

Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

House Bill 898
Ways and Means

(Delegate Gilchrist, *et al.*)

Hometown Heroes Act of 2010 - Income Tax - Subtraction Modification for Retirement Income of Law Enforcement, Fire, Rescue, and Emergency Services Personnel

This bill specifies that the retirement income received by retired federal, State, and local law enforcement officers, firefighters, and emergency medical services personnel can qualify for the existing State pension exclusion if the individual is at least age 50.

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

Fiscal Summary

State Effect: General fund revenues decrease by \$14.8 million in FY 2011, which reflects the impact of one and one-half tax years. Future year revenues reflect annualization, inflation, and an estimated number of eligible retirees. Expenditures are not affected.

(\$ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	(\$14.8)	(\$10.3)	(\$10.8)	(\$11.2)	(\$11.7)
Expenditure	0	0	0	0	0
Net Effect	(\$14.8)	(\$10.3)	(\$10.8)	(\$11.2)	(\$11.7)

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

Local Effect: Local income tax revenues will decrease by \$9.5 million in FY 2011 and by \$7.5 million in FY 2015. Local 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 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 (\$24,500 in tax year 2009) 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.

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.

Background: Public safety personnel participate in a variety of State and local pension systems. While many jurisdictions, including the State, provide systems or plans that are restricted only to law enforcement and/or public safety personnel, smaller or less affluent jurisdictions tend to include such individuals in general employee pension plans. Most public employers provided defined benefit plans, that is, plans that offer death, disability, and retirement benefits based on accrued service and/or age. The more generous plans provide not only higher benefits but also permit retirement with less service (20 or 25 years of service) and at a younger age (50 or 55). General employee plans tend to provide for service retirement after 30 years of service and/or at a normal retirement age, likely to be age 60, 62, or 65.

Chapter 534 of 2004 established the Task Force on the Exemption of Law Enforcement Officers’ Pensions from Taxation. The task force issued its final report in December 2004. The task force estimated there were 9,600 retired State and local law enforcement officers. An analysis of State law enforcement systems concluded that approximately 17% of State police retirees were disabled and 57% of retirees were age 50 to 64. Certain disability pensions, including law enforcement disability pensions, are exempt from federal and State taxation. The task force also stated there were 83,000 federal law enforcement officers and that approximately 2,900 of these federal

officers lived in the State. The federal Office of Personnel Management indicated that the average retired federal law enforcement pension was \$60,000.

The task force estimated there were 12,227 active county and State law enforcement officers. According to the Bureau of Labor Statistics (BLS), approximately 13,240 individuals in November 2004 were employed as firefighters or emergency medical services personnel.

State Revenues: Additional pension income may be exempted under the bill beginning in tax year 2010. As a result, general fund revenues will decrease by \$9.7 million in tax year 2010 and \$10.1 million in tax year 2011. It is assumed that most taxpayers will adjust their withholding and estimated payments resulting in a reduction of \$14.8 million in fiscal 2011. **Exhibit 1** shows the projected State and local revenue loss from exempting retirement income from State and local taxes. Out-year revenue losses reflect annualization, estimated number of eligible retirees, increases in retirement income, and the estimated increase in the pension exclusion provided for retirement income.

Exhibit 1
Projected State and Local Revenue Loss
(\$ in Millions)

<u>Fiscal</u>	<u>State</u>	<u>Local</u>	<u>Total</u>
2011	\$14.8	\$9.5	\$24.2
2012	10.3	6.6	16.9
2013	10.8	6.9	17.6
2014	11.2	7.2	18.4
2015	11.7	7.5	19.1

Local Revenues: Local government revenues will decrease by approximately 3% of the net change in State tax liability resulting from the provisions of the bill. In fiscal 2011, the decrease will be \$9.5 million. Exhibit 1 lists the estimated local income tax revenue decrease in fiscal 2011 through 2015.

Additional Information

Prior Introductions: HB 755 of 2009 and HB 1120 of 2008 received a hearing from the House Ways and Means Committee, but no further action was taken. SB 581 of 2008 received a hearing from the Senate Budget and Taxation Committee, but no further action

was taken. HB 1424 of 2006 received a favorable with amendments report from the House Ways and Means Committee but was not voted on by the full House.

Cross File: None.

Information Source(s): Comptroller's Office, U.S. Bureau of Labor Statistics, Department of Legislative Services

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