SB 659

Department of Legislative Services
2013 Session

FISCAL AND POLICY NOTE

Senate Bill 659 (Senator King, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification for Retirement Income

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 State income tax subtraction modification allowed for retirement income (pension exclusion) if the contributions to the IRA or annuity consist entirely of the tax-free rollover of distributions from an employee retirement system. The bill also reduces to $26,900 the maximum value of the annual pension exclusion in tax year 2013 and indexes the value thereafter as provided under current law.

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: General fund revenues may increase beginning in FY 2014 as the revenue gains from temporarily limiting the amount of the maximum pension exclusion are greater than the revenue losses from eligible rollovers. Overall, the net effect of the bill on State revenues is not expected to be significant. Expenditures are not affected.

Local Effect: Local government revenues may increase beginning in FY 2014, but the overall impact is not expected to be significant. Expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law/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 ($27,100 for 2012) 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 (Social Security offset).

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under current law for 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 even though benefits are partially taxable for federal purposes, 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.

One significant feature of the current pension exclusion is that it is limited to income received from an "employee retirement system." 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(b) 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.

In addition to the special treatment of Social Security and other retirement income, additional 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 also earn more income without being required to file taxes.

In tax year 2008, a total of 236,500 resident returns claimed the pension exclusion. The average amount of pension income excluded was $11,100, or a little less than one-half of the average taxable pension income reported by all returns, including those that did not claim the exclusion. Lower-income returns excluded a higher percentage of pension income; the average pension exclusion was equal to two-thirds of the average pension reported by taxpayers with income less than $25,000 while taxpayers with incomes over $150,000 had average pension income excluded of about one-quarter of the average pension. The Department of Budget and Management estimates that the pension exclusion reduced State revenues by $103.4 million and local income tax revenues by $64.1 million in fiscal 2012. Exempting Social Security benefits is estimated to reduce State income tax revenues by $139.8 million and local income tax revenues by $86.7 million in fiscal 2012.

State Revenues: The bill will (1) increase income tax revenues by reducing to $26,900 the maximum value of the pension exclusion in tax year 2013; and (2) decrease income tax revenues by allowing a rollover IRA or annuity to qualify for the pension exclusion if the contributions to the IRA or annuity consist entirely of the tax-free rollover of distributions from an employee retirement system.

The Comptroller's Office advises that it does not have the data necessary to estimate the revenue impacts of the bill on the State pension exclusion. However, based on the expected maximum value and total revenue loss of the pension exclusion under current law, the impact of the bill on the value of the pension exclusion, and the amount of IRA and annuity income reported by eligible taxpayers, it is expected that the net effect of the bill will not be significant. Any revenue increase from a reduction in the value of the pension exclusion is expected to be offset by the decrease in revenues from allowing specified IRA or annuity income to qualify for the pension exclusion.

Additional Information

Prior Introductions: SB 847 of 2012, a similar bill, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 917, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 743 (Delegate Gilchrist, *et al.*) - Ways and Means.

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

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