Department of Legislative Services

Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 151 (Delegate Hixson, *et al.*)
Ways and Means

Hometown Heroes Act of 2007 - Income Tax - Subtraction Modification for Retirement Income of Law Enforcement, Fire, Rescue, and Emergency Services Personnel

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This bill provides that an individual may exempt the first $5,000 of public safety retirement income from State taxation if the retirement income resulted from employment as a law enforcement officer or fire, rescue, or emergency services personnel of the United States, the State, or political subdivision of the State. Public safety retirement income exempted under the bill cannot be counted towards the State pension exclusion.

The bill takes effect July 1, 2007 and applies to tax year 2007 and beyond.

Fiscal Summary

State Effect: General fund revenues could decrease by $3.3 million in FY 2008 due to additional public safety retirement income being exempted from the State income tax. Future years reflect estimated additional exempted amount of retirement income. General fund expenditures would increase by $19,000 in FY 2008 for computer programming expenses at the Comptroller's Office.

($ in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	($3.34)	($3.50)	($3.65)	($3.82)	($3.89)
GF Expenditure	.02	0	0	0	0
Net Effect	($3.36)	($3.50)	($3.65)	($3.82)	($3.89)

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

Local Effect: Local revenues would decrease by $2.1 million in FY 2008. Future year losses increase by approximately 5% annually thereafter. No effect on expenditures.

Small Business Effect: None.

Analysis

Current Law: No State income tax subtraction modification exists specifically for public safety retirement income, but this income can be exempted under the State's pension exclusion as discussed below.

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 ($22,600 maximum for 2006) 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.

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: Chapter 534 of 2004 established the Task Force on the Exemption of Law Enforcement Officers' Pensions from Taxation. Among its findings was that the average pension in the State Police Retirement System (SPRS) was $34,800 and the Law Enforcement Officers' Pension System (LEOPS) was $26,100. The average county law enforcement pension was estimated to be $30,158 while the average municipal law enforcement officers pension was $24,088. The task force also estimated that there were 2,900 retired federal law enforcement officers in Maryland and that the average pension received was $60,000. In fiscal 2006, there were 2,719 retirees in SPRS, LEOPS, and the Local Fire and Police System (LFPS).

State Revenues: Additional public safety retirement income could be exempted beginning in tax year 2007. As a result, general fund revenues would decrease by $3.3 million in fiscal 2008. This estimate is based on the number of retirees in SPRS, LEOPS, and LFPS as well as an estimated 2,900 retired law enforcement officers. The number of retired county and municipal public safety retirees is based on the number of retirees reported by Baltimore City and Anne Arundel, Frederick, Howard, Montgomery, Prince George's, and Washington counties. The amount from these counties is increased based on the percentage these counties comprise of the total municipal and county public safety employment in the State. The estimate is based also on the following facts and assumptions:

- 15% of retirees live out-of-state and are not subject to State income taxation;
- approximately 12% of retirees receive service-related disability and are currently exempt from State income taxation;
- based on average public safety retirement pensions, the existing State pension exclusion, and estimated age distribution of retirees, it is estimated that on average an additional $4,433 in public safety retirement income per retiree would be exempted in tax year 2007;
- the number retirees increases by 1.5% annually and the average pension amount excluded increases by 3% annually; and
- a total of 15,420 individuals would qualify in tax year 2007.

It is assumed that due to the modest change in State and local income tax liability (approximately $344 per retiree) individuals do not adjust withholdings and estimated payments. To the extent that individuals do adjust withholdings and payments, revenue losses could be greater than estimated in fiscal 2008.

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of $18,800 in fiscal for data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Local Revenues: Local revenues would decrease by $2.1 million in fiscal 2008, $2.2 million in fiscal 2009, $2.3 million in fiscal 2010, $2.4 million in fiscal 2011, and $2.5 million in fiscal 2012.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Anne Arundel County, Baltimore City, Cecil County, Frederick County, Howard County, Montgomery County, Washington County, Department of State Police, Maryland State Retirement Agency, *Task Force on the Exemption of Law Enforcement Officers' Pensions from Taxation*, Department of Legislative Services.

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