HB 440

Department of Legislative Services
2013 Session

FISCAL AND POLICY NOTE

House Bill 440 (Delegate Tarrant, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Retirement Income

This bill expands the existing State pension exclusion subtraction modification for taxpayers who are at least 70 years of age or who qualify for the exclusion under current law due to a disability.

The bill takes effect July 1, 2013, and applies to tax year 2013 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2014 due to additional pension income being exempted. Expenditures are not affected.

Local Effect: Local income tax revenues decrease significantly beginning in FY 2014. Expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: The bill expands the existing State pension exclusion subtraction modification for taxpayers who are at least 70 years of age or who qualify for the exclusion under current law because of a disability.

The bill increases the maximum pension exclusion for qualifying individuals to (1) $33,000 in tax year 2013; (2) $40,000 in tax year 2014; (3) $47,000 in tax year 2015; (4) $54,000 in tax year 2016; (5) $61,000 in tax year 2017; (6) $68,000 in tax year 2018; and (7) $75,000 beginning in tax year 2019. The maximum exclusion amount in each year is reduced by the amount of Social Security payments received as provided under current law.

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 ($27,100 for 2012) 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 even though benefits are partially taxable for federal purposes, 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.

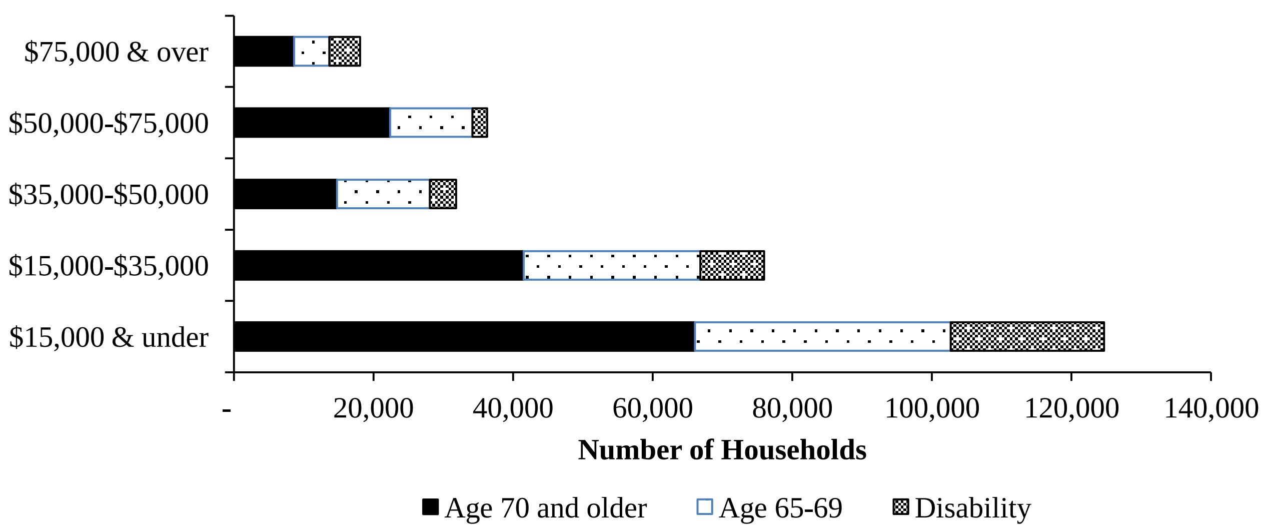
In addition to the special treatment of Social Security and other retirement income, additional income tax relief is provided to senior citizens regardless of the source of their income. Each individual age 65 and older is allowed a $1,000 personal exemption in addition to the regular personal exemption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

In tax year 2008, a total of 236,500 resident returns claimed the pension exclusion. The average amount of pension income excluded was $11,100, or a little less than one-half of the average taxable pension income reported by all returns, including those that did not claim the exclusion. Lower-income returns excluded a higher percentage of pension income; the average pension exclusion was equal to two-thirds of the average pension reported by taxpayers with income less than $25,000 while taxpayers with incomes over $150,000 had average pension income excluded of about one-quarter of the average pension. The Department of Budget and Management estimates that the pension exclusion reduced State revenues by $103.4 million and local income tax revenues by

$64.1 million in fiscal 2012. Exempting social security benefits is estimated to reduce State income tax revenues by $139.8 million and local income tax revenues by $86.7 million in fiscal 2012.

In calendar 2011, an estimated 286,800 Maryland households received a pension that could qualify for the pension exclusion. A little more than one-half of these pensions were received in a household where at least one member was 70 years of age or older, one-third were 65 to 69 years of age, and the remaining 15% were disability pensions, including certain nontaxable pensions, paid to households where the family members were younger than age 65. An average pension income of $26,700 was received for each household reporting pension income. Households in the 65 to 69 years of age range had the highest average pension; disability pension households had an average pension that was 20% lower (the households in the highest age range had an average pension income that was about 10% lower than those in the 65 to 69 years of age range). **Exhibit 1** shows the number of Maryland households by the amount of pension income received by the household in calendar 2011.

Exhibit 1
Number of Maryland Households by Amount of Pension Income
Calendar 2011



Note: Disability pensions include only those households under the age of 65 years old.

Source: U.S. Census Bureau *Current Population Survey*; Department of Legislative Services

State Revenues: The bill expands the existing State pension exclusion subtraction modification beginning in tax year 2013 for taxpayers who are at least 70 years of age or who qualify for the exclusion under current law because of a disability. Accordingly, general fund revenues may decrease significantly beginning in fiscal 2014. The Comptroller advises that it does not capture the data necessary to calculate the impact of the pension exclusion expansion proposed by the bill. Based on limited data, the Comptroller's Office estimates that State revenues may decrease by $6.6 million in tax year 2013, $15.1 million in tax year 2014, $23.7 million in tax year 2015, $32.8 million in tax year 2016, and by $42.4 million in tax year 2017.

Local Revenues: Local revenues decrease by approximately 3% of the total net State subtraction modification claimed. Accordingly, local income tax revenues will decrease significantly beginning in fiscal 2014.

Additional Information

Prior Introductions: SB 752 of 2012, a similar bill, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: SB 48 (Senator Young) - Budget and Taxation.

Information Source(s): U.S. Census Bureau, Comptroller's Office, Department of Budget and Management, Department of Legislative Services

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ncs/jrb

Analysis by: Robert J. Rehrmann

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