Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 802 (Delegate Fisher, *et al.*)
Ways and Means

Retire in Maryland Act of 2018

This bill expands the existing State income tax pension exclusion subtraction modification by generally exempting 100% of the specified retirement and unearned income of an individual who qualifies for the pension exclusion. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $1.5 billion in FY 2019, which reflects the impact of one and one-half tax years. Future year revenue decreases reflect annualization and the projected growth in the number of eligible taxpayers and retirement income. Expenditures are not affected.

($ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	($1,452.9)	($1,019.7)	($1,065.6)	($1,113.5)	($1,163.6)
Expenditure	0	0	0	0	0
Net Effect	($1,452.9)	($1,019.7)	($1,065.6)	($1,113.5)	($1,163.6)

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

Local Effect: Local revenues decrease by $948.0 million in FY 2019 and by $759.0 million in FY 2023. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: In addition to the retirement income that qualifies for the pension exclusion under current law, the bill allows income from the following plans or sources to be included within the subtraction modification: (1) individual retirement accounts and annuities under Section 408 of the Internal Revenue Code (IRC); (2) Roth individual retirement accounts under Section 408(a) of the IRC; (3) simplified employee pensions under Section 408(k) of the IRC; (4) ineligible deferred compensation plans under Section 457(f) of the IRC; and (5) certain unearned income as defined by the bill.

Unearned income under the bill includes income from (1) an annuity, pension, or an endowment or (2) the payment of interest, dividends, or any other distribution from an investment. Unearned income does not include any employee compensation or net self-employment earnings.

A taxpayer who qualifies for the pension exclusion may exempt 100% of qualified retirement and unearned income. The bill specifies that any income excluded by a taxpayer through subtraction modifications taken under Sections 10-207 or 10-208 of the Tax-General Article is not eligible for the State pension exclusion.

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 ($29,900 for 2017) 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." Chapter 524 of 2000 clarified the definition of an "employee retirement system" by providing for the types of retirement income that may be included for purposes of calculating the pension exclusion. As defined by Chapter 524, eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under § 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, Chapter 524 also included language clarifying what is not included in an "employee retirement system": (1) an individual retirement account (IRA) or annuity under § 408 of the IRC; (2) a Roth IRA under § 408A of the IRC; (3) a rollover IRA; (4) a simplified employee pension under § 408(k) of the IRC; or (5) an ineligible deferred compensation plan under § 457(f) of the IRC. Since 2000, there have been no substantive changes to the pension exclusion. **Exhibit 1** shows the eligible and ineligible retirement income under the pension exclusion.

Exhibit 1
Eligible and Ineligible Retirement Plans under the Pension Exclusion

Eligible	**Ineligible**
• 401(k) Cash or Deferred Arrangement Plans	• Traditional IRAs
• 403(b) Plans	• Rollover IRAs
• 457(b) Plans	• Roth IRAs
• Thrift Savings Plans	• Keogh Plans
• Savings Incentive Match Plan for Employees Retirement Plans under § 401(k) of the IRC	• Simplified Employee Pensions
	• Savings Incentive Match Plan for Employees Retirement Plans under § 408 of the IRC

Source: Department of Legislative Services

Additional retirement income may be exempted if the individual has qualified U.S. military, fire, rescue, or emergency services personnel retirement income.

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 2018 the State subtraction modification for Social Security benefits reduced State revenues by $212.5 million (this is in addition to the revenue loss resulting from the partial federal exemption of Social Security benefits), the State pension exclusion reduced State revenues by $167.5 million, and the additional personal exemption reduced State revenues by $30.6 million.

State Revenues: The bill expands the pension exclusion by generally exempting 100% of the retirement and unearned income specified by the bill if the individual qualifies for the State pension exclusion. It is assumed that individuals adjust withholdings and estimated payments. As a result, fiscal 2019 revenues will decrease by $1.5 billion, which reflects the impact of one and one-half tax years. **Exhibit 2** shows the projected State and local revenue loss from exempting additional retirement income.

Exhibit 2
Projected State and Local Revenue Loss
($ in Billions)

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
State	($1.5)	($1.0)	($1.1)	($1.1)	($1.2)
Local	(0.9)	(0.7)	(0.7)	(0.7)	(0.8)
Total Revenues	**($2.4)**	**($1.7)**	**($1.8)**	**($1.8)**	**($1.9)**

In tax year 2016, it is estimated that 736,197 taxpayers would have exempted a total of $25 billion in qualified retirement income specified by the bill. The estimated revenue loss does not include unearned income specified by the bill.

Local Revenues: Local income tax revenues decrease by about 3% of the total net State subtraction modifications claimed. Local revenues will decrease by $948.0 million in fiscal 2019 and by $759.0 million in fiscal 2023, as shown in Exhibit 2.

Additional Information

Prior Introductions: HB 1444 of 2017 and HB 586 of 2016 received a hearing in the House Ways and Means Committee, but no further action was taken. HB 960 of 2015 received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

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

Fiscal Note History: First Reader - February 19, 2018
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