

Department of Legislative Services
 Maryland General Assembly
 2007 Session

FISCAL AND POLICY NOTE

Senate Bill 419
 Budget and Taxation

(Senator Madaleno)

Ways and Means

**Income Tax - Subtraction Modification - Military Retirement Income for
 Commissioned Officers**

This bill expands the existing military retirement income subtraction modification by allowing individuals who retired before July 1, 1991 from active duty with the Commissioned Corps of the Public Health Service, the National Oceanic and Atmospheric Administration (NOAA), or the Coast and Geodetic Survey to qualify for the subtraction modification.

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

Fiscal Summary

State Effect: General fund revenues would decrease by \$117,500 in FY 2008 due to additional retirement income being exempted as provided by the bill. Future years reflect estimated number of eligible taxpayers. Expenditures would not be affected.

(in dollars)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	(\$117,500)	(\$119,300)	(\$120,900)	(\$122,500)	(\$124,200)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$117,500)	(\$119,300)	(\$120,900)	(\$122,500)	(\$124,200)

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

Local Effect: Local government revenues would decrease by \$74,200 in FY 2008. Future year revenue losses would increase by approximately 1.5% annually. Expenditures would not be affected.

Small Business Effect: None.

Analysis

Current Law: Chapter 226 of 2006 expanded a \$2,500 military retirement income subtraction that was limited to enlisted military members with a federal adjusted gross income of \$22,500 or less. Under Chapter 226, an individual may exempt the first \$5,000 of military retirement income from State taxation if the retirement income resulted from: (1) service in an active or reserve component of the armed forces of the United States; (2) service in the Maryland National Guard; or (3) separation after July 1, 1991 from active duty with the Commissioned Corps of the Public Health Service, NOAA, or the Coast and Geodetic Survey. Military retirement income exempted under this provision cannot be counted towards the State pension exclusion. Chapter 226 is estimated to reduce State income tax revenues by \$10.2 million in fiscal 2008 and local income tax revenues by \$6.5 million.

Maryland law also provides a pension exclusion subtraction for individuals who are at least 65 years old or who are totally disabled. Up to a specified maximum amount of taxable pension income (\$22,600 maximum for 2006) 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.

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 can also earn more income without being required to file taxes. The additional exemption amount allowed for elderly or blind individuals is \$1,000. This amount is in addition to the regular personal exemption of \$2,400.

Background: According to the Office of Commissioned Corps Force Management Information System, 762 Maryland residents who retired from the Commission Corps of the Public Health Service received a total of \$52.1 million, or an average of \$68,312, in retirement income during 2005. Of these retirees, 463 (61%) retired before July 1, 1991

and 437 (57%) were 65 years or older. Most of these retirees, 613 (80%) reside in Montgomery County.

State Revenues: Additional individuals could qualify for the military retirement income subtraction modification in tax year 2007. As a result, fiscal 2008 revenues would decrease by \$117,500. This estimate is based on the number of Maryland residents who have retired before July 1, 1991 from the Commissioned Corps of the Public Health Service and the following facts and assumptions:

- an estimated 50 retirees from NOAA and the Coast and Geodetic Survey would qualify for the expansion;
- an estimated 5% of retirees receive service-related disability that is already exempt from State income taxation;
- based on the average Commissioned Corps of the Public Health Service pension amount, individuals would claim the maximum \$5,000 subtraction modification; and
- the number of retirees increases by 1.5% annually.

It is assumed that due to the modest change in State and local income tax liability (\$388 on average) individuals do not adjust estimated payments and withholdings in fiscal 2008. To the extent that individuals do adjust payments and withholdings, revenue losses would be greater than estimated in fiscal 2008.

Local Fiscal Effect: Local government revenues would decrease by 3% of the net change in State tax liability in tax year 2007 resulting from the provisions of the bill. In fiscal 2008 the decrease would be approximately \$74,200. Future year revenue losses would increase by 1.5% annually thereafter.

Additional Information

Prior Introductions: None.

Cross File: HB 392 (Delegates Kaiser and Taylor) – Ways and Means.

Information Source(s): National Oceanic and Atmospheric Administration, Office of Commissioned Corps Force Management Information System, Department of Legislative Services

Fiscal Note History: First Reader - February 15, 2007
ncs/hlb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510