December 21, 2017

The Honorable Henry McMaster
Governor, State of South Carolina
First Floor, State House
Columbia, SC 29201

Dear Governor McMaster:

This letter is in response to a request by staff for the estimated revenue impact of allowing a complete deduction of police officers, peace officers, and firefighters' retirement income from individual income tax beginning in tax year 2018. This proposal would include otherwise eligible police officers, peace officers, and firefighters' retirement income earned in other states and retirement income of South Carolina retirees that do not participate in the Police Officers Retirement System (PORS).

The basis of this analysis is data from PORS. Membership in PORS includes police officers, firefighters, peace officers, coroners, magistrates, and probate judges. Police officers and firefighters must earn at least $2,000 per year and devote at least 1,600 hours per year to this work. This following revenue estimate includes all members of PORS, because the Public Employee Benefits Authority (PEBA) is unable to differentiate retirees by their previous occupations. Therefore, the estimated revenue impact may be over inclusive to the original request.

We estimate that this proposal would reduce General Fund individual income tax revenue by $8,563,000 in FY 2018-19.

The following is a detailed revenue impact analysis of the proposed retirement income deduction. Since current statutes allow various amounts of retirement income deductions by taxpayers depending on their age, we use PORS data to segregate these taxpayers into two categories: age 65 and older and under age 65. Currently, taxpayers age 65 and older may deduct income of up to $15,000 per year, while taxpayers under age 65 may deduct retirement income up to $3,000 per year.

The latest available year of PORS data is for FY 2016-17. We estimate the number of retirees and their retirement benefits for tax year 2018, or FY 2018-19, by applying a 5.5

percent annual growth to the FY 2016-17 data, as advised by the PORS consulting actuaries. We estimate the number of additional retirees not covered by PORS by calculating the percentage of protective service providers in South Carolina for ages 18 to 60 from Census Bureau data and applying that percentage to the South Carolina population aged 60 and over. This adds approximately 12.4 percent more retirees and retirement benefits to the analysis above the retirees and retirement benefits provided by PORS.

PORS data is adjusted further for retirement benefits paid to disabled retirees because income from a total and permanent disability is deductible under current statutes in South Carolina. To account for this already exempt retirement income, we reduce the amount of estimated retirement benefits by 6.1 percent. This estimate is derived from PORS data indicating that approximately 15.3 percent of all retirement benefits in FY 2016-17 were disbursed to disabled retirees. Additionally, PORS' actuarial consultants estimate that 40 percent of disabled retirees would be classified as totally and permanently disabled. The product of these two estimates results in a 6.1 percent reduction in total retirement benefits.

The enclosed tables report the revenue impact by retirees under 65, age 65 and older, and as a total. For example, we expect that 10,600 retirees in FY 2018-19 under age 65 will have $247,815,000 in retirement income. This represents approximately $23,389 in average annual retirement income. Current law allows these retirees to deduct up to $3,000 of retirement income. We estimate that the remaining $216,015,000 in taxable retirement benefits at an average tax rate of 3.5 percent would generate $7,561,000 in individual income tax in FY 2018-19.

For eligible retirees age 65 and older, we expect that 9,770 retirees in FY 2018-19 will have $180,410,000 in retirement income. This represents approximately $18,466 in average annual retirement income. Current law allows these retirees to deduct up to $15,000 of retirement income. We estimate that the remaining $33,860,000 in taxable retirement benefits at an average tax rate of 2.96 percent would generate $1,002,000 in individual income tax in FY 2018-19.

The average tax rates used in this analysis are based on a re-calculation of 2014 income tax returns after the proposed amount of deduction is applied. This method takes into account the large number of returns that have zero taxable income, returns that are reduced to zero taxable income by the deduction, and returns that do not benefit from the full amount of the proposed deduction. The tax rates for the two age groups are different because the larger deduction for age 65 and older further reduces remaining South Carolina income subject to tax.

Combining the revenue impacts of the propsed retirement deduction for both age groups results in an estimated reduction in General Fund individual income tax revenue of $8,563,000 in FY 2018-19.

This analysis may be further refined given additional time and assistance from PEBA and the Department of Revenue. It may be possible to match PORS retirees with their income tax forms to provide a better estimate of the remaining taxable income for these retirees. Additionally, we will continue to research for a means to determine the previous occupations of retirees in PORS to refine our analysis to include only police officers, peace officers, and firefighters.

If we may be of further assistance, please advise.

Sincerely,

Frank A. Rainwater
Executive Director

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Enclosure: 1

cc: Mr. Jay Wolfe, Office of the Governor

Estimated Number of Retirees Under Age 65 Eligible for the Proposed Retirement Deduction

PORS Retirement Benefit Payments	Number of Retirees	Annual PORS Retirement Benefits	Average PORS Retirement Benefit	Annual PORS Retirement Benefits Deducted Under Current Law, Maximum $3,000	Remaining PORS Retirement Income	Tax on Remaining PORS Retirement Income
FY 2015-16	9,746	$216,630,358	$22,229	$29,236,664	$187,393,693	$6,558,779
FY 2016-17	9,887	$222,518,329	$22,506	$29,660,569	$192,857,760	$6,750,022
FY 2017-18e	10,230	$234,826,000	$22,949	$30,690,000	$204,136,000	$7,145,000
FY 2018-19e	10,600	$247,815,000	$23,389	$31,800,000	$216,015,000	$7,561,000

Estimated Number of Retirees Age 65 and Older Eligible for the Proposed Retirement Deduction

PORS Retirement Benefit Payments	Number of Retirees	Annual PORS Retirement Benefits	Average PORS Retirement Benefit	Annual PORS Retirement Benefits Deducted Under Current Law, Maximum $15,000	Remaining PORS Retirement Income	Tax on Remaining PORS Retirement Income
FY 2015-16	8,622	$150,833,719	$17,495	$129,322,757	$21,510,963	$636,724
FY 2016-17	9,117	$161,993,685	$17,769	$136,749,054	$25,244,631	$747,241
FY 2017-18e	9,440	$170,954,000	$18,119	$141,600,000	$29,354,000	$869,000
FY 2018-19e	9,770	$180,410,000	$18,466	$146,550,000	$33,860,000	$1,002,000

Estimated Total Number of Retirees Eligible for the Proposed Retirement Deduction

PORS Retirement Benefit Payments	Number of Retirees	Annual PORS Retirement Benefits	Average PORS Retirement Benefit	Annual PORS Retirement Benefits Deducted Under Current Law, Maximum $3,000 or $15,000	Remaining PORS Retirement Income	Tax on Remaining PORS Retirement Income
FY 2015-16	18,367	367,464,077	$20,007	158,559,421	208,904,656	7,195,504
FY 2016-17	19,003	384,512,014	$20,234	166,409,623	218,102,391	7,497,263
FY 2017-18e	19,670	405,780,000	$20,629	172,290,000	233,490,000	8,014,000
FY 2018-19e	20,370	428,225,000	$21,022	178,350,000	249,875,000	8,563,000

Source: Police Officers Retirement System Actuarial Valuation Report, various years. US Census Bureau Annual Estimates of the Resident Population for Selected Age Groups for South Carolina, July 1, 2016. All calculations and estimates are by RFA staff.