

Department of Legislative Services  
2016 Session

FISCAL AND POLICY NOTE  
First Reader

House Bill 738 (Delegate C. Wilson)  
Ways and Means

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

This bill expands the existing military retirement income tax subtraction modification by increasing from \$10,000 to \$15,000 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 of age.

The bill takes effect July 1, 2016, and applies to tax years 2016 and beyond.

**Fiscal Summary**

**State Effect:** General fund revenues decrease by \$1.7 million in FY 2017 due to additional military retirement income being exempted. Future year revenue decreases reflect the projected growth in the number of eligible taxpayers and retirement income. Expenditures are not affected.

(\$ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	(\$1.7)	(\$1.8)	(\$1.9)	(\$2.0)	(\$2.0)
Expenditure	0	0	0	0	0
Net Effect	(\$1.7)	(\$1.8)	(\$1.9)	(\$2.0)	(\$2.0)

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

**Local Effect:** Local revenues decrease by \$1.1 million in FY 2017 and by \$1.3 million in FY 2021. Local 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 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. 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 also qualify for the subtraction modification. Chapter 125 of 2015 expanded to \$10,000 the maximum value of the subtraction modification for individuals who are at least 65 years of age. This enhanced subtraction modification can be claimed beginning in tax year 2015.

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 (\$29,200 maximum for 2015) 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), 51,195 Maryland military retirees received a total of \$124.3 million in retirement income from the Department of Defense in September 2014. 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 \$1.49 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 under specified circumstances. In addition, DMDC reports that 1,377 Coast Guard retirees and 7,083 military and Coast Guard survivors also received retirement income in September 2014. **Exhibit 1** lists the total retirement pay (including disability pay) received by Maryland military retirees by branch of service.

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**Exhibit 1**  
**Retirement Payments by Branch of Service**  
**September 2014**

<u>Branch</u>	<u>Retirees</u>	<u>Received Pension</u>	<u>Annual Pension Income (\$ in Millions)</u>	<u>Average</u>
Army	20,245	18,783	\$528.2	\$28,150
Navy	15,901	15,122	474.1	31,350
Marines	2,747	2,395	72.1	30,118
Air Force	15,748	14,895	417.4	28,026
<b>Total</b>	<b>54,641</b>	<b>51,195</b>	<b>\$1,491.8</b>	<b>\$29,150</b>

Source: Defense Manpower Data Center

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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 2016. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, fiscal 2017 revenues will decrease by \$1.7 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 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 20% of military retirees are not taxable.

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

	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
State	(\$1.7)	(\$1.8)	(\$1.9)	(\$2.0)	(\$2.0)
Local	(1.1)	(1.2)	(1.2)	(1.3)	(1.3)
<b>Total Revenues</b>	<b>(\$2.9)</b>	<b>(\$3.0)</b>	<b>(\$3.1)</b>	<b>(\$3.3)</b>	<b>(\$3.3)</b>

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**Local Revenues:** Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed. Local revenues will decrease by \$1.1 million in fiscal 2017 and by \$1.3 million in fiscal 2021, as shown in Exhibit 2.

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**Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 293 (Senator Peters, *et al.*) - Budget and Taxation.

**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

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