Department of Legislative Services

Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1198 (Delegate Saab, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Retirement Income (Fairness in Taxation for Retirees Act)

This bill alters the existing pension exclusion subtraction modification under the State income tax by allowing income from additional sources to be included within the subtraction modification. Under the bill, income from the following plans or sources can be included within the subtraction modification: (1) an individual retirement account (IRA) and annuities under Section 408 of the Internal Revenue Code (IRC); (2) Roth IRA under Section 408(a) of the IRC; (3) simplified employee pensions under Section 408(k) of the IRC; and (4) ineligible deferred compensation plan under 457(f) of the IRC. **The bill takes effect July 1, 2022, and applies to tax year 2022 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2023 due to additional retirement income being exempted. Based on an analysis of similar legislation, the revenue loss will likely exceed $60.0 million annually in the near term. Expenditures are not affected.

Local Effect: Local revenues will likely decrease by at least $38.0 million annually beginning in FY 2023. 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 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

IRA: individual retirement account
IRC: Internal Revenue Code

Source: Department of Legislative Services

State/Local Revenues: The bill alters the State pension exclusion beginning with tax year 2022 by allowing income from the additional sources to be included within the subtraction modification. As a result, general fund revenues will decrease significantly beginning in fiscal 2023. Based on an analysis of similar legislation, revenue losses will likely exceed $60.0 million annually in the near term.

Local income tax revenues decrease as a result of additional retirement income exempted against the personal income tax. Local revenue losses will likely exceed $38.0 million annually beginning in fiscal 2023.

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