

Department of Legislative Services
 Maryland General Assembly
 2006 Session

FISCAL AND POLICY NOTE

House Bill 1424
 Ways and Means

(Delegate Hixson, *et al.*)

Hometown Heroes Act of 2006 - Income Tax - Subtraction Modification for Retirement Income of Law Enforcement, Fire, Rescue, and Emergency Services Personnel

This bill provides that the retirement income received by retired federal, State, and local law enforcement officers, firefighters, and emergency medical services personnel can qualify for the existing State pension exclusion if the individual is at least 50 years old.

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

Fiscal Summary

State Effect: General fund revenues would decrease by approximately \$15.5 million in FY 2007, which reflects the impact of one and one-half tax years. Future years reflect annualization, inflation, and an estimated number of eligible retirees. Expenditures would not be affected.

(\$ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	(\$15.5)	(\$8.1)	(\$8.5)	(\$8.9)	(\$9.3)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$15.5)	(\$8.1)	(\$8.5)	(\$8.9)	(\$9.3)

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

Local Effect: Revenues would decrease by approximately \$9.8 million in FY 2007 and by \$5.9 million in FY 2011. Expenditures would not be affected.

Small Business Effect: None.

Analysis

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 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.

Background: Public safety personnel participate in a variety of State and local pension systems. While many locations, including the State, provide systems or plans that are restricted only to law enforcement and/or public safety personnel, smaller or less-affluent jurisdictions tend to include such individuals in general employee pension plans. Most public employers provided defined benefit plans, that is, plans that offer death, disability, and retirement benefits based on accrued service and/or age. The more generous plans provide not only higher benefits but also permit retirement with less service (20 or 25 years of service) and at a younger age (50 or 55). General employee plans tend to provide for service retirement after 30 years of service and/or at a normal retirement age, likely to be age 60, 62, or 65.

Chapter 534 of 2004 established the Task Force on the Exemption of Law Enforcement Officers’ Pensions from Taxation. The task force issued its final report in December 2004. The task force estimated there were 9,600 retired State and local law enforcement

officers. An analysis of State law enforcement systems concluded that approximately 17% of State police retirees were disabled and 57% of retirees were age 50 to 64. Certain disability pensions, including law enforcement disability pensions, are exempt from federal and State taxation. The task force also stated there were 83,000 federal law enforcement officers and that approximately 2,900 of these federal officers lived in the State. The federal Office of Personnel Management indicated that the average retired federal law enforcement pension was \$60,000.

The task force estimated there were 12,227 active county and State law enforcement officers. According to the Bureau of Labor Statistics (BLS), approximately 13,240 individuals in November 2004 were employed as firefighters or emergency medical services personnel.

State Revenues: General fund revenues would decrease by approximately \$7.6 million in tax year 2006. It is assumed that most taxpayers will adjust their withholding and estimated payments after January 1, 2007, resulting in a reduction of \$15.4 million in fiscal 2007. Fiscal 2008 and beyond reflect the impact of one-half of the prior tax year and one-half of the current tax year. **Exhibit 1** shows the projected State and local revenue loss from exempting retirement income from State and local taxes. Out-year revenue losses reflect annualization, estimated number of eligible retirees, increases in retirement income, and the estimated increase in the pension exclusion provided for retirement income.

Exhibit 1
Projected State and Local Revenue Loss

<u>Fiscal</u>	<u>State</u>	<u>Local</u>	<u>Total</u>
2007	\$15,472,652	\$9,772,201	\$25,244,853
2008	8,115,573	5,125,625	13,241,198
2009	8,497,416	5,366,789	13,864,204
2010	8,901,468	5,621,980	14,523,447
2011	9,324,732	5,889,305	15,214,037

This estimate is based on the following facts and assumptions:

- The Task Force on the Exemption of Law Enforcement Officers' Pension from Taxation estimated there were a total of approximately 9,600 retired State and local law enforcement officers and 2,900 federal officers.

- According to the State Retirement Agency, approximately 19% of all State retirees live outside of Maryland. It is assumed that retirees affected by the bill have a similar percentage of individuals who reside outside of the State and do not have State income tax liabilities.
- Based on the ratio of active county and municipal law enforcement officers and firefighter and emergency medical services employment, it is estimated that there are approximately 7,200 retired firefighters and emergency medical services personnel.
- The pension exclusion in tax year 2005 was \$21,500 and is estimated to increase by approximately 2.5% annually from 2005 to 2011.
- Based on data from the task force and BLS, the average pensions in 2005 were: federal law officers (\$60,000), State police officers (\$34,800), county police officers (\$30,200), municipal police officers and firefighters (\$24,100), and emergency medical services personnel (\$19,896).
- An estimated 17% of State police retirees are disabled. It is assumed that other retirees affected by the bill have a similar disability rate.
- An estimated 57% of State police retirees are 50 to 64 years old. It is assumed that the other retirees affected by the bill have a similar percentage of 50 to 64 year olds.
- The number of retirees increases by approximately 2.4% annually from 2005 to 2011.
- Individuals claiming the pension exclusion are able to exclude the maximum amount available in each year and have sufficient tax liability.

Local Revenues: Local government revenues would decrease by approximately 3% of the net change in State tax liability resulting from the provisions of the bill. In fiscal 2007 the decrease would be approximately \$9.8 million. Future year revenues decrease by approximately \$5.2 million in fiscal 2008, \$5.4 million in fiscal 2009, \$5.6 million in fiscal 2010, and \$5.9 million in fiscal 2011.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Bureau of Labor Statistics, Congressional Budget Office, State Retirement Agency, Department of Legislative Services

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