

Department of Legislative Services
 Maryland General Assembly
 2023 Session

FISCAL AND POLICY NOTE
 Third Reader - Revised

Senate Bill 553

(The President, *et al.*) (By Request - Administration)

Budget and Taxation

Ways and Means

Income Tax - Subtraction Modification for Military Retirement Income (Keep Our Heroes Home Act)

This Administration bill enhances the existing military retirement income tax subtraction modification by increasing the maximum amount of military retirement income received by an individual that may be exempted from Maryland income tax. Specifically, the bill increases the maximum value of the subtraction modification from \$5,000 to \$12,500 for individuals younger than age 55 and from \$15,000 to \$20,000 for individuals age 55 and older. **The bill takes effect July 1, 2023, and applies to tax year 2023 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by \$11.2 million in FY 2024. The FY 2024 general fund revenue reduction is assumed in the FY 2024 budget. Future years reflect projected growth in eligible retirement income. Expenditures are not affected.

(\$ in millions)	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
GF Revenue	(\$11.2)	(\$11.7)	(\$12.1)	(\$12.6)	(\$13.1)
Expenditure	0	0	0	0	0
Net Effect	(\$11.2)	(\$11.7)	(\$12.1)	(\$12.6)	(\$13.1)

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

Local Effect: Local revenues decrease by \$7.3 million in FY 2024 and similar amounts annually thereafter. Local expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). The Department of Legislative Services (DLS) disagrees with this assessment as discussed below. (The attached assessment does not reflect amendments to the bill.)

Analysis

Current Law/Background:

Military Retirement Income Tax Subtraction

An individual may exclude from Maryland adjusted gross income certain military retirement income, including death benefits, received as a result of (1) induction into the U.S. Armed Forces for training and service under the Selective Training and Service Act of 1940 or a similar subsequent act; (2) membership in an active or reserve component of the U.S. Armed Forces; (3) membership in the Maryland National Guard; or (4) active duty with the commissioned corps of the Public Health Service, the National Oceanic and Atmospheric Administration, or the Coast and Geodetic Survey.

The maximum value of the subtraction modification is \$15,000 for an individual age 55 or older and \$5,000 for an individual younger than age 55.

As discussed below, an individual who is at least age 65, is totally disabled, or whose spouse is totally disabled may qualify for and claim the standard State pension exclusion for retirement income that is not excluded under the military retirement income subtraction.

Maryland Pension Exclusion

Under the Maryland pension exclusion, an individual who is at least age 65, who is totally disabled, or whose spouse is totally disabled may subtract certain taxable pension and retirement annuity income from federal adjusted gross income for purposes of determining Maryland adjusted gross income. The maximum value of the subtraction is indexed to the maximum annual benefit payable under the Social Security Act (\$34,300 for 2022) and is reduced by the amount of any benefit payments received under the Social Security Act or Railroad Retirement Act (“Social Security offset”).

Senior Tax Credit

Chapters 3 and 4 of 2022 establish a nonrefundable tax credit against the State income tax for a resident who is age 65 or older and whose federal adjusted gross income does not exceed \$100,000 (\$150,000 if filing jointly or as a surviving spouse or head of household). The amount of the tax credit is equal to (1) \$1,000 or (2) \$1,750 for surviving spouses, heads of household, and joint filers if both spouses are at least age 65. The credit is available beginning tax year 2022. For a tax year in which the September general fund estimate issued by the Board of Revenue Estimates for the current fiscal year is more than 7.5% below the March general fund estimate issued in the same year, the value of the tax credit is reduced for specified taxpayers.

Other Tax Relief for Seniors

Social Security benefits and benefits received under the federal Railroad Retirement Act are totally exempt from the Maryland income tax, though they may be partly taxable for federal income tax purposes. 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, individuals age 65 and older may claim an additional exemption of \$1,000.

State/Local Revenues: State general fund revenues and local income tax revenues decrease beginning in fiscal 2024 due to increases in the value of subtraction modifications claimed against Maryland income tax. **Exhibit 1** displays the bill's estimated effect on State and local revenues in fiscal 2024 through 2028. As shown in the exhibit, in fiscal 2024, State general fund revenues decrease by an estimated \$11.2 million, and local income tax revenues decrease by an estimated \$7.3 million. As noted above, the estimated fiscal 2024 general fund revenue reduction is assumed in the fiscal 2024 budget. Future years reflect projected growth in eligible retirement income.

Exhibit 1
Effect on State and Local Revenues
Fiscal 2024-2028
(\$ in Millions)

	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>	<u>FY 2027</u>	<u>FY 2028</u>
State Effect	(\$11.2)	(\$11.7)	(\$12.1)	(\$12.6)	(\$13.1)
Local Effect	(7.3)	(7.6)	(7.9)	(8.2)	(8.6)
Total Effect	(\$18.5)	(\$19.3)	(\$20.0)	(\$20.8)	(\$21.7)

Source: Department of Legislative Services

This estimate is based on analysis by the Comptroller's Office of tax year 2020 State and federal income tax data, adjusted for provisions of the bill. The Comptroller's Office estimates that approximately 33,000 military retirees will be eligible to subtract additional retirement income as a result of the bill.

Small Business Impact: DLS notes that the primary beneficiaries of the bill are individuals, not small businesses. While a portion of the proposed income tax reduction

may be used by individuals for additional spending at Maryland small businesses, the bill's overall effect on small businesses in the State is anticipated to be minimal.

Additional Information

Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: HB 554 (The Speaker, *et al.*) (By Request - Administration) - Ways and Means.

Information Source(s): Comptroller's Office; U.S. Department of Defense; Department of Legislative Services

Fiscal Note History: First Reader - February 15, 2023
rh/hlb Third Reader - March 28, 2023
Revised - Amendment(s) - March 28, 2023
Revised - Budget Information - May 5, 2023

Analysis by: Elizabeth J. Allison

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

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Income Tax - Subtraction Modification for Military Retirement Income
(Keep Our Heroes Home Act)

BILL NUMBER: SB0553/HB0554

PREPARED BY: Brad Fallon

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

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

Maryland is one of 14 states that do not completely exempt military retirement income from taxation. Included in the 36 states that do exempt this income from taxation are West Virginia and Pennsylvania. Both Delaware and Virginia's exemptions, while not full, outcompete Maryland's. As a result, the highly trained and sought-after veteran workforce is incentivized to move to other states in our region. This has a negative economic impact on Maryland as companies assess where to locate and employees determine where to live.

This legislation would increase the military retirement income tax exemption to \$40,000 for recipients of any age beginning in tax year 2024. This will increase Maryland's economic competitiveness by exempting a significant portion of or all of military retirement income received by recipients.