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The Benefits of Eliminating the Tax on Military Retirement Income in Vermont

Executive Summary:

The Vermont Legislative Joint Fiscal Offices February 2021 report looked at the estimated impact of eliminating the taxation of military retirement income. It disregarded the potential benefits of increased migration of military retirees to the state, neglecting the notion that many retirees are often of working age, and also possess many transferable skills which would help negate the states shortage of workers. It also fails to properly recognize the lasting tax revenue that the increased migration of military retirees may bring, as well as the powerful nature of tax incentives in regard to influencing the migration of military retirees to the state. An overall more favorable tax burden may be crucial to encouraging this migration. These potential outcomes should be more deeply considered when deciding whether to eliminate the tax on military retirement income.

Veterans Seeking Employment Opportunities:

For many veterans, there is a desire or need for employment after retiring from service. Many military retirees are still of common working age and thus likely to be interested in a second career. In fact, the average age of retirement for enlisted personnel is 41 years old and for officers is 45 years old¹ The increased migration of military retirees to the state of Vermont would create an influx of workers. In addition, these individuals are often skilled workers with many transferable skills and would contribute to negating the state's shortage of workers by filling much needed roles within the state's economy². In an issue brief published by the Vermont Joint Fiscal Office last February, it was noted national data shows that 70% of military retirees retire between the ages of 35 and 50 years old³. Given that the average retirement age for people in the United States is 63 years old⁴, it is rationale to assume many veterans will be interested in pursuing some kind of secondary employment.

Recent Veteran Migration in Vermont:

The National Center for Veterans Analysis and Statistics calculated the percentage change in veteran population by state from the year 2000 to 2020. The average change amongst all states during the time frame was a decrease of 24.58%, however Vermont's veteran population change was above average, falling 32%.⁵ Despite all states witnessing a fall in veteran populations in recent years, Vermont has seen a particularly significant decline. There are a multitude of factors that have driven this decline. As Vermont remains one of just three states to fully tax military

retirement income, it is reasonable to assume that this may be a core driver of veterans choosing to move elsewhere while deciding on a suitable place to settle down. The idea that tax policy may affect the location decisions of individuals has a long tradition within economics. In fact, tax-induced mobility is a central mechanism in several strands of economic theory.⁶ The structure and financing of a tax change are critical to achieving economic growth. Tax rate cuts or exemptions may encourage individuals to work, save, and invest.⁷ Thus, leading to those directly impacted by the tax change to become positive contributors to their local and state level economies. The tax exemption could contribute to both statewide economic growth as well as act as a powerful economic incentive in the attempt to attract military retirees to the state.

Will Vermont be Able to Negate the Foregone Tax Revenue?

One of the core arguments against eliminating the military retirement income tax is that it will be detrimental from a tax revenue standpoint. As of 2017 there were 43,191 military veterans living in Vermont (number has decreased in the time since). Of that population, only 362 veterans were receiving pension.⁸ The potential foregone tax revenue as a result of this legislation is not a considerable portion of the state’s overall tax revenue. In a study done analyzing the impact of military retirees in Utah it was reported that as of 2015 Vermont ranked the lowest of all 50 states in annual military pension income.⁹ Although Vermont is the second least populated state after Wyoming, it can be seen that military retirement income is not particularly prominent within the state.

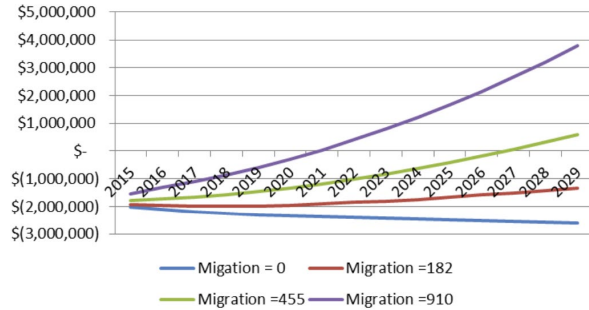
| VA Healthcare and Benefits (as of 9/30/2017) | Vermont | National |
|--|----------------|------------------|
| Number of Veterans Receiving Disability Compensation | 7,887 | 4,552,819 |
| Number of Veterans Receiving Pension | 362 | 276,570 |
| Number of Dependency & Indemnity Comp Beneficiaries | 728 | 411,390 |
| Number of Education Beneficiaries | 2,094 | 987,577 |
| Number of Enrollees in VA Healthcare System | 20,547 | 9,116,200 |
| Number of Unique Patients Treated | 14,913 | 6,035,183 |

The greatest potential for offsetting state income tax losses from an exemption is if more military retirees migrate to Vermont. According to the U.S. Department of Labor, approximately 200,000 women and men leave U.S. military service and return to life as civilians, each year. Vermont will merely have to capture a fraction of that number on an annual basis in order to negate any initial negative tax effect on the state. In an analysis of the fiscal impacts associated with exempting federal military retirees’ pensions from taxation within Arkansas, a simulation was carried out to predict the fiscal effect of different levels of migration. They found that an annual migration level of 500 RMSP per year will push the budget into a surplus by 2021, while an annual increase of 250 RMSP pushes the budget into a surplus by 2027.¹⁰ Similar projections may also translate to the state of Vermont. In an analysis of the fiscal impact of the same tax exemption in the state of Virginia, they found that a full tax exemption of pension income would result in a hit to the state of just over \$1,000 per retiree.¹¹ Based off the 2017 population numbers of military retirees in the state of Vermont who are receiving pension, one can draw estimates in regard to the total amount of tax revenue to be foregone if the exemption were to occur. (Just saw that the Vermont JFO

released a revised issue brief, in which these numbers were far different from the information I found through the US Department of Veteran Affairs).

The state of Vermont has some of the highest tax rates in the country. It collects an average of \$4,950 per taxpayer annually, the most of any state and about \$2,000 more than is typical across all states.¹² This is likely a deterrent when individuals are contemplating moving to the state. By eliminating the tax on military retirement income, the daunting tax burden could become more welcoming to prospective military retirees.

Chart 5: Fiscal Effect of Different Levels of Migration



Conclusion:

Eliminating the tax on military retirement income can prove mutually beneficial for the state of Vermont and military retirees. A potential influx of military retirees could help the lacking labor force within the state and produce tax revenue through veterans second careers. Thus, making Vermont a more attractive and suitable option for these people will have immediate as well as lasting positive effects on the state. Tax incentives amongst many others play a critical role in the decisions of individuals in regard to various aspects of their lives. The state of Vermont has an opportunity to utilize tax policy to positively impact the military retiree population who are a valuable group of individuals within the state. The temporary negative fiscal impact of the tax exemption will soon become cost neutral as more retirees relocate to Vermont, and eventually be greatly outweighed by the tax revenue and participation of military retirees and their families within the workforce.

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- ¹ Warner, John. 2008. "Thinking about Military Retirement: An Analysis for the 10th QRMC." https://www.cna.org/CNA_files/PDF/D0017798.A1.pdf.
- ² Citroën, Lida. 2017. "Veterans Bring Exceptional Skills, Including Soft Skills." Military.com. October 31, 2017. <https://www.military.com/hiring-veterans/resources/veterans-bring-exceptional-skills-including-soft-skills.html>.
- ³ "Statement from Governor Phil Scott Following Bipartisan Military Retirement Income Tax Exemption Presser | Office of Governor Phil Scott." 2022. Vermont.gov. 2022. <https://governor.vermont.gov/press-release/statement-governor-phil-scott-following-bipartisan-military-retirement-income-tax>.
- ⁴ "What Is the Average Retirement Age? | Center for Retirement Research." n.d. <https://crr.bc.edu/briefs/what-is-the-average-retirement-age/>.
- ⁵ Office of Policy and Planning. 2018. "VA.gov | Veterans Affairs." Va.gov. 2018. <https://www.va.gov/vetdata/Expenditures.asp>.
- ⁶ Kleven, Henrik, Camille Landais, Mathilde Muñoz, and Stefanie Stantcheva. 2020. "Taxation and Migration: Evidence and Policy Implications." *Journal of Economic Perspectives* 34 (2): 119–42. <https://doi.org/10.1257/jep.34.2.119>.
- ⁷ Gale, William G, and Andrew A Samwick. 2016. "Effects of Income Tax Changes on Economic Growth." Brookings. Brookings. February 2016. <https://www.brookings.edu/research/effects-of-income-tax-changes-on-economic-growth/>.
- ⁸ "State Summaries - Va.gov Home | Veterans Affairs," accessed February 10, 2022, https://www.va.gov/vetdata/docs/SpecialReports/State_Summaries_Vermont.pdf.
- ⁹ Pace, Levi. "Analysis of Military Retirees in Utah: Impacts ..." Accessed February 10, 2022. https://gardner.utah.edu/wp-content/uploads/2017/02/MilitaryRet.Report-final_2017.pdf.
- ¹⁰ "Analysis of the Fiscal Impacts Associated with ... - Remi.com." Accessed February 11, 2022. <https://www.remi.com/wp-content/uploads/2017/11/408-UAR-Military-Pension-Exemption.pdf>.
- ¹¹ "Should the Commonwealth of Virginia Exempt Military Retiree Pensions from State Income Tax? Fiscal Impact Analysis of Exempting Military Retiree Pensions from State Income Tax White Paper on Study Recommendations." n.d. Accessed February 11, 2022. http://bcsthome.net/hrcmoaa/careers/VA_Military_Pension_Tax_Study2017.pdf.
- ¹² Stebbins, Samuel. "Tax Policy: States with the Highest and Lowest Taxes." USA Today. Gannett Satellite Information Network, September 27, 2018. <https://www.usatoday.com/story/money/taxes/2018/04/06/states-highest-and-lowest-taxes-3-6/482944002/>.