HB 420

Department of Legislative Services

Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 420 (The Speaker, *et al.*) (By Request - Administration)
Ways and Means

Retirement Tax Elimination Act of 2022

This Administration bill creates a subtraction modification against the State income tax for 100% of the income received by an individual who (1) is receiving old age or survivor Social Security benefits or (2) is at least age 65 and is not employed full time. The exemption is phased in over six years, beginning with tax year 2022. **The bill takes effect July 1, 2022.**

Fiscal Summary

State Effect: General fund revenues decrease by $201.2 million in FY 2023 due to eligible income being exempted. The Governor's proposed FY 2023 budget assumes a $188.0 million general fund reduction in FY 2023. Future year revenue decreases reflect the phase-in specified by the bill and the projected growth in the number of eligible taxpayers and income. General fund expenditures increase by $77,000 in FY 2023 due to one-time implementation costs at the Comptroller's Office.

($ in millions)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
GF Revenue	($201.2)	($427.1)	($625.2)	($795.8)	($949.7)
GF Expenditure	$0.1	$0	$0	$0	$0
Net Effect	($201.3)	($427.1)	($625.2)	($795.8)	($949.7)

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

Local Effect: Local revenues decrease by $132.3 million in FY 2023 and by $608.8 million in FY 2027. Local expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). The Department of Legislative Services (DLS) disagrees with the assessment as discussed below.

Analysis

Current Law/Background:

State Pension Exclusion – Retirement Income

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 ($34,300 for 2021) 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.

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.

Additional State Tax Benefits

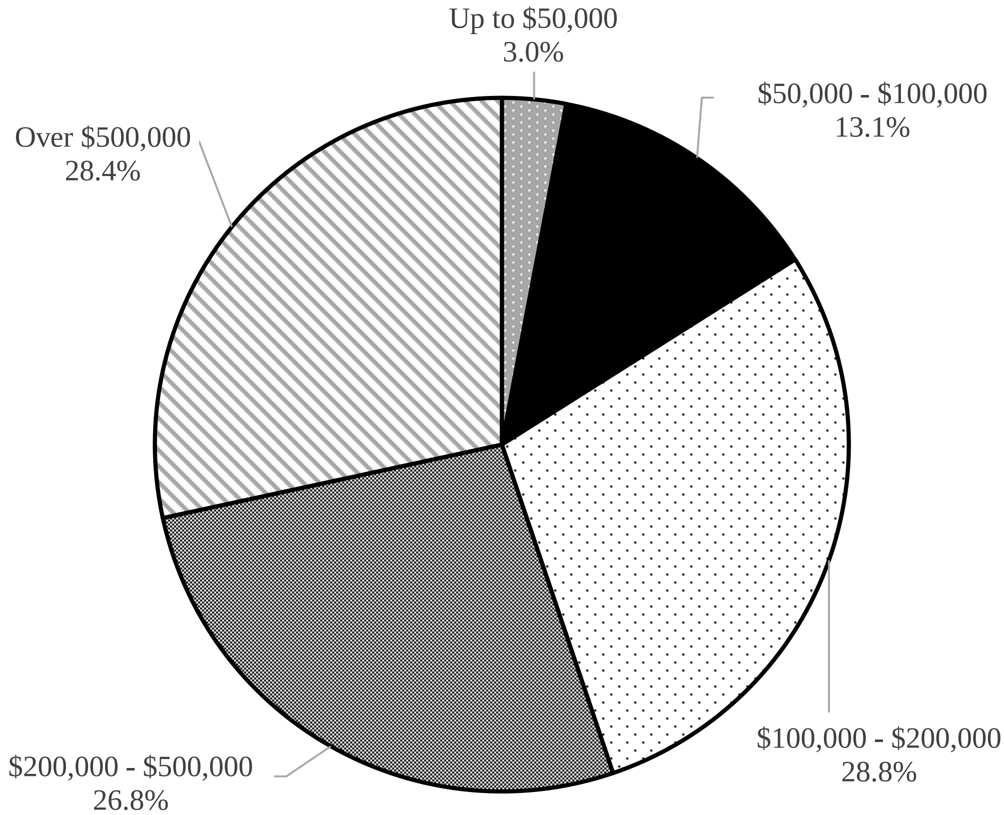
In addition to the special treatment of Social Security and other retirement income, additional income tax relief is provided to senior citizens regardless of the source of their income. Each individual who is at least age 65 is allowed a $1,000 personal exemption in addition to the regular personal exemption allowed for all individuals.

According to the Department of Budget and Management, in fiscal 2018 the State subtraction modification for Social Security benefits reduced State revenues by $303.0 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 $227.0 million, and the additional personal exemption reduced State revenues by $30.6 million. In fiscal 2018, these benefits decreased State revenues by a total of $560.6 million and local revenues by $317.8 million.

Elderly Taxpayer Data

In tax year 2020, an estimated 542,000 resident taxable and nontaxable returns had at least one taxpayer who was at least age 65. These individuals paid an estimated $1.4 billion in State income taxes and $927.0 million in local income taxes. **Exhibit 1** shows the distribution of State income taxes paid by taxpayers at least age 65 by federal adjusted gross income.

Exhibit 1
Distribution of State Income Taxes Paid by FAGI
Resident Taxpayers – Minimum Age of 65 Years
Tax Year 2020



FAGI: federal adjusted gross income

Source: Comptroller's Office; Department of Legislative Services

State Revenues: Eligible individuals can exempt up to $10,000 in income, regardless of source, in tax year 2022. The maximum value of the subtraction modification increases by $10,000 annually over the next four years until it equals $50,000 in tax year 2026. Beginning in tax year 2027, the bill exempts 100% of the income received by an eligible individual. As a result, general fund revenues will decrease by $201.2 million in fiscal 2023. Once the exemption is fully phased-in, general fund revenues will decrease by about $1.7 billion in fiscal 2028. **Exhibit 2** shows the estimated net impact of the bill on State and local revenues.

Exhibit 2
Projected State and Local Revenue Loss
($ in Millions)

	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
State	($201.2)	($427.1)	($625.2)	($795.8)	($949.7)	($1,709.2)
Local	($132.3)	($277.2)	($401.8)	($511.0)	($608.8)	($1,099.4)
Total	**($333.5)**	**($704.3)**	**($1,026.9)**	**($1,306.8)**	**($1,558.5)**	**($2,808.6)**

Source: Comptroller's Office; Department of Legislative Services

This estimate reflects the impact the bill would have had in tax year 2019 and increased by about 4% annually to reflect growth in tax returns and income. The Comptroller's Office estimates that in tax year 2019 about 444,000 taxpayers would have benefited from the proposed exemption. This estimate is based on the income reported by the taxpayers who are (1) under age 65 and receive old age or survivor Social Security benefits or (2) at least age 65 years and either receive these benefits or do not work full-time.

State Expenditures: The Comptroller's Office reports that it will incur a one-time general fund expenditure increase of $77,000 in fiscal 2023 to add the phased-in subtraction modification to the 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 $132.3 million in fiscal 2023 and by $608.8 million in fiscal 2027, as shown in Exhibit 2. Once the exemption is fully phased-in, local revenues will decrease by about $1.1 billion in fiscal 2028.

Small Business Impact: DLS notes that the primary beneficiaries of the bill are not small businesses. A portion of the proposed income tax reduction may be used by individuals for additional spending at Maryland small businesses; however, this potential benefit does not account for any negative impact to small businesses that could result from a reduction in spending and/or an increase in taxes that may be needed in order to balance State and local budgets.

Additional Information

Prior Introductions: None.

Designated Cross File: SB 405 (The President, *et al.*) (By Request - Administration) - Budget and Taxation.

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

Fiscal Note History: First Reader - February 22, 2022
rh/hlb

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Retirement Tax Elimination Act of 2022

BILL NUMBER: HB 420

PREPARED BY: Governor's Legislative Office

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

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

OR

_X_ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

While there are other reasons for retirees to leave the State, it is clear that financial reasons are a factor. Studies indicate that Maryland ranks near the bottom in the country in being tax friendly to retirees and that more retirees migrate from the State than to the State. This bill will encourage retirees to stay in the State and further will be an incentive for retirees who live in other states to migrate here. This will benefit small businesses frequented by retirees.

This bill will also provide retirees who live in the State with more income that they can use at small businesses. While it is not possible to quantify the impact of this bill on small businesses we believe it will have a significant positive impact.