Department of Legislative Services
2014 Session

FISCAL AND POLICY NOTE

Senate Bill 451 (Senator Young, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Retirement Income and Task Force to Study Senior Emigration

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 also establishes the Task Force to Study the Effects of Senior Emigration on State and Local Tax Revenues. By December 1, 2014, the task force must report its findings and recommendations to the Governor and the General Assembly. The Maryland Department of Aging must provide staff for the task force.

The bill takes effect July 1, 2014, and applies to tax year 2014 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2015 due to additional pension income being exempted. Any expenditures related to the task force created by the bill can be handled with existing resources.

Local Effect: Local income tax revenues decrease significantly beginning in FY 2015. 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 2014; (2) $40,000 in tax year 2015; (3) $47,000 in tax year 2016; (4) $54,000 in tax year 2017; (5) $61,000 in tax year 2018; (6) $68,000 in tax year 2019; and (7) $75,000 beginning in tax year 2020. The maximum exclusion amount in each year is reduced by the amount of Social Security payments received as provided under current law.

The nine-member task force established by the bill includes one member of the Senate, one member of the House of Delegates, two members from the Comptroller's Office, two members from the Department of Budget and Management, and one member appointed by the Governor from each of the following organizations – American Association of Retired Persons, Maryland Chamber of Commerce, and the National Association of Retired Federal Employees. The Governor must designate the chair of the task force. A member of the task force may not receive compensation but is entitled to reimbursement for expenses. The Maryland Department of Aging must provide staff support for the task force.

The task force must (1) study the effects of senior emigration on State and local tax revenues and (2) make recommendations regarding changes to State and local tax policies affecting seniors. By December 1, 2014, the task force must report its findings and recommendations to the Governor and the General Assembly.

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 ($27,800 for 2013) 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.

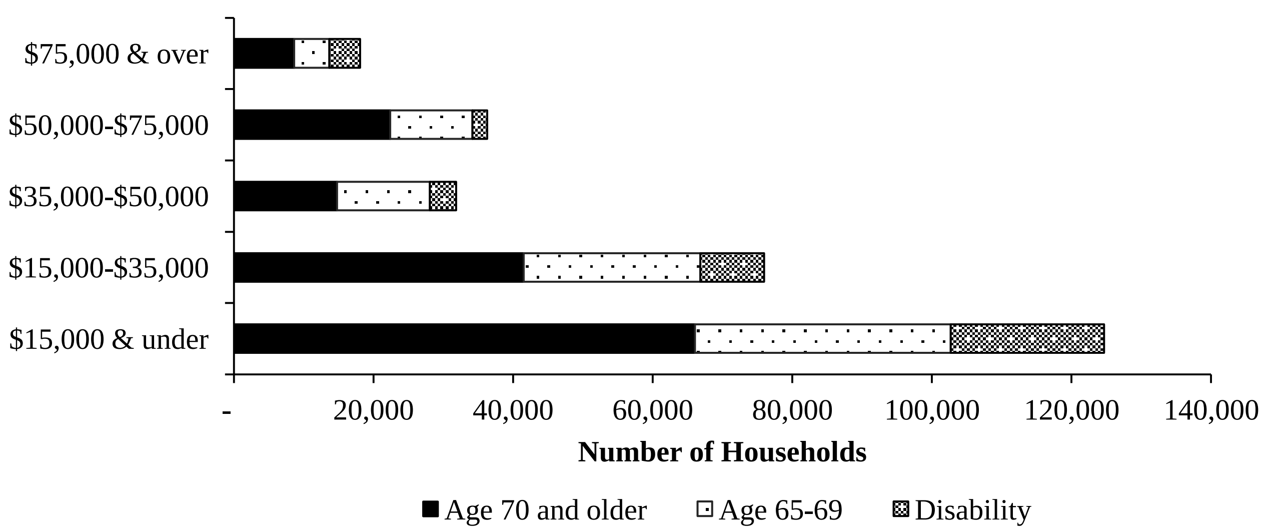
One significant feature of the current pension exclusion is that it is limited to income received from an "employee retirement system." Eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under sections 401(a), 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.

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 2014 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 2015. 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 from prior years, the Comptroller's Office has estimated that State revenues may decrease by approximately $7 million in the first year of the expansion and by approximately $42 million when fully phased in.

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 2015.

Additional Information

Prior Introductions: Similar bills were introduced in the 2012 and 2013 sessions. SB 48 of 2013 received an unfavorable report from the Senate Budget and Taxation Committee. Its cross file, HB 440 of 2013, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 752 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None.

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

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ncs/jrb

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