HB 999

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Bill 999 (Delegate Krebs, *et al.*)
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 and annuities under Section 408 of the Internal Revenue Code; • Roth Individual Retiement Accounts under Section 408(a) of the IRC; • Simplified Employee Pension 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, 2008 and applies to tax year 2008 and beyond.

Fiscal Summary

State Effect: General fund revenues would decrease by at least $19.6 million in FY 2009, 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 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	($19.6)	($13.7)	($14.2)	($14.8)	($15.4)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($19.6)	($13.7)	($14.2)	($14.8)	($15.4)

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

Local Effect: Local income tax revenues would decrease by $12.0 million in FY 2009, $8.4 million in FY 2010, $8.7 million in FY 2011, $9.1 million in FY 2012, and $9.4 million in FY 2013.

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 ($23,600 for 2007) 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 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 2008. It is assumed that most taxpayers will adjust withholdings and estimated payments. As a result, fiscal 2009 revenues would decrease by both the change in tax year 2008 revenues and also by one-half of tax year 2009, resulting in a decrease of approximately $19.6 million in fiscal 2009. This estimate is based on the following facts and assumptions:

- In tax year 2005, approximately 24,000 taxable returns filed by individuals over 65 years old had taxable distributions from an IRA/SEP but no pension income. The average distribution was $18,000.
- The average pension exclusion in tax year 2005 was $10,750.
- Based on an analysis of the March 2007 Current Population Survey, individuals with annuities would increase the total cost of the bill by about 2%.

This estimate does not include revenue losses from distributions from Section 457(F) deferred compensation plans, disabled individuals, 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. This additional revenue loss is likely to be significant. Revenue losses from Roth Individual Retirement Accounts would be minimal, as qualified distributions are not taxable for federal and State income tax purposes.

Additional Information

Prior Introductions: Similar bills were introduced in the 2005 and 2007 sessions. HB 1162 of 2007 was not reported from the House Ways and Means Committee. HB 151 of 2005 was not reported from Ways and Means.

Cross File: None.

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

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