



# NORTH CAROLINA GENERAL ASSEMBLY

Session 2017

## Legislative Fiscal Note

**Short Title:** Military Retiree State Income Tax Relief.  
**Bill Number:** Senate Bill 153 (Third Edition)  
**Sponsor(s):**

### SUMMARY TABLE

	FISCAL IMPACT OF S153, (\$ in millions)				
	<u>FY 2018-19</u>	<u>FY 2019-20</u>	<u>FY 2020-21</u>	<u>FY 2021-22</u>	<u>FY 2022-23</u>
<b>State Impact</b>					
General Fund Revenue					
Section 1	(24.8)	(27.1)	(29.6)	(32.2)	(34.8)
Section 7	(2.0)	(2.1)	(2.1)	(2.1)	(2.2)
Less Expenditures					
Section 2	<i>See Actuarial Note for House Bill 340 for details</i>				
Section 3(a)	-	12.7	13.4	14.1	14.8
<b>General Fund Impact</b>	<b>(26.8)</b>	<b>(41.9)</b>	<b>(45.1)</b>	<b>(48.4)</b>	<b>(51.8)</b>
<b>NET STATE IMPACT*</b>	<b>(\$26.8)</b>	<b>(\$41.9)</b>	<b>(\$45.1)</b>	<b>(\$48.4)</b>	<b>(\$51.8)</b>
<b>Local Impact</b>					
Local Revenue					
Section 3(b)		(0.7)	(0.7)	(0.8)	(0.8)
Section 4		(1.0)	(1.0)	(1.0)	(1.0)
Section 7		(0.8)	(0.8)	(0.8)	(0.9)
Less Local Expenditures					
Section 2	<i>See Actuarial Note for House Bill 340 for details</i>				
<b>NET LOCAL IMPACT*</b>	<b>-</b>	<b>(\$2.5)</b>	<b>(\$2.5)</b>	<b>(\$2.6)</b>	<b>(\$2.7)</b>

\*Net Impacts do not include impact of Section 2. See Actuarial Note for House Bill 340 for details.

### FISCAL IMPACT SUMMARY

**Section 1** allows a deduction for military retirement and survivorship benefits. Benefits paid to retirees who had earned five years of creditable service in the Military Retirement System as of August 12, 1989 and their survivor beneficiaries are already deductible and may not be deducted twice. This memo assumes this provision is effective for taxable years beginning on or after January 1, 2018.

**Section 2** creates new Special Separation Allowances for State and local firefighters and rescue squad workers. These Allowances are similar, but not identical, to those in current law for law enforcement officers. The key features are as follows:

- The Allowances would be payable upon unreduced retirement with 30 years of service or at age 60 with 25 years of service.
- The Allowances would be payable until the retiree reaches age 62, unless he dies or is reemployed under certain conditions prior to reaching age 62.
- The Allowances would only be payable if the firefighter or rescue squad worker has completed at least five years of continuous service rendered on or after July 1, 2017 as a firefighter or rescue squad worker immediately prior to retirement. Thus, no one retiring prior to July 1, 2022 would be eligible for these Allowances.
- The amount of the Allowances would be 0.85% x creditable service x the annual equivalent of the most recent base rate of compensation.
- The Allowances would be paid by the State agency or local government that last employed the retiree.

**Section 3(a)** increases the Disabled Veteran Property Tax Exclusion from \$45,000 to \$100,000 of the homestead appraised value and reimburses local governments for the revenue lost from valuations above \$45,000 and is effective for taxable years beginning on or after July 1, 2019.

**Section 3(b)** creates a homestead property tax exemption for the surviving spouse of an emergency personnel officer who was killed in the line of duty and is effective for taxable years beginning on or after July 1, 2019.

**Section 5** exempts commercial property held for sale, rental or burial rights and is effective for taxable years beginning on or after July 1, 2019.

**Section 7** creates a statutory sales and use tax exemption for certain cranes and crane attachments, which would reduce both State and local sales tax revenue. This section becomes effective July 1, 2018 and applies to purchases made on or after that date.

Under North Carolina tax law, sales of tangible personal property are subject to Sales or Use taxes unless the tangible personal property is specifically exempted from tax in statute. In S.L. 2017-57, Sec. 38.8, the General Assembly repealed its prior taxation policy for certain machinery and equipment and instead exempted the same from sales and use tax. Under the old policy, which ends June 30, 2018, purchasers of eligible machinery and equipment pay tax at a preferential rate of 1% of the purchase price with an \$80 cap; the new policy is effective July 1, 2018 and exempts these purchases from sales tax. Section 7 of this bill expands the sales and use tax exemption by also exempting “sales of a crane, or an attachment or repair part for a crane,” assuming that the crane meets criteria already in statute, including the requirement that the crane is sold to a company that is engaged in the fabrication of metal work and that has annual gross receipts from the metal work fabrication of at least \$8 million.

## **FISCAL ANALYSIS**

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### **Section 1: Military Retirement Income Tax Deduction**

Under the “Bailey Settlement,” military retirement income that is based on military service that includes at least five years of creditable service earned prior to August 1989 is exempt from North Carolina income tax. Senate Bill 153 exempts military retirement income that does not qualify for exemption under the “Bailey Settlement.”

To determine the amount of military retirement income that is not eligible for exemption, Fiscal Research obtained 2016 data on the total amount of military retirement benefits paid to North Carolina residents who first earned service after 1984 from DOD. This analysis assumes that all military retirement benefits based on service earned after 1984 are subject to taxation under current law. Projections of benefit payments were based on the growth predicted in the FY 2014 Valuation of the Military Retirement System.

The share of pension income that is subject to State income tax will increase each year because new retirees are less likely to meet the criteria required for exemption under the “Bailey Settlement.” To determine this share, Fiscal Research used data provided by DOD about retirees’ average years of service and year of retirement to approximate first year of employment for current retirees. This was used to approximate the share of benefit payments that would be eligible for the Bailey exemption each year, assuming no breaks in service during the first five years of employment. The share of benefits that would not be eligible for the Bailey exemption was multiplied by the total amount of benefits to determine the amount of income eligible for the tax deduction. The fiscal impact was calculated by multiplying this amount by an estimated effective tax rate of 3.5 percent. Because the military retirement system does not automatically withhold state tax income, the impact for FY 2018-19 is assumed to equal the full-year impact of tax year 2018, -\$24.8 million.

### **Section 2: Special Separation Allowance for Firefighters and Rescue Squad Workers**

See Actuarial Note for House Bill 340 (Second Edition).

### **Section 3(a): Disabled Veteran Property Tax Exclusion**

The third edition increases the exclusion amount from the first \$45,000 of home value to the first \$100,000. To determine the fiscal impact, the American Community Survey (ACS) was used to determine the percentage of NC homes valued at less than \$100,000. Homes valued at less than \$100,000 would receive an exclusion based on the value of the home because the total value is less than the exclusion amount of \$100,000. Homes valued higher would receive an exclusion of the first \$100,000.

Based on the ACS data, the average value of homes less than \$100,000 was calculated and used to determine the total value for all qualifying homes under \$100,000. The ACS data was also used to calculate the value of qualifying homes over \$100,000 that would receive the full exclusion. The values for home below and above \$100,000 are added together to get the total value of excluded property. The amount currently excluded is subtracted to determine the additional value excluded under the bill. Finally, the statewide weighted average tax rate of 94.3 cents per \$100 value is used to determine the amount of property tax loss, which is equal to the hold harmless amount.



Moody's Analytics projections for existing home prices are used to determine the increase in cost for future years.

### **Section 3(b): Emergency Personnel Surviving Spouse Exclusion**

Based on data from the Department of State Treasurer, a total of 371 emergency personnel have been eligible for death benefit payments since 1971. The death benefit payment is made to the dependents of emergency personnel killed in the discharge of their official duties.

Assuming a total of 371 eligible beneficiaries and a median home value for NC of \$154,900, the cost of the bill in lost property tax revenue to counties and municipalities would be approximately \$700,000. It is not known how many of the 371 personnel have unmarried surviving spouses or if there are eligible surviving spouses of personnel killed prior to 1971. Therefore, it is not possible to estimate the cost more precisely; however, given the length of time covered by the data, the cost is estimated to be less than \$700,000.

### **Section 5: Cemetery Property Tax Exemption**

According to the Cemetery Commission, the value of all cemetery property held for resale is approximately \$108 million. Based on the average statewide property tax rate, the corresponding annual property tax loss would be \$1 million.

### **Section 7: Exempt Cranes from Sales and Use Tax**

Creating a sales and use tax exemption for the sale of cranes used for metal work would reduce sales and use tax revenue for both the State and local governments. The North Carolina Department of Revenue does not collect data on the amount of sales tax revenue generated by specific categories of items sold in the State, so no definitive data exists on the fiscal impact of exempting these items. However, other data source can help approximate the exemption's potential fiscal impact:

- The US Census Bureau's 2012 Economic Census for North Carolina reports that sales in North Carolina by retailers of "overhead traveling crane, hoist, and monorail system[s]" totaled approximately \$411 million when inflated to 2019 dollars. This equates to a State revenue loss of \$19.5 million based on the State's 4.75% sales and use tax rate, plus a loss for local governments of approximately \$8.5 million. This represents the highest end of an estimate range for the impact of Section 7, because this Economic Census category includes items besides cranes, and because it is assumed that not every crane purchased in North Carolina will be used by manufacturers who meet the eligibility criteria in statute.
- Also according to the 2012 Economic Census, primary metal manufacturing and fabricated metal product manufacturing represent a small amount of North Carolina's total manufacturing sector – approximately 7% in 2012. While these two subsectors could account for a disproportional share of North Carolina crane sales, it is unlikely that they comprise the majority of the State's crane sales, because the types of cranes used in these two subsectors account for only a portion of the total US crane market.



Ultimately, the total fiscal impact of the sales tax exemption in Section 7 cannot be estimated with certainty. However, assuming that eligible manufacturers comprise 10% of the State's total crane sales, the impact would be a loss of approximately \$2 million in State revenue and a corresponding local loss of approximately \$825,000.

## **TECHNICAL CONSIDERATIONS**

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N/A.

## **DATA SOURCES**

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U.S. Census Bureau; NC Dept. of Revenue; Moody's Analytics; NC Dept. of State Treasurer

### United States Department of Defense

- Data provided by the Office of the Actuary
- Data from the Office of the Secretary of Defense and the Joint Staff
- FY 2014 Valuation of the Military Retirement System
- FY 2001 – FY 2015 Military Retirement System Statistical Reports
- Defense Manpower Data Center December 2016 Report of Military and Civilian Personnel by Service/Agency by State/Country

## **LEGISLATIVE FISCAL NOTE – PURPOSE AND LIMITATIONS**

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This document is an official fiscal analysis prepared pursuant to Chapter 120 of the General Statutes and rules adopted by the Senate and House of Representatives. The estimates in this analysis are based on the data, assumptions, and methodology described in the Fiscal Analysis section of this document. This document only addresses sections of the bill that have projected direct fiscal impacts on State or local governments and does not address sections that have no projected fiscal impacts.

## **CONTACT INFORMATION**

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Questions on this analysis should be directed to the Fiscal Research Division at (919) 733-4910.

## **ESTIMATE PREPARED BY**

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June 15, 2018



Signed copy located in the NCGA Principal Clerk's Offices