Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

House Bill 722 (Delegate Cardin, *et al.*)
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, the 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, 2010, and applies to tax years 2011 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by a significant amount beginning in FY 2012. Assuming 250 individuals qualify for the exemption, State revenues decrease by $237,000 annually. Expenditures are not affected.

(in dollars)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	$0	($237,000)	($237,000)	($237,000)	($237,000)
Expenditure	0	0	0	0	0
Net Effect	$0	($237,000)	($237,000)	($237,000)	($237,000)

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

Local Effect: Potential significant decrease in local government revenues beginning in FY 2012 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 income tax law currently provides a pension exclusion subtraction modification 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 may be exempt from tax. The maximum exclusion allowed is equal to the maximum annual benefit payable under the Social Security Act for an individual who retired at age 65 for the prior calendar year. This maximum amount ($24,500 in tax year 2009) is reduced by the amount of any Social Security payments received; this is known as the "Social Security offset." Only income from a qualified retirement system can be excluded under the pension exclusion.

Given that Social Security benefits are exempt from Maryland income tax, even though they are partly taxable for federal income tax purposes, the Social Security offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of the allowable exclusion by the amount of Social Security benefits received. 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 and older is allowed a $1,000 personal exemption in addition to the regular personal exemption allowed for all individuals; and can earn more income without being required to file taxes.

Background: According to the Defense Manpower Data Center (DMDC), 47,045 military retirees received a total of $98.4 million in retirement income from the Department of Defense in September 2008. 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 $1.2 billion. This amount includes some retirees who receive 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 tax purposes because they are exempted from federal taxation. In addition, DMDC reports that 1,197 Coast Guard retirees and 6,623 military and Coast Guard survivors received retirement income (including disability pay) during 2008.

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 DHMH. 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 2011. As a result, general fund revenues will decrease beginning in fiscal 2012. 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. Given the average military pension received was about $24,400, an individual will typically qualify only if the individual's additional income (including compensation from the eligible health care job) in the year was less than $40,600.

General fund revenues decrease in fiscal 2012 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 from HB 722

Number of Qualifying Retirees	Revenue Loss State	Revenue Loss 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 2011 resulting from the provisions of the bill. Exhibit 1 lists the potential local income tax revenue impact in fiscal 2012.

Additional Information

Prior Introductions: HB 536 of 2009 received a hearing in the House Ways and Means Committee and was withdrawn.

Cross File: None.

Information Source(s): Defense Manpower Data Center, U.S. Department of Defense (Office of Actuary), Department of Health and Mental Hygiene, Comptroller's Office, Department of Legislative Services

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