SB 759

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 759 (Senator Stone)
Budget and Taxation

Income Tax - Subtraction Modification for Retirement Income - Rollovers to Individual Retirement Accounts

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This bill allows income from a rollover individual retirement account (IRA) or annuity under Section 408 of the Internal Revenue Code (IRC) to be included within the subtraction modification allowed for retirement income from an employee retirement system if • the contributions to the IRA or annuity consist entirely of the tax-free rollover of distributions from an employee retirement system; and • the tax-free rollover resulted from the mandatory withdrawal of amounts in the employee retirement system.

The bill takes effect July 1, 2008 and applies to tax year 2008 and beyond.

Fiscal Summary

State Effect: The extent of any general fund revenue loss depends on several unknown factors, including the number and amount distributed each year from such nontaxable rollovers and the amount of Social Security received by the individuals utilizing these rollovers. The loss could be significant. Expenditures would not be affected.

Local Effect: Local government revenues could decrease significantly beginning in FY 2009 as a result of additional subtraction modifications as provided by the bill. Expenditures would not be affected.

Small Business Effect: None.

Analysis

Background: Maryland law provides a pension exclusion (in the form of a 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 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. The pension exclusion has been a part of the Maryland income tax since 1965.

One important feature of the current pension exclusion is that it is limited to income received from an "employee retirement system." Chapter 524 of 2000 provides a definition of an "employee retirement system" to clarify the types of retirement income that may be included for purposes of calculating the pension exclusion. Eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under sections 401(a), 403, or 457 of the IRC. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, Individual Retirement Arrangements (IRAs), Keogh plans, and simplified employee pension plans are not considered employee retirement systems.

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under current law by an 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 the allowable exclusion by the amount of any Social Security benefits received.

Additional Income Tax Treatment for Elderly Individuals

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 Revenue Effect: The actual cost of the bill, which cannot be reliably estimated at this time, depends on the number of rollovers and the amount distributed each year from rollovers that were formerly distributed from an employee retirement system resulting from the mandatory withdrawal of amounts in the employee retirement system and the amount of Social Security benefits received by these individuals.

However, *for illustrative purposes only*, based on tax year 2004 income tax return data, it is estimated that general fund revenues would decrease by about $4.8 million in fiscal 2009. Although the pension exclusion is expanded beginning in tax year 2008, it is assumed that most taxpayers will not adjust their estimated payments to reflect the increased subtraction until after July 1, 2009. 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;
- the maximum pension exclusion was $23,600 in tax year 2007;
- the average pension exclusion in tax year 2005 was $10,638;
- 50% of IRA distributions resulted from the nontaxable rollover of a distribution from an employee retirement system that resulted from the mandatory withdrawal of amounts in the employee retirement system, and each taxpayer qualifies for an estimated average pension exclusion of $11,604 in tax year 2008; and
- the number of eligible individuals increases by 1% from tax year 2004 to 2008.

Local Revenues: Local government revenues would decrease by approximately 3% of the total State subtraction taken in tax year 2008. Based on the estimate above, this would result in a loss of approximately $3.0 million in fiscal 2009.

Additional Information

Prior Introductions: This bill has been introduced annually since the 2000 session. SB 877 of 2007 and SB 466 of 2006 were not reported from the Senate Budget and Taxation Committee. SB 89 of 2003, SB 135 of 2004, and SB 273 of 2005 received unfavorable reports from Budget and Taxation. SB 399 of 2002 passed the General Assembly but was vetoed by the Governor for tax policy reasons. SB 152 of 2001 passed the Senate but was not reported from the House Ways and Means Committee. SB 319 of 2000 was referred to interim study by Budget and Taxation.

Cross File: None.

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

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Analysis by: Robert J. Rehrmann

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