SB 364

Department of Legislative Services
Maryland General Assembly
2002 Session

FISCAL NOTE

Senate Bill 364 (Senator Currie)
Budget and Taxation

Income Tax - Subtraction Modification for Law Enforcement Officer's Retirement Income

---

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 as a law enforcement officer of the United States, the State, or a political subdivision 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 $15.1 million in FY 2003 (one and one-half tax years). Future year reductions increase by 5% annually. No effect on expenditures.

($ in millions)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	($15.1)	($10.7)	($11.3)	($11.9)	($12.5)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($15.1)	($10.7)	($11.3)	($11.9)	($12.5)

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

Local Effect: Local government revenue decrease of approximately $8.2 million in FY 2003.

Small Business Effect: None.

Analysis

Current Law: See below.

Background: 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.

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.

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

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.

West Virginia does not tax pensions of retired West Virginia police officers and fire fighters.

State Fiscal Effect: General fund revenues would decrease by approximately $9.9 million in tax year 2002. 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, 2002. Consequently, general fund revenues are estimated to decrease by $15.1 million in fiscal 2003 reflecting the impact of one and one-half tax years. The estimate is based on the following facts and assumptions:

- There are approximately 8,857 retired law enforcement officers (excluding correctional officers) residing in Maryland who would be eligible for the subtraction modification in tax year 2002.

- The average annual retirement benefit received by eligible retired law enforcement officers was approximately $26,200 in tax year 2001.

- Approximately one-half of these individuals would take an average pension exclusion of $8,768 in tax year 2002 which offsets the overall revenue decrease by approximately $1.8 million.

For future years, 50% of the revenue loss for a given tax year will be incurred in the first fiscal year, with the remaining 50% in the second fiscal year as taxpayers adjust their withholding and estimated payments to reflect the changes made by the bill. Future year losses are expected to increase by 5% annually.

Local Fiscal Effect: Local government revenues will decrease by approximately 2.8% of the State subtraction taken in tax year 2002. Based on the above estimate, total local government revenues will decrease by approximately $8.2 million in fiscal 2003.

Additional Information

Prior Introductions: This bill was introduced as SB 287 in the 2001 session. It was referred to interim study by the Senate 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 10, 2002
lc/jr

Analysis by: Michael Sanelli

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