Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 170 (The President, *et al.*) (By Request - Administration)
Budget and Taxation

Retirement Tax Fairness Act of 2019

This Administration bill expands the existing State income tax pension exclusion subtraction modification by allowing income from the following plans or sources to be included within the subtraction modification: (1) individual retirement accounts (IRAs) and annuities under Section 408 of the Internal Revenue Code (IRC); (2) Roth IRAs under Section 408(a) of the IRC; (3) simplified employee pensions under Section 408(k) of the IRC; and (4) ineligible deferred compensation plans under Section 457(f) of the IRC. The expansion is phased in over five tax years, beginning with tax year 2019. **The bill takes effect July 1, 2019.**

Fiscal Summary

State Effect: General fund revenues decrease by $17.6 million in FY 2020 due to additional retirement income being exempted. The Governor's proposed FY 2020 operating budget assumes that general fund revenues will decrease by $11.0 million due to the expansion of the pension exclusion. Future years reflect projected retirement income and the phase-in specified by the bill. Expenditures are not affected.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	($17.6)	($25.9)	($33.9)	($44.8)	($56.4)
Expenditure	0	0	0	0	0
Net Effect	($17.6)	($25.9)	($33.9)	($44.8)	($56.4)

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

Local Effect: Local revenues decrease by $11.0 million in FY 2020 and by $35.1 million in FY 2024. Local expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). The Department of Legislative Services (DLS) concurs with this assessment.

Analysis

Current Law/Background:

State Pension Exclusion

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 ($30,600 for 2018) 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 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, law enforcement, correctional officer, 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 allowing additional types of income to be subtracted beginning in tax year 2019. As a result, State income tax revenues will decrease by $17.6 million in fiscal 2020. **Exhibit 2** shows the estimated impact of the bill on State and local revenues.

Exhibit 2
State and Local Revenue Impacts
Fiscal 2020-2024
($ in Millions)

	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
State	($17.6)	($25.9)	($33.9)	($44.8)	($56.4)
Local	(11.0)	(16.1)	(21.1)	(27.9)	(35.1)
Total Revenues	**($28.6)**	**($42.0)**	**($55.0)**	**($72.7)**	**($91.5)**

Due to taxpayer confidentiality requirements, DLS does not have access to income tax data and is dependent on data from the Comptroller's Office. As required by Chapter 648 of 2016, the Comptroller's Office altered the personal income tax form to capture additional data on the pension exclusion by adding Form 502R. The estimated fiscal impact shown in Exhibit 2 is based on an analysis of this data and retirement income reported on federal forms 1099-R and SSA-1099.

Local Revenues: Local income tax revenues decrease as a result of additional retirement income exempted against the personal income tax. Local revenues decrease by $11.0 million in fiscal 2020 and by $35.1 million in fiscal 2024, as shown in Exhibit 2.

Additional Information

Prior Introductions: None.

Cross File: HB 149 (The Speaker, *et al.*) (By Request - Administration) - Ways and Means.

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

Fiscal Note History: First Reader - February 25, 2019
mag/hlb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: **Retirement Tax Fairness Act of 2019**

BILL NUMBER: SB 170/HB 149

PREPARED BY: Governor's Legislative Office

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

__X__ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

____ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS