

Department of Legislative Services
2014 Session

FISCAL AND POLICY NOTE

Senate Bill 143

(Senator Peters, *et al.*)

Budget and Taxation

Ways and Means

Income Tax - Military Retirement Income

This bill expands the existing military retirement income tax subtraction modification by increasing from \$5,000 to \$10,000 the maximum amount of retirement income that can be excluded from Maryland adjusted gross income for purposes of calculating Maryland income tax liability. In order to qualify for the increased subtraction modification, the individual must be at least 65 years old.

The bill takes effect July 1, 2014, and applies to tax years 2014 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by \$2.4 million in FY 2015 due to additional military retirement income being exempted. Future year revenue decreases reflect the estimated number of eligible taxpayers. Expenditures are not affected.

(\$ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF Revenue	(\$2.4)	(\$2.4)	(\$2.5)	(\$2.6)	(\$2.7)
Expenditure	0	0	0	0	0
Net Effect	(\$2.4)	(\$2.4)	(\$2.5)	(\$2.6)	(\$2.7)

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

Local Effect: Local revenues decrease by \$1.5 million in FY 2015 and by \$1.7 million in FY 2019. 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 previously limited to enlisted military members with a federal

adjusted gross income of \$22,500 or less. Chapter 226 allows an individual to 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. Chapters 552 and 553 of 2007 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 (\$27,800 maximum for 2013) 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.

Background: According to the Defense Manpower Data Center (DMDC), 50,504 military retirees received a total of \$118.3 million in retirement income from the Department of Defense in September 2012. 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 \$1.42 billion. A small portion of 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 1,316 Coast Guard retirees and 7,071 military and Coast Guard survivors received retirement income in September 2012. **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 2012

<u>Branch</u>	<u>Retirees</u>	<u>Received Pension</u>	<u>Annual (\$ in Millions)</u>	<u>Average</u>
Army	19,804	18,488	\$501.1	\$27,106
Navy	15,722	14,937	451.4	30,219
Marines	2,665	2,339	68.2	29,141
Air Force	15,585	14,740	399.1	27,077
Total	53,776	50,504	\$1,419.8	\$28,112

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: Additional retirement income can be exempted beginning in tax year 2014. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, fiscal 2015 revenues will decrease by \$2.4 million. **Exhibit 2** shows the projected State and local revenue loss from exempting additional military retirement income for individuals at least 65 years of age. This estimate is based on the number of retirees who are at least 65 years of age and the 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
(\$ in Millions)

<u>Fiscal</u>	<u>State</u>	<u>Local</u>	<u>Total</u>
2015	\$2.4	\$1.5	\$3.9
2016	2.4	1.5	4.0
2017	2.5	1.6	4.1
2018	2.6	1.7	4.3
2019	2.7	1.7	4.5

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed. Local revenues will decrease by \$1.5 million in fiscal 2015 and by \$1.7 million in fiscal 2019, as shown in Exhibit 2.

Additional Information

Prior Introductions: SB 103 of 2013, as amended by the Senate Budget and Taxation Committee to have a delayed impact, passed the Senate and was referred to the House Rules and Executive Nominations Committee, but no further action was taken. Similar bills proposing to expand the existing military retirement income subtraction modification have been introduced since the 2007 session. HB 439 and HB 503 of 2013 received a hearing in the House Ways and Means Committee, but no further action was taken. SB 28 of 2012, SB 190 of 2011, SB 1 of 2010, and SB 284 of 2009 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross files, HB 315 of 2012, HB 1 of 2010, and HB 751 of 2009, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 625 and SB 315 of 2008 and SB 967 of 2007 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. SB 445 of 2007 was withdrawn. HB 549 of 2008 and HB 176 of 2007 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

Information Source(s): U.S. Census Bureau, U.S. Congressional Budget Office, 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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