SB 152

Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE
Revised

Senate Bill 152 (Senator Stone)
Budget and Taxation Ways and Means

Income Tax - Subtraction Modification for Retirement Income - Rollovers to Individual Retirement Accounts

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This bill allows income from a rollover individual retirement account or annuity (IRA) under section 408 of the Internal Revenue Code (IRC) to be included within the subtraction modification allowed for retirement income from an employee retirement system if: (1) the contributions to the IRA consist entirely of the tax-free rollover of distributions from an employee retirement system; and (2) the tax-free rollover resulted from the mandatory withdrawal of amounts in the employee retirement system.

The bill takes effect July 1, 2001, and applies to all taxable years beginning after December 31, 2000.

Fiscal Summary

State Effect: The extent of any general fund revenue loss depends on a number of unknown factors which include the number and amount distributed each year from such nontaxable rollovers and the amount of Social Security received by these individuals. *Under one set of assumptions*, general fund revenues could decline by approximately $1.6 million annually.

Local Effect: Based on the assumptions above, local government revenues could decrease by approximately $900,000.

Small Business Effect: None.

Analysis

Current Law: See below.

Background: Current Maryland income tax law includes tax relief for elderly individuals in several forms.

Social Security Benefits

Social Security benefits and benefits received under the Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal income tax purposes.

Pension Exclusion

Maryland law provides a special 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 ($16,500 for 2000) 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 payment received.

The pension exclusion has been a part of the Maryland income tax since 1965. When the pension exclusion was first enacted, it was intended to equalize the income tax treatment of individuals covered by Social Security and those not covered by Social Security, particularly federal government employees.

Since the original enactment of the pension exclusion, a new federal government retirement system, the Federal Employees Retirement System, became effective in 1987. Almost all new federal civilian employees hired after 1983 were automatically covered by this new retirement system. Under this new system, employees are eligible to receive Social Security benefits upon retirement.

The current pension exclusion is that it is limited to income received from an "employee retirement system." Chapter 524 of 2000 (SB 401) provides a definition of an "employee retirement system" to clarify the types of retirement income that may be included for purposes of calculating the pension exclusion.

Eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under sections 401(a), 403, or 457 of the IRC. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, Individual Retirement Arrangements (IRAs), Keogh plans, and simplified employee pension plans (SEPs) are not considered employee retirement systems.

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under current law by the amount of Social Security benefits received by the individual. The Social Security offset was established at the same time as the pension exclusion. 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.

Additional Personal Exemptions for Elderly Individuals

Other income tax relief is provided to senior citizens regardless of the source of their income. In addition to the regular personal exemptions allowed for individuals ($2,100 per exemption for 2001), each individual age 65 and older is allowed to deduct an additional $1,000 personal exemption.

State Fiscal Effect: The table below presents the savings to a hypothetical retiree under current law and under the bill. The retiree is assumed to receive $13,000 in annual pension income through an employer retirement plan, $4,000 in distributions from an IRA, and $0 in Social Security (SS) payments. As the table indicates, the additional State tax savings to the retiree as a result of the bill is $192.

State Tax Savings to Retirees from the Pension Exclusion in 2001						
	Current Law			SB 152		
Types of Income	Retirement Income	IRA	SS Payment Received	Retirement Income	IRA	SS Payment Received
Amount of Income	$13,000	$4,000	$0	$13,000	$4,000	$0
Pension Exclusion Calculation (assume max. SS benefit allowed in 2001 is $17,200)						
	Take lesser of:			Take lesser of:		
	$13,000 or ($17,200 - $0)			$17,000 or ($17,200)		
Pension Exclusion	$13,000			$17,000		
State Tax Savings	$624			$816		

The actual cost of the bill, which cannot be reliably estimated at this time, depends on the number of rollovers and the amount distributed each year from rollovers that were formerly distributed from an employee retirement system resulting from the mandatory withdrawal of amounts in the employee retirement system, and the amount of Social Security benefits received by these individuals.

However, *for illustrative purposes only*, based on the 1996 Maryland Statistics of Income data, it is estimated that general fund revenues would decrease by about $1.6 million in tax year 2001. Although the pension exclusion is expanded for tax year 2001, it is assumed that most taxpayers will not adjust their estimated payments to reflect the increased subtraction until after July 1, 2001. The estimate is based on the following facts and assumptions:

- For tax year 1996, approximately 15,700 returns were filed with an IRA distribution, but no pension income; the average distribution was $30,000; the average pension exclusion was $6,500.

- The maximum annual benefit under the Social Security Act for tax year 1996 was $14,400 ($16,500 for tax year 2000).

- The maximum annual growth in the pension exclusion amount increases by 4% annually.

- 25% of the IRA distributions resulted from the nontaxable rollover of a distribution from an employee retirement system that resulted from the mandatory withdrawal of amounts in the employee retirement system, and each taxpayer qualifies for the average pension exclusion.

Local Revenues: Local revenues would decrease by approximately 2.74% (tax year 2001) to 2.75% (tax year 2005) of the total State subtraction taken each year. Based on the estimate above, this would result in a loss of approximately $900,000 in tax year 2001.

Additional Information

Prior Introductions: This bill was introduced as SB 319 during the 2000 session. It was referred to interim study by the Budget and Taxation Committee.

Cross File: None.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Department of Legislative Services

Fiscal Note History: First Reader – January 24, 2001
ef/jr Revised – Senate Third Reader – March 23, 2001

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