HB 664

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 664 (Delegate Heller)
Ways and Means

Income Tax - Subtraction Modification for Teachers' Retirement Income

This bill creates a subtraction modification under the Maryland income tax for 100% of retirement income received by a State elementary or secondary public school teacher. Teacher retirement income exempted under this bill cannot be counted towards the State pension exclusion exemption.

The bill takes effect July 1, 2006 and applies to tax year 2006 and beyond.

Fiscal Summary

State Effect: General fund revenues could decrease by approximately $33.8 million in FY 2007, which reflects the impact of one and one-half tax years. Out-year revenue losses reflect annualization and estimated number of eligible retirees. Expenditures would not be affected.

($ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	($33.8)	($25.2)	($27.6)	($30.3)	($32.4)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($33.8)	($25.2)	($27.6)	($30.3)	($32.4)

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

Local Effect: Local government revenues would decrease by approximately $21.4 million in FY 2007 and by $20.5 million in FY 2011. Expenditures would not be affected.

Small Business Effect: None.

Analysis

Current Law: There is no subtraction modification specifically for teachers' retirement income, but the retirement income received by a teacher is eligible for the State pension exclusion.

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 maximum amount of taxable pension income ($21,500 maximum for 2005) 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.

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 income tax purposes. 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 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 taxes.

State Revenues: Subtraction modifications could be claimed beginning in tax year 2006. As a result, general fund revenues would decrease by approximately $21.8 million in tax year 2006. By exempting 100% of teacher retirement income, it is assumed that most taxpayers will adjust their withholding and estimated payments, resulting in a reduction of $33.8 million in fiscal 2007, which reflects all of tax year 2006 and one-half of tax year 2007. Fiscal 2008 and beyond reflect the impact of one-half the prior tax year and one-half the current tax year. Future year losses increase by approximately 4% annually.

The estimate is based on the following facts and assumptions:

- There were 48,091 retirees in the Teachers' Retirement System and the Teachers' Pension System in fiscal 2005.

- Based on federal Bureau and Labor Statistics data, it is estimated that 60% of the retirees in the teachers' retirement and pension systems are elementary and secondary teachers who would qualify for the proposed subtraction modification.

- Approximately 19% of retirees live out-of-state and will not claim the subtraction modification.

- The number of retirees in the State teachers' systems increased by approximately 5% annually from fiscal 1997 to 2005. It is assumed that a similar rate of increase continues from fiscal 2006 to 2011.

- An estimated 65% of retired teachers are 65 years or older.

- Based on average State retired Social Security payments and average teacher pension, retired teachers would exempt approximately $11,200 under the pension exclusion in tax year 2006.

Local Revenues: Local revenues would decrease by approximately 3% of the State subtraction taken in tax year 2006. In fiscal 2007, the decrease would be approximately $21.4 million. Future year revenue decreases would total approximately $15.9 million in fiscal 2008, $17.4 million in fiscal 2009, $19.2 million in fiscal 2010, and $20.5 million in fiscal 2011.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Maryland State Retirement Agency, Bureau of Labor Statistics, Social Security Administration, Department of Legislative Services

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