

Department of Legislative Services
 Maryland General Assembly
 2002 Session

FISCAL NOTE
Revised

Senate Bill 163 (Senator Astle, *et al.*)
 Budget and Taxation

Income Tax - Subtraction Modification - Military Retirement Income

This bill extends the subtraction modification for military retirement income allowed under the Maryland income tax from the first \$2,500 of military retirement income received by a specified retiree to 100% of military retirement income received by all retirees. 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 also eliminates the phase-out of the subtraction that currently applies.

The bill takes effect July 1, 2002 and is applicable to all tax years beginning after December 31, 2001.

Fiscal Summary

State Effect: General fund revenue decrease of approximately \$61.0 million in FY 2003 which reflects the impact of one and one-half tax years. Out-year revenue losses reflect the impact of one tax year, a 2.5% 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 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	(\$61.0)	(\$43.6)	(\$46.4)	(\$49.4)	(\$52.7)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$61.0)	(\$43.6)	(\$46.4)	(\$49.4)	(\$52.7)

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

Local Effect: Local revenues would decrease by approximately \$36.0 million in FY 2003. Expenditures would not be affected. Future year revenues would decrease as the amount of the total State subtraction increases.

Small Business Effect: None.

Analysis

Current Law: See below.

Background: The 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 (\$17,300 for 2001) 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.

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.

It is estimated that the cost of the current subtraction modification for military retirement income is approximately \$577,125 in fiscal 2003.

State Fiscal Effect: Exhibit 1 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 \$15,000 in annual military retirement income. As the exhibit indicates, the State tax savings to the retiree as a result of the bill is \$713.

**Exhibit 1
State Tax Savings for Tax Year 2002 Resulting From Military Retirement
Subtraction**

	<u>Current Law</u>	<u>SB 163</u>
Subtraction Allowed	\$0	\$15,000
State Tax Savings	\$0	\$713

General fund revenues would decrease by \$40.2 million in tax year 2002. 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 \$61.0 million in fiscal 2003. The estimate is based on the following facts and assumptions:

- the Department of Defense paid \$846,336,000 to 40,771 military retirees in Maryland (out of a total 45,590);
- average military retirement income for these retirees was \$20,758;
- 58% of U.S. veterans were ages 55 and over in 1999, according to the 2000 U.S. Statistical Abstract; and
- the number of retirees increases by 2.5% annually and average military retirement pay increases by 4% annually.

Out-year revenue losses reflect a 2.5% 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 2.8% of the State subtraction taken in tax year 2002. In fiscal 2003 the decrease would be approximately \$36.0 million. Future year revenues would decrease as the amount of the total State subtraction increases.

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, HB 774 of 2000, and HB 446 of 2001.

Cross File: HB 53 (Delegate Boschert, *et al.*) – Ways and Means.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Maryland Department of Veterans Affairs, U.S. Department of Defense Statistical Report on the Military Retirement System (May 2001), Department of Legislative Services

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