

Department of Legislative Services
 Maryland General Assembly
 2009 Session

FISCAL AND POLICY NOTE

House Bill 755 (Delegate Gilchrist, *et al.*)
 Ways and Means

Hometown Heroes Act of 2009 - Income Tax - Subtraction Modification for Retirement Income of Law Enforcement, Fire, Rescue, and Emergency Services Personnel

This bill specifies that the retirement income received by retired federal, State, and local law enforcement officers, firefighters, and emergency medical services personnel can qualify for the existing State pension exclusion if the individual is at least age 50.

The bill takes effect July 1, 2009 and applies to tax years 2009 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by \$14.2 million in FY 2010, which reflects the impact of one and one-half tax years. Future year revenues reflect annualization, inflation, and an estimated number of eligible retirees. Expenditures are not affected.

| (\$ in millions) | FY 2010 | FY 2011 | FY 2012 | FY 2013 | FY 2014 |
|------------------|----------|---------|----------|----------|----------|
| GF Revenue | (\$14.2) | (\$9.9) | (\$10.3) | (\$10.8) | (\$11.2) |
| Expenditure | 0 | 0 | 0 | 0 | 0 |
| Net Effect | (\$14.2) | (\$9.9) | (\$10.3) | (\$10.8) | (\$11.2) |

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

Local Effect: Local income tax revenues will decrease by \$9.1 million in FY 2010 and by \$7.2 million in FY 2014. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: Maryland law provides a pension exclusion subtraction for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified amount of taxable pension income (\$24,000 in tax year 2008) 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. The pension exclusion has been a part of the Maryland income tax since 1965.

The “Social Security offset” is the reduction in the maximum pension exclusion allowed under the current law by the individual. The Social Security offset was established at the same time as the pension exclusion. Given that Social Security benefits are exempt from Maryland income tax, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of allowable exclusion by the amount of Social Security benefits received.

Additional Income Tax Treatment for Senior Citizens

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. Each individual age 65 or older (1) is allowed a \$1,000 personal exemption in addition to the regular exemption allowed to all individuals; and (2) can earn more income without being required to file taxes.

Background: Public safety personnel participate in a variety of State and local pension systems. While many locations, including the State, provide systems or plans that are restricted only to law enforcement and/or public safety personnel, smaller or less affluent jurisdictions tend to include such individuals in general employee pension plans. Most public employers provided defined benefit plans, that is, plans that offer death, disability, and retirement benefits based on accrued service and/or age. The more generous plans provide not only higher benefits but also permit retirement with less service (20 or 25 years of service) and at a younger age (50 or 55). General employee plans tend to provide for service retirement after 30 years of service and/or at a normal retirement age, likely to be age 60, 62, or 65.

Chapter 534 of 2004 established the Task Force on the Exemption of Law Enforcement Officers’ Pensions from Taxation. The task force issued its final report in December 2004. The task force estimated there were 9,600 retired State and local law enforcement officers. An analysis of State law enforcement systems concluded that

approximately 17% of State police retirees were disabled and 57% of retirees were age 50 to 64. Certain disability pensions, including law enforcement disability pensions, are exempt from federal and State taxation. The task force also stated there were 83,000 federal law enforcement officers and that approximately 2,900 of these federal officers lived in the State. The federal Office of Personnel Management indicated that the average retired federal law enforcement pension was \$60,000.

The task force estimated there were 12,227 active county and State law enforcement officers. According to the Bureau of Labor Statistics (BLS), approximately 13,240 individuals in November 2004 were employed as firefighters or emergency medical services personnel.

State Revenues: Additional pension income may be exempted under the bill beginning in tax year 2009. As a result, general fund revenues will decrease by \$9.3 million in tax year 2009 and \$9.7 million in tax year 2010. It is assumed that most taxpayers will adjust their withholding and estimated payments resulting in a reduction of \$14.2 million in fiscal 2010. Fiscal 2011 and beyond reflect the impact of one-half of the prior tax year and one-half of the current tax year. **Exhibit 1** shows the projected State and local revenue loss from exempting retirement income from State and local taxes. Out-year revenue losses reflect annualization, estimated number of eligible retirees, increases in retirement income, and the estimated increase in the pension exclusion provided for retirement income.

Exhibit 1
Projected State and Local Revenue Loss
(\$ in Millions)

| <u>Fiscal</u> | <u>State</u> | <u>Local</u> | <u>Total</u> |
|----------------------|---------------------|---------------------|---------------------|
| 2010 | \$14.2 | \$9.1 | \$23.3 |
| 2011 | 9.9 | 6.3 | 16.2 |
| 2012 | 10.3 | 6.6 | 16.9 |
| 2013 | 10.8 | 6.9 | 17.7 |
| 2014 | 11.2 | 7.2 | 18.4 |

Local Revenues: Local government revenues will decrease by approximately 3% of the net change in State tax liability resulting from the provisions of the bill. In fiscal 2010, the decrease will be \$9.1 million. Exhibit 1 lists the estimated local income tax revenue decrease in fiscal 2010 through 2014.

Additional Information

Prior Introductions: SB 581 of 2008 received a hearing from the Senate Budget and Taxation Committee, but no further action was taken. HB 1120 of 2008 received a hearing from the House Ways and Means Committee, but no further action was taken. HB 1424 of 2006 received a favorable with amendments report from the House Ways and Means Committee but was not voted on by the full House.

Cross File: None.

Information Source(s): Bureau of Labor Statistics, Comptroller's Office, Department of Legislative Services

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mlm/hlb

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