Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 59 (Delegate Boschert)
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 is effective in the first tax year following the fiscal year in which actual general fund revenues exceed by at least 0.05% the Board of Revenue Estimates estimated general fund revenues (including all revisions) for that fiscal year. The Act is null and void if this contingency is not met by fiscal 2008.

Fiscal Summary

State Effect: Potential significant decrease in general fund revenues beginning in FY 2005 and increasing in the out-years. If the contingent provision of the bill is met in FY 2004, general fund revenues would decline by approximately $5.3 million in FY 2005. **Exhibit 2** lists the possible fiscal effects of the bill.

Local Effect: Based on the assumption above, local revenues would decline by approximately $3.2 million in FY 2005 and increasing in the out-years.

Small Business Effect: None.

Analysis

Bill Summary: The provisions of this bill are based on the following contingency: the Comptroller must determine actual general fund revenues exceeded by at least 0.05% the Board of Revenue Estimates estimated general fund revenues for that fiscal year. If the Comptroller determines that this contingency occurred in fiscal 2004, the altered subtraction modification schedule applies to tax years 2005 and beyond. If the Comptroller determines the contingency did not occur in fiscal 2004, then the provisions of the bill will become effective the first fiscal year in which the Comptroller determines the contingency has been met. Once the contingency is met in a particular fiscal year, the provisions of the bill remain in effect even if future fiscal year general fund revenues fail to meet the contingency. If the Comptroller determines the contingency has not been met during any fiscal year from 2004 to 2007, the Act is null and void.

Exhibit 1 lists the possible altered subtraction modification schedules provided under the provisions of this bill. The percentages indicate the maximum pension exclusion allowed in each tax year as a percentage of the maximum allowed under the Social Security Act less any Social Security or Railroad Retirement benefits received.

Exhibit 1
Alternative Maximum Exclusions Provided by HB 59
Depending on Category Trigger

If the contingency occurs in fiscal year:	The maximum exclusion for each tax year:			
	2005	**2006**	**2007**	**2008+**
2004	105%	110%	115%	120%
2005	100%	110%	115%	120%
2006	100%	100%	115%	120%
2007	100%	100%	100%	120%

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, 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 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: State revenues would not be affected if the contingency provided under this bill is not met in fiscal 2004 through 2007. Exhibit 2 lists the decline in general fund revenues by fiscal year that would occur based on when general fund revenues exceed the Board of Revenue estimated general fund revenues by at least 0.05%.

Exhibit 2
HB 59 Revenue Loss by Fiscal Year
Depending on Contingency Trigger
($ in millions)

Contingency is met for fiscal year:	**2005**	**2006**	**2007**	**2008**	**2009**
2004	$5.3	$16.4	$28.4	$40.8	$47.9
2005	0.0	5.6	22.9	40.8	47.9
2006	0.0	0.0	8.6	32.2	47.9
2007	0.0	0.0	0.0	11.8	36.1

The decline in revenues is one-half of the tax year following the fiscal year in which the contingency occurs and the following full tax years except tax year 2009. One-half of the decrease of tax year 2009 occurs in fiscal 2009, and one-half occurs in fiscal 2010.

This 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

- if the bill is effective in each year, 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.

Exhibit 3 lists the Board of Revenue Estimates and actual general fund revenues for fiscal years from 1996 to 2003.

Exhibit 3
Actual and Estimated General Fund Revenues
Fiscal 1996 to 2002
($ in millions)

Fiscal Year	Official Estimate	Actual Revenue	Difference	Percent Difference
1996	$7,189,878	$7,211,005	$21,127	0.3%
1997	7,506,443	7,617,333	110,890	1.5%
1998	7,947,096	8,051,340	104,244	1.3%
1999	8,193,981	8,524,367	330,386	4.0%
2000	9,092,047	9,220,119	128,072	1.4%
2001	9,648,350	9,802,434	154,084	1.6%
2002	9,627,617	9,504,042	(123,575)	-1.3%
2003	9,366,556	9,329,140	(37,416)	-0.4%

Except in fiscal 2002 and 2003, actual general fund revenue exceeded the estimated general fund revenue by at least 0.05%. Legislative Services advises that it cannot be reliably estimated if the contingency of the bill will be met for fiscal 2004.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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