DEPARTMENT OF REVENUE

INDIVIDUAL INCOME TAX
Public Pension Subtraction

March 22, 2022

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 3461 (Lislegard), As Proposed to be Amended (H3461A3)

	Fund Impact			
	F.Y. 2022	F.Y. 2023	F.Y. 2024	F.Y. 2025
	(000's)			
General Fund	$0	($34,400)	($34,400)	($34,500)

Effective beginning tax year 2022.

EXPLANATION OF THE BILL

Current Law: Certain government workers who are members of a public pension plan are excluded from Social Security under federal law, provided their pension benefits meet certain requirements. These pension benefits are offered no distinct tax treatment under Minnesota law.

Proposed Law: The bill would offer a subtraction to pension recipients, provided their benefits are based on service for which they are not receiving Social Security benefits.

The subtraction amount would be the sum of a "federal exclusion" and a "state exclusion."

The federal exclusion is calculated in a similar way to the federal exclusion for Social Security benefits. The amount depends on the taxpayer's provisional income, defined as modified adjusted gross income plus one-half of taxable Social Security benefits received during the taxable year, relative to the "base amount" and "adjusted base amount," which are used to calculate the taxable portion of Social Security benefits under federal law. The base amount is $25,000 for most taxpayers, $32,000 for a taxpayer filing a joint return, and zero for a married couple filing separate returns who do not live apart for all of the tax year. The adjusted base amount is $34,000 for most taxpayers, $44,000 for taxpayers filing a joint return, and zero for a married couple filing separate returns who do not live apart for all of the tax year. The amendment corrects the calculation of the federal exclusion to follow the calculation of the federal exclusion for Social Security benefits.

The state exclusion equals the amount of qualified pension benefits in excess of the federal exclusion, subject to a maximum state exclusion, and is phased out by income in the same way as the current Social Security subtraction.

The maximum state exclusion and phase-out thresholds are the same as for the Social Security subtraction. The maximum state exclusion is $5,450 for a joint return, half that amount for a married taxpayer filing a separate return, and $4,260 for all other taxpayers. The maximum amount is reduced by 20% of provisional income in excess of $82,770 for a joint return, half that amount for a married taxpayer filing a separate return, and $64,670 for all other filers. Those amounts will be adjusted annually for inflation beginning in tax year 2023.

EXPLANATION OF THE BILL (Cont.)

The taxpayers eligible for the subtraction include members of the State Patrol Retirement Plan, members of the legacy Legislators Retirement Fund, certain legacy members of the Public Employee Retirement Association (PERA) General Plan, legacy members of the Minneapolis Employees Retirement Fund, members of the PERA Police & Fire Plan, certain legacy members of the Teacher Retirement Association, and certain legacy members of the St. Paul Teachers Retirement Fund Association. The bill also includes any members of a federal pension plan who are ineligible for Social Security, and members of a pension plan administered by another state whose income tax laws permit a “similar deduction or exemption” for beneficiaries of a Minnesota pension plan.

The phrase “similar deduction or exemption” is undefined. For this estimate, a state was considered to have a “similar deduction or exemption” if it offers any deduction or exemption specifically for pension income. The estimate does not include states that offer an additional deduction for elderly taxpayers (irrespective of the source of income), states that offer a tax credit for pension benefits, and states without an income tax.

The subtraction would be allowed for purposes of the alternative minimum tax.

REVENUE ANALYSIS DETAIL

- This estimate is the sum of two separate analyses: an estimate of the impact on state pension plan beneficiaries, and an estimate of the impact on federal pension plan beneficiaries.

State Pension Plans

- The valuation reports for the seven state pension plans specifically covered by this proposal were used to calculate the taxable income, average pension benefit and the number of taxpayers eligible for this subtraction.
- Since data on this population’s taxable income is unavailable, a simulated beneficiary population was constructed using the 2019 income tax sample by selecting a random 4.15% of filers reporting Social Security income and replacing their Social Security income with a hypothetical pension income from the Minnesota-based pension systems. The size of the sample and average pension amount were chosen to match the number of qualifying pension beneficiaries and total amount of pension income calculated from the valuation reports.
- The estimates of the state pension plan costs were reduced by the share of Minnesota pension recipients who retired to other states using data from Minnesota State Retirement System and PERA. Data on TRA and SPTRFA beneficiaries was unavailable. Instead, data from a 2013 National League of Cities report and a 2008 report from the National Association of State Retirement Administrators was used to impute a figure for this group.
- Data from the Census Bureau’s 2019 Annual Survey of Public Pensions (ASPP), Public Plans Data (PPD) from the Center for Retirement Research at Boston University and the IRS’s U.S. Population Migration Data for 2018-2019 were used to estimate the number of Minnesota residents who receive retirement benefits from another state’s pension plan.

REVENUE ANALYSIS DETAIL (Cont.)

- About 2.43 million public plan beneficiaries nationwide are ineligible for Social Security, according to the PPD. Approximately 47% of these beneficiaries were members of a plan administered by a state with a similar deduction or exemption, estimated based on a review of state statutes. It is assumed that 10% of these beneficiaries, or about 115,000 pension recipients, retire to states other than where they worked. Minnesota's share of these pension recipients was estimated using Minnesota's share of inbound state-to-state migrants age 65 and older for 2019 from the IRS migration data. This yields an estimated 1,500 qualifying pensioners from other states who retire in Minnesota.
- Growth rates through 2021 are based on the observed growth rates in pension payouts from the valuation reports. For the remainder of the fiscal years in this estimate, the projected growth rates of benefit payments from the valuation reports were used instead. Both growth rates were adjusted to account for the declining share of employees not covered by Social Security.

Federal Pension Plans

- A similar procedure was followed to construct an estimate for the cost of the provision for federal system retirees under the Civil Service Retirement System (CSRS).
- About 1,724,000 beneficiaries received CSRS benefits at the end of fiscal year 2019, based on information from the Congressional Budget Office. The average annual benefit was $40,728. Minnesota residents made up 1.17% of that total, or 20,440, based on information from the Office of Personnel Management.
- The benefit of the subtraction for CSRS retirees was estimated using a share (3.33%) of Social Security beneficiaries as a model population.
- The federal estimate was discounted by 7.5% to account for the tax-free portion of CSRS benefits.
- Growth rates are based on the average historical growth rates for CSRS pension payments.
- Tax year impacts are allocated to the following fiscal year.

Number of Taxpayers: About 40,600 taxpayers would be affected in tax year 2022, including 20,700 Minnesota state pension recipients, 1,500 non-Minnesota state pension recipients and 18,400 federal pension recipients. The average decrease in tax would be $848.

Minnesota Department of Revenue
Tax Research Division
https://www.revenue.state.mn.us/revenue-analyses