**HB 734**

# Department of Legislative Services

Maryland General Assembly
2001 Session

## FISCAL NOTE

House Bill 734 (Delegate Ports, *et al.*)
Ways and Means

---

**Income Tax - Subtraction for Retirement Income**

---

This bill reduces the age, from 65 to 62, at which a Maryland taxpayer can qualify for the State pension exclusion as an income tax subtraction 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 revenues would decrease by $10.6 million in FY 2002, which includes the impact of tax year 2000 and half of tax year 2001. Future year revenue losses reflect a single fiscal year's loss and 5% growth. Expenditures would not be affected.

| (in millions) | FY 2002 | FY 2003 | FY 2004 | FY 2005 | FY 2006 |
|---|---|---|---|---|---|
| GF Revenue | ($10.6) | ($7.5) | ($7.9) | ($8.3) | ($8.7) |
| Expenditure | $0 | $0 | $0 | $0 | $0 |
| Net Effect | ($10.6) | ($7.5) | ($7.9) | ($8.3) | ($8.7) |

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

**Local Effect:** Local revenues would decrease by $6.1 million in FY 2002 and $4.3 million in FY 2003. Future year revenue losses grow by 5%.

**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*

In addition to the total exemption for Social Security benefits, 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 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 Revenues:** General fund revenues would decrease by $7.0 million in tax year 2001. Although the tax credit is allowed for tax year 2001, it is assumed that most taxpayers will not adjust their tax withholdings to reflect the credit until after July 1, 2001. Consequently, general fund revenues are estimated to decrease by $10.6 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 140,000 taxable returns claimed a pension exclusion in 1996 and the total amount claimed was $951 million.

- 72% of all retirees are 65 and above and 8.7% of all retirees are 62 - 64.

- The average pension exclusion claimed by the 62 - 64 age group is equivalent to the average pension exclusion claimed by the 65 and above age group.

Out-year estimates assume a 5% growth in the amount of pension exclusion claimed.

**Local Revenues:** Local revenues would decrease by $6.1 million in fiscal 2002 and $4.3 million in fiscal 2003. Future year revenue losses grow by 5% annually.

## Additional Information

**Prior Introductions:** This bill was introduced as SB 183 in the 1999 session. It received an unfavorable report from 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 – February 26, 2001
ef/cer

---

Analysis by: Michael Sanelli

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