HB 195

Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 195 (Delegate Krebs, *et al.*)
Ways and Means

Income Tax Subtraction Modification - Retirement Income (Fairness in Taxation for Retirees Act)

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

The bill takes effect July 1, 2017, and applies to tax year 2017 and beyond.

Fiscal Summary

State Effect: General fund revenues will decrease significantly beginning in FY 2018 as a result of additional income being exempted under the pension exclusion. The revenue loss will likely exceed $65.2 million annually. Expenditures are not affected.

Local Effect: Local revenues will decrease significantly beginning in FY 2018 as a result of additional income being exempted under the pension exclusion. The revenue loss will likely exceed $42.6 million annually. Local 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 65 years old or who are totally disabled. Under this subtraction modification, up to a specified maximum amount of taxable pension income ($29,400 for 2016) 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." As defined by Chapter 524 of 2000, 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 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 of income to be subtracted beginning in tax year 2017. As a result, annual State and local income tax revenues will decrease significantly beginning in fiscal 2018.

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 accurate fiscal estimates of various proposals to alter the State pension exclusion. According to the Comptroller's Office, the personal income tax forms have been redesigned in an effort to overcome these data limitations.

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 revenue losses resulting from the bill would have totaled $48.5 million in tax year 2012, the last year of available data. This estimate is increased by 6% annually based on recent and projected growth in taxable pension and annuity income. As a result, general fund revenue losses will likely exceed $65.2 million annually beginning in fiscal 2018.

Under the assumptions above, local income tax revenues would decrease by about $42.6 million annually beginning in fiscal 2018.

This estimate does not include revenue losses resulting from additional income exempted (1) under ineligible Section 457(f) deferred compensation plans, Roth IRAs, and Simplified Employee Pensions; and (2) by individuals with disabilities (under all eligible sources).

Additional Information

Prior Introductions: SB 299 of 2016 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 158, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 194 of 2015 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 144, received an unfavorable report from the House Ways and Means Committee. Similar legislation proposing to expand the State pension exclusion has been introduced since the 2005 session.

Cross File: None designated, although SB 238 is identical.

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

Fiscal Note History: First Reader - February 6, 2017
md/jrb

Analysis by: Robert J. Rehrmann

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