

Department of Legislative Services
 Maryland General Assembly
 2005 Session

FISCAL AND POLICY NOTE

House Bill 59 (Delegate Cryor)
 Ways and Means

Income Tax - Subtraction Modification - Military Compensation

This bill expands the existing subtraction modification for military pay by eliminating the requirement that the pay be attributable to service outside the U.S.

The bill takes effect July 1, 2005 and applies to tax year 2005 and beyond.

Fiscal Summary

State Effect: General fund revenues would decrease by an estimated \$2.8 million in FY 2006, which reflects one and one-half tax years. Future years reflect annualization and 1% increase in number of military personnel eligible for the subtraction. No effect on expenditures.

(\$ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	(\$2.8)	(\$1.9)	(\$1.9)	(\$1.9)	(\$2.0)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$2.8)	(\$1.9)	(\$1.9)	(\$1.9)	(\$2.0)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local government revenues could decrease by approximately \$1.8 million in FY 2006, which reflects one and one-half tax years. Future year revenues reflect annualization and growth in the number of military personnel eligible for the subtraction.

Small Business Effect: None.

Analysis

Current Law: Military personnel serving overseas are allowed a subtraction modification under the State income tax. The subtraction includes the first \$15,000 in pay that is attributable to military service of the individual who is (1) in active service of any branch of the armed forces; and (2) outside the U.S. In addition, the amount of the subtraction is (1) reduced dollar for dollar in the amount by which military pay received by the individual exceeds \$15,000; and (2) reduced to zero if military pay received by the individual exceeds \$30,000.

Background: The military has a substantial presence in Maryland, including numerous military installations such as Fort Meade, Patuxent River Naval Air Station, Aberdeen Proving Ground, and Andrews Air Force Base. According to the Maryland Department of Business and Economic Development, military installations employ approximately 108,000 civilian and military personnel. Not all of the military personnel that live in Maryland, however, are necessarily considered residents for State tax purposes. The federal Servicemembers Civil Relief Act (SCRA) of 2003, provides that military personnel may not be deemed to have acquired residence for purposes of state taxation by reason of being present in the taxing jurisdiction solely in compliance with military orders. This provision of federal law prohibits the State from treating compensation for military or naval service as income derived from sources in the State if the military personnel lives and works in Maryland solely in compliance with military orders. This provision of federal law does not apply to the State's taxation of nonmilitary income earned by the service member that is considered earned in Maryland.

State Revenues: General fund revenues would decrease by approximately \$1.9 million in tax year 2005. Although the subtraction is modified for tax year 2005, it is assumed most taxpayers will not adjust their withholding and estimated payments to reflect the change until after July 1, 2005. Consequently, general fund revenues are estimated to decrease by approximately \$2.8 million in fiscal 2006, reflecting one and one-half tax years. Future fiscal year revenue decreases reflect the impact of one tax year. The estimate is based on the following facts and assumptions:

- As of September 30, 2004 there were approximately 1.4 million total active duty military personnel.
- It is estimated that Maryland's share of total active duty personnel who are subject to State taxation is 0.75%.
- Approximately 35% of active military are serving overseas.
- The total amount of subtraction modifications claimed by individuals is based on the estimated income for all military personnel as estimated by the U.S. Department of Defense and Congressional Budget Office.

- The number of Maryland residents in the military will increase by approximately 1% each year.
- Eighteen percent of returns are assumed to be nontaxable. Providing a subtraction modification to these individuals will not result in State tax revenue losses.

Legislative Services advises that compared to historical levels a high percentage of military individuals are currently serving overseas. To the extent that the percentage of troops serving overseas returns to historical levels in the five-year forecast period, the cost of the subtraction modification will increase.

Local Revenues: Local revenues would decrease by approximately 3.1% of the total State subtraction taken for military income. Based on the estimate above, the reduction would be \$1.8 million for fiscal 2006, which reflects one and one-half tax years. The out-year estimates are as follows:

FY 2007: \$1.2 million
FY 2008: \$1.2 million
FY 2009: \$1.3 million
FY 2010: \$1.3 million

Additional Information

Prior Introductions: This bill was introduced in the 2004, 2003, 2002, and 2001 sessions. HB 913 of 2004, HB 38 of 2003, HB 14 of 2002, and HB 22 of 2001 were not reported from the Ways and Means Committee. HB 171 of 2000, a similar bill, received an unfavorable report by the Ways and Means Committee.

Cross File: None.

Information Source(s): Comptroller's Office, Congressional Budget Office, Maryland Department of Business and Economic Development, U.S. Department of Defense, Department of Legislative Services

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