

Department of Legislative Services
 Maryland General Assembly
 2018 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 129 (Delegates Knotts and Jackson)
 Ways and Means

Income Tax - Subtraction Modification - Retirement Income of Correctional Officers

This bill expands the existing State subtraction modification for retired law enforcement, fire, rescue, and emergency services personnel by extending eligibility to correctional officers. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by \$1.2 million in FY 2019 due to additional retirement income being exempted. Future year revenue decreases reflect projected increase in retirement income. Expenditures are not affected.

(\$ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	(\$1.2)	(\$1.2)	(\$1.3)	(\$1.3)	(\$1.4)
Expenditure	0	0	0	0	0
Net Effect	(\$1.2)	(\$1.2)	(\$1.3)	(\$1.3)	(\$1.4)

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

Local Effect: Local revenues decrease by \$0.8 million in FY 2019 and by \$0.9 million in FY 2023. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law:

State Pension Exclusion – All Eligible Individuals

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. 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.

Law Enforcement Officer and Fire, Rescue, and Emergency Services Personnel

Retired law enforcement officers and fire, rescue, or emergency services personnel who are age 65 or older or are totally disabled qualify and claim the State pension exclusion in the same manner as other eligible retirees as described above.

Chapters 153 and 154 of 2017 established a pension exclusion for retired law enforcement officers or fire, rescue, or emergency services personnel. Retirement income qualifies for the State pension exclusion if the individual is between the ages of 55 and 64 and the retirement income is attributable to employment as a law enforcement officer or as a fire, rescue, or emergency services personnel of the United States, the State, or a local jurisdiction. Emergency services personnel includes emergency medical technicians and paramedics. The maximum exclusion in the tax year is limited to \$15,000.

State Revenues: Additional retirement income may be exempted beginning in tax year 2018. According to the State Retirement Agency, approximately 5,700 State correctional officer retirees and survivors currently receive benefits. Based on the requirements of the bill, it is estimated that approximately 25% of these individuals reside in Maryland and qualify for the pension exclusion proposed by the bill. This estimate is increased to account for federal and local correctional officers based on data from the U.S. Bureau of Labor Statistics. It is assumed that individuals do not adjust withholdings and estimated payments. As a result, general fund revenues will decrease by \$1.2 million in fiscal 2019. **Exhibit 1** shows the estimated impact of the bill on State and local revenues.

**Exhibit 1
State and Local Revenue Impacts
Fiscal 2019-2023**

	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
State	(\$1,211,700)	(\$1,245,600)	(\$1,280,500)	(\$1,316,400)	(\$1,353,300)
Local	(790,800)	(812,900)	(835,700)	(859,100)	(883,200)
Total	(\$2,002,500)	(\$2,058,500)	(\$2,116,200)	(\$2,175,500)	(\$2,236,500)

Local Revenues: Local income tax revenues will decrease as a result of subtraction modifications claimed against the personal income tax. Local revenues will decrease by \$790,800 in fiscal 2019 and by \$883,200 in fiscal 2023, as shown in Exhibit 1.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller’s Office; State Retirement Agency; U.S. Bureau of Labor Statistics; Department of Legislative Services

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