HB 1313

Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE

House Bill 1313 (Delegate Howard)
Ways and Means

Income Tax - Subtraction Modification for Retirement Income of Public School Teachers and Law Enforcement and Public Safety Officers

This bill provides a subtraction modification under the Maryland income tax for retirement income received by an individual that is attributable to the individual's employment in the State as: (1) a certificated teacher in the public elementary or secondary schools; (2) a law enforcement officer of the United States, the State, or a political subdivision of the State; (3) a sheriff or deputy sheriff; (4) a correctional officer; (5) a volunteer or professional fire fighter or rescue squad member; or (6) a sworn member of the Maryland State Fire Marshal's Office. Retirement income that is included in the subtraction may not be taken into account for purposes of calculating the State's pension exclusion modification.

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

Fiscal Summary

State Effect: General fund revenue decrease of approximately $66.1 million in FY 2002, which reflects the impact of one and one-half tax years. Future year reductions reflect a 5% increase in retirement benefits.

($ in millions)	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
GF Revenue	($66.1)	($46.4)	($48.8)	($51.4)	($54.0)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($66.1)	($46.4)	($48.8)	($51.4)	($54.0)

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

Local Effect: Local government revenues would decrease by approximately $37.9 million in FY 2002.

Small Business Effect: None.

Analysis

Current Law: See below.

Background: No subtraction modification of this type exists under the Maryland income tax. However, 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

A special pension exclusion is provided 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.

One important feature of 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 Internal Revenue Code. 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 an additional $1,000 personal exemption.

State Fiscal Effect: General fund revenues could decrease by approximately $43.5 million in tax year 2001. Although the subtraction modification is in effect for tax year 2001, it is assumed that most taxpayers will not adjust their estimated payments to reflect the new subtraction until after July 1, 2001. Consequently, general fund revenues are estimated to decrease by $66.1 million in fiscal 2002, reflecting the impact of one and one-half tax years. The estimate is based on the following facts and assumptions:

- approximately 13,300 retired law enforcement officers, sheriffs, and correctional officers (federal, State, and local) residing in Maryland would be eligible for the subtraction modification in tax year 2001;

- approximately 28,900 retired public school teachers residing in Maryland would be eligible for the subtraction modification in tax year 2001;

- approximately 5,900 retired fire, rescue, and emergency medical personnel residing in Maryland would be eligible for the subtraction modification in tax year 2001; and

- total retirement benefits received by eligible individuals would be approximately $905.3 million in tax year 2001. The average annual benefit is approximately $22,600.

Average retirement benefits are estimated to increase by 5% annually.

Local Fiscal Effect: Local government revenues would decrease by approximately 2.74% of the total State subtraction in fiscal 2002. Based on the estimate above, local government revenues would decrease by approximately $37.9 million in fiscal 2002.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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Analysis by: Michael Sanelli

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510