Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

House Bill 536 (Delegate Cardin)
Ways and Means

Income Tax Exemption - Military Health Care Pensions - Health Care Workforce Shortage

This bill expands the existing military retirement income subtraction modification by exempting 100% of specified military retirement income for any individual who commits to living and working in the State for a period required by the Comptroller, and works in a health care field identified as having a health care workforce shortage. In order to qualify, an individual must have a federal adjusted gross income (FAGI) of $65,000 or less. The Comptroller's Office is required to adopt regulations in consultation with the Department of Health and Mental Hygiene (DHMH) and the Governor's Workforce Investment Board in order to implement the provisions of the bill.

The bill takes effect July 1, 2009 and applies to tax years 2010 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by a significant amount beginning in FY 2011. Assuming 250 individuals qualify for the exemption, State revenues decrease by $237,000 annually. Expenditures are not affected.

Local Effect: Potential significant decrease in local government revenues beginning in FY 2011 due to additional retirement income being exempted. Assuming 250 individuals qualify for the exemption, local government revenues decrease by $151,500 annually. Local expenditures are not 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 an FAGI 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 service in an active or reserve component of the armed forces of the United States or in the Maryland National Guard.

Under Chapter 226, retirees from active duty with the Commissioned Corps of the Public Health Service, National Oceanic and Atmospheric Administration (NOAA), or the Coast and Geodetic Survey qualified for the subtraction modification, but only if separated from service after July 1, 1991. Chapter 553 of 2007 eliminated this restriction and allowed all the individuals described previously to qualify for the subtraction modification, beginning tax year 2007, without regard to the date of separation from employment. Military retirement income exempted under this provision cannot be counted towards the State pension exclusion.

Maryland law also provides a pension exclusion subtraction for individuals who are at least age 65 or who are totally disabled. Up to a specified maximum amount of taxable pension income ($24,000 maximum for 2008) 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 available to all taxpayers.

Background: Chapter 94 of 2003 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. The task force estimated that median household income of military retirees was $71,484 compared with a median household income of $42,151 for all Maryland households. The average income reported by military retirees was $83,435, of which $18,266 was attributable to retirement pay and $65,169 was derived from second career employment and other sources.

According to the Defense Manpower Data Center (DMDC), 46,401 military retirees received a total of $94.5 million in retirement income from the Department of Defense in September 2007. This includes individuals who served in the Army (including Maryland National Guard), Navy, Marines, and Air Force. On an annualized basis, the retirement income totaled approximately $1.13 billion. This amount reflects 3,790 retirees who received approximately $30.1 million annually in disability payments. Disability payments resulting from active service in the armed forces, NOAA, Public Health Service, or foreign service are not taxable for State income purposes because they are exempted from federal taxation. In addition, DMDC reports that 1,165 U.S. Coast Guard retirees received retirement income (including disability pay) in the amount of approximately $27.3 million on an annual basis. Data on total nondisability pay for Coast Guard retirees were unavailable. Coast Guard retirees are paid by the Department of Homeland Security.

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.

Chapter 379 of 2006 established the Statewide Commission on the Shortage in the Health Care Workforce within the Department of Health and Mental Hygiene. In its 2007 mid-year report, the commission determined that:

- A gap between the projected demand and the reported supply (from Maryland postsecondary health care programs) is identified for 18 of the top 25 demand health care occupations. Substantial gaps of more than 40% are identified for seven of the top 25 demand occupations.
- Although improvements have been made since the same analysis was conducted in 2004 (gaps were identified for 23 of 25 of the top occupations), there will be significant implications if there is not a supply of trained graduates for Maryland’s health care occupations.

Chapter 441 of 2007 required the Secretary of Health and Mental Hygiene, with the Governor's Workforce Investment Board and appropriate health care provider regulatory boards, to make findings regarding barriers under the Health Occupations Article to licensing or certifying individuals with training and experience in providing health care through military service that is equivalent to training and experience required for licensure or certification. A report issued as a result of Chapter 441 made several recommendations, including:

- review health care professional standards to eliminate barriers to attracting military personnel to State civilian jobs;
- identify military health care experience, training, and coursework that fulfills industry occupational standards; and
- develop a marketing campaign and provide incentives to attract retired military personnel.

State Fiscal Effect: Additional retirement income will be exempted beginning in tax year 2010. As a result, general fund revenues will decrease beginning in fiscal 2011. However, the amount of the revenue loss cannot be reliably estimated and depends on the percentage of military retirees in the State who are qualified to work as health care workers, what percentage would opt to work and fulfill the requirements of the bill, what percentage will meet the income requirements under the bill, and how many (if any) retirees would move to the State to work as a qualifying health care worker.

General fund revenues decrease in fiscal 2011 by an estimated $1,000 for each qualifying retiree under age 65 and by $480 for each retiree age 65 and over. The potential revenue loss could be significant. **Exhibit 1** lists the total estimated revenue losses given different levels of qualifying retirees. It is assumed that one-tenth of individuals would be age 65 and over.

Individuals under age 65 would benefit by the bill on average by a greater amount since they do not qualify for the State pension exclusion, which can be used to exempt military retirement income above and beyond any amount subtracted under the military retirement subtraction modification. Revenue losses will also depend on the extent of time an individual would receive the tax benefit as it is not clear if individuals would lose the value of the tax benefit if the individual qualified for the tax benefit but works in a health care field that the Comptroller determines no longer has a health care workforce shortage.

Exhibit 1
State and Local Revenue Loss

	Revenue Loss	
Qualifying Retirees	**State**	**Local**
100	$94,800	$60,600
250	237,000	151,500
500	474,000	303,000
750	711,000	454,500
1,000	948,000	605,900

Local Fiscal Effect: Local government revenues would decrease by 3% of the net change in State tax liability in tax year 2010 resulting from the provisions of the bill. Exhibit 1 lists the potential local income tax revenue impact in fiscal 2011.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office; Defense Manpower Data Center, Public Health Service, Department of Legislative Services

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