

Department of Legislative Services
2015 Session

FISCAL AND POLICY NOTE

House Bill 482 (The Speaker, *et al.*) (By Request - Administration)
Ways and Means

Income Tax - Subtraction Modification - Military Retirement Income

This Administration bill expands the existing military retirement income tax subtraction modification by exempting 100% of military retirement income from State taxation. The increase is phased in over four years and is equal to the greater of \$5,000 or 25% of eligible retirement income in tax year 2015, 50% in tax year 2016, 75% in tax year 2017, and 100% in tax year 2018 and beyond.

The bill takes effect July 1, 2015.

Fiscal Summary

State Effect: General fund revenues decrease by \$3.5 million in FY 2016 due to additional military retirement income being exempted. Future year revenue decreases reflect the estimated number of eligible taxpayers, the amount of retirement income, and the phase-in of the subtraction modification as specified by the bill. Expenditures are not affected.

(\$ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	(\$3.5)	(\$18.7)	(\$26.5)	(\$33.3)	(\$34.0)
Expenditure	0	0	0	0	0
Net Effect	(\$3.5)	(\$18.7)	(\$26.5)	(\$33.3)	(\$34.0)

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

Local Effect: Local revenues decrease by \$2.2 million in FY 2016 and by \$21.7 million in FY 2020. Expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). The Department of Legislative Services concurs with this assessment.

Analysis

Current Law: Chapter 226 of 2006 expanded a \$2,500 military retirement income subtraction that was previously limited to enlisted military members with 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 U.S. Armed Forces 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 (\$29,000 maximum for 2014) 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), 50,889 Maryland military retirees received a total of \$121.6 million in retirement income from the Department of Defense in September 2013. 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 \$1.46 billion. A small portion of this amount includes retirees who receive disability payments. Disability payments resulting from active service in the U.S. 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 1,342 Coast Guard retirees and

7,017 military and Coast Guard survivors received retirement income in September 2013. **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 2013

<u>Branch</u>	<u>Retirees</u>	<u>Received Pension</u>	<u>Annual Pension Income (\$ in Millions)</u>	<u>Average</u>
Army	20,023	18,632	\$516.2	\$27,703
Navy	15,828	15,054	463.9	30,819
Marines	2,724	2,379	70.8	29,765
Air Force	15,676	14,824	407.8	27,512
Total	54,251	50,889	\$1,458.8	\$28,666

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 2015. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, fiscal 2016 revenues will decrease by \$3.5 million. **Exhibit 2** shows the projected State and local revenue loss from exempting additional military retirement income. 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, the interaction with the State pension exclusion, and U.S. Congressional Budget Office projections on future military retiree payments. 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>
2016	\$3.5	\$2.2	\$5.7
2017	18.7	11.9	30.6
2018	26.5	17.0	43.5
2019	33.3	21.3	54.6
2020	34.0	21.7	55.7

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed. Local revenues will decrease by \$2.2 million in fiscal 2016 and by \$21.7 million in fiscal 2020, as shown in Exhibit 2.

Average Retiree Tax Savings

The average reduction in State and local taxes for each eligible individual will depend on the age of the individual and whether the individual qualifies for the State pension exclusion, the amount of pension income, and whether the individual owes any tax liability. About one-quarter of all military retirees who receive a pension are younger than age 50 (average pension of \$24,100), 39% are between 50 years and 64 years of age (average pension of \$30,500), and the remaining 36% are age 65 years or older (average pension of \$29,900). **Exhibit 3** shows the average reduction in State and local taxes per eligible individual once the exemption is fully phased in, based on age and the amount of pension income received.

Exhibit 3
Average State and Local Tax Savings
By Retiree Age and Pension Income

	<u>All</u>	<u><\$25,000</u>	<u>Pension Income</u>		
			<u>\$25,000- \$50,000</u>	<u>\$50,000- \$75,000</u>	<u>Over \$75,000</u>
Less than 65 Years	\$1,265	\$691	\$2,016	\$4,056	\$5,848
65 Years and Greater	570	94	1,188	3,156	4,946
All Retirees	\$1,005	\$464	\$1,710	\$3,731	\$5,521

Note: Includes both taxable and nontaxable returns.

Additional Information

Prior Introductions: None.

Cross File: SB 592 (The President, *et al.*) (By Request - Administration) - Budget and Taxation.

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

Fiscal Note History: First Reader - February 25, 2015
md/jrb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Income Tax – Subtraction Modification – Military Retirement Income

BILL NUMBER: SB592/HB482

PREPARED BY: Governor’s Legislative Office

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

 X WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

 WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS