

February 4, 2025

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of S.F. 4 (Rarick), As Proposed to be Amended (SCS0004A-1)

	Fund Impact			
	<u>F.Y. 2026</u>	<u>F.Y. 2027</u>	<u>F.Y. 2028</u>	<u>F.Y. 2029</u>
		(000's)		
General Fund	(\$3,500)	(\$3,700)	(\$3,900)	(\$4,100)

Effective beginning with tax year 2025.

EXPLANATION OF THE BILL

Current Law: A taxpayer may subtract the amount of a military service pension from their Minnesota taxable income to the extent that pension is taxed under federal law. A taxpayer may also subtract from their taxable income a portion of benefits earned from state and federal pension systems whose members do not earn Social Security benefits. Other pension benefits are fully taxable under Minnesota law, to the extent they are included in federal adjusted gross income (FAGI).

Retired federal civilian employees primarily receive pension benefits from one of two federal pension programs: the Civil Service Retirement System (CSRS) and the Federal Employee Retirement System (FERS).

CSRS covers federal employees who were hired before 1984, and it is not integrated with Social Security. CSRS annuitants may currently subtract a portion of their pension benefits under Minnesota's current retirement benefits subtraction.

FERS covers federal employees who were hired in 1984 or after, and it is integrated with Social Security. FERS annuitants may not subtract any part of their pension benefits under Minnesota's retirement benefits subtraction.

Proposed Law: The proposal would expand Minnesota's military service pension and retirement pay subtraction to allow veterans to subtract a portion of their pension benefits earned for service as a federal employee under CSRS or FERS.

The amount of pension benefits that may be subtracted under this proposal would be limited by a "military service ratio." The military service ratio equals the number of years credited to the taxpayer for military service divided by the total number of years in federal employment, both civilian and military, credited to the taxpayer for the purpose of CSRS or FERS benefit calculations.

The amendment specifies that any amount used to claim the subtraction may not be used to claim the public pension subtraction.

REVENUE ANALYSIS DETAIL

- This estimate uses data from the Office of Personnel Management's (OPM) annual reports on the Civil Service Retirement and Disability Fund. These reports provide information on the number of annuitants nationwide and federal spending on civilian pension benefits.
- A 2023 Congressional Research Service (CRS) report provides data on the number of CSRS and FERS annuitants residing in each state. This data was used to apportion federal civilian pension spending to Minnesota.
- The share of CSRS and FERS annuitants with creditable military service was imputed using the share of federal employees who are veterans based on data from a 2023 OPM report on employment of veterans in the federal executive branch.
- The average military service ratio was imputed by dividing the average length of military service by the sum of the average length of federal civilian service and the average length of military service, based on data from OPM and a 2011 Pew Research Center report.
- Since data on this population's taxable income is unavailable, a simulated beneficiary population was constructed using the 2022 income tax sample by selecting a random group of filers reporting Social Security income and adding a hypothetical pension income from FERS or replacing their Social Security income with a hypothetical pension income from CSRS. 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 OPM and CRS reports.
- The subtraction amount was adjusted by the imputed military service ratio. To account for the portion of CSRS and FERS benefits already excluded from FAGI, the estimate was further discounted by 7.5% or 3.5%, respectively.
- Growth rates for the estimate were based on estimated future federal civilian pension spending from the OPM reports.
- It is assumed that about 75% of eligible CSRS annuitants will choose to use the existing retirement benefits subtraction rather than the proposed expanded military retirement subtraction. This assumption was made based on the estimated average military service ratio, the phaseout threshold for the retirement benefits subtraction, and the distribution of FAGI.
- This estimate assumes full take-up of the proposed subtraction by all eligible taxpayers.
- Tax year impacts are allocated to the following fiscal year.

Number of Taxpayers: About 6,700 taxpayers would be affected in tax year 2025. The average decrease in tax would be \$524.

Minnesota Department of Revenue
Tax Research Division
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