HB 1162

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 1162 (Delegate Krebs)
Ways and Means

Income Tax - Subtraction Modification - Retirement Income

This bill expands the existing State pension exclusion subtraction modification by allowing income from the following plans to be included within the subtraction modification allowed for retirement income: • Individual Retirement Accounts (IRAs) and annuities under Section 408 of the Internal Revenue Code (IRC); • Simplified Employee Pension (SEPs) under Section 408(K) of the IRC; and • an ineligible deferred compensation plan under Section 457(F) of the IRC.

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

Fiscal Summary

State Effect: General fund revenues would decrease by at least $24.8 million, which represents the impact of one and one-half tax years. Future years reflect annualization, the estimated number of eligible taxpayers, and additional amounts of income subtracted as provided by the bill. Expenditures would not be affected.

($ in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	($24.8)	($17.4)	($18.1)	($18.8)	($19.6)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($24.8)	($17.4)	($18.1)	($18.8)	($19.6)

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

Local Effect: Local income tax revenues would decrease by $15.7 million in FY 2008, $11.0 million in FY 2009, $11.4 million in FY 2010, $11.9 million in FY 2011, and $12.4 million in FY 2012.

Small Business Effect: None.

Analysis

Current Law: Maryland income tax law currently provides a pension exclusion 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 annual amount of taxable pension income ($22,600 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; this is known as the "Social Security offset."

Given that Social Security benefits are exempt from Maryland income tax, even though they are partly taxable for federal income tax purposes, the Social Security 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 Social Security benefits received.

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. 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 $1,000 personal exemption in addition to the regular personal exemption of $2,400 allowed for all individuals; and • can earn more income without being required to file taxes.

State Revenue Effect: Additional amounts of income could be subtracted as provided by the bill beginning in tax year 2007. It is assumed that most taxpayers will adjust withholdings and estimated payments. As a result, fiscal 2008 revenues would decrease by both the change in tax year 2007 revenues and also by one-half of tax year 2008, resulting in a decrease of approximately $24.8 million in fiscal 2008. This estimate is based on the following facts and assumptions:

- for tax year 2004, approximately 16,677 returns were filed with IRA distributions totaling approximately $308.7 million, but no pension income; the average distribution was $18,512;
- in tax year 2004, the IRS reports that 32,288 Maryland returns reported a total of $544.8 million in income from SEPs;

- based on IRS data, it is estimated that 12,200 individuals have $255 million in annuity income;
- about one-half of individuals who receive annuity and SEP distributions would be eligible for the pension exclusion;
- the maximum pension exclusion in 2006 is $22,600; and
- the average Social Security benefit received in 2004 by retired workers in the State was $11,460.

This estimate does not include revenue losses from distributions from Section 457(F) deferred compensation plans and individuals who already receive a pension and would be able to subtract even more income under the pension exclusion due to additional types of qualifying retirement income provided by the bill.

Additional Information

Prior Introductions: HB 151 of 2005, a similar bill, was not reported from the House Ways and Means Committee.

Cross File: None.

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

Fiscal Note History: First Reader - March 21, 2007
ncs/hlb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510