Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 586 (Delegate Fisher, *et al.*)
Ways and Means

Retire in Maryland Act of 2016

This bill expands the existing State income tax pension exclusion subtraction modification by allowing income from the following plans or sources to be included within the subtraction modification: (1) individual retirement accounts and annuities under Section 408 of the Internal Revenue Code (IRC); (2) Roth individual retirement accounts under Section 408(a) of the IRC; (3) simplified employee pensions under Section 408(k) of the IRC; (4) ineligible deferred compensation plans under Section 457(f) of the IRC; and (5) certain unearned income as defined by the bill.

The bill takes effect July 1, 2016, and applies to tax year 2016 and beyond.

Fiscal Summary

State Effect: General fund revenues will decrease significantly beginning in FY 2017 as a result of additional income being exempted under the pension exclusion. The revenue loss will likely exceed $450 million annually. Expenditures are not affected.

Local Effect: Local revenues will decrease significantly beginning in FY 2017 as a result of additional income being exempted under the pension exclusion. The revenue loss will likely exceed $290 million annually. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: Unearned income under the bill includes income from (1) an annuity, pension, or an endowment or (2) the payment of interest, dividends, or any other distribution from an investment. Unearned income does not include any employee compensation or net self-employment earnings.

The bill specifies that any income excluded by a taxpayer through subtraction modifications taken under Sections 10-207 or 10-208 of the Tax-General Article is not eligible for the State pension exclusion.

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 ($29,200 for 2015) 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 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. **Exhibit 1** shows the eligible and ineligible retirement income under the pension exclusion.

Exhibit 1
Eligible and Ineligible Retirement Plans under the Pension Exclusion

Eligible	**Ineligible**
• 401(k) Cash or Deferred Arrangement (CODA) Plans	• Traditional IRAs
• 403(b) Plans	• Rollover IRAs
• 457(b) Plans	• Roth IRAs
• Thrift Savings Plans	• Keogh Plans
• Savings Incentive Match Plan for Employees (SIMPLE) Retirement Plans Under § 401(k) of the IRC	• Simplified Employee Pensions • SIMPLE Retirement Plans Under § 408 of the IRC

Source: Department of Legislative Services

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 2016 the State subtraction modification for Social Security benefits reduced State revenues by $210.5 million (this is in addition to the revenue loss resulting from the partial federal exemption of Social Security benefits), the State pension exclusion reduced State revenues by $166.0 million, and the additional personal exemption reduced State revenues by $30.3 million.

State/Local Revenues: The bill expands the pension exclusion by allowing additional types and amounts of income to be subtracted beginning in tax year 2016. As a result, annual State and local income tax revenues will decrease significantly beginning in fiscal 2017.

Due to taxpayer confidentiality requirements, the Department of Legislative Services (DLS) does not have access to income tax data and is dependent on data from the Comptroller's Office. The Comptroller's Office has advised DLS that it does not have sufficient data to produce an accurate fiscal estimate of various proposals to alter the State pension exclusion. According to the Comptroller's Office, it is in the process of redesigning the personal income tax forms in an effort to overcome the data limitations described above.

Based on limited data on the additional amount of eligible retirement income reported on Maryland federal income tax returns relative to the amount claimed under the current pension exclusion, the Comptroller estimates that annual revenue losses resulting from the bill could total over $450 million beginning in fiscal 2017. Part of this revenue loss may be offset to the extent that income that is currently excluded under the pension exclusion may not be excluded under the bill. The bill specifies that any income excluded by a taxpayer under Sections 10-207 or 10-208 of the Tax-General Article may not also be excluded under the State pension exclusion.

Under the assumptions above, local income tax revenues would decrease by about $290 million annually beginning in fiscal 2017.

Additional Information

Prior Introductions: HB 960 of 2015 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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mel/jrb

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