

**Department of Legislative Services**  
 Maryland General Assembly  
 2002 Session

**FISCAL NOTE**

House Bill 618 (Delegates Ports and Redmer)  
 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, 2002 and applies to all taxable years beginning after December 31, 2001.

**Fiscal Summary**

**State Effect:** General fund revenues would decrease by \$24.1 million in FY 2003, which includes the impact of tax year 2002 and half of tax year 2003. Future year revenue losses reflect a single fiscal year's loss and 4% growth. Expenditures would not be affected.

(\$ in millions)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	(\$24.1)	(\$17.0)	(\$17.9)	(\$18.8)	(\$19.7)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$24.1)	(\$17.0)	(\$17.9)	(\$18.8)	(\$19.7)

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

**Local Effect:** Local revenues would decrease by \$14.2 million in FY 2003, which reflects the impact of one and one-half tax years, and \$10.0 million in FY 2004. Future year revenue losses grow by 4%.

**Small Business Effect:** None.

## Analysis

**Current Law:** 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 (\$17,300 for 2002) 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.

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 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*

In addition to the regular personal exemptions allowed for individuals (\$2,400 per exemption for 2002), each individual age 65 and older is allowed to deduct an additional \$1,000 personal exemption.

**State Revenues:** General fund revenues would decrease by \$15.8 million in tax year 2003. Although the pension exclusion is altered for tax year 2002, it is assumed that most taxpayers will not adjust their tax withholdings to reflect the credit until after July 1, 2002. Consequently, general fund revenues are estimated to decrease by \$24.1 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 tax year 1997, the average pension exclusion was approximately \$7,297; it is estimated to be approximately \$10,961 for those ages 62-65 for tax year 2002.
- For tax year 2002 there would be an estimated 116,785 individuals ages 62-65.
- Approximately 52% of individuals with a tax liability and who were over age 65 claimed the pension exclusion.
- Approximately 26% of those eligible would be retired and therefore able to claim the pension exclusion.

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 withholdings and estimated payments to reflect the changes made by the bill. Future year losses are expected to increase by about 4% annually.

**Local Revenues:** Local government revenues would decrease by approximately 2.8% of the total State subtraction taken. Local revenues would decrease by \$14.2 million in fiscal 2003, which represents one and one-half tax years, and \$10.0 million in fiscal 2004. Future year revenue losses grow by 4% annually.

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## Additional Information

**Prior Introductions:** This bill was introduced as HB 734 in the 2001 session. It received an unfavorable report from the House Ways and Means 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 17, 2002  
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