HB 499

Department of Legislative Services

Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 499 (Delegate Grammer)
Ways and Means

Income Tax - Subtraction Modification - Retirement Income

This bill alters the existing pension exclusion subtraction modification under the State income tax by (1) exempting 100% of eligible pension income, phased in over three tax years and (2) allowing income from the additional plans or sources to be included within the subtraction modification. **The bill takes effect July 1, 2022, and applies to tax years 2022 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease by $106.5 million in FY 2023 due to additional retirement 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 retirement income. Expenditures are not affected.

($ in millions)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
GF Revenue	($106.5)	($325.2)	($665.8)	($765.5)	($800.0)
Expenditure	0	0	0	0	0
Net Effect	($106.5)	($325.2)	($665.8)	($765.5)	($800.0)

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

Local Effect: Local revenues decrease by $62.1 million in FY 2023 and by $530.6 million in FY 2027. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: The bill alters the maximum exclusion amount for qualifying individuals to equal (1) 30% of qualified income in tax year 2022; (2) 60% in tax year 2023; and (3) 100% beginning in tax year 2024. The maximum exclusion amount in each year is not 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.

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

Source: Department of Legislative Services

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: The bill alters the State pension exclusion beginning with tax year 2022. State revenues will be impacted by (1) altering the value of the maximum exclusion and (2) allowing income from additional plans or sources to qualify. **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	($106.5)	($325.2)	($665.8)	($765.5)	($800.0)
Local	(62.1)	(189.5)	(437.8)	(507.8)	(530.6)
Total Revenues	**($168.6)**	**($514.7)**	**($1,103.6)**	**($1,273.3)**	**($1,330.6)**

Source: Department of Legislative Services

Due to taxpayer confidentiality requirements, the Department of Legislative Services 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 $62.1 million in fiscal 2023 and by $530.6 million in fiscal 2027, as shown in Exhibit 2.

Additional Information

Prior Introductions: HB 166 of 2021 and HB 61 of 2020 received a hearing in the House Ways and Means Committee, but no further action was taken.

Designated Cross File: None.

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

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