Department of Legislative Services

Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

Senate Bill 753 (Senator Muse, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Retirement Income

This bill expands the existing State pension exclusion subtraction modification by broadening the types of income that can qualify to include: (1) Individual Retirement Accounts (IRAs) or annuities under Section 408 of the Internal Revenue Code (IRC); and (2) Simplified Employee Pensions (SEPs) under Section 408(K) of the IRC. The bill also expands the pension exclusion by providing that 100% of income can be exempted from State income taxes if it is from these sources or is income from a retirement system that currently qualifies under the pension exclusion.

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 $356.8 million due to expansion of the pension exclusion, which represents the impact of one and one-half tax years. Future years reflect annualization, estimated number of eligible taxpayers, and additional amount 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	($356.8)	($250.0)	($260.9)	($272.5)	($284.7)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($356.8)	($250.0)	($260.9)	($272.5)	($284.7)

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

Local Effect: Local income tax revenues would decrease by $225.3 million in FY 2008, $157.9 million in FY 2009, $164.8 million in FY 2010, $172.1 million in FY 2011, and $179.8 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 Fiscal 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 $356.8 million in fiscal 2008. This estimate is based on the following facts and assumptions:

- in tax year 2004, Maryland individuals aged 65 years or older reported taxable income totaling $872 million in Section 408 IRA distributions and $5.3 billion in pension, annuity, and SEP income;
- in tax year 2004, a total of $2.0 billion in income was excluded under the pension exclusion;

- the amount of pension income increases by 5% annually and IRA distributions increase by 7%; and
- the number of disabled individuals increases the cost by 5%.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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