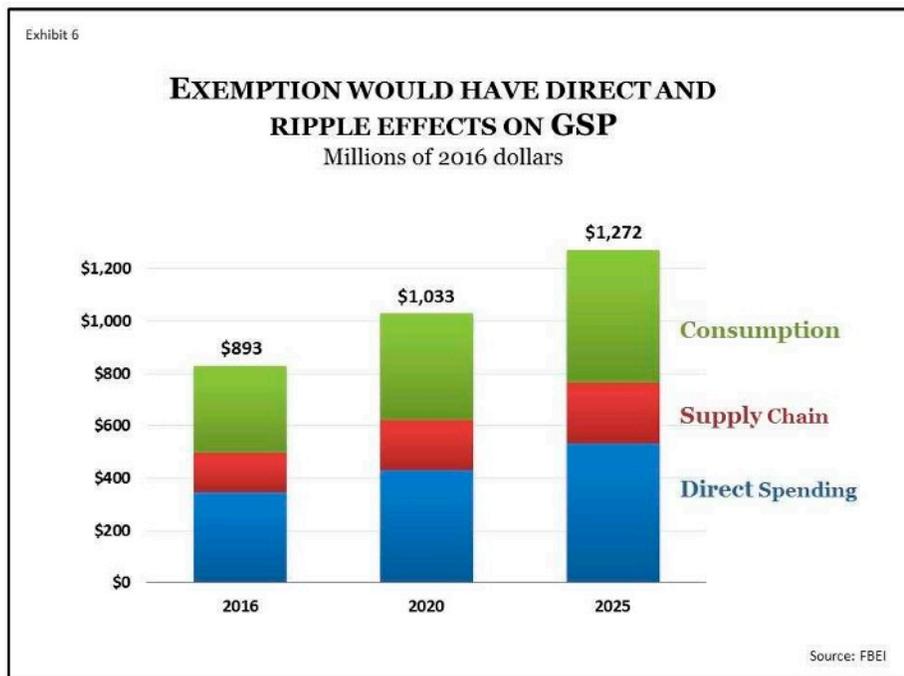
#### IV. THE ECONOMIC IMPACT OF ENDING MILITARY RETIREE PAY TAXATION IN CALIFORNIA

Attracting a larger base of military retirees to California with a more favorable tax structure and facilitating a better trend over time would yield significant economic benefits.

The addition of new military retirees would boost California's employment, total personal income, gross state product (GSP), and total business sales. Both direct and ripple effects would flow through the economy.

The addition of new retirees would raise consumer spending for various goods, services, and housing. Many of these retirees could be expected to take jobs as they remain at a prime age after only 20 years in the service. Some of those would start their own businesses and hire additional workers.

The spending and employment of additional military retirees would represent the direct economic drivers. The ripple or multiplier effects would encompass two dimensions. The first would be the supply chain or business-to-business effects as a result of spending by the retirees or their firms. The second would be the consumption effects as newly hired employees of retiree-owned businesses, or employees hired anywhere in the supply chains impacted by retiree outlays, spent part of their wages on various goods and services. (See Exhibit 6.)



The initial year of fully excluding military retiree pay from taxation could create nearly 8,300 additional jobs, with that impact rising to a number approaching 13,000 by 2025. Personal income could see a lift of about \$830 million by 2025 (in constant dollars), while California’s GSP could see a gain of \$1.3 billion. Total business sales could be expected to rise by an additional \$2.0 billion. (See Exhibit 7.)

Exhibit 7

**ECONOMIC IMPACTS OF MILITARY RETIREE PAY EXEMPTION**

	Employment	Personal Income (2016 \$, mil)	GSP (2016 \$, mil)	Sales (2016 \$, mil)
2016	8,281	\$ 542.9	\$ 829.6	\$ 1,342.4
2017	8,797	\$ 577.0	\$ 881.8	\$ 1,425.9
2018	9,293	\$ 609.8	\$ 932.2	\$ 1,506.4
2019	9,791	\$ 642.7	\$ 982.8	\$ 1,587.1
2020	10,281	\$ 675.2	\$ 1,032.7	\$ 1,666.5
2021	10,762	\$ 707.1	\$ 1,081.8	\$ 1,744.5
2022	11,235	\$ 738.5	\$ 1,130.2	\$ 1,821.2
2023	11,700	\$ 769.5	\$ 1,177.8	\$ 1,896.6
2024	12,157	\$ 799.9	\$ 1,224.7	\$ 1,970.6
2025	12,609	\$ 830.4	\$ 1,271.7	\$ 2,043.8

Source: FBEI

The ending of the taxation of military retiree pay in California would therefore yield significant economic benefits that would grow over time.

**V. THE FISCAL IMPACTS OF ENDING MILITARY RETIREE PAY TAXATION IN CALIFORNIA**

California would lose some revenue if it ended the taxation of military pensions, but there would be offsets that would more than compensate for that loss.

If military retirement pay had not been taxed in 2016, the state would have seen a reduction from that revenue source of an estimated \$46.0 million. However, state revenues resulting from the additional projected retirees and their families would have equaled an offsetting \$46.1 million. These revenues would have come through a combination of state sales taxes, personal income taxes, corporate taxes, and other state fees and taxes. The addition to California’s resident population also

would have boosted local property taxes and other revenues for cities and counties by \$18.3 million. (See Exhibit 8.)

Exhibit 8

## REVENUE IMPACTS OF MILITARY RETIREE PAY EXEMPTION

Millions of 2016 dollars

	Retiree Income Tax Loss	Revenue Gains					Total State Revenue Gains	Total Local revenue Gains
		State Personal Income Tax	State Sales Tax	State Corporate Taxes	Other State Fees & Taxes	Local Property Taxes and other fees		
2016	46.0	\$ 17.5	\$ 19.8	\$ 2.9	\$ 5.8	\$ 18.3	\$ 46.1	\$ 18.3
2017	45.5	\$ 18.5	\$ 21.1	\$ 3.1	\$ 6.2	\$ 19.4	\$ 48.9	\$ 19.4
2018	45.1	\$ 19.6	\$ 22.3	\$ 3.3	\$ 6.5	\$ 20.5	\$ 51.7	\$ 20.5
2019	44.6	\$ 20.7	\$ 23.5	\$ 3.5	\$ 6.9	\$ 21.6	\$ 54.5	\$ 21.6
2020	44.2	\$ 21.7	\$ 24.7	\$ 3.7	\$ 7.2	\$ 22.7	\$ 57.3	\$ 22.7
2021	43.7	\$ 22.7	\$ 25.8	\$ 3.8	\$ 7.6	\$ 23.8	\$ 60.0	\$ 23.8
2022	43.3	\$ 23.7	\$ 27.0	\$ 4.0	\$ 7.9	\$ 24.8	\$ 62.6	\$ 24.8
2023	42.8	\$ 24.7	\$ 28.1	\$ 4.2	\$ 8.2	\$ 25.9	\$ 65.2	\$ 25.9
2024	42.4	\$ 25.7	\$ 29.2	\$ 4.4	\$ 8.6	\$ 26.9	\$ 67.8	\$ 26.9
2025	42.0	\$ 26.7	\$ 30.3	\$ 4.5	\$ 8.9	\$ 27.9	\$ 70.4	\$ 27.9

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
STATE NET REVENUE	\$ 0.1	\$ 3.4	\$ 6.7	\$ 9.9	\$ 13.1	\$ 16.2	\$ 19.3	\$ 22.4	\$ 25.4	\$ 28.4
STATE & LOCAL NET REVENUE	\$ 18.4	\$ 22.9	\$ 27.2	\$ 31.5	\$ 35.8	\$ 40.0	\$ 44.2	\$ 48.2	\$ 52.3	\$ 56.3

Source: FBFI

The net impact on state revenues of fully exempting military retiree pay from taxation would have been \$0.1 million in 2016, and \$18.4 million including both state and local tax revenues. Over time, the potential state loss from the taxes on military retiree pay would diminish as the number of military retirees continued to shrink in California. Meanwhile, military retiree counts due to a tax change would grow. As a result, by 2025 the state could see a net revenue gain from military retirees of \$28.4 million (in constant dollars). Including the positive impact on local government finances, the total net fiscal impact would equal \$56.3 million.

The overall fiscal impacts on both state and local finances of fully exempting military retiree pay from taxation thus appear to be clearly positive after factoring in all of the direct and ripple effects over time.

It should be noted that the full benefits shown above would not be achieved in the first year of a new policy ending the taxation of military retiree pay. It is estimated that it could take up to five years to reach the break-even point for state revenues.

## **VI. QUALITATIVE EFFECTS OF MILITARY RETIREES**

The impact of military retirees in California extends far beyond their economic and fiscal effects. Retired members of the military represent some of the state's most important residents.

These individuals can be anchors of support in local communities. They can fill critical volunteer or leadership positions in civic and philanthropic organizations. They can play integral roles in schools, churches, and neighborhood groups. They can be vital mentors to young people.

The many military retirees who choose to work can provide a badly needed source of talent at a time when many firms are experiencing great difficulty in finding qualified employees. These retirees can fill strategic positions in such fields as engineering, computer science, management, health care, communications, and education. They are some of California's best and brightest.

Military retirees also bring a key set of important values. A strong work ethic, integrity, and respect rank among their core values, which by themselves are vital to a state's prosperity and success.

## **VII. CONCLUSIONS AND POLICY RECOMMENDATIONS**

States vary significantly regarding policies of taxing the pensions of military retirees. California is in the minority, although not alone, in taxing all of that pay. States must constantly balance the costs and benefits of taxing various segments of their populations or economies.

In the case of California, a static analysis shows that the state would lose a modest number of tax dollars if it ended the taxation of military retiree pay. That loss would diminish over time as the state's military retiree count continued to dwindle for a number of reasons, including the cost of housing.

Ending military pension taxation would yield significant benefits. It would raise the number of military retirees choosing to reside in California and also diminish the current declining trend over time. The economic benefits would be tangible and significant in terms of jobs, total personal income, GSP, and total business sales. It might take up to five years for the state to break even in terms of taxes. However, a net positive gain would then expand over time. Including the positive impact on

local finances, the net revenue gain would be even more positive and grow substantially over time.

The major changes in federal tax law enacted at the end of 2017 could make California's tax climate even more unfavorable for some military retirees who still itemize due to limits on deductions for state and local taxes as well as mortgage interest. The rate of decline of its retired military population could accelerate faster than shown in this study's models.

California's tax structure, which has not been changed in a major way since 1935 when the state income tax was introduced, is obsolete and critically needs to be revised. Reforming the way the state taxes military retirees could be an important step and would represent a "win-win" strategy for California's economy, fiscal position, and local communities.

## APPENDIX: METHODOLOGY

### Retiree military counts and pay

The Department of Defense (DOD) Statistical Report on the Military Retirement System from 2000-2016 was used to gather information on the number of military retirees receiving pay for the United States and each state.

For the years 2014, 2015, and 2016, the total average monthly salary per person (paid by the DOD) per state was calculated for all 50 states. In order to calculate this, data was acquired from the DOD and found at [actuary.defense.gov](http://actuary.defense.gov). The number of people paid by the DOD and the total monthly payment for all individuals per state was provided for each branch of the military by the source.

To calculate the total average monthly salary per person per state, the number of retirees per state was totaled. Next, the total monthly payment for all individuals was summed. Then, the total monthly payment was divided by the total number of retirees per state to determine the total average monthly salary per person. This number is in thousands of dollars.

Once each state had an average monthly salary per person for each of the years 2014, 2015, and 2016, the percentage these states taxed military retiree pay was calculated.

In order to calculate these tax rates, information regarding the taxation rates for military pensions per state was found on [militaryintransition.com](http://militaryintransition.com). Each state has its own rules and regulations on military pension taxes.

A total of 29 states do not have a state tax on military pensions. A total of 11 states do not have any tax exemption for military pensions. The remaining 10 states have special exemptions depending on the state. Below shows how each of those states' tax rates was calculated.

#### Arizona:

Arizona allows a \$2,500 tax exemption. In order to calculate the tax rate for each year (2014-2016), the average monthly salary per person was multiplied by 1,000 and then multiplied by 12 in order to determine the annual pension payment. The \$2,500 exemption was divided by the annual pension payment. This answer was then subtracted from 1 to determine the percentage Arizona taxes military pensions.

#### Colorado:

Colorado allows a \$20,000 tax exemption for individuals under the age of 65 and a \$24,000 tax exemption for individuals over the age of 65. In order to determine the percentage tax for the entire state a weighted average was used. First, the percentage of individuals over 65 and under 65 was calculated using the Actuary Defense Data. To calculate the number of retirees over 65, the number of individuals over 65 was divided by the total number of retirees. This number was then subtracted from 1 to determine the number of retirees under 65. Then next step was to calculate the exemption percentage for the two age brackets. To calculate this, the average monthly salary per person was multiplied by 1,000 and then multiplied by 12 in order to determine the annual pension payment. The \$24,000 or the \$20,000 (depending on the age bracket) exemption was divided by the annual pension payment. The final step was to create the weighted average. The percentage of individuals over 65 was multiplied by the tax rate for the individuals over 65. This number was added to the percentage of individuals under 65 multiplied by the tax rate for individuals under 65. This number was subtracted by 1 to determine the percentage Colorado taxes military pensions.

#### Delaware:

Delaware allows a \$2,000 tax exemption for individuals under the age of 65 and a \$12,500 tax exemption for individuals over the age of 65. In order to determine the percentage tax for the entire state a weighted average was used. First, the percentage of individuals over 65 and under 65 was calculated using the Actuary Defense Data. To calculate the number of retirees over 65, the number of individuals over 65 was divided by the total number of retirees. This number was then subtracted from 1 to determine the number of retirees under 65. Then next step was to calculate the exemption percentage for the two age brackets. To calculate this, the average monthly salary per person was multiplied by 1,000 and then multiplied by 12 in order to determine the annual pension payment. The \$2,000 or the \$12,500 (depending on the age bracket) exemption was divided by the annual pension payment. The final step was to create the weighted average. The percentage of individuals over 65 was multiplied by the tax rate for the individuals over 65. This number was added to the percentage of individuals under 65 multiplied by the tax rate for individuals under 65. This number was subtracted by 1 to determine the percentage Delaware taxes military pensions.

#### Indiana:

Indiana allows a \$5,000 tax exemption. In order to calculate the tax rate for each year (2014-2016), the average monthly salary per person was multiplied by 1,000 and then multiplied by 12 in order to determine the annual pension

payment. The \$5,000 exemption was divided by the annual pension payment. This answer was then subtracted from 1 to determine the percentage Indiana taxes military pensions.

#### Maryland:

Maryland allows a \$5,000 tax exemption for individuals under the age of 65 and a \$10,000 tax exemption for individuals over the age of 65. In order to determine the percentage tax for the entire state a weighted average was used. First, the percentage of individuals over 65 and under 65 was calculated using the Actuary Defense Data. To calculate the number of retirees over 65, the number of individuals over 65 was divided by the total number of retirees. This number was then subtracted from 1 to determine the number of retirees under 65. Then next step was to calculate the exemption percentage for the two age brackets. To calculate this, the average monthly salary per person was multiplied by 1,000 and then multiplied by 12 in order to determine the annual pension payment. The \$5,000 or the \$10,000 (depending on the age bracket) exemption was divided by the annual pension payment. The final step was to create the weighted average. The percentage of individuals over 65 was multiplied by the tax rate for the individuals over 65. This number was added to the percentage of individuals under 65 multiplied by the tax rate for individuals under 65. This number was subtracted by 1 to determine the percentage Maryland taxes military pensions.

#### Nebraska:

In 2014 Nebraska did not offer tax exemptions for military retirees on their pensions. Beginning in the 2015 tax year, individuals were given a choice on how they would like to institute an exemption on their military pension. According to military.com the first option allows for an individual to exclude 40 percent of retirement income for seven consecutive taxable years beginning with the year in which the election is made; the second option allows an individual to exclude 15 percent of military retirement income for all taxable years beginning with the year in which the individual turns 67 years of age. In order to determine a single tax rate for the state of Nebraska, the age demographics of the retirement population were analyzed with the finding that roughly 54 percent of the population would elect for option number one while 46 percent of the population would elect for option number. Next, 0.54 was multiplied by 0.40 to represent the above-mentioned option one and 0.46 was multiplied by 0.15 to represent the above-mentioned option two. After adding the option one and two calculations together, the total was subtracted from 1 to determine a percentage that Nebraska taxes military pensions for the years 2015 and 2016.

#### Oklahoma:

Oklahoma exempts the greater of \$10,000 or 75% of military retiree pay.

#### South Carolina:

South Carolina allows a \$17,000 tax exemption for individuals under the age of 65 and a \$30,000 tax exemption for individuals over the age of 65. In order to determine the percentage tax for the entire state a weighted average was used. First, the percentage of individuals over 65 and under 65 was calculated using the Actuary Defense Data. To calculate the number of retirees over 65, the number of individuals over 65 was divided by the total number of retirees. This number was then subtracted from 1 to determine the number of retirees under 65. Then next step was to calculate the exemption percentage for the two age brackets. To calculate this, the average monthly salary per person was multiplied by 1,000 and then multiplied by 12 in order to determine the annual pension payment. The \$17,000 or the \$30,000 (depending on the age bracket) exemption was divided by the annual pension payment. The final step was to create the weighted average. The percentage of individuals over 65 was multiplied by the tax rate for the individuals over 65. This number was added to the percentage of individuals under 65 multiplied by the tax rate for individuals under 65. This number was subtracted by 1 to determine the percentage South Carolina taxes military pensions.

#### Utah:

Utah allows a tax exemption for individuals over 65. If they are single, the exemption is \$450 and if they are married and file jointly, the exemption is \$900. In order to calculate the tax rate, first the percentage of individuals over 65 and under 65 was calculated using the Actuary Defense Data. To calculate the number of retirees over 65, the number of individuals over 65 was divided by the total number of retirees. This number was then subtracted from 1 to determine the number of retirees under 65. Then, the number of people married and unmarried was calculated using information acquired through the University of Utah's study titled: "Analysis of Military Retirees in Utah: Impacts, Demographics, and Tax Policy." The study said 79% of military retirees are married, meaning 21% are unmarried. The 79% and 21% were respectively multiplied by the number of retirees over 65 (source: Actuary Defense Data). Then the pension per year was calculated by multiplying the average monthly salary per person by 1,000 and then multiplied by 12. The \$450 and the \$900 exemptions were then calculated by dividing the exemption by the total pension per year. Finally, these percent exemptions were multiplied by the respective 79 and 21% to represent the percentage married and unmarried. Those numbers were added together and then subtracted from 1 to determine the percentage Utah taxes military pensions.

## West Virginia:

West Virginia allows for an exemption of \$20,000. In order to calculate the tax rate for each year (2014-2016), the average monthly salary per person was multiplied by 1,000 and then multiplied by 12 in order to determine the annual pension payment. The \$20,000 exemption was divided by the annual pension payment. This answer was then subtracted from 1 to determine the percentage West Virginia taxes military pensions.

## State income tax bracket rates for military pensions per state:

The individual state income tax bracket rate for military retiree pensions for years 2014, 2015, and 2016 was calculated. In order to calculate this information, tax bracket information was found on taxfoundation.org. In addition, we assumed 40% of military retirees were single and 60% were married filing jointly.

In order to calculate the income tax bracket, a weighted average was used. First, the yearly annual pension per person was used to determine the tax bracket each individual fell into. The annual pension was calculated by multiplying the average monthly salary per person by 1,000 and then multiplying that number by 12. This number determined the tax bracket for these individuals. We only looked at the highest tax bracket according to the pension. For each single and married, the highest tax bracket was multiplied by 40% and 60% respectively. These numbers were added together to generate a weighted average state income tax bracket.

## Economic and revenue impact modeling

EViews, an econometric software programming system, was used to build the models predicting the number of military retirees in each state and their growth over time. A number of different explanatory variables were tested, including home prices, weather, job expansion, active duty populations, the share of military pay taxation, unemployment rates, and effective income tax rates. Data was pooled across all fifty states over the three years 2014-2016. The models selected were based on their explanatory power.

The models were then simulated under the assumption of a zero taxation of military retiree pay in California. Projections for the number of retirees in California for the years 2016 through 2035 were then calculated.

IMPLAN, a widely used platform for economic impact analysis, was used to estimate the economic effects of fully exempting military retiree pay in California from taxation. The model using California base data for 2016 was utilized.

The retirement incomes from all of the additional projected military retirees were calculated based on data on the value of average pensions from the DOD. Approximately half of the additional retirees were assumed to become actively employed. They were assigned to various industries based on skills acquired in the military. These included security, telecommunications, transportation, engineering, consulting, education, health care, computer systems, and others. Data from the U.S. Department of Veterans Affairs was used to estimate the number of retirees who would own their own business and also the number who would hire additional workers.

The IMPLAN models were then simulated for each of the years 2016 through 2035 to calculate all of the total effects on jobs, total personal income, GSP, and total sales.

The IMPLAN model also produced estimates of the impact on state and local tax revenues for each of the years 2016-2035. The different types of taxes were divided between the state and local entities as well as for the major sources of the state's tax sources. A separate calculation of the impact of the simulated change in tax law was made for personal income taxes using assumptions for the relevant tax brackets, filing status, and exemptions. Sales taxes were also estimated using the data on projected sales volumes and California's state tax rate. These calculations yielded results close to those produced by the IMPLAN model.

All data, calculations, assumptions, and results were examined for accuracy, completeness, and reasonableness for all stages of the study.

## APPENDIX: SOURCES

### Housing Costs

<https://www.zillow.com/home-values/>

### United States and States Population

<https://www.census.gov/>

### Weather Average Temperatures

<https://www.currentresults.com/Weather/US/average-annual-state-temperatures.php>

### Number of Jobs

[www.bls.gov](http://www.bls.gov)

### Actuary Defense Data

[http://actuary.defense.gov/Portals/15/Documents/MRS\\_StatRpt\\_2014.pdf?ver=2015-06-24-072935-040](http://actuary.defense.gov/Portals/15/Documents/MRS_StatRpt_2014.pdf?ver=2015-06-24-072935-040)

### Tax Exemption Per State Information

<http://militaryintransition.com/military-pension-tax-rates-state/>  
<http://themilitarywallet.com/military-retirement-pay-tax-exempt/>

### Utah Military Report

[http://gardner.utah.edu/wp-content/uploads/2017/02/MilitaryRet.Report-final\\_2017.pdf](http://gardner.utah.edu/wp-content/uploads/2017/02/MilitaryRet.Report-final_2017.pdf)

### State Individual Income Tax Rates and Brackets

<https://taxfoundation.org/state-individual-income-tax-rates-brackets-2017/>



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