SB 209

Department of Legislative Services

2015 Session

FISCAL AND POLICY NOTE

Senate Bill 209 (Senator Young, *et al.*)
Budget and Taxation

Income Tax - Subtraction Modification - Retirement Income

This bill expands the existing State pension exclusion subtraction modification for taxpayers who are at least 70 years of age or who qualify for the exclusion under current law due to a disability. The maximum pension exclusion increases to $75,000, phased in over seven tax years.

The bill takes effect July 1, 2015.

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2016 due to additional pension income being exempted. Based on limited data, general fund revenues may decrease by $25.1 million in FY 2016 due to additional income being exempted. Future year revenue decreases reflect the estimated number of eligible taxpayers and retirement income. Expenditures are not affected.

($ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	($25.1)	($47.3)	($66.1)	($82.3)	($95.8)
Expenditure	0	0	0	0	0
Net Effect	($25.1)	($47.3)	($66.1)	($82.3)	($95.8)

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

Local Effect: Local revenues may decrease by $16.9 million in FY 2016 and by $64.4 million in FY 2020. Expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: The bill expands the existing State pension exclusion subtraction modification for taxpayers who are at least 70 years of age or who qualify for the exclusion under current law because of a disability.

The bill increases the maximum pension exclusion for qualifying individuals to (1) $33,000 in tax year 2015; (2) $40,000 in tax year 2016; (3) $47,000 in tax year 2017; (4) $54,000 in tax year 2018; (5) $61,000 in tax year 2019; (6) $68,000 in tax year 2020; and (7) $75,000 beginning in tax year 2021. The maximum exclusion amount in each year is reduced by the amount of Social Security payments received as provided under current law.

Current Law/Background: 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 ($29,000 for 2014) 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 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

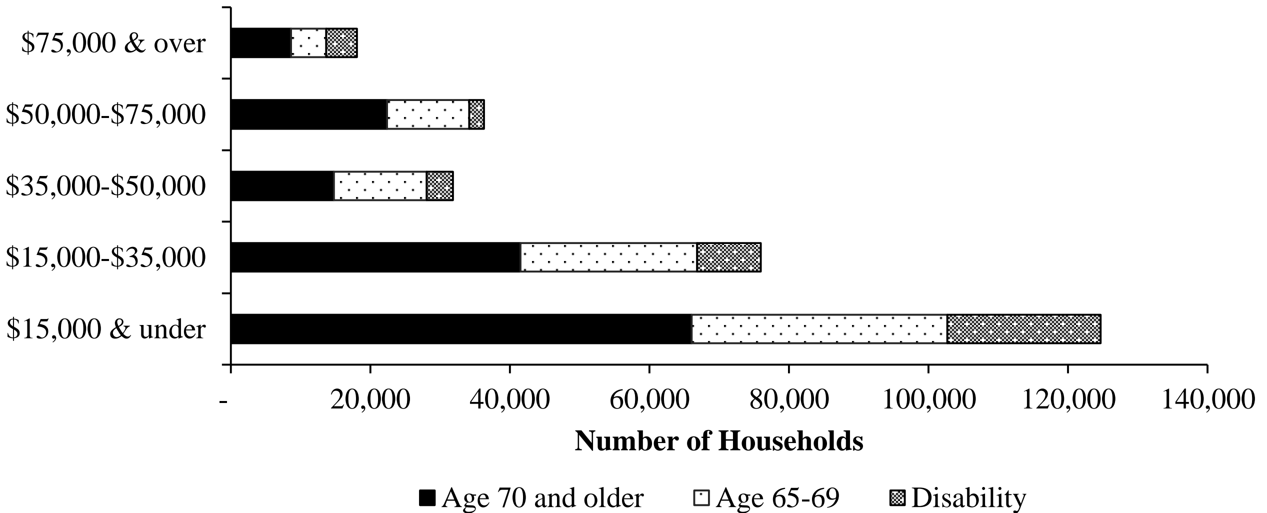
Eligible	**Ineligible**
• 401(k) Cash or Deferred Arrangement (CODA) Plans	• Traditional IRAs
• 403(b) Plans	• Rollover IRAs
• 457(b) Plans	• Roth IRAs
• Thrift Savings Plans	• Keogh Plans
• Savings Incentive Match Plan for Employees (SIMPLE) Retirement Plans Under § 401(k) of the IRC	• Simplified Employee Pensions
	• SIMPLE Retirement Plans Under § 408 of the IRC

Source: Department of Legislative Services

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. According to the Department of Budget and Management, in fiscal 2014 the State subtraction modification for Social Security benefits reduced State revenues by $165.8 million, the State pension exclusion reduced State revenues by $144.4 million, and the additional personal exemption reduced State revenues by $18.3 million.

In calendar 2011, an estimated 286,800 Maryland households received a pension that could qualify for the pension exclusion. A little more than one-half of these pensions were received in a household where at least one member was 70 years of age or older, one-third were 65 to 69 years of age, and the remaining 15% were disability pensions, including certain nontaxable pensions, paid to households where the family members were younger than age 65. An average pension income of $26,700 was received for each household reporting pension income. Households in the 65 to 69 years of age range had the highest average pension; disability pension households had an average pension that was 20% lower (the households in the highest age range had an average pension income that was about 10% lower than those in the 65 to 69 years of age range). **Exhibit 2** shows the number of Maryland households by the amount of pension income received by the household in calendar 2011.

Exhibit 2
Number of Maryland Households by Amount of Pension Income
Calendar 2011



Note: Disability pensions include only those households under the age of 65 years old.

Source: U.S. Census Bureau *Current Population Survey*; Department of Legislative Services

State Revenues: The bill expands the existing State pension exclusion subtraction modification beginning in tax year 2015 for taxpayers who are at least 70 years of age or who qualify for the exclusion under current law because of a disability. Accordingly, general fund revenues may decrease significantly beginning in fiscal 2016.

Due to taxpayer confidentiality requirements, the Department of Legislative Services (DLS) does not have access to income tax data and is dependent on data from the Comptroller's Office. The Comptroller's Office has advised DLS that it does not have sufficient data to produce a fiscal estimate of various proposals to alter the State pension exclusion. According to the Comptroller's Office, it is in the process of redesigning the personal income tax forms in an effort to overcome the data limitations described above. These changes will occur beginning with tax year 2014, but will not be fully implemented until tax year 2015. If these changes are effectively implemented and the data is accurately captured by the Comptroller's Office, this information will be available for the 2017 legislative session.

Based on limited data from the Comptroller's Office, U.S. Census Bureau, and the Current Population Survey, DLS estimates that the bill will decrease general fund revenues by $25.1 million in fiscal 2016, $47.3 million in fiscal 2017, $66.1 million in

fiscal 2018, $82.3 million in fiscal 2019, and $95.8 million in fiscal 2020. Revenue losses could, however, be significantly different than estimated.

Local Revenues: Local revenues decrease by approximately 3% of the total net State subtraction modification claimed. Accordingly, local income tax revenues may decrease by $16.9 million in fiscal 2016, $31.8 million in fiscal 2017, $44.4 million in fiscal 2018, $55.4 million in fiscal 2019, and $64.4 million in fiscal 2020.

Additional Information

Prior Introductions: SB 451 of 2014, a similar bill, received an unfavorable report from the Senate Budget and Taxation Committee. Its cross file, HB 868, was withdrawn. SB 48 of 2013 received an unfavorable report from the Senate Budget and Taxation Committee. Its cross file, HB 440, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 752 of 2012, a similar bill, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: HB 392 (Delegate K. Young) − Ways and Means.

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

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mel/jrb

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