HB 245

Department of Legislative Services
Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE
Revised

House Bill 245 (The Speaker, *et al.*) (By Request – Administration)
Ways and Means Budget and Taxation

Income Tax - Subtraction Modification - Military Retirement Income

This Administration bill expands the existing military retirement income subtraction modification by providing that 50% of military retirement income is exempted from State taxation if the individual served at least 20 years active duty and was an enlisted member at the time of retirement.

The bill takes effect July 1, 2005 and applies to tax years 2007 and beyond.

Fiscal Summary

State Effect: General fund revenues would decrease by approximately $1.1 million in FY 2007. Out-year revenue losses reflect annualization, phase-in of the subtraction modification as provided in the bill, estimated number of retirees, increases 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 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	$0	($1.1)	($3.2)	($5.4)	($7.6)
Expenditure	$0	$0	$0	$0	$0
Net Effect	$0	($1.1)	($3.2)	($5.4)	($7.6)

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

Local Effect: Local revenues would decrease by approximately $689,500 in FY 2007, increasing to $5.0 million by FY 2010. Expenditures would not be affected.

Small Business Effect: The Administration has determined that the bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment. The attached assessment does not reflect amendments to the bill.

Analysis

Bill Summary: The bill provides that 50% of military retirement income is exempted from State taxation if the individual served at least 20 years active duty and was an enlisted member at the time of retirement. The bill expands the existing subtraction modification by repealing: (1) the requirements that an individual be at least 55 years old on the last day of the taxable year; and (2) 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 10% for tax year 2007, 20% for tax year 2008, 30% in tax year 2009, 40% in tax year 2010, and 50% in tax years 2011 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.

Maryland law also provides a pension exclusion subtraction for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified maximum amount of taxable pension income ($20,700 maximum for 2004) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received. The pension exclusion has been a part of the Maryland income tax since 1965.

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under the current law by the individual. The Social Security offset was established at the same time as the pension exclusion. Given that Social Security benefits are exempt from Maryland income tax, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of allowable exclusion by the amount of Social Security benefits received.

Additional Income Tax Treatment for Elderly Individuals

Social Security benefits and benefits received under the federal Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal income tax purposes. In addition to the special treatment of Social Security and other retirement income, other income tax relief is provided to senior citizens regardless of the source of their income. Each individual age 65 or older: (1) is allowed a $1,000 personal exemption in addition to the regular exemption of $2,400 allowed to all individuals; and (2) can earn more income without being required to file taxes.

Background: Chapter 664 of 2002 established the Task Force to Study the Financial Impact of Retired Military Service Personnel on the Economy of the State. The task force issued its final report in December 2003. Among its findings was that in 2000 there were approximately 42,600 military retirees living in Maryland. Approximately 70% were estimated to be formerly enlisted. The task force estimated that average household income of military retirees was $83,435 compared with a median household income of $42,151 for all Maryland households, and that these military retiree households paid approximately $163 million in State and local income taxes.

State Revenues: General fund revenues would decrease by approximately $2.1 million in tax year 2007. It is assumed that most taxpayers will adjust their withholding and estimated payments after January 1, 2007, resulting in a reduction of $1.1 million in fiscal 2007. Fiscal 2008 and beyond reflect the impact of one-half of the prior tax year and one-half the current tax year When fully phased-in, general fund revenues would decrease by approximately $10 million in fiscal 2011.

This estimate is based on the following facts and assumptions:

- according to the Department of Defense, approximately $860.3 million was paid to 46,262 military retirees in Maryland in tax year 2001;
- approximately 85% of these retirees can be identified as filing taxes in 2001;
- according to the 2003 Retired Military Almanac, 70.5% of military retirees were formally enlisted members;
- the amount of pension income is increased from tax year 2001 through 2011 on average by approximately 2% annually;
- the number of retirees increased by 4% annually in 2002 and 2003 and is estimated to remain constant from 2004 to 2011;

- it is estimated that under the current military retirement income subtraction approximately \$6.4 million of military retirement income will be excluded in tax year 2006; 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 be \$10,141 in tax year 2004 and increase by 5% annually.

Local Revenues: Local revenues would decrease by approximately 3.1% of the net change in State tax liability in tax year 2007 resulting from the provisions of the bill. In fiscal 2007 the decrease would be approximately \$689,500. Future year revenues decrease as the amount of the total State subtraction increases, totaling approximately \$2.1 million in fiscal 2008, \$3.5 million in fiscal 2009, and \$5.0 million in fiscal 2010.

Additional Information

Prior Introductions: Identical bills were introduced at the 2004 session as SB 877/HB 1182. SB 877 was not reported from the Budget and Taxation Committee. HB 1182 was not reported from the Ways and Means Committee.

Cross File: SB 211 (The President, *et al.*) (By Request – Administration) – Budget and Taxation.

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

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