HB 917

Department of Legislative Services

2012 Session

FISCAL AND POLICY NOTE

House Bill 917 (Delegate Gilchrist, *et al.*)
Ways and Means

Income Tax - Subtraction Modification for Retirement Income

This bill allows income from a rollover individual retirement account (IRA) or annuity under Section 408 of the Internal Revenue Code (IRC) to be included within the State income tax subtraction modification allowed for retirement income (pension exclusion) if the contributions to the IRA or annuity consist entirely of the tax-free rollover of distributions from an employee retirement system. The bill also freezes the maximum value of the annual pension exclusion at $26,300 in tax year 2012 and 2013 and indexes the value thereafter as provided under current law.

The bill takes effect July 1, 2012, and applies to tax year 2012 and beyond.

Fiscal Summary

State Effect: The extent of any general fund revenue decrease from rollover distributions depends on several unknown factors, including the amount distributed each year from eligible rollovers and the amount of Social Security income received by the individuals utilizing these rollovers. Based on tax year 2006 and 2008 data, general fund revenues may decrease by $0.9 million in FY 2013. General fund revenues increase beginning in FY 2014 as the revenue gains from temporarily limiting the amount of the pension exclusion are greater than the revenue losses from eligible rollovers. Expenditures are not affected.

($ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	($0.9)	$1.6	$1.7	$1.7	$1.7
Expenditure	0	0	0	0	0
Net Effect	($0.9)	$1.6	$1.7	$1.7	$1.7

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

Local Effect: Local government revenues may decrease by $0.7 million in FY 2013, and increase by $1.2 million in FY 2014. Expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law\Background: 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 ($26,300 for 2011) 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).

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under current law for an 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 the allowable exclusion by the amount of any Social Security benefits received.

One significant feature of the current pension exclusion is that it is limited to income received from an "employee retirement system." Eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under sections 401(a), 403, or 457(b) of the IRC. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, individual retirement arrangements (IRAs), Keogh plans, and simplified employee pension plans are not considered employee retirement systems.

In addition to the special treatment of Social Security and other retirement income, additional income tax relief is provided to senior citizens regardless of the source of their income. Each individual age 65 and older is allowed a $1,000 personal exemption in addition to the regular personal exemption allowed for all individuals, and can also earn more income without being required to file taxes.

State Revenues: The actual cost of the bill, which cannot be reliably estimated at this time, depends on the number of eligible rollovers and the amount of income distributed each year from these rollovers, the amount of Social Security benefits received by these individuals, and the impact of freezing the pension exclusion amount in tax years 2012 and 2013.

However, *for illustrative purposes only*, based on tax year 2006 and 2008 income tax data, it is estimated that net general fund revenues may decrease by about $0.9 million in fiscal 2013, which reflects a revenue increase of $2.5 million resulting from temporarily freezing the value of the pension exclusion minus a revenue reduction of $3.4 million resulting from eligible rollovers. Although the bill is effective in tax year 2012, it is assumed that most taxpayers will not adjust estimated payments. This estimate is based on the following facts and assumptions:

- for tax year 2006, about 15,500 returns were filed with IRA distributions totaling approximately $268.7 million but no pension income, with an average distribution of $17,299;
- the average amount excluded under the pension exclusion in tax year 2008 was $11,160, which was about 47% of the maximum exclusion; and
- 50% of IRA distributions are from an account consisting entirely of tax-free rollovers from employee retirement systems.

Exhibit 1 shows the potential fiscal impact of the bill in fiscal 2013 through 2017.

Exhibit 1
Fiscal Impact of HB 917
Fiscal 2013-2017

	FY 2013	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**
Pension Exclusion	$2,481,000	$5,158,000	$5,362,000	$5,574,000	$5,794,000
Rollover IRAs	(3,360,000)	(3,528,000)	(3,704,000)	(3,889,000)	(4,083,000)
Net Effect					
State Revenues	*(879,000)*	*1,630,000*	*1,658,000*	*1,685,000*	*1,711,000*
Local Revenues	*(659,000)*	*1,223,000*	*1,244,000*	*1,264,000*	*1,283,000*

Legislative Services advises that there is considerable uncertainty over the fiscal impact of allowing rollover IRAs to qualify for the pension exclusion. As such, the revenue impact may be significantly different than the amounts shown in Exhibit 1.

Local Revenues: Local government revenues decrease by approximately 3% of the total net State subtraction modification claimed. Based on the estimate above, local revenues may decrease by $0.7 million in fiscal 2013, with a revenue increase of $1.2 million in fiscal 2014.

Additional Information

Prior Introductions: None.

Cross File: SB 847 (Senator King) - Budget and Taxation.

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

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