HB 439

Department of Legislative Services
2013 Session

FISCAL AND POLICY NOTE

House Bill 439 (Delegate Frank, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Military Retirement Income

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This bill expands the existing military retirement income tax subtraction modification by exempting 100% of military retirement income from State taxation. The increase in the amount of the subtraction modification is limited in the first four effective tax years. The subtraction modification is 20% for tax year 2013, 40% for tax year 2014, 60% in tax year 2015, 80% in tax year 2016, and 100% in tax year 2017 and beyond.

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: General fund revenues decrease by $0.8 million in FY 2014 due to a net increase in military retirement income being exempted. Future year revenue decreases reflect the estimated number of eligible taxpayers and phase-in of the subtraction modification as specified by the bill. Expenditures are not affected.

($ in millions)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
GF Revenue	($0.8)	($12.0)	($23.0)	($33.5)	($43.3)
Expenditure	0	0	0	0	0
Net Effect	($0.8)	($12.0)	($23.0)	($33.5)	($43.3)

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

Local Effect: Local revenues decrease by $0.5 million in FY 2014 and decrease by $27.3 million in FY 2018. Expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: Chapter 226 of 2006 (SB 22) expanded a $2,500 military retirement income subtraction that was previously 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 and local 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 552 and 553 of 2007 (SB 419/HB 392) eliminated this restriction and allowed all of the individuals described previously to qualify for the subtraction modification, beginning in tax year 2007, without regard to the date of separation from employment.

Maryland law also provides a pension exclusion subtraction modification for individuals who are at least age 65 or who are totally disabled. Up to a specified maximum amount of taxable pension income ($27,100 maximum for 2012) 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. Military retirement income exempted under the subtraction modification cannot be counted toward the State pension exclusion.

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. In addition to the regular personal exemption available to all taxpayers, an additional exemption amount of $1,000 may be claimed by an elderly or blind individual. Each individual age 65 or older can also earn more income without being required to file taxes.

Background: According to the Defense Manpower Data Center (DMDC), 49,681 military retirees received a total of $112.0 million in retirement income from the Department of Defense in September 2011. This includes individuals who served in the Army (including the Maryland National Guard), Navy, Marines, and Air Force. On an annualized basis, this retirement income totaled $1.34 billion. This amount includes retirees who receive disability payments. Disability payments resulting from active service in the Armed Forces, NOAA, Public Health Service, or the foreign service are not taxable for State income tax purposes because those payments are exempt from federal taxation. In addition, DMDC reports that 1,302 Coast Guard retirees and 7,100 military and Coast Guard survivors received retirement income during 2011. **Exhibit 1** lists the total retirement pay (including disability pay) received by Maryland military retirees by branch of service.

Exhibit 1
Retirement Payments by Branch of Service
September 2011

Branch	Retirees	Received Pension	Annual ($ in Millions)	Average
Army	19,503	18,223	$475.1	$26,070
Navy	15,499	14,683	426.4	29,038
Marines	2,643	2,326	65.2	28,014
Air Force	15,283	14,449	377.5	26,129
Total	**52,928**	**49,681**	**$1,344.1**	**$27,055**

Source: Defense Manpower Data Center

According to the Office of Commissioned Corps Force Management Information System, 762 Maryland residents who retired from the Commissioned Corps of the Public Health Service received a total of $52.1 million, or an average of $68,300, in retirement income during 2005.

State Revenues: The bill alters the amount of the military retirement income subtraction modification beginning in tax year 2013. It is assumed that individuals do not adjust withholdings and estimated payments. In tax year 2013, military retirees will be able to exempt 20% of eligible retirement income instead of $5,000. As a result, fiscal 2014 revenues will decrease by $0.8 million. **Exhibit 2** shows the projected State and local revenue impact from exempting military retirement income as specified by the bill. This estimate is based on the number of retirees and amount of retirement income received by State residents as reported by DMDC and the Office of Commissioned Corps Force Management Information System, the estimated cost of the current military retirement income subtraction modification, and the interaction with the State pension exclusion. Based on data from the U.S. Census Bureau, it is estimated that about 15% of military retirees are not taxable.

Exhibit 2
Projected State and Local Revenue Loss – Military Retirement Income Exemption
Fiscal 2014-2018
($ in Millions)

Fiscal	State	Local	Total
2014	$0.8	$0.5	$1.3
2015	12.0	7.6	19.6
2016	23.0	14.5	37.5
2017	33.5	21.1	54.6
2018	43.3	27.3	70.6

Although it is estimated that the average subtraction modification will increase in tax year 2013, as military retirees under age 65 years old will exempt an additional $132 under the bill and the exemption claimed by military retirees 65 years and older will increase by $695, the majority of veterans (about two-thirds of those with the lowest pensions) may be able to exempt less under the bill. Beginning in tax year 2014, the increase in the phase-in will reduce the number of retirees with lower-pension incomes who may be able to exempt less income until all retirees can exempt more with the full exemption of retirement income.

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed. Local revenues will decrease by $0.5 million in fiscal 2014 and decrease by $27.3 million in fiscal 2018, as shown in Exhibit 2.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): U.S. Census Bureau, Defense Manpower Data Center, Department of Defense (Office of Actuary), National Oceanic and Atmospheric Administration, Office of Commissioned Corps Force Management Information System, Department of Legislative Services

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