

Department of Legislative Services
 Maryland General Assembly
 2015 Session

FISCAL AND POLICY NOTE

Senate Bill 115 (Senator Manno, *et al.*)
 Budget and Taxation

**Income Tax Subtraction Modification - Retirement Income of Law Enforcement,
 Correctional Officer, Fire, Rescue, and Emergency Services Personnel
 (Hometown Heroes)**

This bill allows retirement income to qualify for the State pension exclusion if the individual is at least 50 years old and the retirement income is attributable to employment as a law enforcement officer; correctional officer; or fire, rescue, or emergency services personnel of the United States, the State, or a local jurisdiction. The maximum exclusion in the tax year is limited to \$10,000.

The bill takes effect July 1, 2015, and applies to tax year 2015 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by \$5.6 million in FY 2016 due to additional retirement income being exempted. Future year revenue decreases reflect the estimated number of eligible taxpayers. Expenditures are not affected.

(\$ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	(\$5.6)	(\$5.7)	(\$5.9)	(\$6.0)	(\$6.2)
Expenditure	0	0	0	0	0
Net Effect	(\$5.6)	(\$5.7)	(\$5.9)	(\$6.0)	(\$6.2)

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

Local Effect: Local revenues decrease by \$3.9 million in FY 2016 and by \$4.3 million in FY 2020. Expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law: 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 (\$29,000 for 2014) 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 Internal Revenue Code. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, individual retirement arrangements, 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.

According to the Department of Budget and Management, in fiscal 2014 the State subtraction modification for Social Security benefits reduced State revenues by \$165.8 million, the State pension exclusion reduced State revenues by \$144.4 million, and the additional personal exemption reduced State revenues by \$18.3 million.

Background: Public safety personnel participate in a variety of State and local pension systems. While many locations, including the State, provide systems or plans that are restricted only to law enforcement and/or public safety personnel, other jurisdictions may include such individuals in general employee pension plans. Most public employers

provide defined benefit plans that offer death, disability, and retirement benefits based on accrued service and/or age.

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 in the State. An analysis of State law enforcement systems concluded that approximately 17% of State police retirees retired with a disability 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 that there were 83,000 federal law enforcement officers and that approximately 2,900 of these federal officers lived in the State.

State Revenues: Additional retirement income may be exempted beginning in tax year 2015. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, general fund revenues will decrease by \$5.6 million in fiscal 2016. **Exhibit 1** shows the estimated State and local revenue impacts resulting from the bill.

Exhibit 1
State and Local Revenue Impacts
Fiscal 2016-2020
(\$ in Millions)

	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>
State	(\$5.6)	(\$5.7)	(\$5.9)	(\$6.0)	(\$6.2)
Local	(3.9)	(4.0)	(4.1)	(4.2)	(4.3)
Total	(\$9.5)	(\$9.7)	(\$9.9)	(\$10.2)	(\$10.5)

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed by taxpayers. As a result, local revenues will decrease by \$3.9 million in fiscal 2016, as shown in Exhibit 1.

Additional Information

Prior Introductions: HB 1461 of 2014, a similar bill, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 99 (Delegate Hixson, *et al.*) - Ways and Means.

Information Source(s): Comptroller's Office, Maryland State Retirement Agency,
Department of Legislative Services

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