

Department of Legislative Services
2015 Session

FISCAL AND POLICY NOTE

House Bill 714 (Delegate Proctor, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - 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.

The bill takes effect July 1, 2015, and applies to tax years 2017 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by \$9.9 million in FY 2018 due to additional military retirement income being exempted. Future year revenue decreases reflect the estimated number of eligible taxpayers and the amount of retirement income. Expenditures are not affected.

| (\$ in millions) | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 |
|------------------|---------|---------|---------|---------|---------|
| GF Revenue | \$0 | \$0 | (\$9.9) | (\$9.4) | (\$8.8) |
| Expenditure | 0 | 0 | 0 | 0 | 0 |
| Net Effect | \$0 | \$0 | (\$9.9) | (\$9.4) | (\$8.8) |

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

Local Effect: Local revenues decrease by \$6.1 million in FY 2018 and by \$6.6 million in FY 2020. 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 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 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 2017. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, fiscal 2018 revenues will decrease by \$9.9 million. **Exhibit 2** shows the projected State and local revenue loss from exempting additional military retirement income for individuals. This estimate is based on the number of retirees 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
Fiscal 2016-2020
(\$ in Millions)

| <u>Fiscal</u> | <u>State</u> | <u>Local</u> | <u>Total</u> |
|---------------|--------------|--------------|--------------|
| 2016 | \$0 | \$0 | \$0 |
| 2017 | 0 | 0 | 0 |
| 2018 | 9.9 | 6.1 | 16.0 |
| 2019 | 9.4 | 5.8 | 15.1 |
| 2020 | 8.8 | 6.6 | 15.4 |

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed. Local revenues will decrease by \$6.1 million in fiscal 2018 and by \$6.6 million in fiscal 2020, as shown in Exhibit 2.

Additional Information

Prior Introductions: HB 770 of 2014 received a hearing in the House Ways and Means Committee, but no further action was taken. SB 103 of 2013, as amended by the Senate Budget and Taxation Committee to have a delayed impact and apply only to eligible retirees at least age 65, 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 2009 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.

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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