SB 877

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

Senate Bill 877 (Senators Kittleman and Astle)
Budget and Taxation

Income Tax - Subtraction Modification - Military Retirement Income

This bill expands the existing military subtraction modification by providing that 100% of military retirement income is exempted from State taxation if the individual served at least 20 years active duty.

The bill takes effect July 1, 2004 and applies to tax years 2005 and beyond.

Fiscal Summary

State Effect: General fund revenues would decrease by $2.4 million in FY 2005. Out-year revenue losses reflect annualization, phase-in of the subtraction modification as provided in the bill, a 1.2% annual increase in the number of retirees, a 2.5% annual increase in military retirement income, and the estimated cost of the current subtraction modification and pension exclusion provided for military retirement income. Expenditures would not be affected.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	($2.4)	($7.6)	($13.3)	($19.4)	($25.8)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($2.4)	($7.6)	($13.3)	($19.4)	($25.8)

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

Local Effect: Local revenues would decrease by approximately $1.5 million in FY 2005, increasing to $15.7 million by FY 2009. Expenditures would not be affected.

Small Business Effect: None.

Analysis

Bill Summary: The bill provides that 100% of military retirement income is exempted from State taxation if the individual served at least 20 years active duty. The bill expands the existing subtraction modification by repealing 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 repeals the current phase-out of the subtraction modification that begins once federal gross income exceeds $17,500. If an individual exempts military retirement income under the provisions of this bill, that income cannot be counted towards the State pension exclusion exemption.

The increase in the amount of the subtraction modification is limited in the first four effective tax years. The subtraction modification in the first four tax years is 20% for tax year 2005, 40% for tax year 2006, 60% in tax year 2007, 80% in tax year 2008, and 100% in tax years 2009 and beyond.

Current Law: A subtraction modification 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. 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.

In addition to this exclusion available to retired military, additional tax benefits are available to retired military individuals. 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 ($19,900 maximum for 2003) 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.

State Fiscal Effect: General fund revenues would decrease by approximately $4.8 million in tax year 2005. It is assumed that most taxpayers will adjust their withholding and estimated payments after July 1, 2004, resulting in a reduction of $2.4 million in fiscal 2005. Fiscal 2006 and beyond reflect the impact of one-half of the prior tax year and one-half the current tax year.

This estimate is based on the following facts and assumptions:

- according to the Department of Defense, $879,156,000 was paid to 46,262 military retirees in Maryland in tax year 2002;
- average military retirement income for these retirees was $19,004;
- according to the *2003 Retired Military Almanac*, 70.5% of active duty military were formerly enlisted personnel;
- approximately 60% of U.S. veterans were ages 55 and over in 1999, according to the *2000 U.S. Statistical Abstract*;
- the number of retirees increases by 1.5% annually and average military retirement pay increases by 2.5% annually; and
- for tax year 1997, 44% of returns with military pension income also had a pension exclusion that averaged $7,207. The amount of pension exclusion is estimated to increase by 5% annually.

It is assumed that these retirees have served 20 years active duty. To the extent there are retirees that do not serve 20 years active duty and earn retirement income, the cost of the bill will be less.

Local Revenues: Local revenues would decrease by approximately 2.8% of the State subtraction taken in tax year 2005. In fiscal 2005 the decrease would be approximately $1.5 million. Future year revenues decrease as the amount of the total State subtraction increases, totaling approximately $4.6 million in fiscal 2006, $8.1 million in fiscal 2007, $11.9 million in fiscal 2008, and $15.7 million in fiscal 2009.

Additional Information

Prior Introductions: None.

Cross File: HB 1182 (Delegate Love, *et al.*) – Ways and Means.

Information Source(s): Comptroller's Office, Department of Legislative Services

Fiscal Note History: First Reader - March 17, 2004
ncs/jr

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