HB 413

Department of Legislative Services

Maryland General Assembly
2002 Session

FISCAL NOTE

House Bill 413 (Delegate Howard)
Ways and Means

Income Tax - Subtraction Modification for Retirement Income of Public School Teachers

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 a certified teacher in the public elementary or secondary schools of the State. Retirement income included in the subtraction may not be taken into account for purposes of calculating the State's pension exclusion subtraction modification.

The bill takes effect July 1, 2002 and applies to all taxable years beginning after December 31, 2001.

Fiscal Summary

State Effect: General fund revenue decrease of approximately $45.1 million in FY 2003 which reflects the impact of one and one-half tax years. Future years reflect an 8% average increase in eligible retirees and a 9% average increase in benefits.

($ in millions)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	($45.1)	($33.5)	($36.3)	($39.4)	($42.8)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($45.1)	($33.5)	($36.3)	($39.4)	($42.8)

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

Local Effect: Local government revenues would decrease by approximately 2.8% of the total State subtraction taken. Revenues would decline by approximately $26.6 million in FY 2003 and $19.7 million in FY 2004.

Small Business Effect: None.

Analysis

Current Law: 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.

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 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, Keogh plans, and simplified employee pension plans are not considered employee retirement systems.

Additional Personal Exemptions for Elderly Individuals

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.

Background: Teachers in Maryland are included in one of two pension systems. The Teachers' Retirement System (TRS) includes members who were enrolled prior to 1980. There are currently approximately 10,000 active members and 32,000 retirees, vested accounts, and beneficiaries in the TRS. The TRS was closed to new members in 1980, and all teachers hired since that time are in the Teachers' Pension System (TPS). There are currently approximately 82,000 active members and 25,000 retirees, vested accounts, and beneficiaries in TPS.

State Fiscal Effect: General fund revenues would decrease by approximately $30.9 million in tax year 2002. Although the subtraction modification is in effect for tax year 2002, it is assumed that most taxpayers will not adjust their estimated payments to reflect the new subtraction until after July 1, 2002. Consequently, general fund revenues are estimated to decrease by $45.1 million in fiscal 2003 reflecting the impact of one and one-half tax years. The estimate is based on the following facts and assumptions:

- For fiscal 2001, 40,126 retired teachers and beneficiaries received approximately $814.0 million in pension/retirement payments.
- The number of individuals eligible for the subtraction under the bill will increase by approximately 8% annually; this represents a 2.01% increase of eligible TRS members and a 17.73% increase of eligible TPS members.
- Average annual benefits per member will increase by between 3.0% for TPS members and 4.3% for TRS members.
- Approximately 77% of retirees are over 65 and therefore would have been eligible for the pension exclusion.
- The cost of the pension exclusion for fiscal 2003 for retired teachers is estimated to be $14.1 million; the estimate assumes that retired teachers take the subtraction under the bill instead of the pension exclusion.

Local Revenues: Local government revenues would decrease by approximately 2.8% of the total State subtraction taken. Local government revenues would decrease by approximately $26.6 million in fiscal 2003 and by $19.7 million in fiscal 2004.

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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lc/mdr

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