SB 694

Department of Legislative Services

Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE

Senate Bill 694 (Senator Lawlah)
Budget and Taxation

Income Tax - Subtraction Modification for Retirement Income of Fire, Rescue, and Emergency Medical Services Personnel

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 service as fire, rescue, or emergency medical personnel 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, 2003 and applies to all taxable years beginning after December 31, 2002.

Fiscal Summary

State Effect: General fund revenue decrease of approximately $2.9 million in FY 2004. Future year reductions increase by 3% annually. No effect on expenditures.

($ in millions)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	($2.9)	($2.0)	($2.0)	($2.1)	($2.2)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($2.9)	($2.0)	($2.0)	($2.1)	($2.2)

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

Local Effect: Local government revenue decrease of approximately $1.7 million in FY 2004.

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 ($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.

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 ($2,400 per exemption beginning in 2002), 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: Based on wage and employment data from the Department of Labor, Licensing, and Regulation, general fund revenues would decrease by approximately $1.9 million in tax year 2003. Although the subtraction modification is in effect for tax year 2003, it is assumed that most taxpayers will not adjust their estimated payments to reflect the new subtraction until after July 1, 2003. Consequently, general fund revenues are estimated to decrease by $2.9 million in fiscal 2004 reflecting the impact of one and one-half tax years. The estimate is based on the following assumptions:

- an estimated 10,039 individuals will be employed as Emergency Medical Technician Paramedics, Firefighters, 1st Line Fire Fighter/Prevention Supervisors, Fire Inspectors/Investigators, Police/Fire/Ambulance Dispatchers, and Ambulance Drivers/Attendants in tax year 2003;

- the number of eligible retirees is in a tax year estimated to equal 10% of the workforce in a tax year;

- retirement pay is approximately 35% of salary at retirement; increases by 3% annually; and

- approximately 45% of these retirees already take the pension exclusion subtraction modification; the average pension exclusion is estimated to be $9,658 for tax year 2003 will increase by 5% 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 3% annually.

Local Fiscal Effect: Local government revenues will decrease by approximately 2.8% of the State subtraction taken in tax year 2003. Based on the above estimate, total local government revenues will decrease by approximately $1.7 million in fiscal 2004.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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