HB 589

Department of Legislative Services
Maryland General Assembly
2002 Session

FISCAL NOTE

House Bill 589 (Delegate Boutin, *et al*.)
Ways and Means

Income Tax - Subtraction for Retirement Income

This bill alters the State's pension exclusion calculation for retirement income. Specifically, the bill: (1) expands the types of income eligible for the pension exclusion by including income from Individual Retirement Arrangements (IRAs), rollover IRAs, and simplified employee pensions (SEPs); (2) lowers the age of eligibility for the pension exclusion from 65 to 59 1/2 years old; and (3) establishes a maximum annual pension exclusion of $35,000 and eliminates the Social Security offset (the reduction of the maximum pension exclusion by the amount of Social Security received).

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 $312.1 million in FY 2003, which includes the impact of tax year 2002 and half of tax year 2003. Future year revenue decreases 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	($312.1)	($216.3)	($225.0)	($234.0)	($243.4)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($312.1)	($216.3)	($225.0)	($234.0)	($243.4)

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

Local Effect: Local revenues would decrease by $179.5 million in FY 2003, representing the impact of one and one-half tax years, and $126.2 million in FY 2004. Expenditures would not be affected.

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

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 2001) 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 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

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 Fiscal Effect: Based on the *1996 Maryland Statistics of Income* data, it is estimated that general fund revenues would decrease by about $206.1 million in tax year 2002. Although the pension exclusion is expanded, the Social Security offset is eliminated, and the age of eligibility is lowered for tax year 2002, it is assumed that most taxpayers will not adjust their estimated payments to reflect the increased subtraction until after July 1, 2002. Consequently, general fund revenues are estimated to decrease by $312.1 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 1996, approximately 83,356 joint returns were filed claiming an average pension exclusion of $7,245 while 73,479 other types of returns were filed claiming an average pension exclusion of $5,885; the average pension exclusion for 2002 is estimated to be $8,877.
- Approximately 41% of individuals over age 65 would have had taxable returns with pension income in 1996.
- Approximately 55,100 taxpayers between the ages of 59 1/2 and 64 would have had pension income and therefore would have been eligible for the pension exclusion in 1996.
- The maximum annual benefit under the Social Security Act for tax year 1996 was $14,400 ($17,300 for tax year 2001).
- The amount of the pension exclusion is expected to increase by 4% annually.

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 about 4% annually.

Local Revenues: Local revenues would decrease by approximately 2.8% of the total State subtraction in fiscal 2003. This results in a loss of approximately $179.5 million in fiscal 2003 (one and one-half tax years) and $126.2 million in fiscal 2004. Future year revenue losses increase by about 4% annually.

Additional Information

Prior Introductions: This bill was introduced as HB 71 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 18, 2002
ncs/jr

Analysis by: Michael Sanelli

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