

Department of Legislative Services
 Maryland General Assembly
 2020 Session

FISCAL AND POLICY NOTE
 First Reader

Senate Bill 211 (Senator Salling, *et al.*)
 Budget and Taxation

Income Tax - Subtraction Modification - Military Retirement Income

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 three years, beginning with tax year 2021. **The bill takes effect July 1, 2020.**

Fiscal Summary

State Effect: General fund revenues decrease by \$18.4 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	\$18.4	\$22.7	\$28.1	\$28.3
Expenditure	0	0	0	0	0
Net Effect	\$0.0	\$18.4	\$22.7	\$28.1	\$28.3

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

Local Effect: Local revenues decrease by \$12.0 million in FY 2022 and by \$18.5 million in FY 2025. 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. 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.

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

SB 211/ Page 2

survivors also received retirement income in September 2016, the last year of available data. **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 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
Total	55,680	51,724	\$1,593.3	\$30,803

Source: Defense Manpower Data Center

State Revenues: Additional retirement income can be exempted beginning in tax year 2021. The amount that may be exempted is equal to (1) the greater of \$15,000 or 50% of eligible income in tax year 2021; (2) the greater of \$15,000 or 75% of eligible income in tax year 2022; and (3) 100% of eligible income beginning in tax year 2023. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, revenues will decrease by \$18.4 million in fiscal 2022.

Exhibit 2 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 2
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	(\$18.4)	(\$22.7)	(\$28.1)	(\$28.3)
Local	0.0	(12.0)	(14.8)	(18.3)	(18.5)
Total Revenues	\$0.0	(\$30.5)	(\$37.5)	(\$46.4)	(\$46.8)

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 \$12.0 million in fiscal 2022 and by \$18.5 million in fiscal 2025, as shown in Exhibit 2.

Additional Information

Prior Introductions: Similar legislation was introduced in the 2017, 2018, and 2019 sessions. SB 875 of 2019 received an unfavorable report from the Senate Budget and Taxation Committee. Its cross file, HB 718, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 312 of 2018 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 362, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 321 of 2017 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 375, received a hearing in the House Ways and Means Committee, but no further action was taken.

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

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