SB 715

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 715 (Senator Klausmeier, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Military Compensation Outside the State

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This bill expands the existing overseas military pay subtraction modification by • allowing military members serving out of state to qualify; and • eliminates the current phase out that reduces and eliminates the benefit for certain individuals.

The bill takes effect July 1, 2008 and applies to tax years 2008 and beyond.

Fiscal Summary

State Effect: General fund revenues would decrease by $5.1 million in FY 2009 due to additional subtraction modifications. Future years reflect the estimated number of taxpayers impacted by the expanded subtraction modification. No effect on expenditures.

($ in millions)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	($5.1)	($5.3)	($5.7)	($6.3)	($6.9)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($5.1)	($5.3)	($5.7)	($6.3)	($6.9)

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

Local Effect: Local government revenues would decrease by $3.3 million in FY 2009. Future revenue losses would increase by a little over 6% annually and would total $4.5 million in FY 2013. No effect on expenditures.

Small Business Effect: None.

Analysis

Current Law: Maryland residents serving a military assignment overseas are allowed a State income tax subtraction modification. The subtraction includes the first $15,000 of military pay that is • received by an individual who is in active service of any branch of the armed forces; and • attributable to military service outside the United States. The amount of the subtraction is reduced dollar for dollar in the amount by which the individual's military pay exceeds $15,000 and is reduced to zero if pay exceeds $30,000.

Background: Several laws determine the federal and State taxation of military members serving overseas as discussed below.

Federal Tax Treatment

Under Section 112 of the Internal Revenue Code, certain pay received by a member of the armed forces serving in a designated combat zone can be excluded from FAGI. The combat exclusion applies for any month in which the individual either served in a combat zone or was hospitalized due to service in a combat zone. Income from the following sources can be excluded:

- active duty pay;
- imminent danger/hostile fire pay;
- a reenlistment bonus if the reenlistment occurs in the month served in a combat zone;
- pay for accrued leave earned in any month served in a combat zone;
- pay received for duties as a member of the armed forces in clubs, messes, and other nonappropriated funds;
- awards for suggestions or inventions if the submission was made in a month served in a combat zone; and
- student loan repayments.

The amount of pay that can be excluded by commissioned officers is limited to the highest rate of enlisted pay that can be earned that month plus any imminent danger/hostile fire received.

A combat zone is any area the President of the United States designates by executive order as an area in which U.S armed forces are engaging or have engaged in combat. The current combat zones are the Afghanistan area, Kosovo area, and Persian Gulf area. In addition, since 1995 the hazardous duty area in the former Yugoslavia comprised of

Bosnia and Herzegovina, Croatia, and Macedonia qualifies as a combat zone for income tax purposes.

The Servicemembers Civil Relief Act (SCRA) (50 U.S.C. App. §§ 501-596), which replaced the Soldiers' and Sailors' Civil Relief Act, is a federal law that provides military members certain protections as they enter active duty and other protections while they are on active duty. Section 511 provides that a nonresident service member's military income and personal property are not subject to state taxation if the service member is present in the state only due to military orders. States are also prohibited from using the military pay of these nonresident service members to increase the state income tax of the spouse. For example, a Maryland member of the military that is stationed in California is exempt from the California income tax but pays Maryland income taxes if the individual maintains a permanent residence or is domiciled in Maryland. Conversely, Maryland does not tax the military pay of a California military member merely because the individual is stationed at a Maryland military base.

State Tax Treatment

Maryland conforms to federal tax treatment of military pay in combat zones; any amount received is not taxable for State income tax purposes. In addition to the subtraction modification available to military serving overseas, Chapter 368 of 2006 created a subtraction modification for the foreign earned income of an individual employed by the United States or an agency of the United States and includes pay received by U.S. military. The amount of the subtraction may not exceed $3,500 in each of tax year 2007, 2008, and 2009.

Current Troop Force and Deployments

As of September 2007 there are approximately 1.4 million active duty military personnel in the armed forces, with 991,000 serving within the United States. A significantly higher than usual number of troops are currently serving overseas, primarily due to troop deployments related to the Iraq and Afghanistan wars. The Congressional Budget Office projects that related expenditures (which total $725 billion through fiscal 2009) will in the long-term drop from the current level of $139 billion annually to $58 billion and that the number of U.S. military personnel deployed in contingency operations will fall from about 200,000 to about 75,000 in 2013 and remain at that level through 2025.

State Revenues: Additional amounts of military income could be exempted beginning in tax year 2008. It is assumed that most individuals do not adjust withholdings. As a result, general fund revenues could decrease by approximately $5.1 million in fiscal 2009 and $6.9 million by fiscal 2013. **Exhibit 1** shows the potential State and local revenue decrease over the five-year period. This estimate is based on current troop deployments and the following facts and assumptions:

- It is estimated that Maryland's share of total active duty personnel who are also subject to State taxation is 1%.
- The number of Maryland residents in the military serving overseas increases by 1% annually.
- Force deployments in combat zones decrease as forecasted by the CBO.
- Revenue losses from commissioned officers serving in combat zones is minimal.

Exhibit 1
Potential State and Local Revenue Decrease

Fiscal	State	Local	Total
2009	$5,068,200	$3,307,700	$8,375,900
2010	5,314,000	3,468,100	8,782,100
2011	5,722,700	3,734,800	9,457,500
2012	6,267,300	4,090,200	10,357,500
2013	6,925,600	4,519,900	11,445,500

Revenue losses in fiscal 2010 and beyond would increase as a result of an overall increase in Marylanders serving in the military and due to the reduction of Marylanders serving in combat zones; these individual would then be subject to State taxation and would utilize the subtraction modification.

Local Revenues: Local income tax revenues would decrease by about 3% of the amount of subtractions claimed as shown in Exhibit 1. Local income tax revenues would decrease by $3.3 million in fiscal 2009, $3.5 million in fiscal 2010, $3.7 million in fiscal 2011, $4.1 million in fiscal 2012, and $4.5 million in fiscal 2013.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Congressional Budget Office, Internal Revenue Service, U.S. Department of Defense, Department of Legislative Services

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