Date of Hearing: March 24, 2025

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Mike Gipson, Chair

AB 814 (Schiavo) – As Introduced February 19, 2025

Majority vote. Tax levy. Fiscal committee.

SUBJECT: Personal Income Tax Law: exclusions: law enforcement retirement

SUMMARY: Excludes from gross income, under the Personal Income Tax (PIT) Law, peace officer retirement pay and amounts received by the beneficiary of an annuity plan set up for the surviving spouse or dependent of a person that lost their life in services as a peace officer, as specified. Specifically, **this bill**:

1) Excludes from gross income, for taxable years beginning on or after January 1, 2025, and before January 1, 2030, retirement pay received from a pension plan earned by a taxpayer based on their service as a peace officer and amounts received as the beneficiary of an annuity plan set up for the surviving spouse or dependent of a person that lost their life in services as a peace officer.

2) Defines the following terms:

   a) "Law enforcement agency" has the same meaning as is defined in Government Code Section 7286.5.

   b) "Peace officer" means a person described in Penal Code Section 830 *et seq*.

   c) "Qualified payments" are either of the following:

      i) Amounts received by a taxpayer from a pension plan they are a beneficiary of based on services performed as a peace officer in this state; or,

      ii) Amounts received by a taxpayer as the beneficiary of an annuity plan set up by a law enforcement agency to provide annuity payments for a surviving spouse or a dependent of a person that lost their life in service as a peace officer in this state.

3) Finds and declares the following for the purposes of satisfying the requirements of Revenue and Taxation Code (R&TC) Section 41:

   a) The specific goals, purposes, and objectives of this bill are as follows:

      i) To honor the service of California law enforcement and provide fiscal relief so that they and their families will remain or retire in California; and,

      ii) To increase the number of highly skilled retired former law enforcement officers in California's workforce.

b) To measure whether this bill achieves its intended purpose, the performance indicators for the Legislature to use in determining whether the exclusion is achieving its stated goals are the following:

   i) The number of retired law enforcement and survivor benefit plan beneficiaries taking advantage of the tax exclusions;

   ii) The economic security of retired law enforcement and survivor benefit plan beneficiaries in California;

   iii) The number of retired law enforcement and survivor benefit plan beneficiaries leaving California; and,

   iv) The earned income generated by retired law enforcement and survivor benefit plan beneficiaries subject to state income tax under the R&TC.

4) Requires the Legislative Analyst's Office (LAO) to submit a written report, in collaboration with the Department of Justice and the Franchise Tax Board (FTB), to the Legislature on the effectiveness of the exclusions on or before December 1, 2030. To the extent that data are available, the report must include an analysis of the performance indicators detailed above.

5) Takes immediate effect as a tax levy.

6) Sunsets the gross income exclusion's statutory provisions on December 1, 2030.

EXISTING LAW:

1) Conforms generally to federal law, which provides that "gross income" includes all income from whatever source derived unless expressly excluded. (Internal Revenue Code (IRC) Section 61 and R&TC Section 17071.) Gross income includes compensation for services, business income, gain from selling property, interest, rents, royalties, dividends, and pensions.

2) Provides various exclusions from gross income in determining tax liability under the PIT Law. (R&TC Section 17131 *et seq.*)

3) Excludes from gross income, under state and federal law, certain types of income for an individual's active service in the Armed Forces, such as military pay for time served in combat zones, disability compensation, and death benefits paid to qualified survivors. (R&TC Section 17142.5.)

4) Excludes from gross income specified death benefits received by the surviving spouse or designated beneficiary of any member of the California National Guard, State Military Reserve, or Naval Militia who dies or is killed in the performance of duty, as specified. (R&TC Section 17132.4.)

5) Excludes from gross income survivor benefits attributable to service by a public safety officer killed in the line of duty. (R&TC Section 17132.5)

FISCAL EFFECT: The FTB estimates General Fund revenue losses of $650 million for fiscal year (FY) 2025-26, $430 million for FY 2026-27, and $440 million for FY 2027-28.

COMMENTS:

1) The author has provided the following statement in support of this bill:

> Law enforcement is one of the toughest careers to enter. The mental and physical toll on peace officers can be immense as police often respond to those experiencing their worst moment. As officers retire, they maintain their readiness to assist active duty law enforcement in times of large scale emergency, such as the January fire in Los Angeles, and become integral parts of their communities. Unfortunately, some peace officers move away from California due to the taxes on their pensions. AB 814 supports those who have worked protecting our communities for years and at the same time helps them live out their retirement in California.

2) Writing in support of this bill, the California State Sheriffs' Association notes, in part:

> The dangers that law enforcement officers face on the job have been highlighted in recent years, resulting in law enforcement agencies around the state facing severe recruitment challenges and staff shortages. Retaining dedicated, upstanding personnel has been a challenge for all law enforcement agencies. Tax incentives, such as those contemplated by AB 814, could encourage more peace officers to stay in their profession and drive others to seek law enforcement related positions. This short-term proposal will also guide policy makers to study the long-term effectiveness of these tax policies on the law enforcement profession and its impact on California's economy.

3) Writing in opposition to this bill, the California Federation of Teachers (CFT) notes, in part:

> For every dollar that is provided in tax expenditures, approximately 40 cents of each dollar comes out of California's classrooms. For this reason, CFT opposes tax expenditures. While the merit and goal of the bill are laudable, educators prefer that the state invest in progressive tax policies, such as a wealth tax, which would gather a minuscule amount of revenue from those who count their net worth in the billions. Revenue from such a source would more than cover the goal of this bill and more, without harming others in this zero-sum environment.

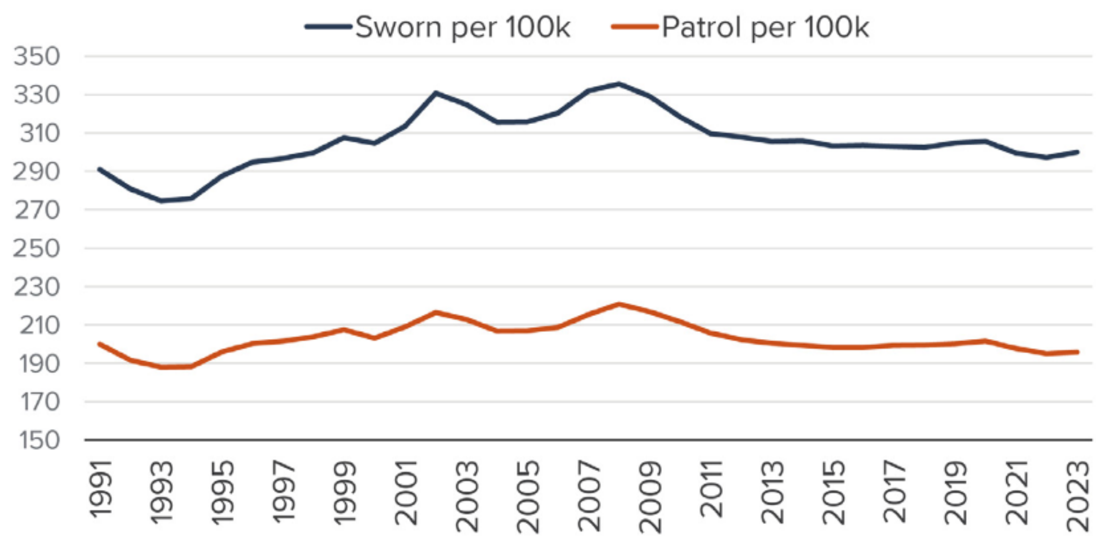
4) Committee Staff Comments:

   a) *What would this bill do*? This bill provides a gross income exclusion for retirement pay that was earned by a taxpayer's service as a peace officer in California. In other words, this bill would provide that a peace officer's retirement benefits are not subject to income tax. Additionally, this bill provides that the surviving spouse or dependent of a peace officer that lost their life in service would not be taxed on annuity payments ("survivor benefits") from the law enforcement agency. It should be noted, however, that current federal and state law already excludes survivor benefits from gross income.

   b) *Who stands to benefit*? The definition of a "peace officer" used in this bill is inclusive of all sworn officers, including those employed by county sheriff offices, municipal police departments, as well as those employed by statewide departments and agencies, including the California Department of Justice (CADOJ), the California Highway Patrol (CHP), and 21 other state agencies with law enforcement divisions. A number of colleges, universities, K-12 school districts, and special districts also employ sworn officers that would be covered by this bill.

In 2023, there were nearly 117,000 full-time law enforcement employees in California; roughly 76,300 were sworn law enforcement officers (with full arrest powers) and about 40,700 were civilian staff. Of all sworn officers, about 49% were municipal police officers, while 40% were county sheriff deputies, 9% worked for the CHP, and the remaining 1% were employed by other agencies. Of the roughly 76,300 sworn officers in 2023, about 65,700 were patrol officers and around 10,600 worked in county jails.[1]

c) *What problems are this bill attempting to solve?* According to the author and supporters, a substantial number of peace officers decide to leave California when they retire. Anecdotal evidence suggests that taxes may play a role in this decision, but other cultural and social factors are also cited.[2] Additionally, supporters contend that California is experiencing a shortage of peace officers and is struggling to attract new recruits to become peace officers, particularly in rural areas. From 2022 to 2023, the state gained about 190 sworn and about 800 civilian staff. The increase comes after two years of large decreases in both. From 2020 to 2022, the state lost 3,563 sworn and 1,240 civilian staff. Staffing levels are down by 3.2% compared to 2020.[1]



Source: Public Policy Institute of California (PPIC).

d) *What is a "tax expenditure"*? Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, U.S. Treasury officials began arguing that these features of the tax law should be referred to as "expenditures" since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each (in the form of foregone

[1] Lofstrom, Martin, and Skelton, *Law Enforcement Staffing in California*, Public Policy Institute of California (February 2025). https://www.ppic.org/wp-content/uploads/jtf-law-enforcement-staffing-in-california.pdf.
[2] McNeff, *Why retired California cops are fleeing the Golden State*, Law Officer (November 10, 2019). https://www.lawofficer.com/why-retired-california-cops-are-fleeing-the-golden-state/.

revenues).

As the Department of Finance notes in its annual Tax Expenditure Report, there are several key differences between tax expenditures and direct expenditures. First, tax expenditures are typically reviewed less frequently than direct expenditures. Second, there is generally no control over the amount of revenue losses associated with any given tax expenditure. Finally, it should also be noted that, once enacted, it takes a two-thirds vote to rescind an existing tax expenditure absent a sunset date. This effectively results in a "one-way ratchet" whereby tax expenditures can be conferred by majority vote, but cannot be rescinded, irrespective of their efficacy or cost, without a supermajority vote.

e) *Pensions and defined-benefit plans*: A pension plan is an employee benefit that commits the employer to making regular contributions to a pool of money set aside to fund payments to eligible employees after they retire. In the United States, traditional pension plans, known as defined-benefit plans, have become increasingly rare and are being replaced by defined-contribution plans that are less costly to employers, such as the 401(k) retirement savings plan.

Under a defined-benefit plan, a qualifying employee is guaranteed a set monthly payment for life or a lump-sum payment at retirement. This is typically calculated using a formula that considers the employee's compensation during their employment, their age at retirement, and their total years of service. In California, public safety bargaining units typically enjoy a retirement formula that provides a higher benefit factor and lower minimum retirement age compared to non-safety bargaining units.[3]

f) *Taxation of pension income*: In order for a pension plan to receive tax advantages, the plan must be qualified, meaning it satisfies the requirements of IRC Section 401(a) and the Employee Retirement Income Security Act of 1974 (ERISA). These requirements include basic protections regarding disclosures about the plan and how it is funded, a vesting timeline, fairness in coverage and participation, and limitations on contributions and deferrals. Nonqualified plans, such as Individual Retirement Accounts (IRAs), are not governed by ERISA because they are not established by an employer, but they may be eligible for certain tax benefits to encourage saving.

Qualified plans offer tax benefits to both the employee and the employer. Employees either defer taxes (with a traditional plan) or pay them upfront in order to withdraw them tax-free in retirement (with a Roth plan), while the employer can deduct any contributions it makes. Money contributed to a qualified retirement plan grows tax-free until it is withdrawn. Under a traditional plan, no income taxes are paid on the money contributed until it is withdrawn (front-end benefit). Qualifying contributions reduce a taxpayer's adjusted gross income (AGI), effectively lowering the amount of their income subject to tax. Under a Roth plan, income taxes are paid upfront but no further taxes will be owed on withdrawals (back-end benefit) as long as it has been at least five years since the first contribution to the account.

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[3] *Benefit Factor Charts*, California Public Employee Retirement System (CalPERS). https://www.calpers.ca.gov/members/retirement-benefits/benefit-factor-charts.

g) *The "California Rule"*: As described above, one of the advantages of a defined-benefit pension plan is that it creates a contractual guarantee between an employee and employer that certain benefits will be paid out in retirement, even if the underlying investments in the fund are not performing as intended. An employer cannot renege on benefits they have already promised an employee or group of employees. Under what is often referred to as the "California Rule", a public employee is vested in a pension benefit at the start of their employment.

Given this limitation, a serious concern for retirement system administrators is that the level of future obligations will outpace the value of assets held by the plan, which is referred to as an "unfunded mandate". Because policymakers cannot reduce the benefits paid out to existing pension plan members to address an unfunded mandate, California lawmakers significantly reformed the public pension system for new employees only.

California enacted the Public Employees' Pension Reform Act (PEPRA) in an effort to reduce unfunded mandates in both state and local retirement systems under then Governor Jerry Brown. Government employees hired after January 1, 2013 are subject to stricter cost-sharing (higher employee contributions and lower employer contributions), as well as a cap on pensionable compensation. Additionally, PEPRA restricted a variety of financial benefits that had counted towards workers' pensions, including standby pay and large amounts of accrued vacation. The California Supreme Court has repeatedly upheld both PEPRA and the California Rule, resulting in significantly less generous retirement benefits for post-PEPRA employees compared to employees hired prior to its effective date.[4]

h) *An incentive or reward*? Typically, tax expenditures are provided prospectively as a matter of legislative grace to encourage taxpayers to behave in ways they might not absent a financial incentive. This income exclusion, in turn, is intended to encourage retired peace officers to stay in California and encourage new people to become peace officers. As currently drafted, the income exclusion provided by this bill would be effective starting January 1, 2025. The author may wish to consider amending the bill to provide the tax benefit prospectively so that the exclusion is not rewarding behavior that would have otherwise already occurred.

i) *Potential unintended consequences*:

   i) *Double tax benefit*: As described above, contributions to qualified pension plans already receive preferential treatment for tax purposes either on the front end (deduction) or back end (tax-free withdrawal). This bill would provide an additional tax benefit on top of the existing front-end deduction that is typical for defined-benefit plans, effectively making peace officer pension income entirely tax-free at the state level.

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[4] Berliner and Youril, *California Supreme Court Leaves The California Rule Largely Intact in Highly Anticipated Opinion Concerning Public Employee Pension Rights*, Libert Cassidy Whitmore Legal. https://www.lcwlegal.com/news/california-supreme-court-leaves-the-california-rule-largely-intact-in-highly-anticipated-opinion-concerning-public-employee-pension-rights/.

ii) *Nonconformity to federal law*: This bill establishes exclusions for which federal law has no counterpart. Generally, nonconformity to federal law adds complexity and additional administrative burdens for taxpayers.

iii) *Section 41*: A bill that authorizes a gross income exclusion is exempt from including information about detailed performance indicators and data collection requirements if the Legislature determines there is no available data to collect and report. This bill requires detailed performance indicators and data collection requirements. If the author determines there is no available data to collect or report, this requirement does not need to be included in the bill.

iv) *A slippery slope*? It should be noted that California currently taxes the retirement benefits of teachers, military veterans, and other public service workers. As a result, this Committee may face a slippery slope of choosing which groups should be rewarded with similar income exclusions for retirement pay. Further, the Committee may wish to consider whether reducing revenues now could ultimately jeopardize the ability of the state and local governments to pay for the salaries and retirement benefits of future generations of peace officers and public employees.

j) *Related legislation*: AB 53 (Ramos) excludes up to $20,000 of uniformed services retirement pay and annuity payments from a United States Department of Defense Survivor Benefit Plan received by qualified taxpayers during the taxable year from gross income. AB 53 is currently pending on this Committee's Suspense File.

REGISTERED SUPPORT / OPPOSITION:

Support

Association for Los Angeles Deputy Sheriffs
California State Sheriffs' Association
Peace Officers Research Association of California

Opposition

California Federation of Teachers

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