HB 870

Department of Legislative Services

Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE

House Bill 870 (Delegate Parrott, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Elderly or Disabled Individuals

This bill exempts from the State and local income tax 100% of the income received by a resident who is at least age 65 or is totally disabled or the resident's spouse is totally disabled.

The bill takes effect July 1, 2015, and applies to tax year 2015 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $1.4 billion in FY 2016 due to the exemption of specified income. Future year revenue estimates reflect annualization and the current income tax revenue forecast. General fund expenditures may increase in FY 2016 due to implementation costs at the Comptroller's Office.

($ in billions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	(1.4)	(1.0)	(1.0)	(1.0)	(1.1)
GF Expenditure	-	$0	$0	$0	$0
Net Effect	(1.4)	(1.0)	(1.0)	(1.0)	(1.1)

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

Local Effect: Local revenues will decrease by $870 million in FY 2016 and by $680 million in FY 2020 due to the exemption of specified income. 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 age 65 or who are totally disabled. Under this subtraction modification, up to a specified maximum amount of taxable pension income ($29,000 for 2014) 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." Chapter 524 of 2000 clarified the definition of an "employee retirement system" by providing for the types of retirement income that may be included for purposes of calculating the pension exclusion. As defined by Chapter 524, eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under § 401(a), § 403, or § 457(b) of the Internal Revenue Code (IRC). These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, Chapter 524 also included language clarifying what is not included in an "employee retirement system": (1) an individual retirement account (IRA) or annuity under § 408 of the IRC; (2) a Roth IRA under § 408A of the IRC; (3) a rollover IRA; (4) a simplified employee pension under § 408(k) of the IRC; or (5) an ineligible deferred compensation plan under § 457(f) of the IRC. Since 2000, there have been no substantive changes to the pension exclusion.

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. According to the Department of Budget and Management, in fiscal 2014 the State subtraction modification for Social Security benefits reduced State revenues by $165.8 million, the State pension exclusion reduced State revenues by $144.4 million, and the additional personal exemption reduced State revenues by $18.3 million.

State Revenues: Additional income may be exempted beginning in tax year 2015. It is assumed that individuals adjust withholdings and estimated payments. As a result, general fund revenues will decrease by $1.4 billion in fiscal 2016, which reflects the impact of all of tax year 2015 and one-half of tax year 2016. **Exhibit 1** shows the estimated State and local revenue impacts resulting from the bill.

Exhibit 1
State and Local Revenue Impacts
Fiscal 2016-2020
($ in Billions)

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
State	($1.4)	($1.0)	($1.0)	($1.0)	($1.1)
Local	(0.9)	(0.6)	(0.6)	(0.7)	(0.7)
Total	**($2.2)**	**($1.6)**	**($1.6)**	**($1.7)**	**($1.8)**

Local Revenues: Local income tax revenues decrease by about 3% of the total net subtraction modification claimed by taxpayers. As a result, local revenues will decrease by $870 million in fiscal 2016 and by $680 million in fiscal 2020, as shown in Exhibit 1.

Additional Information

Prior Introductions: HB 1216 of 2014, a similar bill, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

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

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md/jrb

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