

**LEGISLATIVE SERVICES AGENCY  
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**FISCAL IMPACT STATEMENT**

**LS 6376**

**BILL NUMBER:** SB 155

**NOTE PREPARED:** Dec 8, 2012

**BILL AMENDED:**

**SUBJECT:** Income Tax Exemption for Military Pay.

**FIRST AUTHOR:** Sen. Waltz

**BILL STATUS:** As Introduced

**FIRST SPONSOR:**

**FUNDS AFFECTED:**  **GENERAL**  
 **DEDICATED**  
 **FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill exempts military pay earned by members of an active component of the United States armed forces from the individual income tax. (Current law exempts from the individual income tax the military pay earned by members of the National Guard and reserve components of the United States armed forces while serving on active duty.)

**Effective Date:** January 1, 2013 (retroactive).

**Explanation of State Expenditures:** *Department of State Revenue (DOR):* The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to reflect the deduction change. The DOR's current level of resources should be sufficient to implement this change.

**Explanation of State Revenues:** *Summary* - The bill increases the adjusted gross income (AGI) deduction for military service pay earned by individuals who are members of an active component of the U.S. armed forces. The deduction would be increased from a maximum of \$5,000 to a full deduction for military service pay earned by such individuals. This change would be effective beginning in tax year 2013. It is estimated that the revenue loss from this change could potentially total \$14.4 M in FY 2014 and \$15.3 M in FY 2015. The revenue loss could grow by 4% to 5% annually thereafter.

This estimate is based on pay information and personnel counts from 2005 to 2012 from the U.S. Department of Defense (DOD), Defense Manpower Data Center. These data provide counts of active duty personnel reporting Indiana as their state of legal residence and annualized taxable pay to those individuals. The estimates assume that these individuals are already claiming the current military income deduction of up to \$5,000. It

also accounts for Armed Forces Reserve and National Guard personnel who claim the current full deduction for active duty pay they may earn. The estimate does not include active duty personnel reported with an Indiana duty location who are not Indiana residents.

*Background Information* - Current statute provides an AGI deduction for the first \$5,000 of income earned by an individual for his or her service in an active or reserve component of the U.S. armed forces, including the National Guard. The \$5,000 deduction also applies to military retirement income or survivor's benefits received by a taxpayer who is 60 years old or older. Also, current statute provides a full deduction for active duty pay earned by members of the Armed Forces Reserve or National Guard in lieu of the deduction for military service income described above. (Note: Combat pay is already excluded from federal gross income and, as a result, is excluded from Indiana AGI.)

In 2012, the DOD reported that 19,722 individuals on active duty during the year reported that Indiana was their state of legal residence. These individuals received an estimated \$529.5 M in active duty pay during the year. In tax year 2011 (the most recent tax return data available), 2,268 members of the Armed Forces Reserve and National Guard claimed deductions for active duty pay totaling about \$43.8 M.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** Because the increase in deduction will decrease taxable income, counties imposing local option income taxes could potentially experience a decrease in revenue from these taxes. Based on the current average LOIT rate of 1.45%, the revenue loss due to the increased deduction could total \$6.1 M in SFY 2014 and \$6.5 M in SFY 2015.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties with local option income taxes.

**Information Sources:** U.S. Department of Defense, Defense Manpower Data Center. OFMA Income Tax Return databases.

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