Department of Legislative Services
2014 Session

FISCAL AND POLICY NOTE

House Bill 424 (Delegate Gilchrist, *et al.*)
Ways and Means

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 takes effect July 1, 2014, and applies to tax year 2014 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2015 as a result of additional income being exempted under the pension exclusion. Expenditures are not affected.

Local Effect: Local revenues will decrease significantly beginning in FY 2015 as a result of additional income being exempted under the pension exclusion. No effect on local expenditures.

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 ($27,800 for 2013) 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.

State/Local Revenues: The bill will allow a rollover IRA or annuity to qualify for the pension exclusion beginning in tax year 2014 if the contributions to the IRA or annuity consist entirely of the tax-free rollover of distributions from an employee retirement system. As a result, annual State and local income tax revenues will decrease significantly beginning in fiscal 2015.

Additional Information

Prior Introductions: Similar bills that also proposed to reduce the amount of the pension exclusion were introduced in the 2012 and 2013 sessions. SB 659 of 2013 and SB 847 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross file of SB 659, HB 743, passed the House and received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. HB 917 of 2012 received a hearing in the House Ways and Means Committee, but no further action was taken.

This bill was also introduced in the 2000 to 2009 sessions. SB 961 of 2009, SB 115 of 2009, SB 759 of 2008, 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 the Senate Budget and Taxation Committee. HB 190 of 2009 and HB 1173 of 2004 were not reported from the House Ways and Means Committee. SB 399 of 2002 passed the General Assembly but was vetoed by the Governor for 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 the Senate Budget and Taxation Committee.

Cross File: SB 233 (Senator Kasemeyer, *et al.*) - Budget and Taxation.

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

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