

Department of Legislative Services
2018 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 512 (Senator Waugh, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Military Compensation

This bill expands the existing overseas military pay income tax subtraction modification by increasing (1) the maximum amount of pay that can be exempted from tax and (2) the current phase out that reduces or eliminates the benefit for an individual whose military pay exceeds specified amounts. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by \$822,000 annually beginning in FY 2019 due to additional military pay being exempted. Future year estimates reflect stable amount of eligible military pay. Expenditures are not affected.

(in dollars)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	(\$822,000)	(\$822,000)	(\$822,000)	(\$822,000)	(\$822,000)
Expenditure	0	0	0	0	0
Net Effect	(\$822,000)	(\$822,000)	(\$822,000)	(\$822,000)	(\$822,000)

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

Local Effect: Local revenues decrease by \$536,000 annually beginning in FY 2019. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary/Current Law: Members of the U.S. Armed Forces who are on active duty overseas qualify for a State income tax subtraction modification. The subtraction modification includes the first \$15,000 of military pay attributable to the military service of an individual outside the United States who is in active service of any branch of the U.S. Armed Forces. The amount of the subtraction is reduced dollar for dollar in the amount by which the individual's military pay exceeds \$15,000 and is reduced to zero if pay exceeds \$30,000. **Exhibit 1** compares the maximum subtraction value and phase-out of the subtraction modification under current law and as proposed by the bill.

Exhibit 1 Overseas Military Subtraction Modification Phase-out and Maximum Benefit

	<u>Current Law</u>	<u>Proposed</u>
<u>Maximum Subtraction:</u>		
Amount	\$15,000	\$22,500
<u>Phase-out:</u>		
Full Benefit	\$0-\$15,000	\$0-\$22,500
Phase-out Range	\$15,001-\$30,000	\$22,501-\$45,000
Phased out/No Benefit	Greater than \$30,000	Greater than \$45,000

In addition to the State subtraction modification, certain military pay may be excluded from federal and State taxation if the individual serves in a combat zone as described below.

Background: Under Section 112 of the Internal Revenue Code, certain pay received by a member of the U.S. Armed Forces serving in a designated combat zone can be excluded from federal adjusted gross income. The combat exclusion may apply if the individual either served in a combat zone or was hospitalized due to service in a combat zone. Military service outside a combat zone is considered to be performed in a combat zone if the Department of Defense designates that the service is in direct support of the operations within the combat zone and the military service qualifies for hostile fire or imminent danger pay. Maryland conforms to federal tax treatment of military pay in combat zones so any amounts received are not taxable for State income tax purposes.

State Revenues: Additional military pay can be exempted beginning in tax year 2018. According to the Comptroller's Office, approximately 1,750 taxpayers claimed the

subtraction modification in tax year 2015. Based on the number of existing claims and data on the number and military pay of overseas military personnel, general fund revenues will decrease by an estimated \$822,000 annually beginning in fiscal 2019.

Local Revenues: Local income tax revenues will decrease as a result of subtraction modifications claimed against the personal income tax. Local revenues will decrease by \$536,000 annually beginning in fiscal 2019.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office; Defense Manpower Data Center; U.S. Congressional Budget Office; Department of Legislative Services

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nb/hlb

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