

**NORTH CAROLINA GENERAL ASSEMBLY**

**LEGISLATIVE FISCAL NOTE**

**BILL NUMBER:** House Bill 845

**SHORT TITLE:** Exclude Pensions from Income Tax

**SPONSOR(S):** Reps. Davis, Morris and Warner

**FISCAL IMPACT (\$Million)**

	Yes (X)	No ( )	No Estimate Available ( )		
	<u>FY 2001-02</u>	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>
<b>REVENUES</b>					
<b>State General Fund</b>	<b>-3,510,000*</b>	<b>-3,850,000</b>	<b>-4,812,500</b>	<b>-6,015,625</b>	<b>-7,519,531</b>

**PRINCIPAL DEPARTMENT AFFECTED:** The income tax is administered by the Department of Revenue. The enactment of the bill should have no impact on the Department's budget requirements.

**EFFECTIVE DATE:** Tax years beginning on or after January 1, 2001.

\*Includes a one-time loss of \$430,000 due to fact that 2001-02 fiscal year impact includes both the full amount of the 2001 tax year savings and reduced withholding for the 2002 tax year for state and local retirees. It is assumed that federal retirees will receive their relief through either higher tax refunds or lower tax due payments.

**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 full 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):** During the 1999 session the Department of State Treasurer provided a tabulation in February, 1999 that showed the total number of state and local retirees from the Teachers and State Employees Retirement System and Local Government Retirement System in North Carolina by size of retirement check. In addition, the Department provided the same distribution data for August 12, 1989 vested retirees only. These two pieces of data enabled us to subtract the August 12, 1989

vested retirees from the total list to determine the number of nonvested retirees by size of annual retirement benefits.

The next step in the 1999 analysis was to multiply the average annual retirement pay for each income grouping by the appropriate marginal tax rate (6%, 7%, or 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.

To update the 1999 analysis, the Department of State Treasurer provided a March 16, 2001 tabulation of retirement checks by size of check and an estimate of the August 12, 1989 nonvested retirees. This updated data was used to project the 2001 tax year savings to nonvested state and local retirees in North Carolina under the bill, using the same methodology as that used in 1999.

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

To estimate the future year cost of the permanent impact portion of the estimate, an annual growth rate of 25% was used. This rate is based partly on the actual experience between February 1999, and March 2001. 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 3,500 state and local retirees who would receive relief under the bill. The estimated number of impacted federal retirees is 3,700. The numbers represent only about one-third 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 under current law.

**Retirees of Other States:** There is no data in North Carolina on retirees from state and local units of other states. 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 information was then used to make the same type of calculation as that for federal retirees. **The total impact of this portion of the bill is \$80,000 for 2001.**

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**APPROVED BY:** James D. Johnson

**DATE:** April 18, 2001



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