HB 404

Department of Legislative Services

Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE

House Bill 404 (Delegate Sossi, *et al.*)
Ways and Means

Income Tax - Subtraction for Retirement Income

This bill increases the amount of the State's pension exclusion subtraction modification to an amount equal to twice the maximum annual benefit under the Social Security Act. Under current law the pension exclusion is equal to the maximum annual benefit under the Social Security Act.

The bill takes effect July 1, 2003 and applies to all taxable years beginning after December 31, 2002.

Fiscal Summary

State Effect: General fund revenue decrease of approximately $218.2 million in FY 2004, which reflects the impact of one and one-half tax years. Future year revenue decreases reflect increasing pension exclusion amounts and growth. No effect on expenditures.

($ in millions)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	($218.2)	($157.3)	($161.8)	($166.2)	($170.6)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($218.2)	($157.3)	($161.8)	($166.2)	($170.6)

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

Local Effect: Local government revenue decrease of approximately $128.7 million in FY 2004. Future year revenue decreases reflect increasing pension exclusion amounts and growth.

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 ($18,500 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 current pension exclusion is that it 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 Fiscal Effect: Based on the *1997 Maryland Statistics of Income* data, general fund revenues could decrease by about $140.7 million in tax year 2004. Because the pension exclusion calculation is altered beginning with tax year 2003, it is assumed that most taxpayers will adjust their estimated payments to reflect the increased subtraction prior to July 1, 2003. Consequently, general fund revenues are estimated to decrease by $218.2 million in fiscal 2004, reflecting the impact of one and one-half tax years. The estimate is based on the following facts and assumptions:

- for tax year 1997, approximately 65,629 joint returns and an additional 56,751 other returns were filed that claimed the pension exclusion;
- the maximum annual benefit under the Social Security Act for tax year 2003 is $39,800 for joint returns and $19,000 for all others, and is estimated to increase by $700 annually (for those filing single);
- the maximum pension exclusion under the bill (for joint returns) would be $79,600 for tax year 2003, $82,400 for tax year 2004, $85,200 for tax year 2005, $88,000 for tax year 2006, $90,800 for tax year 2007, and $93,600 for tax year 2007; and
- the number of individuals eligible for the pension exclusion will increase by approximately 5% per year to 20% by tax year 2007.

In future years it is assumed that the one-half of a tax year impact will be realized in the first fiscal year with the remaining impact in the second fiscal year.

Local Fiscal Effect: Local government revenues are estimated to decrease by approximately 2.8% of the total State subtraction taken. As a result, total local government revenues would decrease by approximately $128.7 million in fiscal 2004, which represents the impact of one and one-half tax years. Future year revenue decreases reflect increasing pension exclusion amounts and growth.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

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Analysis by: Michael Sanelli

Direct Inquiries to:
(410) 946-5510
(301) 970-5510