Institute on Taxation and Economic Policy

For Release on October 30, 1998

An Analysis of the Effects of an Increase in Maryland's Retirement Income Exemption

Several proposals for reforming the Maryland personal income tax have recently been suggested, including accelerating previously enacted rate cuts, increasing retirement income exemptions, and introducing new rate cuts above those enacted in 1997. The Institute on Taxation and Economic Policy has analyzed the consequences of one such plan: an increase in the retirement income exemption for elderly and disabled Maryland residents.

The state of Maryland currently allows a retirement income exemption with a maximum of $15,000 per person. This exemption allows a disabled person or a person 65 or older to exclude certain types of income from Maryland taxable income. The excludable types of income include pensions, annuities, and endowments from employee retirement systems, and the amount of the exclusion is reduced by social security retirement benefits received.

The following table, based on an ITEP microsimulation analysis, shows the distributive consequences of an increase in this maximum exemption level from $15,000 ($30,000 for joint filers) to $33,000 ($66,000 for joint filers).

Our analysis of the pension exemption increase shows that such a plan would cut net state taxes on the typical elderly Marylander by about $38. In particular:

- Elderly Marylanders earning less than $15,000 would, on average, see *no* tax cut under such a plan, while elderly residents earning between $15,000 and $30,000 would see an average net tax cut of $17 in 1998.
- Senior citizens earning between $30,000 and $50,000 would see an average net tax cut of $183.
- Seniors earning between $50,000 and $100,000 would see an average net tax cut of $409.
- The primary beneficiaries of such a plan would be senior citizens earning more than $50,000 a year. This income group, which constitutes 22 percent of Maryland's elderly population in 1998, would receive 65 percent of the total net tax cut under this plan.

Effects of Increasing the Maryland Pension Exemption from $15,000 to $33,000

Share of Tax Cuts by Elderly Income Group, 1998					
Income Range	**Less Than $15,000**	**$15,000–$30,000**	**$30,000–$50,000**	**$50,000 – $100,000**	**$100,000 or more**
Average Income In Group	$9,200	$22,200	$38,800	$67,800	$220,400
% of Elderly MD Population	23%	31%	23%	15%	7%
Average Tax Cut from Exemption Hike	**$ 0**	**$ 17**	**$ 192**	**$ 453**	**$ 534**
Average Federal Tax Increase	**0**	**0**	**9**	**44**	**144**
Average Net Tax Reduction	**$ 0**	**$ 17**	**$ 183**	**$ 409**	**$ 390**
Tax Change as a % of income	—	–0.1%	–0.5%	–0.7%	–0.2%
Share of Total Tax Cut	0%	4%	31%	46%	19%
Addendum: Median Tax Cut for Elderly Marylanders: $38					
Source: Institute on Taxation and Economic Policy Microsimulation Tax Model, October 21, 1998.					

In addition, more than 10 percent of such a tax cut would go not to Marylanders, but to the federal government. This is because Maryland taxpayers who itemize are able to deduct their Maryland income taxes on their federal tax return, lowering their federal personal income tax liability. A cut in Maryland income tax therefore means an *increase* in federal income taxes for Marylanders who itemize. More specifically:

Of the tax reduction that would result from the pension exemption hike, 12 percent of the total tax cut-- would be taken out of the Maryland economy altogether.

This analysis is a preliminary finding from an upcoming ITEP analysis of several proposed tax reform options for Maryland.