HB 1358

Department of Legislative Services

Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1358 (Delegate Krebs, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Retirement Income

This bill expands the existing State income tax pension exclusion subtraction modification by allowing any income reported under IRS Form 1099-R to be included within the subtraction modification. **The bill takes effect July 1, 2020, and applies to tax year 2020 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $68.2 million in FY 2021 due to additional pension income being exempted. Future years reflect projected growth in eligible retirement income. Expenditures are not affected.

($ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	($68.2)	($71.3)	($74.5)	($77.8)	($81.3)
Expenditure	0	0	0	0	0
Net Effect	($68.2)	($71.3)	($74.5)	($77.8)	($81.3)

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

Local Effect: Local revenues decrease by $42.8 million in FY 2021 and by $51.1 million in FY 2025. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: According to the IRS, Form 1099-R is used to report distributions from:

- profit-sharing or retirement plans;
- any individual retirement accounts (IRAs);
- annuities, pensions, insurance contracts, survivor income benefit plans;
- permanent and total disability payments under life insurance contracts; and
- charitable gift annuities.

Current Law/Background:

State Pension Exclusion

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 ($31,100 for 2019) 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 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 Plans	• Traditional IRAs
• 403(b) Plans	• Rollover IRAs
• 457(b) Plans	• Roth IRAs
• Thrift Savings Plans	• Keogh Plans
• Savings Incentive Match Plan for Employees Retirement Plans under § 401(k) of the IRC	• Simplified Employee Pensions
	• Savings Incentive Match Plan for Employees Retirement Plans under § 408 of the IRC

IRC: Internal Revenue Code
IRA: individual retirement account

Source: Department of Legislative Services

Additional retirement income may be exempted if the individual has qualified U.S. military, law enforcement, correctional officer, fire, rescue, or emergency services personnel retirement income.

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.

State Revenues: The bill expands the pension exclusion by allowing additional types of income to be subtracted beginning in tax year 2020. As a result, general fund revenues will decrease by $68.2 million in fiscal 2021. **Exhibit 2** shows the estimated impact of the bill on State and local revenues.

Exhibit 2
State and Local Revenue Impacts
Fiscal 2021-2025
($ in Millions)

	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
State	($68.2)	($71.3)	($74.5)	($77.8)	($81.3)
Local	(42.8)	(44.7)	(46.8)	(48.9)	(51.1)
Total	**($111.0)**	**($116.0)**	**($121.3)**	**($126.7)**	**($132.4)**

Due to taxpayer confidentiality requirements, the Department of Legislative Services does not have access to income tax data and is dependent on data from the Comptroller's Office. As required by Chapter 648 of 2016, the Comptroller's Office altered the personal income tax form to capture additional data on the pension exclusion by adding Form 502R. The estimated fiscal impact shown in Exhibit 2 is based on an analysis of this data and income reported on federal forms 1099-R and 1040.

Local Revenues: Local income tax revenues decrease as a result of additional retirement income exempted against the personal income tax. Local revenues decrease by $42.8 million in fiscal 2021 and by $51.1 million in fiscal 2025, as shown in Exhibit 2.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

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

Fiscal Note History: First Reader - March 4, 2020
an/hlb

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