HB 774

Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE

House Bill 774 (Delegate O'Donnell, *et al.*)
Ways and Means

Income Tax - Subtraction Modification for Military Retirement Income

This bill increases from $2,500 to $10,000 the maximum amount allowed under the income tax subtraction modification for military retirement income. The bill eliminates the requirements that an individual must be at least 55 years old on the last day of the taxable year and must have been an enlisted member of the military at the time of the retirement. The bill increases from $17,500 to $70,000 the level of federal adjusted gross income above which the maximum subtraction is reduced.

The bill takes effect July 1, 2000, and applies to all taxable years beginning after December 31, 1999.

Fiscal Summary

State Effect: General fund revenues would decrease by $10.8 million in FY 2001, which includes the impact in tax year 2000 and half of tax year 2001. Out-year revenue losses reflect a 1% annual increase in the number of retirees and a 4% average annual increase in military retirement pay. Expenditures would not be affected.

(in millions)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
GF Revenues	($10.8)	($7.5)	($7.9)	($8.3)	($8.7)
GF Expenditures	0.0	0.0	0.0	0.0	0.0
Net Effect	($10.8)	($7.5)	($7.9)	($8.3)	($8.7)

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

Local Effect: Local revenues would decrease by $6.0 million in FY 2001. Expenditures would not be affected.

Small Business Effect: None.

Analysis

Current Law: See below.

Background: The current Maryland income tax includes tax relief for elderly individuals in several forms. Social Security benefits and benefits received under the Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal income tax purposes. The Railroad Retirement Act is the result of railroad pension plans that failed during the 1920s and 1930s and the subsequent bailout of these plans by the federal government. The system operates along the lines of Social Security and functions as a substitute for Social Security for railroad employees.

In addition to the total exemption for Social Security benefits, Maryland law provides a pension exclusion subtraction for individuals who are at least 65 years old or who are totally disabled. As originally enacted in 1968, the pension exclusion was intended to equalize the income tax treatment of individuals covered by Social Security and those not covered by Social Security, such as federal and civil service employees.

Under the subtraction modification, some taxable pension income ($16,100 for 1999) may be exempt from tax. The maximum exclusion is the maximum annual benefit under the Social Security Act and is reduced by the amount of any Social Security payments received. Thus, in addition to the exclusion for Social Security benefits received, a retiree is allowed to deduct the lesser of (1) the amount of pension income actually received; or (2) the maximum Social Security benefit reduced by the amount of Social Security received. For tax year 1995 the average amount excluded under this pension exclusion was just over $6,500. The pension exclusion is estimated to cost the State approximately $55 million a year.

The pension exclusion discussed above can have special significance for military retirees, because as federal employees, they are less likely than the general population to receive Social Security income, meaning that they are more likely to be eligible for a larger maximum pension exclusion. To the extent that they do receive Social Security benefits, the maximum pension exclusion available to them would be reduced.

In addition to the pension exclusion discussed above, an exclusion is provided for military retirement income. Under current law, the first $2,500 of military retirement income received by an individual can be subtracted from federal adjusted gross income for the taxable year provided that the individual is at least 55 years of age on the last day of the taxable year and was an enlisted member of the military at the time of retirement. In addition, this subtraction is reduced by 50% of the amount by which the federal adjusted gross income exceeds $17,500. No subtraction is allowed for individuals having federal adjusted gross income over $22,500.

State Fiscal Effect: Exhibit 1 below presents the savings to a military retiree under current law and under the bill. The retiree is assumed to be a retired officer who is 60 years old and receives $10,000 in annual military retirement income. As the exhibit indicates, the State tax savings to the retiree as a result of the bill is $485.

Exhibit 1
State Tax Savings for Tax Year 2000 Resulting from
Military Retirement Subtraction

	Current Law	HB 774
Subtraction Allowed	$0	$10,000
State Tax Savings	$0	$485

General fund revenues would decrease by $7.1 million in tax year 2000. Although the tax credit is allowed for tax year 2000, it is assumed that most taxpayers will not adjust their tax withholdings to reflect the credit until after July 1, 2000. Consequently, general fund revenues are estimated to decrease by $10.8 million in fiscal 2001, reflecting the impact of one and one-half tax years. In future years it is assumed that one-half of the tax year revenue decrease would occur in the current fiscal year and one-half in the subsequent fiscal year. The estimate is based on the following facts and assumptions:

ºThere were approximately 14,751 military retirees in Maryland in 1997. Average military retirement income was $19,846.

º80% of these retirees had adjusted gross income of less than $70,000; 5% had adjusted gross income between $70,000 and $80,000; 4% had adjusted gross income between $80,000 and $90,000; and 11% and adjusted gross income greater than $90,000 (and are therefore ineligible for the subtraction due to the phase out).

ºThe number of retirees increases by 1% annually and average military retirement pay increases by 4% annually.

Out-year revenue losses reflect a 1% annual increase in the number of retirees and a 4% average annual increase in military retirement pay.

Local Revenues: Local revenues would decrease by approximately 55% of the change in the subtraction amount. In fiscal 2001 the decrease would be approximately $16.7 million

Additional Information

Prior Introductions: Two bills were introduced during the 1999 session that dealt with proposals regarding military retirement income.

HB 196 (failed) and HB 557 (failed) would have expanded this existing subtraction modification under the income tax for military retirement income. As stated above, this subtraction is available only to individuals at least 55 years old who were enlisted members at the time of retirement, is limited to $2,500 each year, and is phased out for individuals with income above $17,500. HB 196 would have eliminated all of these restrictions on the subtraction.

HB 557 would have increased the maximum amount allowed under the subtraction from $2,500 to $5,000 and would have increased the level of federal adjusted gross income above which the subtraction is phased out from $17,500 to $32,000.

Cross File: None.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Department of Legislative Services

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