DEPARTMENT OF REVENUE

**INDIVIDUAL INCOME TAX**
**Public Safety Pension Subtraction**

March 14, 2022

| | Yes | No |
|---|---|---|
| **DOR Administrative Costs/Savings** | | X |

Department of Revenue
Analysis of S.F. 3538 (Howe), As Proposed to be Amended (SCS3538A-1)

| | Fund Impact | | | |
|---|---|---|---|---|
| | **F.Y. 2022** | **F.Y. 2023** | **F.Y. 2024** | **F.Y. 2025** |
| | (000's) | | | |
| General Fund | $0 | $0 | ($700) | ($1,500) |

Assumed effective beginning tax year 2023.

## EXPLANATION OF THE BILL

**Current Law:** Most pension income is taxed as ordinary income under federal law, with exception only to avoid double-taxation of after-tax contributions to pension plans. Minnesota offers no distinct treatment for pension income relative to federal law, outside of pension income for retired and disabled former active service members of the military.

**Proposed Law:** The bill creates a subtraction for pension income from a qualifying public safety pension. The subtraction applies to individuals under the age of 55 as of December 31, 2022 with at least 20 years of public service and their surviving spouses. The amount of the subtraction would equal the amount of income received, to the extent it is included in federal adjusted gross income (FAGI) and excluding disability income.

The specific state and local pension plans which would qualify for the subtraction are the Public Employees Retirement Association (PERA) Police & Fire Plan (P&F), the PERA Correctional Plan, the State Patrol Retirement Fund (SPRF), and the Minnesota State Retirement System (MSRS) Correctional Plan.

The subtraction would also include "any similar annuity or benefit from a retirement system administered by the federal government." The phrase "similar annuity or benefit" is not defined. For this estimate, any public safety officer receiving pension benefits from either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS) is considered eligible.

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

## REVENUE ANALYSIS DETAIL

- This estimate is the sum of six separate analyses, one for each of the qualifying pension plans under this subtraction.
- The valuation reports for the four state pension plans specifically covered by this proposal were used to calculate the average pension benefits and the eligible number of taxpayers for this subtraction under Minnesota state pension plans.

**REVENUE ANALYSIS DETAIL (Cont.)**

- The Congressional Budget Office's (CBO) forecasts of the two federal pension plans were used to calculate the average pension benefits for this subtraction under federal pension plans. About 0.08% of participants in those plans are assumed to be eligible for the subtraction, based on Minnesota's share of federal employees and the share of federal employees in Minnesota employed in public safety occupations, according to the 2019 Quarterly Census of Employment & Wages from the Bureau of Labor Statistics.
- Since data on this population's income from sources other than pensions is limited, simulated beneficiary populations were constructed using the 2019 income tax sample by selecting random shares of filers reporting Social Security income and assigning them a hypothetical pension income from each the six pension systems. For Social Security-exempt pensioners, which includes those in the P&F, SPRF and CSRS plans, any Social Security income in the income tax sample was eliminated from FAGI.
- The share sizes of Social Security recipients in the income tax sample were chosen to match the total amount of pension income and qualifying pension beneficiaries calculated from the valuation reports and the CBO forecast.
- 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 MSRS and PERA.
- The federal estimates were discounted by 7.5% and 3.5% to account for the tax-free portion of CSRS and FERS benefits, respectively.
- Each of the four state pension plans was further adjusted by the imputed share of beneficiaries with less than 20 years of service, based on the distribution of service terms among active members over the age of 45 according to the valuation reports. The federal adjustment is the beneficiary-weighted average of the four state pension adjustments.
- Growth rates for the state pension plans 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, and for federal pension plans across all fiscal years, the projected growth rates of benefit payments from the valuation reports and the CBO forecast were used instead.
- The forecasted estimates for each pension plan were then adjusted to remove the estimated number of retirees who attained age 55 before December 31, 2022 using data in the valuation reports from 2018-2021. Federal estimates were discounted by the average share of eligible beneficiaries in the state pension plans.
- The fiscal impact of this subtraction grows linearly over time as the number of retirees who attained age 55 before December 31, 2022 makes up a larger share of annuitants. If the birth year restriction were not in place for tax year 2023, the fiscal impact would be about $21,300,000.
- Tax year impacts are allocated to the following fiscal year.

**Number of Taxpayers:** About 300 tax returns would be affected in tax year 2023. The average decrease in tax would be $2,353.

Minnesota Department of Revenue
Tax Research Division
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