Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE

House Bill 1247 (Delegate Montgomery, *et al.*)
Ways and Means

Income Tax - Military Service Retirement Tax Relief Act

This bill expands the existing military retirement income subtraction modification and repeals the Maryland-mined coal tax credits.

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

Fiscal Summary

State Effect: General fund revenues could increase by approximately $13.4 million in FY 2006 due to coal mine credits no longer being claimed against the public service franchise and corporate income tax and increased military retirement income subtractions. Transportation Trust Fund (TTF) increase of approximately $96,000 in FY 2006 due to credits no longer being claimed against the corporate income tax. Out-year estimates reflect 3% annual increase in coal production, annualization, and estimated number of military retirees.

($ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	$13.4	$15.0	$15.5	$15.9	$16.0
SF Revenue	.1	.1	.1	.1	.1
Expenditure	$0	$0	$0	$0	$0
Net Effect	$13.5	$15.1	$15.6	$16.0	$16.1

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

Local Effect: Local highway user revenues would increase by approximately $29,000 annually beginning in FY 2006. Local income tax revenues would decrease by approximately $1.8 million in FY 2006 due to increased military retirement subtraction modifications and by approximately $1.3 million annually beginning in FY 2007.

Small Business Effect: None.

Analysis

Bill Summary: The bill expands the existing military retirement income subtraction modification by increasing to $7,500 the amount of military retirement income that can be exempted from State taxation. In addition, the phase-out of the subtraction modification is increased. The subtraction is reduced by 50% of the amount by which the federal adjusted gross income exceeds $30,000. No subtraction is allowed for individuals having federal adjusted gross income over $40,000. If an individual exempts military retirement income under the provisions of the bill, that income cannot be counted towards the State pension exclusion exemption.

Current Law:

Military Retirement Income

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. 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.

Maryland-mined Coal Credits

Public service companies in Maryland can claim a $3 per ton credit for the amount of Maryland-mined coal they purchase in a calendar year. This tax credit can be claimed against the public service company franchise tax and cannot exceed the State tax liability for that tax year.

Cogenerators and electricity suppliers that are not subject to the public service franchise tax can claim a $3 per ton credit for the amount of Maryland-mined coal they purchase in a calendar year. The credit is restricted to the electricity suppliers that were defined before July 1, 1999 as an electricity company under the Public Utility Companies Article. This restriction does not apply if an electricity supplier is an affiliate of one of the suppliers that were defined as an electricity company prior to July 1, 1999. This credit can be claimed against the State income tax and cannot exceed the tax liability for that tax year.

Background: Chapter 792 of 1988 established the tax credit for Maryland-mined coal purchased by public service companies, with a sunset provision of June 30, 1991. The credit allowed was $3 per ton of coal purchased by a public service company in excess of the number of tons purchased by the public service company in 1986. Chapter 832 of 1989 established a Maryland-mined coal tax credit for cogenerators and electricity producers not subject to the public service company franchise tax. The credit was equal to $3 per ton of coal purchased in excess of the amount that the cogenerator or electricity producer purchased in 1986. A cogenerator is a generating facility that produces electricity and another form of useful thermal energy (such as heat or steam) that is used for industrial, commercial, or heating and cooling purposes. The tax credit for cogenerators and electricity suppliers can be applied against the State income tax.

Chapter 700 of 2000 allowed the credit to be claimed for all amounts of coal purchased for both tax credits, not just the amount in excess of the amount purchased in 1986. Chapter 700 of 2000 also repealed the sunset provision originally established under

Chapter 792 of 1988 for the tax credit available to public service companies. Chapter 700 of 2000 was not approved by the Attorney General's Office for constitutionality and legal sufficiency, in that it was determined that a court is likely to have serious problems under the Commerce Clause of the U.S. Constitution.

Maryland-mined coal has relatively high ash content and moderate levels of sulfur as compared to other types of coal such as anthracite. The sulfur and ash content contribute to acid rain and particulate pollution. As a result of amendments to the federal 1990 Clean Air Amendment, public service companies in Maryland significantly decreased their consumption of Maryland-mined coal. The Attorney General ruled in 1995 that consumption was not a requirement for claiming the credit. As a result, many companies have claimed the credit by acting as a broker, purchasing Maryland-mined coal and selling it to out-of-state companies who consume the coal.

Exhibit 1 lists the amount of credits claimed against the public service company franchise and corporate income taxes for tax years 2000-2003. Due to reporting restrictions, the amount of credits claimed against the corporate income tax is estimated. Exhibit 1 also lists the estimated amount of coal that is purchased and claimed as a credit. This estimate is based on the amount of credits claimed in each year and the amount of coal produced as reported by the State Bureau of Mines.

Exhibit 1
Amounts of Credits Claimed
Tax Years 2000-2003

Tax Year	Public Service Franchise Tax	Corporate Income Tax	Total	Percent of Coal Produced Estimated to Be Claimed as a Tax Credit
2000	$11,405,867	$900,000	$12,305,867	89%
2001	9,753,644	1,100,000	10,853,644	76%
2002	11,488,131	1,100,000	12,588,131	83%
2003	14,404,406	500,000	14,904,406	97%

Source: State Department of Assessments and Taxation; *Maryland Tax Expenditures Report Fiscal Year 2004*, Bureau of Mines; Department of Legislative Services

In addition, Maryland-mined coal is subject to State and local taxation. The State imposes a reclamation tax of $0.15 per ton on surface-mined coal. Nine cents per ton goes to the Bituminous Coal Open-Pit Mining Reclamation Fund and $0.06 per ton goes to the county in which the coal was extracted. There is a State $0.17 per ton reclamation tax on deep-mined coal. Counties can impose a $0.30 per ton tax on coal that is surface-mined. In fiscal 2003, Allegany and Garrett were the only counties that assessed this tax and collected a total of $517,022.

Military Retirement Income

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: This bill repeals the Maryland-mined coal credits and expands the existing State subtraction modification for military retirement income beginning in tax year 2005. As a result of the bill, general fund revenues would increase by approximately $13.4 million in fiscal 2006, $15.0 million in fiscal 2007, $15.5 million in fiscal 2008, $15.9 million in fiscal 2009, and $16.0 million in fiscal 2010. TTF revenues would increase by approximately $96,000 annually beginning in fiscal 2006.

Expanding Military Retirement Income Benefits

The bill changes the existing military retirement income subtraction modification by: (1) increasing to $7,500 the amount of military retirement income that can be exempted; (2) increasing the phase-out of the subtraction modification to $30,000; and (3) requiring that if an individual exempts military retirement income under the provisions of the bill, that income cannot be counted towards the State pension exclusion exemption.

As a result, general fund revenues would decrease by approximately $1.9 million in tax year 2005. It is assumed that most taxpayers will adjust their withholding and estimated payments after July 1, 2005, resulting in a reduction of approximately $2.9 million in fiscal 2006. Fiscal 2007 and beyond reflect the impact of one-half of the prior tax year and one-half the current tax year. As a result, general fund revenues would decrease by approximately $1.9 million annually beginning in fiscal 2007.

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.

- It is estimated that under current law $6.9 million of pension income will be excluded in tax year 2005.

- 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.

- 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.

Repealing the Maryland-mined Coal Credits

As a result of repealing the Maryland-mined coal tax, general fund revenues will increase by approximately $16.3 million in fiscal 2006, $16.9 million in fiscal 2007, $17.4 million in fiscal 2008, $17.8 million in fiscal 2009, and $17.9 million in fiscal 2010. TTF revenues will increase by approximately $96,000 annually beginning in fiscal 2006. The estimated revenue gains, and out-year projections, are based on the following facts and assumptions:

- According to the Maryland Bureau of Mines, approximately 5.3 million tons of coal was mined in 2004. From 1999 to 2004 the amount of coal mined increased on average by 5.4 % annually.

- The amount of coal mined from 2004 through 2010 is estimated to increase on average by approximately 3%.

- Approximately 96% of all coal will be claimed as a credit against the public service company franchise tax.

- Cogenerators will claim approximately $400,000 against the corporate income tax.

- Public service companies and corporations claiming the credit have sufficient tax liability to claim the entire credit available.

Local Revenues: **Exhibit 2** lists the impact of the bill on local revenues from fiscal 2006 through 2010.

Exhibit 2
Impact of HB 1247 on Local Revenues

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Local Highway User Revenues	$28,800	$28,800	$28,800	$28,800	$28,800
Local Income Tax	-1,838,954	-1,216,369	-1,216,369	-1,216,369	-1,216,369
Total	**$-1,810,154**	**$-1,187,569**	**$-1,187,569**	**$-1,187,569**	**$-1,187,569**

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Department of Environment (Bureau of Mines), Comptroller's Office, State Department of Assessments and Taxation, Department of Legislative Services

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