# Department of Legislative Services
2014 Session

## FISCAL AND POLICY NOTE

House Bill 1216 (Delegate Parrott, *et al.*)
Ways and Means

**Income Tax - Subtraction Modification - Retirement Income**

This bill exempts from the State income tax 100% of the income received by an individual who is at least 65 years old.

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

## Fiscal Summary

**State Effect:** General fund revenues decrease by $1.4 billion in FY 2015 due to the exemption of specified income. Future year revenue estimates reflect annualization and the current income tax revenue forecast. General fund expenditures may increase in FY 2015 due to implementation costs at the Comptroller's Office.

| ($ in billions) | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|---|---|---|---|---|---|
| GF Revenue | ($1.4) | ($1.0) | ($1.0) | ($1.0) | ($1.1) |
| GF Expenditure | - | - | - | - | - |
| Net Effect | ($1.4) | ($1.0) | ($1.0) | ($1.0) | ($1.1) |

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

**Local Effect:** Local revenues will decrease by $870 million in FY 2015 and by $680 million in FY 2019 due to the exemption of specified income. 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 Revenues:** The bill exempts 100% of the income received by an individual who is at least 65 years old. As a result, general fund revenues will decrease by $1.4 billion in fiscal 2015, reflecting the impact of about one and one-half tax years. Future year revenue losses reflect annualization and the current economic forecast. **Exhibit 1** shows the estimated impact of the bill on State and local revenues.

**Exhibit 1**
**State and Local Revenue Impacts**
**Fiscal 2015-2019**
**($ in Billions)**

| | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|---|---|---|---|---|---|
| State | ($1.4) | ($1.0) | ($1.0) | ($1.0) | ($1.1) |
| Local | (0.9) | (0.6) | (0.6) | (0.7) | (0.7) |
| **Total Revenues** | **($2.2)** | **($1.6)** | **($1.6)** | **($1.7)** | **($1.8)** |

**State Expenditures:** General fund expenditures for the Comptroller's Office may increase beginning in fiscal 2015 as a result of adding the subtraction modification to the personal income tax form and hiring an additional revenue specialist to process and verify impacted returns.

**Local Revenues:** Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed. Local revenues will decrease by $870 million in fiscal 2015 and by $680 million in fiscal 2019, as shown in Exhibit 1.

## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

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

**Fiscal Note History:** First Reader - March 5, 2014
ncs/jrb

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