

Department of Legislative Services  
 Maryland General Assembly  
 2020 Session

FISCAL AND POLICY NOTE  
 First Reader

House Bill 371 (Delegates Lisanti and P. Young)  
 Ways and Means

Income Tax – Subtraction Modification – Military Retirement Income  
 (Defense Workforce Opportunity Act)

This bill expands the existing military retirement income tax subtraction modification by exempting 100% of military retirement income from State taxation. The exemption is phased in over four years, beginning with tax year 2021. **The bill takes effect July 1, 2020.**

Fiscal Summary

**State Effect:** General fund revenues decrease by \$3.5 million in FY 2022 due to additional military retirement income being exempted. Future year estimates reflect projected growth in retirement income and the phase-in specified by the bill. Expenditures are not affected.

(\$ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	\$0	(\$3.5)	(\$12.5)	(\$15.4)	(\$28.3)
Expenditure	0	0	0	0	0
Net Effect	\$0.0	(\$3.5)	(\$12.5)	(\$15.4)	(\$28.3)

*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 2022 and by \$18.5 million in FY 2025. Local expenditures are not affected.

**Small Business Effect:** None.

Analysis

Bill Summary/Current Law:

*Military Retirement Subtraction Modification*

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 (NOAA), 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.

The bill exempts 100% of military retirement income, beginning with tax year 2024. **Exhibit 1** shows the subtraction modification values in each tax year as proposed by the bill.

---

**Exhibit 1**  
**Proposed Subtraction Modification**  
**By Tax Year**

<u>Age</u>	<u>TY 2020</u>	<u>TY 2021</u>	<u>TY 2022</u>	<u>TY 2023</u>	<u>TY 2024</u>
At Least 55 Years	\$15,000	\$17,500	\$25,000	\$30,000	100%
All Other Individuals	5,000	7,500	15,000	20,000	100%

---

*State Pension Exclusion*

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 (\$31,100 for 2019) 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). 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.

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), 51,700 Maryland military retirees received a total of \$132.8 million in retirement income from the Department of Defense in September 2018. 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 \$1.59 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 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, the last year of available data. **Exhibit 2** lists the total retirement pay (including disability pay) received by Maryland military retirees by branch of service.

**Exhibit 2**  
**Retirement Payments by Branch of Service**  
**September 2018**

<u>Branch</u>	<u>Retirees</u>	<u>Received Pension</u>	<u>Annual Pension Income (\$ in Millions)</u>	<u>Average</u>
Army	21,392	19,499	\$582.3	\$29,862
Navy	15,713	14,961	499.4	33,378
Marines	2,954	2,560	80.4	31,388
Air Force	15,621	14,704	431.3	29,331
<b>Total</b>	<b>55,680</b>	<b>51,724</b>	<b>\$1,593.3</b>	<b>\$30,803</b>

Source: Defense Manpower Data Center

**State Revenues:** Additional retirement income can be exempted beginning in tax year 2021. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, revenues will decrease by \$3.5 million in fiscal 2022.

**Exhibit 3** shows the projected State and local revenue loss from exempting military retirement income. This estimate is based on the number of retirees who meet the

requirements of the bill 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.

---

**Exhibit 3**  
**Projected State and Local Revenue Loss**  
**(\$ in Millions)**

	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
State	\$0.0	\$3.5	\$12.5	\$15.4	\$28.3
Local	0.0	2.3	8.2	10.1	18.5
<b>Total</b>	<b>\$0.0</b>	<b>\$5.9</b>	<b>\$20.7</b>	<b>\$25.5</b>	<b>\$46.8</b>

Source: Department of Legislative Services

---

**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 2022 and by \$18.5 million in fiscal 2025, as shown in Exhibit 3.

---

**Additional Information**

**Prior Introductions:** None.

**Designated Cross File:** None.

**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 19, 2020  
mm/hlb

---

Analysis by: Robert J. Rehrmann

Direct Inquiries to:  
(410) 946-5510  
(301) 970-5510