DEPARTMENT OF REVENUE

INDIVIDUAL INCOME TAX
Retirement Benefits Subtraction

March 22, 2022

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 3930 (Frederick) / S.F. 3906 (Rest)

	Fund Impact			
	F.Y. 2022	**F.Y. 2023**	**F.Y. 2024**	**F.Y. 2025**
		(000's)		
General Fund	$0	($29,000)	($31,400)	($32,700)

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 expand the Social Security subtraction to a more general retirement benefits subtraction, allowing taxpayers to subtract from their taxable income both Social Security benefits and pension benefits from service for which the beneficiary is not also receiving Social Security benefits.

The retirement benefits subtraction would follow the form of the current Social Security subtraction, allowing a portion of qualified retirement benefits to be subtracted, subject to a maximum subtraction amount, which is reduced by 20 percent of provisional income above a phase out threshold specific to a taxpayer's filing status.

In tax year 2022, for married taxpayers filing a joint return and surviving spouses, the new maximum subtraction and phaseout thresholds are $7,000 and $81,630, respectively. For single or head of household taxpayers, the new maximum subtraction and phase out thresholds are $5,460 and $63,770. For married taxpayers filing separate returns, the new maximum subtraction and phase out thresholds are $3,500 and $40,815, respectively. These amounts will be adjusted annually for inflation beginning in tax year 2023.

Taxpayers with eligible pensions 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 (TRA), and certain legacy members of the St. Paul Teachers Retirement Fund Association (SPTRFA). The proposal 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.

EXPLANATION OF THE BILL (Cont.)

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.

REVENUE ANALYSIS DETAIL

- This estimate is the sum of three separate analyses: an estimate of the proposal's impact to current claimants of the Social Security subtraction using the House Income Tax Simulation Model, an estimate of the impact on state pension plan beneficiaries, and an estimate of the impact on federal pension plan beneficiaries.

Increase Maximum Subtraction and Phase-out Threshold
- The House Income Tax Simulation (HITS 7.1) Model was used to estimate the impact of the changes to the maximum subtraction amounts and phase out thresholds on current Social Security subtraction claimants. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2022. The model uses a stratified sample of 2019 individual income tax returns compiled by the Minnesota Department of Revenue.

State Pension Plans
- The valuation reports for the seven state pension plans specifically covered by this proposal were used to calculate the 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 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 316,900 tax returns would be affected in tax year 2022, including 276,300 Social Security recipients, 20,700 Minnesota state pension recipients, 1,500 non-Minnesota state pension recipients and 18,400 federal pension recipients. For Social Security recipients, the average decrease in tax would be $80. For federal and state pension plan beneficiaries, the average decrease in tax would be $168.

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