

Department of Legislative Services
 Maryland General Assembly
 2017 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 550 (Delegate Aumann, *et al.*)
 Ways and Means

Income Tax - Subtraction Modification - Military Retirement Income

This bill expands the existing military retirement income tax subtraction modification by exempting 100% of specified military retirement income. In order to qualify, the individual must serve at least 20 years of military service.

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

Fiscal Summary

State Effect: General fund revenues decrease by \$42.9 million in FY 2018 due to additional military retirement income being exempted, which reflects revenues from one and one-half tax years. Future year revenue decreases reflect annualization and the projected growth in the number of eligible taxpayers and retirement income. Expenditures are not affected.

(\$ in millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
GF Revenue	(\$42.9)	(\$29.3)	(\$29.9)	(\$30.5)	(\$31.1)
Expenditure	0	0	0	0	0
Net Effect	(\$42.9)	(\$29.3)	(\$29.9)	(\$30.5)	(\$31.1)

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

Local Effect: Local revenues decrease by \$27.1 million in FY 2018 and by \$19.6 million in FY 2022. 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 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. 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 also qualify for the subtraction modification. Chapter 125 of 2015 expanded to \$10,000 the maximum value of the subtraction modification for individuals who are at least 65 years of age.

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 (\$29,400 maximum for 2016) 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), 51,425 Maryland military retirees received a total of \$127.4 million in retirement income from the Department of Defense in September 2015. This includes individuals who served in the Army, Navy, Marines, and Air Force. On an annualized basis, this retirement income totaled \$1.53 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 generally not taxable for State income tax purposes because those payments may be exempt from federal taxation under specified circumstances. In addition, DMDC reports that 1,389 Maryland National Guard retirees and 7,003 military and Coast Guard survivors also received retirement income in September 2015. **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 2015

<u>Branch</u>	<u>Retirees</u>	<u>Received Pension</u>	<u>Annual Pension Income (\$ in Millions)</u>	<u>Average</u>
Army	20,595	19,000	\$546.0	\$28,738
Navy	15,893	15,120	484.3	32,029
Marines	2,825	2,446	74.8	30,574
Air Force	15,733	14,859	423.9	28,526
Total	55,046	51,425	\$1,529.0	\$29,732

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.

Military retirement plans have changed over time; however, each plan has generally required nondisability retirees to serve at least 20 years of active duty service and reserve retirees to be at least 60 years of age and have at least 20 qualified years of service. The National Defense Authorization Act authorized the military services to offer early retirement to service members who have completed at least 15 years of active service. The U.S. Army has used this temporary early retirement authority (TERA) over time as part of its comprehensive force management strategy. In federal fiscal 2015, TERA retirees comprised about 3% of all nondisability retirees in the United States, and TERA payments were about 2% of total nondisability retirement payments. About 4% of all U.S. nondisability active duty retirees had less than 20 years of active service.

State Revenues: Additional retirement income can be exempted beginning in tax year 2017. It is assumed that individuals adjust withholdings and estimated payments. As a result, fiscal 2018 revenues will decrease by \$42.9 million, which reflects the impact of one and one-half tax years. **Exhibit 2** shows the projected State and local revenue loss from exempting military retirement income. 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 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 20% of military retirees are not taxable. It is also assumed that (1) 97% of retiree payments are made to retirees who have 20 years of service and (2) 100% of survivor benefits qualify for the exemption.

Exhibit 2
Projected State and Local Revenue Loss
(\$ in Millions)

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>
State	(\$42.9)	(\$29.3)	(\$29.9)	(\$30.5)	(\$31.1)
Local	(27.1)	(18.5)	(18.9)	(19.2)	(19.6)
Total Revenues	(\$70.0)	(\$47.8)	(\$48.7)	(\$49.7)	(\$50.7)

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed. Local revenues will decrease by \$27.1 million in fiscal 2018 and by \$19.6 million in fiscal 2022, as shown in Exhibit 2.

Additional Information

Prior Introductions: None.

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

Fiscal Note History: First Reader - February 10, 2017
fn/jrb

Analysis by: Robert J. Rehrmann

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