

Department of Legislative Services
2011 Session

FISCAL AND POLICY NOTE

Senate Bill 190 (Senator Peters, *et al.*)
Budget and Taxation

Income Tax - Military Retirement Income

This bill expands the existing military retirement income tax subtraction modification by increasing from \$5,000 to \$10,000 the maximum amount of retirement income that can be excluded from the State income tax.

The bill takes effect July 1, 2013, and applies to tax years 2013 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by \$10.8 million beginning in FY 2014 due to additional military retirement income being exempted. Future year revenues reflect the estimated number of eligible taxpayers. Expenditures are not affected.

(\$ in millions)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
GF Revenue	\$0	\$0	(\$10.8)	(\$11.0)	(\$11.3)
Expenditure	0	0	0	0	0
Net Effect	\$0	\$0	(\$10.8)	(\$11.0)	(\$11.3)

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

Local Effect: Local government revenues decrease by \$6.8 million in FY 2014 and by \$7.1 million in FY 2016. Expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: Chapter 226 of 2006 expanded a \$2,500 military retirement income subtraction that was limited to enlisted military members with a federal adjusted gross income of \$22,500 or less. Under Chapter 226, an individual may exempt the first \$5,000 of military retirement income from State taxation if the retirement income

resulted from service in an active or reserve component of the armed forces of the United States or in the Maryland National Guard.

Under Chapter 226, retirees from active duty with the Commissioned Corps of the Public Health Service, National Oceanic and Atmospheric Administration (NOAA), or the Coast and Geodetic Survey qualified for the subtraction modification, but only if separated from service after July 1, 1991. Chapter 553 of 2007 eliminated this restriction and allowed all the individuals described previously to qualify for the subtraction modification, beginning in tax year 2007, without regard to the date of separation from employment. Military retirement income exempted under this subtraction modification cannot be counted toward the State pension exclusion.

Maryland law also provides a pension exclusion subtraction for individuals who are at least age 65 or who are totally disabled. Up to a specified maximum amount of taxable pension income (\$26,100 maximum for 2010) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received.

The “Social Security offset” is the reduction in the maximum pension exclusion allowed under the current law by the individual. The Social Security offset was established at the same time as the pension exclusion. Given that Social Security benefits are exempt from Maryland income tax, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of allowable exclusion by the amount of Social Security benefits received.

Social Security benefits and benefits received under the federal Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal income tax purposes. In addition to the special treatment of Social Security and other retirement income, other income tax relief is provided to senior citizens regardless of the source of their income. The additional exemption amount allowed for elderly or blind individuals is \$1,000. In addition to the regular personal exemption available to all taxpayers, an additional exemption amount of \$1,000 may be claimed by an elderly or blind individual. Each individual age 65 or older can also earn more income without being required to file taxes.

Background: According to the Defense Manpower Data Center (DMDC), 47,995 military retirees received a total of \$107.0 million in retirement income from the Department of Defense in September 2009. This includes individuals who served in the Army (including the Maryland National Guard), Navy, Marines, and Air Force. On an annualized basis, the retirement income totaled almost \$1.3 billion. This amount includes some retirees who receive disability payments. Disability payments resulting from active service in the armed forces, NOAA, Public Health Service, or the foreign service are not

taxable for State income tax purposes because those payments are exempt from federal taxation. In addition, DMDC reports that 1,486 Coast Guard retirees and 5,828 military and Coast Guard survivors received retirement income during 2009. **Exhibit 1** lists the total retirement pay (including disability pay) received by Maryland military retirees by branch of service.

According to the Office of Commissioned Corps Force Management Information System, 762 Maryland residents who retired from the Commission Corps of the Public Health Service received a total of \$52.1 million, or an average of \$68,300, in retirement income during 2005.

State Revenues: Additional retirement income can be exempted beginning in tax year 2013. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, fiscal 2014 revenues will decrease by \$10.8 million. **Exhibit 2** shows the projected State and local revenue loss from exempting additional military retirement income. This estimate is based on the number of retirees and amount of retirement income received by State residents as reported by DMDC and the Office of Commissioned Corps Force Management Information System, the estimated cost of the current military retirement income subtraction modification, and the interaction with the State pension exclusion. Based on data from the U.S. Census Bureau, it is estimated that 15% of military retirees are not taxable.

Exhibit 1
Retirement Payments by Branch of Service
September 2009

<u>Branch</u>	<u>Retirees</u>	<u>Received Pension</u>	<u>Annual (\$ in Millions)</u>	<u>Average</u>
Army	18,989	17,754	\$459.7	\$25,895
Navy	15,035	14,192	406.6	28,649
Marines	2,557	2,238	62.5	27,925
Air Force	<u>14,677</u>	<u>13,811</u>	<u>355.6</u>	<u>25,748</u>
Total	51,258	47,995	\$1,284.4	\$26,762

Source: Defense Manpower Data Center

Exhibit 2
Projected State and Local Revenue Loss – Military Retirement Income Exemption
(\$ in Millions)

<u>Fiscal</u>	<u>State</u>	<u>Local</u>	<u>Total</u>
2012	\$0	\$0	\$0
2013	0	0	0
2014	10.8	6.8	17.5
2015	11.0	7.0	18.0
2016	11.3	7.1	18.5

Local Fiscal Effect: Local government revenues decrease by about 3% of the net change in taxable income in tax year 2013 resulting from the provisions of the bill. In fiscal 2014, the decrease will total approximately \$6.8 million. Exhibit 2 lists the local income tax revenue impact by fiscal year.

Additional Information

Prior Introductions: SB 1 of 2010 and SB 284 of 2009 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross files of SB 1 and SB 284, HB 1 and HB 751, received a hearing in the House Ways and Means Committee, but no further action was taken. Similar bills proposing to expand the existing military retirement subtraction modification were also introduced in the 2007 and 2008 sessions. SB 625 and SB 315 of 2008 and SB 967 of 2007 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. SB 445 of 2007 was withdrawn. HB 549 of 2008 and HB 176 of 2007 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

Information Source(s): U.S. Census Bureau, Defense Manpower Data Center, Department of Defense (Office of Actuary), National Oceanic and Atmospheric Administration, Office of Commissioned Corps Force Management Information System, Department of Legislative Services

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