

**Department of Legislative Services**  
 Maryland General Assembly  
 2020 Session

**FISCAL AND POLICY NOTE**  
**Third Reader - Revised**

Senate Bill 488

(Senator Peters, *et al.*)

Budget and Taxation

Ways and Means

**Income Tax - Subtraction Modification - Military and Public Safety Retirement  
 Income**

This bill expands beginning in tax year 2020 the existing military retirement income tax subtraction modification by increasing to \$20,000 the maximum amount of retirement income that can be excluded. In order to qualify for the increased subtraction modification, the individual must be at least 55 years of age. The bill also expands the existing State subtraction modification for retired law enforcement; correctional officer; and fire, rescue, and emergency services personnel by exempting up to \$20,000 in eligible retirement income if the individual is at least 55 years of age. This expansion is phased in over two tax years beginning with tax year 2021. **The bill takes effect July 1, 2020.**

**Fiscal Summary**

**State Effect:** General fund revenues decrease by \$2.9 million in FY 2021 due to additional retirement income being exempted. Future year revenues reflect phase in specified by the bill and projected growth in eligible retirement income. General fund expenditures may increase by \$56,000 in FY 2022 due to implementation costs at the Comptroller’s Office.

| (\$ in millions) | FY 2021 | FY 2022 | FY 2023  | FY 2024  | FY 2025  |
|------------------|---------|---------|----------|----------|----------|
| GF Revenue       | (\$2.9) | (\$8.5) | (\$12.5) | (\$12.8) | (\$13.1) |
| GF Expenditure   | \$0     | \$0.1   | \$0      | \$0      | \$0      |
| Net Effect       | (\$2.9) | (\$8.6) | (\$12.5) | (\$12.8) | (\$13.1) |

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

**Local Effect:** Local revenues decrease by \$1.9 million in FY 2021 and by \$8.3 million in FY 2025. Local expenditures are not affected.

**Small Business Effect:** None.

## Analysis

**Bill Summary:** Under current law, the maximum value of the subtraction modification for retired law enforcement; correctional officer; and fire, rescue, and emergency services personnel who are age 55 to 64 years is reduced by the amount of Social Security benefits received. After this adjustment, the maximum value is further limited to \$15,000. Retired law enforcement officers; correctional officers; and fire, rescue, or emergency services personnel who are age 65 or older or are totally disabled qualify and claim the State pension exclusion in the same manner as other eligible retirees as described below.

In tax year 2021, all eligible individuals who are age 55 and over may exempt the first \$10,000 in eligible retirement income. Eligible individuals who are age 55 to 64 years may also claim the pension exclusion provided under current law as described above. However, the maximum value of the exclusion is limited to \$7,500.

Beginning in tax year 2022, the bill allows all eligible individuals for retired law enforcement; correctional officer; and fire, rescue, and emergency services personnel who are at least age 55 years to exempt the first \$20,000 in qualified retirement income. This subtraction modification is not reduced by the amount of Social Security benefits received. 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 this retirement income subtraction.

### **Current Law:**

#### *State Pension Exclusion – All Eligible 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 (\$31,100 for 2019) 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.

*Law Enforcement Officers; Correctional Officers; and Fire, Rescue, or Emergency Services Personnel*

Retired law enforcement officers; correctional officers; and fire, rescue, or emergency services personnel who are age 65 or older or are totally disabled qualify and claim the State pension exclusion in the same manner as other eligible retirees as described above.

Chapters 153 and 154 of 2017 established a pension exclusion for retired law enforcement officers or fire, rescue, or emergency services personnel. Retirement income qualifies for this exclusion if the individual is between the ages of 55 and 64 and the retirement income is attributable to employment as a law enforcement officer or as a fire, rescue, or emergency services personnel of the United States, the State, or a local jurisdiction. Emergency services personnel includes emergency medical technicians and paramedics.

Chapters 573 and 581 of 2018 extended eligibility to correctional officers. An eligible retiree includes an individual who was employed in (1) a State correctional facility; (2) a local correctional facility; (3) a juvenile facility; and (4) a facility of the United States that is equivalent to a State or local correctional facility or juvenile facility in the State.

The maximum exclusion in the tax year is limited to \$15,000.

*Military Retirement Income*

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.

**Background:** According to the Defense Manpower Data Center (DMDC), 51,700 Maryland military retirees received a total of \$132.8 million in retirement income from the Department of Defense in September 2018. 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 \$1.59 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, the last year of available data. **Exhibit 1** lists the total retirement pay (including disability pay) received by Maryland military retirees by branch of service.

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**Exhibit 1**  
**Retirement Payments by Branch of Service**  
**September 2018**

| <u>Branch</u> | <u>Retirees</u> | <u>Received Pension</u> | <u>Annual Pension Income (\$ in Millions)</u> | <u>Average</u>  |
|---------------|-----------------|-------------------------|---|-----------------|
| Army          | 21,392          | 19,499                  | \$582.3                                       | \$29,862        |
| Navy          | 15,713          | 14,961                  | 499.4   | 33,378          |
| Marines       | 2,954           | 2,560                   | 80.4  | 31,388          |
| Air Force     | 15,621          | 14,704                  | 431.3   | 29,331          |
| <b>Total</b>  | <b>55,680</b>   | <b>51,724</b>           | <b>\$1,593.3</b>                              | <b>\$30,803</b> |

Source: Defense Manpower Data Center

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**State Revenues:** Additional retirement income can be exempted beginning in tax year 2020. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, State revenues will decrease by \$2.9 million in fiscal 2021. **Exhibit 2** shows the projected State and local revenue loss from exempting specified retirement income. The estimated impact of exempting additional military retirement income is based on the number of retirees who are at least 55 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 20% of military retirees are not taxable.

The estimated impact of exempting additional public safety retirement income is based on the number of retirees who claimed the subtraction modification in tax year 2017. This estimate is increased to account for (1) correctional officers and those employed in a correctional facility or juvenile facility, who were not eligible in tax year 2017 and (2) eligible retirees who are at least 65 years of age.

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

|                        | <u>FY 2021</u> | <u>FY 2022</u>  | <u>FY 2023</u>  | <u>FY 2024</u>  | <u>FY 2025</u>  |
|------------------------|----------------|-----------------|-----------------|-----------------|-----------------|
| <b>State</b>           |                |                 |                 |                 |                 |
| Military Retirement    | (\$2.9)        | (\$3.0)         | (\$3.1)         | (\$3.1)         | (\$3.2)         |
| Public Safety Retirees | 0.0            | (5.5)           | (9.4)           | (9.7)           | (9.9)           |
| <b>Total</b>           | <b>(\$2.9)</b> | <b>(\$8.5)</b>  | <b>(\$12.5)</b> | <b>(\$12.8)</b> | <b>(\$13.1)</b> |
| <b>Local</b>           |                |                 |                 |                 |                 |
| Military Retirement    | (\$1.9)        | (\$2.0)         | (\$2.0)         | (\$2.0)         | (\$2.1)         |
| Public Safety Retirees | 0.0            | (3.5)           | (6.0)           | (6.1)           | (6.3)           |
| <b>Total</b>           | <b>(\$1.9)</b> | <b>(\$5.4)</b>  | <b>(\$8.0)</b>  | <b>(\$8.1)</b>  | <b>(\$8.3)</b>  |
| <b>Total Revenues</b>  | <b>(\$4.8)</b> | <b>(\$14.0)</b> | <b>(\$20.5)</b> | <b>(\$20.9)</b> | <b>(\$21.4)</b> |

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**State Expenditures:** The Comptroller’s Office reports that it will incur a one-time general fund expenditure increase of \$56,000 to migrate the existing subtraction modification to a new form. This includes data processing changes to the income tax return processing and imaging systems and systems testing.

**Local Revenues:** Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed. Local revenues will decrease by \$1.9 million in fiscal 2021 and by \$8.3 million in fiscal 2025 as shown in Exhibit 2.

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## Additional Information

**Prior Introductions:** None.

**Designated Cross File:** None.

**Information Source(s):** Comptroller's Office; State Retirement Agency; Department of Legislative Services

**Fiscal Note History:** First Reader - February 10, 2020  
rh/hlb Third Reader - April 14, 2020  
Revised - Amendment(s) - April 14, 2020

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