Department of Legislative Services

Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 344 (Senators Hershey and Elfreth)
Budget and Taxation

Retirement Tax Reduction Act of 2022

This bill creates a subtraction modification against the State income tax for 100% of the income received by an individual who has federal adjusted gross income of $100,000 or less and (1) is receiving old age or survivor Social Security benefits or (2) is at least age 65 and is not employed full time. The exemption is phased in over two years, beginning with tax year 2023. The Comptroller's Office must adopt regulations implementing the bill. **The bill takes effect July 1, 2022.**

Fiscal Summary

State Effect: General fund revenues decrease by $365.1 million in FY 2024 due to eligible income being exempted. Future year revenue decreases reflect phase-in specified by the bill and the projected growth in the number of eligible taxpayers and income. General fund expenditures increase by $0.1 million in FY 2024 due to one-time implementation costs at the Comptroller's Office.

($ in millions)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
GF Revenue	$0	($365.1)	($530.0)	($565.9)	($588.5)
GF Expenditure	$0	$0.1	$0	$0	$0
Net Effect	$0.0	($365.1)	($530.0)	($565.9)	($588.5)

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

Local Effect: Local revenues decrease by $237.6 million in FY 2024 and by $381.9 million in FY 2027. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law:

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 ($34,300 for 2021) 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 Internal Revenue Code (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.

Additional State Tax Benefits

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.

State Revenues: Eligible individuals can exempt up to the greater of 50% or $15,000 in income, regardless of source, in tax year 2023. Beginning in tax year 2024, the bill exempts 100% of the income received by an eligible individual. As a result, revenues will decrease by $365.1 million in fiscal 2024. **Exhibit 1** shows the estimated net impact of the bill on State and local revenues.

Exhibit 1
Projected State and Local Revenue Loss
($ in Millions)

	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
State	$0.0	($365.1)	($530.0)	($565.9)	($588.5)
Local	0.0	(237.6)	(344.1)	(367.2)	(381.9)
Total Revenues	**$0.0**	**($602.7)**	**($874.1)**	**($933.1)**	**($970.4)**

Source: Comptroller's Office; Department of Legislative Services

This estimate reflects the impact the bill would have had in tax year 2019 and increased by about 4% annually to reflect growth in tax returns and income. The Comptroller's Office estimates that in tax year 2019 about 325,000 taxpayers would have benefited from the proposed exemption. This estimate is based on the income reported by each individual who is estimated to have federal adjusted gross income of $100,000 or less and are (1) under age 65 and receive old age or survivor Social Security benefits or (2) are at least age 65 and either receive these benefits or do not work full-time.

State Expenditures: The Comptroller's Office reports that it will incur a one-time general fund expenditure increase of $77,000 in fiscal 2024 to add the phased-in subtraction modification to the income tax forms. This includes data processing changes to the income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues decrease as a result of additional retirement income exempted against the personal income tax. Local revenues decrease by $237.6 million in fiscal 2024 and by $381.9 million in fiscal 2027, as shown in Exhibit 1.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

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

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