HB 1282

Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

House Bill 1282 (Delegate Gordon)
Ways and Means

Income Tax - Exemptions for Elderly or Totally Disabled Individuals

This bill repeals the existing pension exclusion under the State income tax. The bill replaces it with a $12,000 deduction that any individual, other than a fiduciary, may deduct if they are at least 65 years old or disabled. Individuals who are disabled or age 65 or older after December 31, 2004 are subject to an income means test.

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

Fiscal Summary

State Effect: General fund revenues could decrease by approximately $61.2 million in FY 2006, which reflects the impact of one and one-half tax years. Future years reflect annualization and estimated cost of pension exclusion and deduction proposed by the bill. General fund expenditures would increase by $17,000 in FY 2006 due to one-time tax form changes and computer testing.

($ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	($61.2)	($36.6)	($32.8)	($28.8)	($24.6)
GF Expenditure	0	0	0	0	0
Net Effect	($61.2)	($36.6)	($32.8)	($28.8)	($24.6)

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

Local Effect: Local income tax revenues would decrease by approximately 3.1% of the additional income exempted under the bill. Local government revenues would decrease by approximately $40 million in FY 2006 and by $16.1 million in FY 2010.

Small Business Effect: None.

Analysis

Bill Summary: The bill replaces the existing State pension exclusion beginning with tax year 2005 with a $12,000 deduction. Individuals who are 65 years or older or disabled after December 31, 2004 are subject to an income means test. For these individuals, the deduction is reduced on a dollar-for-dollar basis in the amount by which the individual's federal adjusted gross income, not including any taxable Social Security benefits, exceeds: (1) $75,000 for an individual; (2) $100,000 for married, filing joint; head of household; and qualified widows; and (3) $37,500 for married individuals filing separately.

Current Law: Maryland law provides a pension exclusion subtraction for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified amount of taxable pension income ($20,700 in tax year 2004) 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.

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under the current law by the individual. The Social Security offset was established at the same time as the pension exclusion. Given that Social Security benefits are exempt from Maryland income tax, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of allowable exclusion by the amount of Social Security benefits received.

One important feature of the current pension exclusion is that it is limited to income received from an "employee retirement system." Chapter 254 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 410(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, IRAs, Keogh plans, and SEPs are not considered employee retirement systems.

Additional Income Tax Treatment for Elderly Individuals

Social Security benefits and benefits received under the federal Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal purposes. In addition, each taxpayer over 65 or older: (1) is allowed a $1,000 personal exemption in addition to the regular exemption of $2,400 allowed to all individuals; and (2) can earn more income without being required to file a tax return.

State Revenues: The provisions of the bill repealing the pension exclusion and adding a new $12,000 deduction take effect beginning with tax year 2005. As a result, general fund revenues would decrease by approximately $61.2 million, which reflects the impact of all of tax year 2005 and one-half of tax year 2006. Future fiscal years reflect the impact of one-half the prior tax year and one-half the current tax year. **Exhibit 1** lists the fiscal impact of the bill in fiscal 2006 through 2010.

Exhibit 1
HB 1282 Fiscal Impact
($ in Millions)

	FY 06	FY 07	FY 08	FY 09	FY 10
Exempted under HB 1282	$163.6	$108.8	$108.7	$108.5	$108.3
Existing Pension Exclusion	102.4	72.3	75.9	79.7	83.7
Net State Revenue Loss	**$61.2**	**$36.6**	**$32.8**	**$28.8**	**$24.6**
Net Local Revenue Loss	**39.9**	**23.9**	**21.4**	**18.8**	**16.1**

State Expenditures: The Comptroller's Office reports that it would incur a one-time general fund expenditure increase of $17,000 in fiscal 2006 in order to add the new exemption to the personal income tax form. This includes data processing changes to the SMART income tax return processing and imaging systems, and systems testing.

Local Revenues: Exhibit 1 lists the decrease in local income tax revenues due to the provisions of the bill from fiscal 2006 through 2010.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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mp/hlb

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