GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

Legislative Fiscal Note

BILL NUMBER: House Bill 233 (First Edition)

SHORT TITLE: Equal Tax Treatment of Govt. Retiree Benefits.

SPONSOR(S): Representatives Glazier, Pate, Underhill, and Faison

FISCAL IMPACT ($Million)

Yes (X) **No** ( ) **No Estimate Available** ( )

	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-011	FY 2011-12
REVENUES					
State General Fund	**-$20.1**	**-$52.2**	**-$71.4**	**- $97.6**	**- $133.4**

PRINCIPAL DEPARTMENT AFFECTED: The income tax is administered by the Department of Revenue. The enactment of the bill is not expected to have an impact on the Department's budget requirements.

EFFECTIVE DATE: Tax years beginning on or after January 1, 2008.

BILL SUMMARY: Under the **Bailey** decision, public sector retirees who have five years of creditable service as of August 12, 1989, are entitled to a 100% income tax exclusion for their retirement pay. The remaining "nonvested" public sector retirees as of that date and taxpayers receiving a pension from a state or local unit in another state receive a $4,000 exclusion.

The bill provides that all federal, state, and local retirees would receive the full exclusion regardless of their vesting status or their state of employment. The exemption for retirees from other states would be limited to the amount the other state allows to retirees of the North Carolina or its political subdivisions, but not lower than $4,000.

ASSUMPTIONS AND METHODOLOGY: **"Nonvested" State and Local Retirees (As of August 12, 1989):** The Department of State Treasurer provided Fiscal Research Division with a December 2006 tabulation of the total number of "vested" (as of 8/12/89) state and local retirees by size of retirement check. In addition, the Department provided the same distribution data for nonvested retirees.

The next step in the analysis of nonvested retirees was to multiply the average annual retirement pay for each income grouping by the assumed marginal income tax rate (6%, 7%, 7 ¾%) to determine the tax savings per retiree. The "per retiree" number was then multiplied by the number of retirees for that income class to determine the annual revenue loss for the income grouping. The total loss for each income class was then added to the amounts for the other classes to determine the total statewide impact.

There was no comparable distribution data for federal civil service and military retirees. To make an estimate for these classes, we looked at a historical estimate of the total number of federal pensioners relative to state and local retiree (federal is 5.6% higher) and the average check size (federal is 33% higher) and arrayed this total into various assumed check size amounts for federal retirees. The tax savings were then tabulated using the same methodology as that used for state and local retirees.

The next issue was how to grow the number of nonvested retirees in the future The method used was to analyze the growth in the tax cost of the proposal between the 1999 session estimates (based on February 1999 tabulation of nonvested retirees) and the December 2006 basis. The average annual growth rate turns out to be 37.6%. This is roughly comparable to the 31.7% growth rates used in the 2005 fiscal estimates. The rate is high due to a combination of: (1) the rapid increase of August 12, 1989 nonvested retirees, (2) the recent tendency for employees to work for the state just long enough to obtain health insurance coverage, and (3) the annual increase in pension benefits.

The analysis indicates that there are about 10,175 state and local retirees who would receive relief under the bill. The estimated number of impacted federal retirees is 10,786. The numbers represent only about 45% of the August 12, 1989 nonvested retirees because many retirees receive a pension that is lower than the $4,000 exclusion and thus do not pay a tax on their retirement pay under current law.

The tax year estimates of the impact were split into fiscal years by following the traditional practice of Fiscal Research and the Department of Revenue of putting 45% of the tax year impact in the fiscal year ending June 30 of the tax year in which the relief begins and the remaining 55% in the following tax year. This division conforms to one of the tax filing rules that indicates that 90% of the ultimate liability for the year must be paid during the tax year to avoid an underpayment penalty Thus, it is assumed that 45% (one half of 90%) would be paid by June 30 of the tax year and the remainder after June 30.

Retirees of Other States: There is no data on the number of retirees from state and local units of other states living in North Carolina. It was assumed for this analysis that there are 1,000 such retirees and that the average pension is the same as federal retirees. This assumption was then used to make the same type of calculation as that for federal retirees. The resulting total impact of this portion of the bill is $700,000 for the 2007 tax year. For future years the impact was grown at the same rate as retirees from the State or local units in North Carolina. In addition, the division between state fiscal year is the same as that for the North Carolina retirees.

PREPARED BY: Dave Crotts & Joe Futima

APPROVED BY: Lynn Muchmore, Director
Fiscal Research Division

DATE: March 22, 2007

Signed Copy Located in the NCGA Principal Clerk's Offices