Department of Legislative Services

Maryland General Assembly
2021 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 572 (The President)(By Request - Administration)
Budget and Taxation

Retirement Tax Reduction Act of 2021

This Administration bill creates a subtraction modification against the State income tax for an individual who has a federal adjusted gross income of $100,000 or less and (1) is receiving old age or survivor Social Security benefits or (2) is at least age 65 and is not employed full time. The maximum value of the subtraction modification is equal to $50,000 in tax year 2026, phased-in over five tax years beginning with tax year 2022. **The bill takes effect July 1, 2021.**

Fiscal Summary

State Effect: General fund revenues decrease by $111.2 million in FY 2023 due to additional retirement income being exempted. Future year estimates reflect projected retirement income and the phase-in specified by the bill. General fund expenditures increase by $60,000 in FY 2023 due to one-time implementation costs at the Comptroller's Office.

($ in millions)	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
GF Revenue	$0	($111.2)	($215.6)	($287.4)	($339.9)
GF Expenditure	$0	$0.1	$0	$0	$0
Net Effect	$0.0	($111.3)	($215.6)	($287.4)	($339.9)

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

Local Effect: Local revenues decrease by $75.6 million in FY 2023 and by $249.4 million in FY 2027. Local 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 (DLS) concurs with this assessment.

Analysis

Bill Summary: The subtraction modification may be claimed beginning in tax year 2022. The value of the subtraction modification may not exceed (1) $10,000 in tax year 2022; (2) $20,000 in tax year 2023; (3) $30,000 in tax year 2024; (4) $40,000 in tax year 2025; and (5) $50,000 beginning in tax year 2026.

The subtraction modification can be claimed without regard to the source of the income received by a qualifying individual. However, an individual who excludes income under the subtraction modification may not also exclude that income under the State pension exclusion.

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 ($33,100 for 2020) 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. **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 creates a subtraction modification against the State income tax for an individual who has federal adjusted gross income of $100,000 or less and (1) is receiving old age or survivor Social Security benefits or (2) is at least age 65 and is not employed full time. The maximum value of the subtraction modification equals $10,000 in tax year 2022, increasing by $10,000 annually over the next four years until it equals $50,000 in tax year 2026 and beyond.

As a result, State income tax revenues will decrease by $111.2 million in fiscal 2023. **Exhibit 2** shows the estimated impact of the bill on State and local revenues.

Exhibit 2
State and Local Revenue Impacts
Fiscal 2023-2027
($ in Millions)

	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
State	($111.2)	($215.6)	($287.4)	($339.9)	($379.9)
Local	(75.6)	(143.8)	(189.9)	(223.6)	(249.4)
Total Revenues	**($186.8)**	**($359.4)**	**($477.3)**	**($563.5)**	**($629.3)**

Due to taxpayer confidentiality requirements, DLS 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.

State Expenditures: The Comptroller's Office reports that it will incur a one-time general fund expenditure increase of $60,000 in fiscal 2023 to add the exemption to the personal income tax forms. This includes data processing changes to the income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues decrease as a result of additional retirement income exempted against the personal income tax. Local revenues decrease by $75.6 million in fiscal 2023 and by $249.4 million in fiscal 2027, as shown in Exhibit 2.

Additional Information

Prior Introductions: SB 278 of 2020 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 342, received a hearing in the House Ways and Means Committee, but no further action was taken.

Designated Cross File: HB 733 (The Speaker)(By Request - Administration) - Ways and Means.

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

Fiscal Note History: First Reader - February 8, 2021
rh/hlb

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: **Retirement Tax Reduction Act of 2021**

BILL NUMBER: SB 572

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 BUSINESSES

OR

___ WILL HAVE A MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS