

**Department of Legislative Services**  
 Maryland General Assembly  
 2001 Session

**FISCAL NOTE**  
**Revised**

House Bill 446 (Delegates O'Donnell and D'Amato)  
 Ways and Means

**Income Tax - Subtraction Modification for Military Retirement Income**

This bill increases from \$2,500 to \$5,000 the maximum amount allowed under the income tax subtraction modification for military retirement income. The bill eliminates the requirements that an individual be at least 55 years old on the last day of the taxable year and have been an enlisted member of the military at the time of the retirement. The bill increases from \$17,500 to \$35,000 the level of federal adjusted gross income above which the maximum subtraction is reduced.

The bill takes effect July 1, 2001, and applies to all taxable years beginning after December 31, 2000.

**Fiscal Summary**

**State Effect:** General fund revenues would decrease by \$1.92 million in FY 2002. Out-year revenue losses reflect a 1% annual increase in the number of retirees, a 4% average annual increase in military retirement income and the estimated cost of the current subtraction. Expenditures would not be affected.

(\$ in millions)	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
GF Revenue	(\$1.92)	(\$1.64)	(\$1.34)	(\$1.41)	(\$1.48)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$1.92)	(\$1.64)	(\$1.34)	(\$1.41)	(\$1.48)

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

**Local Effect:** Local revenues would decrease by approximately \$900,300 in FY 2002. 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 (\$16,500 for 2000) 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 \$60 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 \$240.

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

	<u>Current Law</u>	<u>HB 446</u>
Subtraction Allowed	\$0	\$5,000
State Tax Savings	\$0	\$240

General fund revenues would decrease by \$1.92 million in tax year 2001. It is assumed that the State revenue reductions would occur in the fiscal year following the year that tax returns were filed. Consequently, general fund revenues decrease by \$1.92 million in fiscal 2002. The estimate is based on the following facts and assumptions:

- There were approximately 14,751 military retirees in Maryland in 1997. Average military retirement income was \$19,846.
- 57% of these retirees had adjusted gross income of less than \$35,000; 10% had adjusted gross income between \$35,000 and \$45,000; and 33% had adjusted gross income greater than \$45,000 (and are therefore ineligible for the subtraction due to the phase out).
- The 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 2.74% of the State subtraction taken. In fiscal 2002 the decrease would be approximately \$900,300.

## **Additional Information**

**Prior Introductions:** Several bills dealing with the State taxation of military retirement income have been introduced during the last several sessions, including HB 196 and HB 557 of 1999 and HB 774 of 2000.

**Cross File:** None.

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

**Fiscal Note History:** First Reader – February 19, 2001  
ncs/cer Revised – Correction – February 20, 2001

---

Analysis by: Michael Sanelli

Direct Inquiries to:  
John Rixey, Coordinating Analyst  
(410) 946-5510  
(301) 970-5510