SB 49

Department of Legislative Services

Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 49 (Senator Brooks)
Budget and Taxation

Income Tax - Subtraction Modification - Retirement Income

This bill includes income from individual retirement accounts (IRAs) and annuities under § 408 of the Internal Revenue Code (IRC) within the State subtraction modification for retirement income (Maryland pension exclusion) if the contributions to the IRA or annuity consist entirely of the tax-free rollover of distributions from an employee retirement system. **The bill takes effect July 1, 2023, and applies to tax year 2023 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2024, as discussed below; however, the amount of the decrease cannot be readily estimated at this time. General fund expenditures increase by $74,700 in FY 2024; future years reflect annualization and ongoing costs.

(in dollars)	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
GF Revenue	(-)	(-)	(-)	(-)	(-)
GF Expenditure	$74,700	$121,100	$126,500	$132,300	$139,400
Net Effect	(-)	(-)	(-)	(-)	(-)

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

Local Effect: Local revenues decrease significantly beginning in FY 2024, as discussed below. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law:

Maryland Pension Exclusion

Under the Maryland pension exclusion, an individual who is at least age 65, who is totally disabled, or whose spouse is totally disabled may subtract certain taxable pension and retirement annuity income from federal adjusted gross income for purposes of determining Maryland adjusted gross income. The maximum value of the subtraction is indexed to the maximum annual benefit payable under the Social Security Act ($34,300 for 2022) and is reduced by the amount of any benefit payments received under the Social Security Act or Railroad Retirement Act ("Social Security offset"). As Social Security benefits are exempt from Maryland income tax (though partially taxable for federal income tax purposes), the offset works to equalize the tax treatment of individuals who receive retirement benefits from different sources.

The pension exclusion is limited to income received from an employee retirement system. "Employee retirement system" is defined as a plan (1) established and maintained by an employer for the benefit of its employees and (2) qualified under § 401(a), § 403, or § 457(b) of the IRC. This includes defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans.

However, State law expressly excludes rollover IRAs from the definition of an employee retirement system for purposes of the pension exclusion. Thus, a taxpayer may not include income from a rollover IRA for purposes of calculating the pension exclusion. The following are also excluded from the definition of an employee retirement system: (1) IRAs and annuities under § 408 of the IRC; (2) Roth IRAs under § 408(a) of the IRC; (3) simplified employee pensions under § 408(k) of the IRC; and (4) ineligible deferred compensation plans under § 457(f) of the IRC. **Exhibit 1** shows the types of 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

Senior Tax Credit

Chapters 3 and 4 of 2022 establish a nonrefundable tax credit against the State income tax for a resident who is age 65 or older and whose federal adjusted gross income does not exceed $100,000 ($150,000 if filing jointly or as a surviving spouse or head of household). The amount of the tax credit is equal to (1) $1,000 or (2) $1,750 for surviving spouses, heads of household, and joint filers if both spouses are at least age 65. The credit is available beginning in tax year 2022. For a tax year in which the September general fund estimate issued by the Board of Revenue Estimates for the current fiscal year is more than 7.5% below the March general fund estimate issued in the same year, the value of the tax credit is reduced for specified taxpayers.

Other Tax Relief for Seniors

Social Security benefits and benefits received under the federal Railroad Retirement Act are totally exempt from the Maryland income tax, though they may be partly taxable for federal income tax purposes. Other income tax relief is provided to senior citizens regardless of the source of their income; in addition to the regular personal exemption available to all taxpayers, individuals age 65 and older may claim an additional exemption of $1,000.

State/Local Revenues: State and local income tax revenues decrease significantly beginning in fiscal 2024 due to the bill's expansion of the pension exclusion. However, the amount of the revenue loss cannot be reliably estimated, as it depends on the amount of additional pension income that would be newly eligible for the exclusion as a result of the bill.

Due to taxpayer confidentiality requirements, the Department of Legislative Services (DLS) does not have access to income tax data and is reliant on data provided by 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 Comptroller's Office has used this data and other income tax data to model the fiscal impact of various proposed alterations to the pension exclusion.

While Form 502R asks taxpayers to report income from IRAs consisting entirely of contributions rolled over from defined benefit plans, it does not specifically collect information on income from IRAs consisting entirely of contributions rolled over from other types of employee retirement systems that, under the bill, would become eligible for the pension exclusion. Given the data limitations, a reliable estimate of the bill's effect on State and local revenues is not feasible at this time. Nevertheless, for context and based on information provided by the Comptroller's Office, general fund revenues likely decrease by *at least* $2.0 million annually and local revenues likely decrease by *at least* $1.3 million annually. Preliminary estimates by DLS suggest that general fund revenues may decrease by upward of $10.0 million annually, and local revenues may decrease by $6.3 million annually.

State Expenditures: General fund expenditures for the Comptroller's Office increase by $74,716 in fiscal 2024, which reflects a six-month start-up delay from the bill's July 1, 2023 effective date. This estimate reflects the cost of hiring two revenue examiners to process and approve additional subtraction modifications. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	2.0
Salaries and Fringe Benefits	$60,428
Operating Expenses	14,288
Total FY 2024 State Expenditures	**$74,716**

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Additional Information

Prior Introductions: Similar legislation has been introduced within the last three years. See SB 123 and HB 189 of 2022 and HB 682 of 2020.

Designated Cross File: None.

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

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ea/hlb

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