Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 406 (Senator Kramer, *et al.*)
Budget and Taxation

Fairness in Taxation for Retirees Act

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 (IRC); Roth Individual Retirement Accounts under Section 408(a) of the IRC; Simplified Employee Pensions under Section 408(K) of the IRC; and ineligible deferred compensation plans under Section 457(F) of the IRC. The bill also alters the method of calculating the maximum amount of the pension exclusion.

The bill takes effect July 1, 2010, and applies to tax year 2010 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by at least $86.4 million in FY 2011, which represents the impact of one and one-half tax years. Future year revenues reflect annualization, the estimated number of eligible taxpayers, and additional amounts of income subtracted as provided by the bill. Expenditures are not affected.

($ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	($86.4)	($60.8)	($63.7)	($66.8)	($70.0)
Expenditure	0	0	0	0	0
Net Effect	($86.4)	($60.8)	($63.7)	($66.8)	($70.0)

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

Local Effect: Local income tax revenues decrease by $54.6 million in FY 2011 and by $44.2 million in FY 2015. Expenditures are not affected.

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 may be exempt from tax. The maximum exclusion allowed is equal to the maximum annual benefit payable under the Social Security Act for an individual who retired at age 65 for the prior calendar year. This maximum amount is reduced by the amount of any Social Security payments received; this is known as the "Social Security offset." Only income from a qualified retirement system can be excluded under the pension exclusion. A qualified retirement plan is maintained by an employer for the benefit of its employees and does not include Individual Retirement Accounts and annuities under Section 408 of the Internal Revenue Code; Roth Individual Retirement Accounts under Section 408(a) of the IRC; rollover individual retirement accounts; Simplified Employee Pension under Section 408(K) of the IRC; and ineligible deferred compensation plans under Section 457(F) of the IRC.

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. 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 2010. It is assumed that most taxpayers will adjust withholdings and estimated payments. As a result, fiscal 2011 revenues will decrease by both the change in tax year 2010 revenues and also by one-half of tax year 2011, resulting in a decrease of approximately $86.4 million in fiscal 2011. 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 2007 was $11,115.
- According to the Social Security Administration, the maximum benefit for an individual aged 65 who retired in 2009 was $26,064 and projected to be

$31,608 in 2015. The maximum benefit for an individual who retired at age 65 during 2009 was $36,648 and projected to be $42,852 in 2015.

This estimate does not include revenue losses from distributions from Section 457(F) deferred compensation plans, disabled individuals, annuities, 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.

Local Revenues: Local government revenues decrease by 3% of the net change in State tax liability resulting from the provisions of the bill. Accordingly, local government revenues decrease by $54.6 million in fiscal 2011, $38.4 million in fiscal 2012, $40.3 million in fiscal 2013, $42.2 million in fiscal 2014, and by $44.2 million in fiscal 2015.

Additional Information

Prior Introductions: Similar bills have been introduced in the past several sessions. SB 527 of 2009 was not reported from the Senate Budget and Taxation Committee. HB 158 of 2009, HB 999 of 2008, HB 1162 of 2007, and HB 151 of 2005 were not reported from the House Ways and Means Committee.

Cross File: HB 300 (Delegate Krebs, *et al.*) - Ways and Means.

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

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