SB 659

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

Senate Bill 659 (Senator Hooper, *et al.*)
Budget and Taxation

Income Tax - Pension Exclusion - Application to Spouses Filing a Joint Return

This bill increases the existing State pension exclusion subtraction modification for joint filers to twice the amount of the maximum annual benefits payable under the Social Security Act reduced by any Social Security payments received.

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

Fiscal Summary

State Effect: General fund revenues would decrease by $114.0 million in FY 2005, reflecting the impact of one and one-half tax years. Future year revenue decreases reflect annualization, increasing pension exclusion amounts, and income growth. No effect on expenditures.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	($114.0)	($79.9)	($83.4)	($87.0)	($90.7)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($114.0)	($79.9)	($83.4)	($87.0)	($90.7)

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

Local Effect: Local revenues would decline by approximately $69.6 million in FY 2005 and by $55.3 million in FY 2009.

Small Business Effect: None.

Analysis

Current Law: Current Maryland income tax law includes tax relief for elderly individuals in several forms.

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 ($19,900 for 2003) may be exempt from tax. The maximum exclusion allowed for all filers, whether joint or individual, 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.

Social Security Benefits

In addition to the special pension exclusion, 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.

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 Revenues: The bill would expand the pension exclusion for joint returns when: (1) only one individual is at least 65 years old or disabled, reports pension income, and utilizes the maximum pension exclusion; or (2) both individuals are at least 65 years old or disabled, each reports pension income, and together they utilize the maximum exclusion. General fund revenues are estimated to decrease by $114.0 million in fiscal 2005, reflecting the impact of all of tax year 2004 and one-half of tax year 2005. The estimate is based on the following facts and assumptions:

- for tax year 1996, 25,284 joint returns claimed the pension exclusion with both individuals reporting pension exclusion where only one filer was reported as being over 65 years old;
- for tax year 2001, 57,131 joint returns claimed the pension exclusion where both were individuals at least 65 years old and each reported pension income;
- the number of individuals with taxable pensions is estimated to increase by 1% annually, pension amounts are increased 10% annually, and pension exclusions by 5% annually;
- the number of individuals filing a pension exclusion noted above is increased by 6.8% to include disabled individuals under the age of 65; and
- the maximum annual benefit under the Social Security Act for tax year 2004 is $41,400 for joint returns and is estimated to increase by $700 annually.

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 $69.6 million in fiscal 2005, $48.8 million in fiscal 2006, $50.9 million in fiscal 2007, $53.1 million in fiscal 2008, and $55.3 million in fiscal 2009.

Additional Information

Prior Introductions: None.

Cross File: None.

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