

Department of Legislative Services
 Maryland General Assembly
 2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 875 (The President, *et al.*) (By Request - Administration)
 Budget and Taxation

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 exemption is phased in over two years, beginning with tax year 2020. **The bill takes effect July 1, 2019.**

Fiscal Summary

State Effect: General fund revenues decrease by \$10.3 million in FY 2021 due to additional military retirement income being exempted. Future year estimates reflect projected growth in retirement income and the phase-in specified by the bill. Expenditures are not affected.

(\$ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	\$0	(\$10.3)	(\$26.4)	(\$26.9)	(\$27.5)
Expenditure	0	0	0	0	0
Net Effect	\$0.0	(\$10.3)	(\$26.4)	(\$26.9)	(\$27.5)

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

Local Effect: Local revenues decrease by \$6.7 million in FY 2021 and by \$17.9 million in FY 2024. Local 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. An individual can exempt certain military retirement income from State and local taxation if the retirement income resulted from service (1) in an active or reserve component of the U.S. Armed Forces; (2) as a member of the Maryland National Guard; or (3) as an active duty member with the Commissioned Corps of the Public Health Service, the National Oceanic and Atmospheric Administration (NOAA), or the Coast and Geodetic Survey. The subtraction modification can also be claimed by a surviving spouse or ex-spouse.

Legislation enacted in the 2015 and 2018 sessions expanded the maximum value of the subtraction modification to:

- \$15,000 for individuals who are at least age 55; and
- \$5,000 for all other individuals.

Maryland law provides a pension exclusion (in the form of a subtraction modification) for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified maximum amount of taxable pension income (\$30,600 for 2018) 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 (Social Security offset). Military retirees who are at least age 65 or are totally disabled can qualify and claim the State pension exclusion for retirement income that is not excluded under the military retirement income subtraction.

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), 51,502 Maryland military retirees received a total of \$128.1 million in retirement income from the Department of Defense in September 2016. 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 \$1.54 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 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 1,363 Maryland National Guard retirees and 6,887 military and Coast Guard survivors also received retirement income in September 2016. **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 2016

<u>Branch</u>	<u>Retirees</u>	<u>Received Pension</u>	<u>Annual Pension Income (\$ in Millions)</u>	<u>Average</u>
Army	20,827	19,147	\$554.2	\$28,942
Navy	15,794	15,037	483.3	32,143
Marines	2,875	2,506	76.2	30,417
Air Force	15,677	14,812	423.0	28,555
Total	55,173	51,502	\$1,536.7	\$29,837

Source: Defense Manpower Data Center

State Revenues: Additional retirement income can be exempted beginning in tax year 2020. The amount that may be exempted is equal to 50% in tax year 2020 and 100% of eligible income beginning in tax year 2021. It is assumed that individuals (1) do not adjust withholdings and estimated payments and (2) who are at least age 55 can claim a subtraction modification equal to the greater of 50% or \$15,000 in tax year 2020. As a result, revenues will decrease by \$10.3 million in fiscal 2021.

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.

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

	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
State	\$0.0	(\$10.3)	(\$26.4)	(\$26.9)	(\$27.5)
Local	0.0	(6.7)	(17.2)	(17.6)	(17.9)
Total Revenues	\$0.0	(\$17.0)	(\$43.6)	(\$44.5)	(\$45.4)

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed. Local revenues will decrease by \$6.7 million in fiscal 2021 and by \$17.9 million in fiscal 2024, as shown in Exhibit 2.

Additional Information

Prior Introductions: Similar legislation was proposed by the Administration in the 2017 and 2018 sessions. SB 312 of 2018 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 362, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 321 of 2017 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 375, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 718 (The Speaker, *et al.*) (By Request - Administration) - Ways and Means.

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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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: **Income Tax - Subtraction Modification - Military Retirement Income**

BILL NUMBER: SB 875 / HB 718

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