Department of Legislative Services
2015 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 592 (The President, *et al.*) (By Request - Administration)

Budget and Taxation Ways and Means

Income Tax - Subtraction Modification - Military Retirement Income - Individuals at Least 65 Years Old

This Administration 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 Maryland adjusted gross income for purposes of calculating Maryland income tax liability. In order to qualify for the increased subtraction modification, the individual must be at least 65 years old.

The bill takes effect July 1, 2015, and applies to tax years 2015 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $2.7 million in FY 2016 due to additional military retirement income being exempted. The Governor's FY 2016 Supplemental Budget No. 2 assumes this revenue loss. Future year revenue decreases reflect the estimated number of eligible taxpayers retirement income. Expenditures are not affected.

($ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	($2.7)	($3.0)	($2.9)	($2.7)	($3.1)
Expenditure	0	0	0	0	0
Net Effect	($2.7)	($3.0)	($2.9)	($2.7)	($3.1)

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

Local Effect: Local revenues decrease by $2.0 million in FY 2016 and by $2.1 million in FY 2020. Expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). The Department of Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Current Law: Chapter 226 of 2006 expanded a $2,500 military retirement income subtraction that was previously limited to enlisted military members with federal adjusted gross income of $22,500 or less. Chapter 226 allows an individual to exempt the first $5,000 of military retirement income from State and local taxation if the retirement income resulted from service in an active or reserve component of the U.S. Armed Forces 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. Chapters 552 and 553 of 2007 eliminated this restriction and allowed all of the individuals described previously to qualify for the subtraction modification, beginning in tax year 2007, without regard to the date of separation from employment.

Maryland law also provides a pension exclusion subtraction modification for individuals who are at least age 65 or who are totally disabled. Up to a specified maximum amount of taxable pension income ($29,000 maximum for 2014) 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. Military retirement income exempted under the subtraction modification cannot be counted toward the State pension exclusion.

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. 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.

Background: According to the Defense Manpower Data Center (DMDC), 50,889 Maryland military retirees received a total of $121.6 million in retirement income from the Department of Defense in September 2013. This includes individuals who served in the Army (including the Maryland National Guard), Navy, Marines, and Air Force. On an annualized basis, this retirement income totaled $1.46 billion. A small portion of this amount includes retirees who receive disability payments. Disability payments resulting from active service in the U.S. Armed Forces, NOAA, Public Health Service, or the foreign service are generally not taxable for State income tax purposes because those payments may be exempt from federal taxation. In addition, DMDC reports that 1,342 Coast Guard retirees and 7,017 military and Coast Guard survivors received retirement income in September 2013. **Exhibit 1** lists the total retirement pay (including disability pay) received by Maryland military retirees by branch of service.

Exhibit 1
Retirement Payments by Branch of Service
September 2013

Branch	Retirees	Received Pension	Annual Pension Income ($ in Millions)	Average
Army	20,023	18,632	$516.2	$27,703
Navy	15,828	15,054	463.9	30,819
Marines	2,724	2,379	70.8	29,765
Air Force	15,676	14,824	407.8	27,512
Total	**54,251**	**50,889**	**$1,458.8**	**$28,666**

Source: Defense Manpower Data Center

According to the Office of Commissioned Corps Force Management Information System, 762 Maryland residents who retired from the Commissioned 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 2015. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, fiscal 2016 revenues will decrease by $2.7 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 who are at least 65 years of age and the 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, the interaction with the State pension exclusion, and U.S. Congressional Budget Office projections on future military retiree payments. Based on data from the U.S. Census Bureau, it is estimated that about 15% of military retirees are not taxable.

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

Fiscal	State	Local	Total
2016	$2.7	$2.0	$4.7
2017	3.0	1.9	4.9
2018	2.9	1.8	4.6
2019	2.7	2.0	4.7
2020	3.1	2.1	5.1

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed. Local revenues will decrease by $2.0 million in fiscal 2016 and by $2.1 million in fiscal 2020, as shown in Exhibit 2.

Additional Information

Prior Introductions: SB 143 of 2014 received a favorable report from the Senate Budget and Taxation Committee, passed the Senate, and received a hearing in the House Ways and Means Committee, but no further action was taken. SB 103 of 2013, amended by the Senate Budget and Taxation Committee to have a delayed impact, passed the Senate and was referred to the House Rules and Executive Nominations Committee, but no further action was taken. HB 439 and HB 503 of 2013 received a hearing in the House Ways and Means Committee, but no further action was taken. SB 28 of 2012, SB 190 of 2011, 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, HB 315 of 2012, HB 1 of 2010, and HB 751 of 2009, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: Although designated as a cross file, HB 482 (The Speaker, *et al* – By Request - Administration - Ways and Means) is not identical.

Information Source(s): U.S. Census Bureau, U.S. Congressional Budget Office, 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

Fiscal Note History: First Reader - February 25, 2015
md/jrb Revised - Senate Third Reader - April 7, 2015

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Income Tax – Subtraction Modification – Military Retirement Income

BILL NUMBER: SB592/HB482

PREPARED BY: Governor's Legislative Office

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

_X_ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

___ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS