SB 413

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 413 (Senator Peters, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Retirement Income

This bill expands the existing military retirement income tax subtraction modification by increasing to $20,000 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 55 years old. The bill also (1) expands the existing State subtraction modification for retired law enforcement; correctional officer; and fire, rescue, and emergency services personnel by increasing to $20,000 the maximum amount of retirement income that can be excluded and (2) specifies that a surviving spouse can claim the subtraction modification. **The bill takes effect July 1, 2019, and applies to tax year 2019 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $3.6 million in FY 2020 due to additional retirement income being exempted. Future year revenues reflect projected growth in the number of eligible taxpayers and retirement income. Expenditures are not affected.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	($3.6)	($3.6)	($3.7)	($3.8)	($3.9)
Expenditure	0	0	0	0	0
Net Effect	($3.6)	($3.6)	($3.7)	($3.8)	($3.9)

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

Local Effect: Local revenues decrease by $2.3 million in FY 2020 and by $2.5 million in FY 2024. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law:

State Pension Exclusion – All Eligible Individuals

Maryland law provides a pension exclusion (in the form of a subtraction modification) for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified maximum amount of taxable pension income ($30,600 for 2018) 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 (Social Security offset).

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under current law for an 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 even though benefits are partially taxable for federal purposes, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of the allowable exclusion by the amount of any Social Security benefits received.

One significant feature of the current pension exclusion is that it is limited to income received from an employee retirement system. Eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under Sections 401(a), 403, or 457(b) of the Internal Revenue Code. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, individual retirement arrangements, Keogh plans, and simplified employee pension plans are not considered employee retirement systems.

Law Enforcement Officer; Correctional Officer; and Fire, Rescue, or Emergency Services Personnel

Retired law enforcement officers; correctional officers; and fire, rescue, or emergency services personnel who are age 65 or older or are totally disabled qualify and claim the State pension exclusion in the same manner as other eligible retirees as described above.

Chapters 153 and 154 of 2017 established a pension exclusion for retired law enforcement officers or fire, rescue, or emergency services personnel. Retirement income qualifies for this exclusion if the individual is between the ages of 55 and 64 and the retirement income is attributable to employment as a law enforcement officer or as a fire, rescue, or emergency services personnel of the United States, the State, or a local jurisdiction. Emergency services personnel includes emergency medical technicians and paramedics. The maximum exclusion in the tax year is limited to $15,000.

Chapters 573 and 581 of 2018 extended eligibility to correctional officers. An eligible retiree includes an individual who was employed in (1) a State correctional facility; (2) a local correctional facility; (3) a juvenile facility; and (4) a facility of the United States that is equivalent to a State or local correctional facility or juvenile facility in the State.

Military Retirement Income

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. An individual can exempt certain military retirement income from State and local taxation if the retirement income resulted from service (1) in an active or reserve component of the U.S. Armed Forces; (2) as a member of the Maryland National Guard; or (3) as an active duty member with the Commissioned Corps of the Public Health Service, the National Oceanic and Atmospheric Administration, or the Coast and Geodetic Survey. The subtraction modification can also be claimed by a surviving spouse or ex-spouse.

Legislation enacted in the 2015 and 2018 sessions expanded the maximum value of the subtraction modification to:

- $15,000 for individuals who are at least age 55; and
- $5,000 for all other individuals.

Military retirees who are at least age 65 or are totally disabled can qualify and claim the State pension exclusion for retirement income that is not excluded under the military retirement income subtraction.

Background: According to the Defense Manpower Data Center (DMDC), 51,502 Maryland military retirees received a total of $128.1 million in retirement income from the U.S. Department of Defense in September 2016. This includes individuals who served in the Army, Navy, Marines, and Air Force. On an annualized basis, this retirement income totaled $1.54 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, National Oceanic and Atmospheric Administration, Public Health Service, or 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 1,363 Maryland National Guard retirees and 6,887 military and Coast Guard survivors also received retirement income in September 2016. **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 2016

Branch	Retirees	Received Pension	Annual Pension Income ($ in Millions)	Average
Army	20,827	19,147	$554.2	$28,942
Navy	15,794	15,037	483.3	32,143
Marines	2,875	2,506	76.2	30,417
Air Force	15,677	14,812	423.0	28,555
Total	**55,173**	**51,502**	**$1,536.7**	**$29,837**

Source: Defense Manpower Data Center

State Revenues: Additional retirement income can be exempted beginning in tax year 2019. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, State revenues will decrease by $3.6 million in fiscal 2020. **Exhibit 2** shows the projected State and local revenue loss from exempting specified military and correctional officer retirement income. The estimated impact of exempting additional military retirement income is based on the number of retirees who are at least 55 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 20% of military retirees are not taxable.

The estimated impact of exempting additional public safety retirement income is based on the number of retirees who claimed the subtraction modification in tax year 2017. This estimate is increased to account for correctional officers and those employed in a correctional facility or juvenile facility, who were not eligible in tax year 2017.

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed. Local revenues will decrease by $2.3 million in fiscal 2020 and by $2.5 million in fiscal 2024 as shown in Exhibit 2.

Exhibit 2
Projected State and Local Revenue Loss
($ in Millions)

	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
State					
Military Retirement	($2.4)	($2.5)	($2.5)	($2.6)	($2.6)
Public Safety Retirees	(1.1)	(1.2)	(1.2)	(1.2)	(1.2)
Total	**($3.6)**	**($3.6)**	**($3.7)**	**($3.8)**	**($3.9)**
Local					
Military Retirement	($1.6)	($1.6)	($1.7)	($1.7)	($1.7)
Public Safety Retirees	(0.7)	(0.8)	(0.8)	(0.8)	(0.8)
Total	**($2.3)**	**($2.4)**	**($2.4)**	**($2.5)**	**($2.5)**
Total Revenues	**($5.9)**	**($6.0)**	**($6.1)**	**($6.3)**	**($6.4)**

Additional Information

Prior Introductions: None.

Cross File: HB 1199 (Delegates Chang and Lisanti) - Ways and Means.

Information Source(s): Comptroller's Office; Department of Legislative Services

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