Department of Legislative Services
Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 787 (Delegate Krebs, *et al.*)
Ways and Means

Retiree Income Tax Relief Act of 2022

This bill alters the existing pension exclusion subtraction modification under the State income tax by (1) increasing to $55,000 the maximum exemption amount and indexing future amounts to inflation; (2) allowing income from the additional sources, including Social Security payments, to be included within the subtraction modification; and (3) eliminating the Social Security offset. The bill also eliminates the existing State subtraction modification for Social Security payments. **The bill takes effect July 1, 2022, and applies to tax year 2022 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $387.5 million in FY 2023 due to additional retirement income being exempted. Future year revenue decreases reflect the projected growth in the number of eligible taxpayers and retirement income and indexation of maximum exclusion amount. Expenditures are not affected.

($ in millions)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
GF Revenue	($387.5)	($403.0)	($419.1)	($435.8)	($453.3)
Expenditure	0	0	0	0	0
Net Effect	($387.5)	($403.0)	($419.1)	($435.8)	($453.3)

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

Local Effect: Local revenues decrease by $245.6 million in FY 2023 and by $287.4 million in FY 2027. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary/Current Law:

State Pension Exclusion

Current Law

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).

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 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

IRA: individual retirement account
IRC: Internal Revenue Code

Source: Department of Legislative Services

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.

Proposed by the Bill

The maximum value of the pension exclusion is increased to $55,000 for tax year 2022. Beginning with tax year 2023, the maximum value is indexed for inflation. The bill eliminates the Social Security offset – the proposed maximum exclusion is not reduced by the Social Security payments received in the tax year.

The bill expands the pension exclusion by allowing income from the following plans or sources to be included within the subtraction modification: (1) an IRA and annuities under Section 408 of the IRC; (2) Roth IRA under Section 408(a) of the IRC; (3) simplified employee pensions under Section 408(k) of the IRC; and (4) savings investment match plans under Section 408 of the IRC.

The bill also eliminates the State subtraction modification that exempts Social Security benefits from State taxation. In lieu of this exemption, a taxpayer can exempt up to $55,000 in combined Social Security payments and qualified retirement plan income as expanded by the bill.

State Revenues: The bill alters the State pension exclusion beginning with tax year 2022 and the taxation of Social Security payments. As a result, general fund revenues will decrease by $387.5 million in fiscal 2023. **Exhibit 2** shows the estimated net impact of the bill on State and local revenues.

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

	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
State	($387.5)	($403.0)	($419.1)	($435.8)	($453.3)
Local	(245.6)	(255.5)	(265.8)	(276.4)	(287.4)
Total Revenues	**($633.1)**	**($658.5)**	**($684.9)**	**($712.2)**	**($740.7)**

Source: Department of Legislative Services

Local Revenues: Local income tax revenues decrease as a result of additional retirement income exempted against the personal income tax. Local revenues decrease by $245.6 million in fiscal 2023 and by $287.4 million in fiscal 2027, as shown in Exhibit 2.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

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

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Analysis by: Robert J. Rehrmann

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