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# OHIO LEGISLATIVE SERVICE COMMISSION

Office of Research  
and Drafting

Legislative Budget  
Office

H.B. 18 (I\_133\_0639)  
133rd General Assembly

## Fiscal Note & Local Impact Statement

[Click here for H.B. 18's Bill Analysis](#)

**Version:** As Introduced

**Primary Sponsors:** Reps. Vitale and Crawley

**Local Impact Statement Procedure Required:** Yes

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### Highlights

- The bill unequivocally exempts military disability severance pay from the personal income tax. As of this writing, LSC staff is uncertain whether this provision constitutes more than a clarification of continuing state tax law regarding this income source. Consequently, the bill has an indeterminate fiscal effect at this time.
- The bill authorizes a refundable credit in tax year (TY) 2019 or TY 2020 for an amount equal to state income tax paid by the taxpayer on income received as a disability severance payment in TY 1991 and any year prior to the effective date of H.B. 18. If one assumes that Ohio income tax was paid on this income source when it was earned, this provision could reduce income tax receipts by between \$4 million and \$25 million during the FY 2020-FY 2021 biennium. If fewer veterans than estimated in this preliminary analysis file amended Ohio income tax returns, the revenue loss would be close to or below the lower end of this range.
- Under current law, the GRF would bear 96.68% of any revenue loss under the income tax beginning July 1, 2019, while the Local Government Fund and Public Library Fund would each bear 1.66% of any such revenue loss.

### Detailed Analysis

H.B. 18 permits taxpayers to deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, amounts received by the taxpayer as a disability severance payment, computed under 10 U.S.C. 1212, following discharge or release under honorable conditions from the armed forces.

The bill authorizes a refundable personal income tax (PIT) credit for TY 2019 or TY 2020 for an amount equal to the taxes paid by the taxpayer under that section on an amount

received as a disability severance payment, computed under 10 U.S.C. 1212, in any taxable year ending after January 17, 1991, but before the effective date of the bill.

## **Background – disability severance pay**

Members who separate from the military before they are eligible for retirement may receive separation or severance pay. Disability severance pay is a one-time lump sum payment. The amount equals two months of basic pay for each year of service which includes active service and inactive duty points, but the total service years cannot exceed 19 years. Additionally, the minimum number of years required for computation purposes is six years for a disability incurred in the line of duty in a combat zone, or 3 years in the case of any other member.<sup>1</sup>

A qualifying military member must meet all of the following requirements to be eligible:

- be found unfit for duty,
- have less than 20 years of service, and
- have a disability rating of less than 30%.

Disability severance pay for personal injury or sickness resulting from active service in the armed forces is exempt from federal taxation under Section 104(a)(4) of the Internal Revenue Code. Generally, income exempt from federal taxation would also be exempt from state income taxation because federal income serves as the starting point for determining taxable income in Ohio.

## **State exemption for Ohio military retirement pay**

Beginning with TY 2008, the personal income tax exempts "amounts received by the taxpayer as retired personnel pay for service in the uniformed services or reserve components thereof, or the national guard."<sup>2</sup> As of this writing, LSC is awaiting a reply from the Ohio Department of Taxation about whether this exemption available under current law would apply to the income that would be made exempt by H.B. 18. Therefore, LSC is uncertain about the extent to which military disability severance pay is included in the personal income tax base, but it will unequivocally be exempt under H.B. 18.

## **The Combat-Injured Veterans Tax Fairness Act of 2016**

Since 1991, the Secretary of Defense has improperly withheld taxes from severance pay for wounded veterans, thus denying them their due compensation and a significant benefit intended by Congress.<sup>3</sup>

On December 16, 2016, the President of the United States signed into law the Combat-Injured Veterans Tax Fairness Act of 2016, which provides eligible veterans the right to seek a refund of taxes they may have paid on disability severance pay. The Defense Finance and

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<sup>1</sup> <https://www.dfas.mil/retiredmilitary/plan/separation-payments/disability-severance-pay.html>.

<sup>2</sup> Division (A)(26) of section 5747.01 of the Revised Code.

<sup>3</sup> Public Law 114-292 of 114th Congress.

Accounting Service (DFAS) and the Internal Revenue Service (IRS) are jointly responsible for ensuring that affected separated members receive notification of their rights under this new law.<sup>4</sup>

During July 2018, DFAS and the IRS sent letters to approximately 130,000 separated military members who had received disability severance pay as income and with federal tax withholding applied.<sup>5</sup>

For veterans who received a lump sum disability severance payment after January 17, 1991, the Combat-Injured Veterans Tax Fairness Act of 2016 may provide additional time to claim a credit or refund for the overpayment attributable to the disability severance payment.

The amount of time for claiming these federal tax refunds is limited. However, the law grants veterans an alternative time frame – one year from the date of the letter from the Department of Defense (DOD). Veterans making these claims have the normal limitations period for claiming a refund or one year from the date of their letter from DOD, whichever expires later. As taxpayers can usually only claim tax refunds within three years from the due date of the return, this alternative time frame is especially important since some of the claims may be for refunds of taxes paid as far back as 1991.

LBO economists contacted DFAS for potential information about Ohio veterans. As of this writing, DFAS has yet to respond.

## **Potential fiscal effect**

Because LSC is uncertain about the current taxable status of the income exempted by H.B. 18, the fiscal effect is indeterminate as of this writing. Regardless, the revenue loss would be concentrated on those veterans filing amended returns after given notice by DOD and subsequently claiming refundable tax credits. Potentially, those amended returns could yield PIT refunds to those with qualifying incomes in TYs 1991 and after.

LBO economists are still formulating a more comprehensive analysis as more data and clarification becomes available. These preliminary estimates are therefore subject to change.

The U.S. Census Bureau's American Community Survey (ACS) reports that Ohio has 45,525 civilian veterans with a service-connected disability rating below 30%.<sup>6</sup> The same ACS information indicates that about one-fourth of Ohio's veterans would have served in an era that makes them potentially eligible for a disability severance payment in TY 1991 or later. Nevertheless, ACS does not identify the state of residence for Ohio's veterans at the time they separated from the military. Certainly, some of these armed forces members were residents of a different state when they received their disability severance pay. For example, if an Ohio veteran formerly lived on a military base in North Carolina at the time of the member's separation, then H.B. 18 would likely not apply because the income was earned in that state

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<sup>4</sup> [https://www.dfas.mil/dsp\\_irs](https://www.dfas.mil/dsp_irs).

<sup>5</sup> <https://www.irs.gov/individuals/military/combat-injured-veterans-tax-fairness-act-claim-information-available>.

<sup>6</sup> U.S. Census Bureau, 2013-2017 American Community Survey 5-Year Estimates, Service-Connected Disability-Rating Status and Ratings for Civilian Veterans 18 Years and Over.

rather than Ohio. Conversely, veterans now living out of state who were previously subject to Ohio's income tax on disability severance pay resulting from service on Ohio military bases would potentially benefit from H.B. 18.

If we assume 25% of 45,525 Ohio veterans received a disability severance payment since 1991 that was also subject to Ohio's PIT during that time period, H.B. 18 would benefit about 11,381 veterans. On the other hand, if Ohio was home to a proportionate share (about 3.6% of U.S. population) of the 130,000 veterans contacted by DFAS and the IRS, a potentially smaller group of veterans, 4,680, would benefit.

If LBO analysts assume the two months of basic pay for these veterans totaled between \$3,500 and \$5,500, on average, for the era they served, and the average service time among severance payment recipients was between six and ten years, then the resulting severance disability pay would be between \$21,000 and \$55,000. If the veteran paid a 4% marginal rate on this income, their PIT liability would be between \$840 and \$2,200. Therefore, the retrospective refund provision of H.B. 18 could reduce PIT receipts by between \$4 million and \$25 million. The actual amount depends on how many veterans were paying Ohio's state income tax on their disability severance pay when they separated from the military. If fewer veterans than estimated in this preliminary analysis file amended Ohio income tax returns, the revenue loss would be close to or below the lower end of this range.

Prospectively, H.B. 18 has a minimal fiscal effect, if any, for income earned in taxable years on or after the bill's effective date.