SB 426

Department of Legislative Services
Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 426 (Senator Peters, *et al.*)
Budget and Taxation

Income Tax Subtraction Modification - Military Pay

This bill expands the existing overseas military pay subtraction modification by • increasing to $30,000 the maximum amount of qualifying military pay that can be exempted; and • increasing to $45,000 the amount of military pay that can be received before the exemption is phased out. The subtraction modification would be reduced to zero once an individual receives more than $75,000 in military pay.

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 $1.3 million in FY 2009 due to additional subtraction modifications. Future years reflect the estimated number of taxpayers eligible for the subtraction modification. No effect on expenditures.

($ in millions)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	($1.3)	($1.3)	($1.4)	($1.4)	($1.4)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($1.3)	($1.3)	($1.4)	($1.4)	($1.4)

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

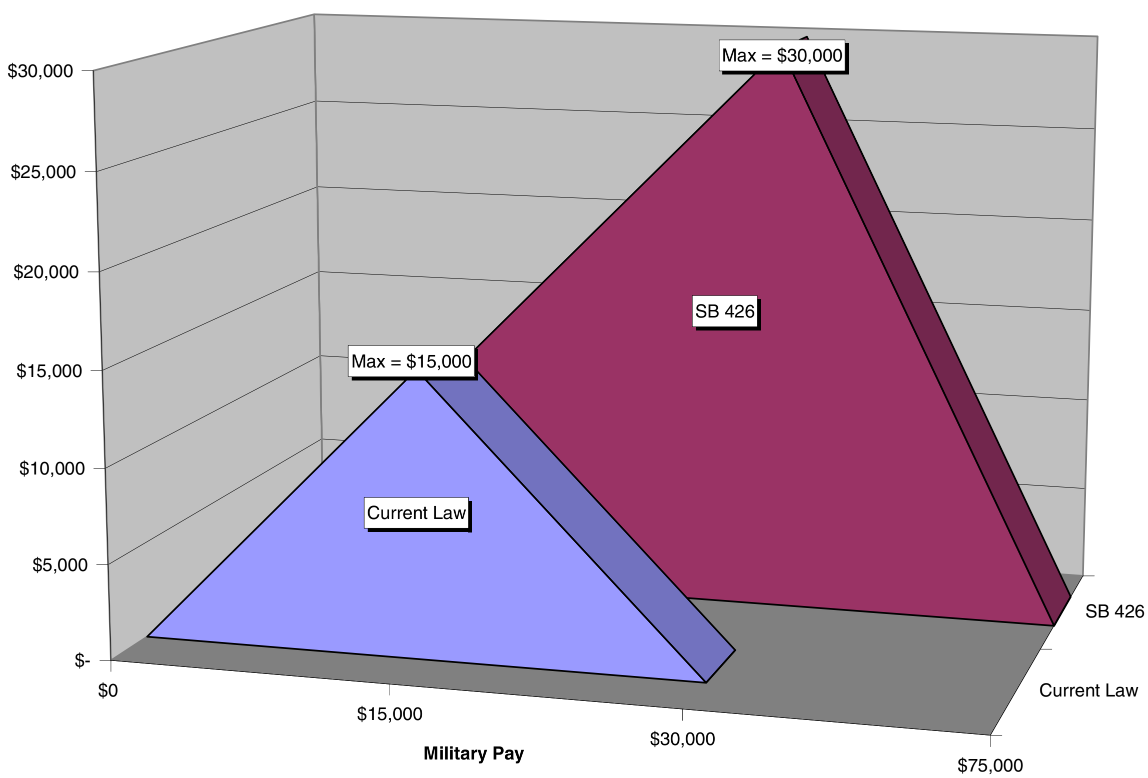
Local Effect: Local government revenues would decrease by $865,800 in FY 2009. Future revenue losses would increase by 1% annually and would total $900,000 by FY 2013. No effect on expenditures.

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. **Exhibit 1** lists the value of the exemption under current law and as proposed under SB 426.

Exhibit 1
SB 426 Proposed Exemption Value



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.

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 $1.3 million in fiscal 2009 and $1.4 million by fiscal 2013. **Exhibit 2** 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.
- To the extent force deployments in combat zones decrease, these troops will be redeployed to the United States and not overseas.
- Revenue losses from commissioned officers serving in combat zones is minimal.

Exhibit 2
Potential State and Local Revenue Decrease

Fiscal	State	Local	Total
2009	$1,326,600	$865,800	$2,192,400
2010	1,339,900	874,400	2,214,400
2011	1,353,300	883,200	2,236,500
2012	1,366,800	892,000	2,258,800
2013	1,380,500	900,900	2,281,400

Local Revenues: Local income tax revenues would decrease by about 3% of the amount of subtractions claimed as shown in Exhibit 2. Local income tax revenues would decrease by $865,800 in fiscal 2009, $874,400 in fiscal 2010, $883,200 in fiscal 2011, $892,000 in fiscal 2012, and $900,900 in fiscal 2013.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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ncs/hlb

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