Department of Legislative Services
Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE

House Bill 488 (The Speaker, *et al.*) (By Request - Administration)
Ways and Means

Income Tax Subtraction Modification - Law Enforcement, Fire, Rescue, and Emergency Services Personnel (Hometown Heroes Act)

This Administration bill allows retirement income to qualify for the State pension exclusion if the individual is at least age 50 and the retirement income is attributable to employment as a law enforcement officer or fire, rescue, or emergency services personnel of the United States, the State, or a local jurisdiction. This expansion of the pension exclusion is phased in over four years, beginning with tax year 2015.

The bill also accelerates to tax year 2015 the increase in the value of the State income tax subtraction modification for qualifying volunteer fire, rescue, or emergency medical services personnel phased in through tax year 2019 by Chapters 371 and 372 of 2014.

The bill takes effect July 1, 2015.

Fiscal Summary

State Effect: General fund revenues decrease by $3.0 million in FY 2016 due to additional retirement income being exempted and subtraction modification claims. Future year revenue decreases reflect the estimated number of eligible taxpayers and phase-in of the pension exclusion amount. Expenditures are not affected.

($ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	($3.0)	($5.5)	($8.1)	($10.9)	($11.1)
Expenditure	0	0	0	0	0
Net Effect	($3.0)	($5.5)	($8.1)	($10.9)	($11.1)

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

Local Effect: Local revenues decrease by $2.0 million in FY 2016 and by $7.3 million in FY 2020. Expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). The Department of Legislative Services concurs with this assessment.

Analysis

Current Law:

State Pension Exclusion

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." 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 Internal Revenue Code. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, individual retirement arrangements, 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.

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.

Volunteer Fire, Rescue, and Emergency Medical Services Personnel

The Honorable Louis L. Goldstein Volunteer Fire, Rescue, and Emergency Medical Services Personnel Subtraction Modification Program allows a subtraction modification for individuals who serve in a volunteer capacity and qualify for active duty service during the tax year. Individuals can qualify if they are (1) a member of a Maryland fire, rescue, or emergency medical services organization; (2) a member of an auxiliary organization of a Maryland fire, rescue, or emergency medical services organization; (3) a member of the Maryland Defense Force; (4) a member of the U.S. Coast Guard Auxiliary; or (5) a member of the Maryland Civil Air Patrol.

Chapter 267 of 2003 allowed an individual to claim the subtraction modification if the individual did not qualify due to being called into service on active duty in the U.S. Armed Forces or was a qualifying civilian or member of the Merchant Marines in support of the U.S. Armed Forces in a designated combat zone.

Chapters 371 and 372 of 2014 increased the value of the State income tax subtraction modification for qualifying volunteer fire, rescue, or emergency medical services personnel from $3,500 to $5,000, phased in over six years beginning in tax year 2014. The amount of the subtraction is equal to (1) $3,750 in tax year 2014; (2) $4,000 in tax year 2015; (3) $4,250 in tax year 2016; (4) $4,500 in tax year 2017; (5) $4,750 in tax year 2018; and (6) $5,000 beginning with tax year 2019.

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, other jurisdictions may include such individuals in general employee pension plans. Most public employers provide defined benefit plans that offer death, disability, and retirement benefits based on accrued service and/or age.

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 in the State. An analysis of State law enforcement systems concluded that approximately 17% of State police retirees retired with a disability 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 that there were 83,000 federal law enforcement officers and that approximately 2,900 of these federal officers lived in the State.

State Revenues: Under current law, an individual must be at least age 65 to be eligible to claim the State pension exclusion, unless the individual or individual's spouse is totally disabled. The bill will allow an eligible retiree to claim the pension exclusion if he or she is at least age 50, resulting in additional income being exempted beginning in tax year 2015. The amount of eligible retirement income that can qualify for the pension exclusion is equal to (1) 25% in tax year 2015; (2) 50% in tax year 2016; (3) 75% in tax year 2017; and (4) 100% in tax year 2018 and each year thereafter. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, total general fund revenues will decrease by $3.0 million in fiscal 2016. **Exhibit 1** shows the estimated State and local revenue losses resulting from (1) expansion of the pension exclusion for law enforcement officers or fire, rescue, or emergency services personnel who are age 50 and older; and (2) acceleration of the increase in the subtraction modification for qualifying volunteer fire, rescue, or emergency medical services personnel.

Exhibit 1
State and Local Revenue Impacts
Fiscal 2016-2020

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
State					
Pension Exclusion	($2,507,000)	($5,140,000)	($7,904,000)	($10,803,000)	($11,074,000)
Subtraction Modification	(525,000)	(371,000)	(233,000)	(111,000)	0
Total	**($3,032,000)**	**($5,511,000)**	**($8,137,000)**	**($10,914,000)**	**($11,074,000)**
Local					
Pension Exclusion	($1,649,000)	($3,380,000)	($5,198,000)	($7,104,000)	($7,282,000)
Subtraction Modification	(327,000)	(231,000)	(145,000)	(69,000)	0
Total	**($1,976,000)**	**($3,611,000)**	**($5,343,000)**	**($7,173,000)**	**($7,282,000)**

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification and pension exclusion claimed by taxpayers. As a result, local revenues will decrease by $2.0 million in fiscal 2016, as shown in Exhibit 1.

Additional Information

Prior Introductions: HB 1461 of 2014, a similar bill that proposed to expand the pension exclusion to law enforcement officers or fire, rescue, or emergency services personnel who are at least age 50, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: SB 594 (The President, *et al.*) (By Request - Administration) - Budget and Taxation.

Information Source(s): Comptroller's Office, Maryland State Retirement Agency, Department of Legislative Services

Fiscal Note History: First Reader - February 25, 2015
md/jrb

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Income Tax Subtraction Modification-Law Enforcement, Fire, Rescue, and Emergency Services personnel (Hometown Heroes)

BILL NUMBER: SB594/HB488

PREPARED BY: Governor's Legislative Office

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

_X_ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

___ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS