SB 65

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 65 (Senator Young, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Retirement Income

This bill alters the existing pension exclusion subtraction modification under the State income tax by (1) increasing the maximum pension exclusion to $75,000, phased in over five tax years and (2) allowing income from the additional plans or sources to be included within the subtraction modification. An individual may not claim the pension exclusion if the individual's income from qualified retirement plans exceeds $100,000. **The bill takes effect July 1, 2019**.

Fiscal Summary

State Effect: General fund revenues will decrease significantly beginning in FY 2020 as a result of additional income being exempted under the pension exclusion. Based on data provided by the Comptroller's Office, annual general fund revenue losses will likely exceed $350 million by FY 2024. Expenditures are not affected.

Local Effect: Local revenues will decrease significantly beginning in FY 2020 as a result of additional income being exempted under the pension exclusion. Annual local revenue losses may exceed $230 million by FY 2024. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: The bill increases the maximum pension exclusion for qualifying individuals to (1) $33,000 in tax year 2019; (2) $43,500 in tax year 2020; (3) $54,000 in tax year 2021; (4) $64,500 in tax year 2022; and (5) $75,000 beginning in tax year 2023. The maximum exclusion amount in each year is reduced by the amount of Social Security payments received as provided under current law.

The bill expands the pension exclusion by allowing 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; and (3) simplified employee pensions under Section 408(k) of the IRC.

An individual may not claim the pension exclusion if the individual's income from qualified retirement plans exceeds $100,000. This includes income from the plans or sources described in the previous paragraph plus income from retirement plans that qualify for the pension under current law.

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 ($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 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, 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/Local Revenues: The bill alters the State pension exclusion beginning with tax year 2019. State revenues will decrease due to (1) increasing the value of the maximum exclusion and (2) allowing income from additional plans or sources to qualify. Conversely, State revenues will increase due to a reduction in the number of individuals who claim the pension exclusion due to the limitation on total retirement income specified by the bill.

The decrease in revenue in each year will increase due to the phased-in increase of the pension exclusion specified by the bill. Based on a preliminary analysis of data provided by the Comptroller's Office, State revenue losses resulting from the bill will likely exceed $350 million annually by fiscal 2024. Local income tax revenues will decrease by at least $230 million annually by fiscal 2024.

Additional Information

Prior Introductions: SB 11 of 2018 received an unfavorable report from the Senate Budget and Taxation Committee. Its cross file, HB 405, 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

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