HB 408

Department of Legislative Services
Maryland General Assembly
2002 Session

FISCAL NOTE

House Bill 408 (Delegate O'Donnell, *et al*.)
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, 2002 and applies to all taxable years beginning after December 31, 2001.

Fiscal Summary

State Effect: General fund revenues would decrease by $4.3 million in FY 2003. Out-year revenue losses reflect 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	($4.3)	($4.6)	($4.9)	($5.2)	($5.5)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($4.3)	($4.6)	($4.9)	($5.2)	($5.5)

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

Local Effect: Local revenues would decrease by approximately $2.5 million in FY 2003. Expenditures would not be affected.

Small Business Effect: None.

Analysis

Current Law: 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.

Maryland law also provides a pension exclusion subtraction for individuals who are at least 65 years old or who are totally disabled. 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, 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.

An additional exclusion is provided for military retirement income. Under State 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: Under the bill, a retired officer who is 60 years old and receives $15,000 in annual military retirement income would be able to exclude $5,000 from income and therefore, would realize State tax savings of $238, as compared to current law.

General fund revenues would decrease by $4.3 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 $4.3 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 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*; 85% of active duty military were enlisted; 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 $2.5 million. Future year revenues would decrease as the amount of the total State subtraction increases.

Additional Information

Prior Introductions: This bill was introduced as HB 446 in the 2001 session. No action was taken by the House Ways and Means Committee.

Cross File: None.

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

Fiscal Note History: First Reader - February 17, 2002
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