Department of Legislative Services
2014 Session

FISCAL AND POLICY NOTE

House Bill 75 (Delegates McDermott and Smigiel)
Ways and Means

Income Tax - Subtraction Modification - Retirement Income

This bill expands the existing State pension exclusion subtraction modification by (1) increasing to $50,000 the maximum amount that can be excluded under the pension exclusion and (2) allowing income from the following plans to be included within the subtraction modification: 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. In addition, the value of the pension exclusion will no longer be indexed to inflation or reduced by the amount of Social Security benefits received.

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

Fiscal Summary

State Effect: General fund revenues will 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. 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 ($27,800 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 expands the pension exclusion by allowing additional types and amounts of income to be subtracted and also increases to $50,000 the maximum amount that can be excluded beginning in tax year 2014. As a result, annual State and local income tax revenues will decrease significantly beginning in fiscal 2015. The bill also will freeze the value of the pension exclusion at $50,000; under current law, the pension exclusion is indexed to inflation. Under the current economic forecast, the proposed maximum value of the pension exclusion would be greater than that provided under current law for the next 26 years.

The Comptroller's Office advises that it does not currently capture data related to the pension exclusion. Based on the additional amount of retirement income reported on

Maryland federal income tax returns relative to the amount claimed under the current pension exclusion, the Comptroller estimates that annual revenue losses could total over $300 million beginning in fiscal 2015. Under these assumptions, local income tax revenues would decrease by about $200 million annually beginning in fiscal 2015.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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ncs/jrb

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