HB 822

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 822 (Delegate Gordon, *et al.*)
Ways and Means

Income Tax - Subtraction Modification for Retirement Income

This bill alters the computation of the State's pension exclusion subtraction modification. The bill increases the maximum State pension exclusion to a specified percentage of the maximum annual benefit under the Social Security Act less any Social Security or Railroad Retirement benefits received. The percentage is 105% for tax year 2005, 110% for 2006, 115% for 2007, and 120% for 2008 and beyond.

The bill takes effect July 1, 2004 and applies to tax years 2005 and beyond.

Fiscal Summary

State Effect: General fund revenues would decrease by $5.3 million in FY 2005, which represents the impact of one-half tax year. Future year revenue decreases reflect increasing pension exclusion amounts and income growth.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	($5.3)	($16.5)	($28.4)	($40.8)	($47.9)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($5.3)	($16.5)	($28.4)	($40.8)	($47.9)

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

Local Effect: Local revenues would decline by approximately $3.2 million in FY 2005 and increasing in the out-years.

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 ($19,900 for 2003) 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 payments received. The pension exclusion has been a part of the Maryland income tax since 1965.

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 (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 special treatment of Social Security and other retirement income, other income tax relief is provided to senior citizens regardless of the source of their income. Each individual age 65 and older is allowed a $2,400 personal exemption in addition to the regular personal exemptions allowed for all individuals ($2,400 per exemption for 2003).

State Fiscal Effect: Based on the *1997 Maryland Statistics of Income* data, it is estimated that general fund revenues would decrease by about $10.5 million in tax year 2005. Because the pension exclusion calculation is altered beginning with tax year 2005, it is assumed that most taxpayers will adjust their estimated payments to reflect the increased subtraction prior to July 1, 2004. Consequently, general fund revenues are estimated to decrease by $5.3 million in fiscal 2005, reflecting the impact of one-half tax year. The estimate is based on the following facts and assumptions:

- for tax year 1997, approximately 62,014 joint returns and an additional 52,511 other returns were filed that claimed the pension exclusion;
- the number of individuals with taxable pensions is estimated to increase by 1% annually and pension amounts are increased 10% annually;
- the maximum annual benefit under the Social Security Act for tax year 2004 is $41,400 for joint returns and $20,700 for all others, and is estimated to increase by $700 annually; and
- the maximum pension exclusion under the bill (for joint returns) would be $44,940 for tax year 2005, $48,620 for tax year 2006, $52,440 for tax year 2007, $56,400 for tax year 2008, and $58,080 for tax year 2009.

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 Revenues: Local revenues are estimated to decline by approximately 2.8% of the total State subtraction taken. Revenues would decrease by approximately $3.2 million in fiscal 2005, $10.0 million in fiscal 2006, $17.4 million in fiscal 2007, $24.9 million in fiscal 2008, and $29.2 million in fiscal 2009.

Additional Information

Prior Introductions: HB 292 of 2003, an identical bill, received an unfavorable report from the House Ways and Means Committee. SB 372 of 2002, a similar bill, received an unfavorable report from the Senate Budget and Taxation Committee.

Cross File: None.

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

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