

Department of Legislative Services  
Maryland General Assembly  
2023 Session

FISCAL AND POLICY NOTE  
First Reader

House Bill 227  
Ways and Means

(Delegate Charles, *et al.*)

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Income Tax - Subtraction Modification - Military Retirement

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This bill increases the value of the military retirement income subtraction modification to \$20,000 for individuals who, on the last day of the taxable year, have been declared by the U.S. Department of Veterans Affairs (VA) to have a permanent, 100% service-connected disability. **The bill takes effect July 1, 2023, and applies to tax year 2023 and beyond.**

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Fiscal Summary

**State Effect:** General fund revenues may decrease beginning in FY 2024. Expenditures are not affected.

**Local Effect:** Local income tax revenues may decrease beginning in FY 2024. Local expenditures are not affected.

**Small Business Effect:** None.

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Analysis

**Current Law:**

*Military Retirement Income 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”).

### *Federal and State Income Tax Treatment of Military Retirement Pay and Disability Income*

Military retirement pay based on age or length of service is considered taxable income for federal and State income tax purposes.

However, veterans’ benefits received from the VA, as well as certain military disability pensions, are not taxable for federal and State income tax purposes. Publication 525 of the Internal Revenue Service lists the conditions under which military disability pension income may be excluded. Military disability income received for a service-connected disability may be excluded if the (1) individual received the disability payments for a combat-related injury or (2) would be entitled to receive disability compensation from the VA if the individual had filed an application for it (in such case, the exclusion is equal to the amount that the individual would be entitled to receive from the VA). Disability income may also be excluded if the individual was entitled to receive a disability payment before September 25, 1975, or was a member of a listed government service or its reserve component, or had a written commitment to become a member, as of September 24, 1975.

Disability pensions received based on years of service generally must be included in income. However, if the pension qualifies for exclusion for a service-connected disability, the part of the pension that would have been received had it been based on a percentage of disability may be excluded from income. The rest of the pension must be included as taxable income.

If an individual retires from the U.S. Armed Forces based on years of service and is later given a retroactive service-connected disability rating by the VA, the retirement pay for the retroactive period is not taxable up to the amount of disability benefits the individual would have been entitled to receive.

**State/Local Revenues:** State general fund revenues and local income tax revenues may decrease beginning in fiscal 2024 to the extent the bill results in the exemption of additional retirement income under Maryland income tax.

In general, most service-connected disability pensions are not expected to be taxable under current law. The bill may increase the amount of nondisability pension income that may be excluded under the military retirement income subtraction; however, any such effect cannot be reliably estimated due to data limitations.

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### **Additional Information**

**Prior Introductions:** Similar legislation has been introduced within the last three years. See HB 473 of 2022; HB 864 of 2021; and HB 1110 of 2020.

**Designated Cross File:** None.

**Information Source(s):** Comptroller's Office; Internal Revenue Service; Department of Legislative Services

**Fiscal Note History:** First Reader - February 8, 2023  
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