Senate
State of Minnesota

December 11, 1984

TO: Members of the Senate Tax Committee and
Other Interested Parties

FROM: Keith E. Carlson, KC Fiscal Analyst, Senate Tax Committee

RE: Analytical Report on Minnesota's Pension Exclusion

The pension exclusion is an element of the state's individual income tax system which has continually been surrounded by controversy since its inception. Because the constituency served by the exclusion, i.e. senior citizens, is a group that either party is reluctant to cross, the value of the exclusion has been constantly enriched over the years so that it is now reaching the point where over $113 million of tax revenues are being lost each year. Because of this cost to the state treasury, it is important for legislators to put aside political considerations and examine the pension exclusion objectively to see whether it truly serves the population intended and whether it does so in an equitable manner. The attached report provides information which permits such an analysis.

The report was done by myself. Consequently, any opinions stated within the report should be attributed only to myself and does not reflect the opinion of any legislator or legislators.

If you have any questions or need any additional information, please contact me at 296-4901.

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MINNESOTA's PENSION TAX EXCLUSION: HISTORY AND EFFECTS

Minnesota has long been known for the degree of care and concern exhibited for its senior citizens. If tax advantages available to seniors are any indication, that reputation is well deserved. There are at least four provisions of the income tax alone that are of sole or primary benefit to those over 65: an additional personal credit, the low income credit, the exclusion of social security and railroad retirement income and the pension exclusion.

This latter provision, the pension exclusion, has become the most significant income tax provision affecting senior citizens, with an estimated cost in foregone revenues exceeding $113 million a year. To put this figure into perspective, the entire individual income tax will raise about $2.2 billion in fiscal 1985, thus the pension exclusion, if repealed, would increase state tax collections by about five percent. Consequently, due to cost concerns, a review of the pension exclusion would appear to be warranted. In addition, the need for review exists because of the political pressures that are bearing on the legislature to increase the exclusion. Unfortunately, there is little data available upon which to intelligently base a response to these pressures. Indeed, who is claiming and benefitting from the exclusion and, perhaps more importantly, who is not, is, at best, not well documented and, at worse, perhaps not known at all. This report is an attempt to begin to address these and other concerns about the exclusion.

HISTORY:

Prior to 1977, most public employee pensions were exempt from the state's income tax. In addition, an Internal Revenue Service interpretation of federal law with which Minnesota conformed exempted all social security benefits from both federal and state income taxes. Railroad retirement benefits were exempt from both federal and state income taxes by federal law. Presumably the public pension exclusion was first enacted, in part, for equity reasons: as public employees did not initially participate in the social security system, they would have been taxed at both the federal and state level on their entire retirement income. In contrast, retirees from private employment covered by social security would have received at least a portion of their retirement income free from state and federal income taxes. The pension exclusion thus partially equalized after-tax retirement income of retirees from public and private employment.

Beginning in the late 1950's, this rationale began to disappear as Minnesota's public employee retirement systems began to convert from providing what are called "basic" or "uncoordinated" retirement benefits (without social security benefits) to providing "coordinated" benefits (along with social security benefits) to their memberships. At present, the PERA Police and Fire Plan is the only major Minnesota public employee pension system not providing "coordinated" retirement benefits for current enrollees. Although a number of "basic" members are either still drawing retirement benefits or will begin drawing them in the near future, these retirees are a small, and declining, portion of the total and tend to have smaller pensions. In addition, although a more recent occurence, it should be noted that new federal employees are also coming under social security coverage.

As a result of these changes, retirees from public employment no longer found themselves at a tax disadvantage relative to private pensioners but rather enjoyed the advantage of having both their pension and their social security excluded from state tax. Partially due to the recognition of this, the legislature acted for the first time in 1977 to limit the exclusion for public pension income. The intent of this legislation was again to equalize the after-tax income of retirees. Only in this instance that equalization was to be attained by reducing the after-tax income of governmental pension recipients. The first change in the pension exclusion consisted of reducing the exclusion to $7,200 less the sum of social security, railroad retirement and earned income, as defined in the Internal Revenue Code. To the extent social security benefits did not exceed $7,200 (which was invariably true at that time), this provision would have attained the legislature's objective of equalizing the tax treatment of public employee pensions and social security--no one would have received more than $7,200 of retirement income tax free.*

The 1977 change never went into effect. The reaction from public retirees to this change was so fierce that the legislature was forced to modify the exclusion in 1978 by replacing the dollar-for-dollar earned income offset with an offset for federal adjusted gross income in excess of $13,000 (this offset did not apply to volunteer fire-fighter's pensions if distribution on a lump-sum basis was required). In an effort to retain some equity in the tax treatment of retirees, the legislature also extended the pension exclusion, with the same dollar limitation and offsets, to virtually all pensions derived from private employment. This latter group includes 1) distributions from Individual Retirement Accounts (IRA's); Keogh, Simplified Employee Retirement and 401K plans; and profit-sharing plans, 2) annuities or certain bonds purchased by the employer on the employee's behalf, and 3) certain annuities purchased by teachers and employees of non-profit organizations (but not annuities traditionally purchased from life insurance

Despite the 1978 change, the criticism of the repeal of the total exclusion for all public pensions continued unabated. However ill founded, the most commonly-voiced complaint was, "You're taxing my social security," as social security benefits reduced the exemption for pension income (but were not in and of themselves taxed). Consequently, the legislature responded again in 1979 by increasing the exclusion to $10,000 and by eliminating the social security and railroad retirement offset while increasing the threshold at which the excess federal adjusted gross income offset began to take effect to $17,000. The exclusion was increased to $11,000 in 1980, where it has remained through the current tax year. With the changes made in 1979 and 1980, the amount of pension exclusion claimed expanded well over twofold between 1978 and 1982, from $169 million in tax year 1978 to $334 million in tax year 1980 to $469 million in tax year 1982.

Beginning in tax year 1985, an alternative exclusion of $11,000 less the sum of social security, railroad retirement and federal adjusted gross income in excess of $23,000 will also be available. In addition, "federal adjusted gross income" will not include any social security or railroad retirement benefit for purposes of the offset beginning in tax year 1984.

*The "earned income" offset was potentially disequalizing in its impact but that depended on the income recipient because social security also had (and still has) an earned income offset of its own. Its earned income offset is a $1 benefit reduction for every $2 of earned income in excess of an indexed threshold, $3,240 in 1978. Beginning in 1982, the earned income offset for social security does not apply after age 70. It was age 72 prior to that.

If the 1977 state law change had been put into effect in 1978, initially the government pension recipient alone would have suffered a penalty of $1 times his or her state marginal tax rate for every $1 of earnings. But once the social security recipient's earnings reached $3,240, the social security recipient would have quickly caught up with the government pensioner in terms of penalty and would have begun to surpass the government pensioner in penalty once his or her earned income exceeded $4,500 assuming a 14 percent state marginal tax rate. This amount would have been lower if the government pensioner was in a lower tax bracket.

DESCRIPTION OF THE PENSION EXCLUSION:

Prior to analyzing the incidence of the present exclusion, it is worthwhile to describe its provision in greater detail:

INCOME INCLUDED:

I. Only that included within federal adjusted gross income*

II. To the extent included in federal adjusted gross income:

A. Pensions derived from government service
B. Distributions from qualified plans including:
  1. Almost all pensions or annuities derived from private employment regardless of who contributes (the employee or employer) as long as it is pursuant to a plan administered by the employer (or sometimes one negotiated by a union).
  2. Certain annuities that may be purchased by a teacher or employees of nonprofit organizations
  3. Distributions from:
    a. IRA's
    b. Keoghs
    c. Simplified Employee Retirement plans
    d. 401K plans

INCOME EXCLUDED FROM COVERAGE BY THE PENSION EXCLUSION:

I. Deferred compensation received by state and local government employees.

II. Life insurance annuities and other annuities not purchased through an IRA account (except those mentioned under "Income Included" in #1 and #2).

III. Any income derived from personal savings no matter what the form of that savings unless from an IRA or annuity referred to under "Income Included".

IV. Wage or salary or partnership or proprietorship income.

CALCULATION:

I. The lesser of the recipient's pension or $11,000 less the recipient's federal adjusted gross income (not including any social security or railroad retirement benefit included therein) in excess of $17,000.

II. Low income credit recipients cannot claim the exclusion. They must take whichever is of most benefit to them--the pension exclusion or the low income credit.

III. Pension exclusion recipients must prorate their federal tax deduction since a portion of the income they paid federal tax on is not taxable in Minnesota.

*To the extent that an employee's contribution to a retirement plan is taxed at the time of contribution, the employee is allowed to recover that contribution at the time of distribution before any of the distribution is included in federal adjusted income or consequently subject to state or federal tax. Usually recovery of the employee contribution takes place within the first three years of retirement. If not, then a pro-rata share is excluded every year that retirement benefits are drawn.

EFFECTS OF THE PENSION EXCLUSION:

Below are several tables which illustrate the effect of the pension exclusion.

MINNESOTA INCOME TAX BY FAGI BY PENSION RECEIVED
MARRIED, OVER 65, STANDARD DEDUCTION
ESTIMATED 1984 RATES AND BRACKETS

FAGI	PENSION INCLUDED IN FAGI					
	$0	$2,500	$5,000	$7,500*	$10,000*	$11,000*
$5,000	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
$10,000	295	73	0	0	0	0
$15,000	742	492	262	52	0	0
$20,000	1,234	968	702	462	414	414
$25,000	1,746	1,461	1,404	1,404	1,404	1,404
$30,000	2,278	2,278	2,278	2,278	2,278	2,278

MINNESOTA INCOME TAX BY FAGI BY PENSION RECEIVED
SINGLE, OVER 65, STANDARD DEDUCTION
ESTIMATED 1984 RATES AND BRACKETS

FAGI	PENSION INCLUDED IN FAGI					
	$0	$2,500	$5,000	$7,500*	$10,000*	$11,000*
$ 5,000	$ 39	$ 0	$ 0	$ 0	$ 0	$ 0
10,000	391	185	19	0	0	0
15,000	810	576	362	166	10	0
20,000	1,264	1,011	767	540	497	497
25,000	1,718	1,451	1,402	1,402	1,402	1,402
30,000	2,184	2,184	2,184	2,184	2,184	2,184

*Pension included in FAGI cannot exceed FAGI, e.g., pension included in $5,000 of FAGI under "$7,500" is $5,000, not $7,500

DOLLAR REDUCTION IN TAX FOR SELECTED AMOUNT OF PENSION RECEIVED BY FAGI
MARRIED, OVER 65, STANDARD DEDUCTION
ESTIMATED 1984 RATES AND BRACKETS

FAGI	PENSION INCLUDED IN FAGI					
	$0	$2,500	$5,000	$7,500	$10,000	$11,000
$ 5,000	$0	$ 0	$ 0	$ 0	$ 0	$ 0
10,000	0	222	295	295	295	295
15,000	0	250	480	690	742	742
20,000	0	266	532	772	820	820
25,000	0	285	342	342	342	342
30,000	0	0	0	0	0	0

DOLLAR REDUCTION IN TAX FOR SELECTED AMOUNT OF PENSION RECEIVED BY FAGI
SINGLE, OVER 65, STANDARD DEDUCTION
ESTIMATED 1984 RATES AND BRACKETS

	PENSION INCLUDED IN FAGI					
FAGI	$0	$2,500	$5,000	$7,500	$10,000	$11,000
$ 5,000	$0	$ 39	$ 39	$ 39	$ 39	$ 39
10,000	0	206	372	391	391	391
15,000	0	234	448	644	800	810
20,000	0	253	497	724	767	767
25,000	0	267	316	316	316	316
30,000	0	0	0	0	0	0

PERCENT REDUCTION IN TAX BY FAGI BY PENSION RECEIVED
MARRIED, OVER 65, STANDARD DEDUCTION
ESTIMATED 1984 RATES AND BRACKETS

	PENSION INCLUDED IN FAGI					
FAGI	$0	$2,500	$5,000	$7,500	$10,000	$11,000
$ 5,000	0%	0%	0%	0%	0%	0%
10,000	0	75	100	100	100	100
15,000	0	34	65	93	100	100
20,000	0	22	43	63	66	66
25,000	0	16	20	20	20	20
30,000	0	0	0	0	0	0

PERCENT REDUCTION IN TAX BY FAGI BY PENSION RECEIVED
SINGLE, OVER 65, STANDARD DEDUCTION
ESTIMATED 1984 RATES AND BRACKETS

	PENSION INCLUDED IN FAGI					
FAGI	$0	$2,500	$5,000	$7,500	$10,000	$11,000
$ 5,000	0%	100%	100%	100%	100%	100%
10,000	0	53	95	100	100	100
15,000	0	29	55	80	99	100
20,000	0	20	39	57	61	61
25,000	0	16	18	18	18	18
30,000	0	0	0	0	0	0

As these examples indicate, the pension exclusion introduces a considerable amount of inequity into the tax system. With the same amount of income one taxpayer without a pension will pay considerably more in tax than another taxpayer receiving a pension--a difference of up to $810 for a single taxpayer and up to $820 for a married couple (filing a joint return). At the same time, taxpayers with less than $5,000 of income pay more in tax than taxpayers with $15,000 or more of income based solely on the proportion of their income derived from pensions. With the state's current rate and bracket structure, a single taxpayer who claims the standard deduction and has an income of $15,800 with $11,000 from pensions and a married, one-earner couple who claim the standard deduction and have an income of $17,400 with $11,000 from pensions will pay no tax as a result of the exclusion. As the pension exclusion is calculated on a separate-recipient basis, it is entirely possible for a married couple to receive nearly $32,000 in total income and pay no state tax.

An examination of data from 1982 tax returns shows the inequities introduced into the tax system by the pension exclusion are even greater than the above examples would indicate. First, the data show that the pension exclusion is of no benefit to many seniors--less than 30 percent of potentially eligible seniors claim any pension exclusion. Second, with regard to "vertical equity" or the progressivity of the income tax, a very damaging effect is the fact that the average amount of exclusion claimed goes up with income before it is reduced by the offset for incomes somewhere between $20,000 and $25,000. This combined with the fact that the benefit of even a fixed exclusion goes up with income as a taxpayer's marginal tax rate increases as the previous examples indicated (i.e., $1,000 exclusion is of no value to an individual with an income of $2,000, as that individual would pay no tax in any event, but it is of great value to an individual whose income is $25,000 and in the 14 percent tax bracket) results in higher income pension recipients receiving substantially greater tax benefits in absolute dollar terms relative to low income pension recipients. Thus, the greater one's income, the greater the tax benefit, subject only to the FAGI offset. These effects greatly call into question the validity of the pension exclusion as a policy tool to provide meaningful and fair tax relief for low-income senior citizens. This question begs answering even more when it is noted that many beneficiaries of the pension exclusion are not even senior citizens: of the 108,286 taxpayers claiming the pension exclusion in 1982, nearly 35,000 were taxpayers under age 65.

ESTIMATED AVERAGE TAX REDUCTION DUE TO PENSION EXCLUSION FOR TAX YEAR 1982 BY FAGI BY FILER TYPE

	Seniors Not Claiming Exclusion		Seniors Claiming Exclusion			
FAGI to: Loss	Average Pension Exclusion	Average Tax	Average Pensions Exclusion	Average Tax	Est. Tax Without Exclusion	Est. Tax Reduction Due to Exclusion
$	$ 0	$ 2	$3,152	$ 498	$ 863	$ 365
999*	0	11	339	1	14	13
1,999*	0	22	859	8	65	57
2,999*	0	58	997	27	97	70
3,999*	0	92	1,491	42	150	108
4,999*	0	110	1,812	58	193	135
5,999	0	161	2,441	65	266	201
6,999	0	205	3,032	80	338	258
7,999	0	265	3,356	101	400	299
8,999	0	327	4,651	76	471	395
9,999	0	366	3,859	169	528	359
10,999	0	424	4,842	171	638	467
11,999	0	484	5,780	126	642	516
12,999	0	519	4,332	283	720	437
13,999	0	650	7,004	237	917	680
14,999	0	755	6,267	299	923	624
19,999	0	837	6,856	426	1,119	603
24,999	0	1,323	5,762	748	1,365	617
29,999	0	1,646	1,429	1,236	1,383	147
>29,999**	0	3,861	2,677	5,242	5,593	351

Under 65 Taxpayers Claiming Exclusion

FAGI to: Loss	Average Pension Exclusion	Average Tax	Est. Tax Without Exclusion	Reduction Due to Exclusion
	$4,204	$ 0	$ 304	$304
$ 999*	699	1	39	38
1,999*	1,150	2	62	60
2,999*	841	20	67	47
3,999*	2,474	24	174	150
4,999*	1,721	68	181	113
5,999	3,791	36	306	270
6,999	3,735	79	371	292
7,999	5,098	35	415	380
8,999	4,486	99	464	365
9,999	5,562	104	572	468
10,999	5,743	32	479	447
11,999	5,861	216	744	528
12,999	8,161	128	860	732
13,999	5,748	404	979	575
14,999	7,225	282	979	697
19,999	5,380	516	1,066	550
24,999	4,709	871	1,385	514
29,999	1,257	1,515	1,654	139
>29,999**	1,681	1,938	2,130	192

*Because of the manner in which the Department of Revenue allocates credits between spouses filing on a combined return, the average tax indicated in the lower income categories is probably overstated. Consequently, the tax reduction due to the pension exclusion for the same lower income categories is also probably overstated.

**The amount of exclusion claimed by taxpayers with over $29,999 is not in error. Data is drawn from the entire population of tax returns prior to audit and over 500 taxpayers with income in excess of $29,999 claimed the pension exclusion either 1) erroneously or 2) for lump-sum distributions received by volunteer firemen, in which case the offset does not apply.

INTERPLAY OF THE PENSION EXCLUSION WITH THE SOCIAL SECURITY EXCLUSION:

While the interplay of the pension exclusion with the exclusion for social security is not readily ascertainable from existing data and consequently cannot be explicitly analyzed, at least a few observations are in order. It should be intuitively obvious that most of the taxpayers who benefit from the pension exclusion also benefit from the social security exclusion because it is only through a taxpayer's or a taxpayer's spouse's former employment that both pension and social security coverage are derived. Consequently, social security recipients and pensioners to an extraordinary extent constitute one and the same group. The table below gives some indication of this overlap. Although not clearly discernable from the data, the fact that the number of recipients of either social security and/or other pensions is little greater than the number receiving social security alone indicates there is significant overlap between pension recipients and social security recipients. Therefore, the inequities illustrated above are probably even more pronounced when you take into account the social security exclusion.

FREQUENCY DISTRIBUTION: U.S. SENIOR CITIZENS
BY COMPREHENSIVE INCOME CLASS BY INCOME SOURCE, 1982
(Numbers in Thousands)

Comprehensive Income Class	Total Pop. Age 65 & Over	Receiving SS or RR Retirement	Number Receiving Other Retire. Income	Number Receiving SS &/or other Retire Income
Loss	23	9	2	9
$ 999	117	46	2	48
1,999	106	84	3	86
2,999	323	287	22	293
3,999	680	637	27	640
4,999	736	706	59	718
5,999	895	867	123	871
6,999	892	872	251	881
7,999	702	685	289	690
8,999	642	637	315	639
9,999	566	540	292	551
12,499	1,251	1,182	746	1,204
14,999	879	824	526	846
17,499	625	591	418	602
19,999	420	367	245	381
24,999	563	462	327	490
29,999	274	217	161	228
34,999	202	128	109	166
39,999	117	84	66	95
49,999	151	95	88	116
59,999	105	71	49	76
74,999	72	28	34	54
>74,999	101	51	45	60
TOTAL	10,442	9,470	4,199	9,744

What is perhaps even more troublesome than the double benefit most pensioners receive from the social security and pension exclusions is the fact that data from another source indicates that seniors who receive neither social security or pensions are particularly reliant on earned income from employment for a disproportionately large share of their income. Consequently, not only do these seniors, for whatever reason, have to continue working past normal retirement age to provide for themselves, but they have to pay significantly greater taxes than seniors receiving social security or pension benefits.

RELATIVE IMPORTANCE OF EARNINGS
BY SOCIAL SECURITY BENEFICIARY STATUS:

PERCENTAGE DISTRIBUTION OF U.S. HOUSEHOLDS AGE 65 AND OVER IN 1978

	Social Security Beneficiaries	Non-Social Security Beneficiaries
Number in Thousands	3,784	731
Proportion of Income Total Percent	100	100
1-19	28	5
20-39	26	3
40-59	24	6
60-79	15	12
80 or more	8	73
50 or more	32	89
90 or more	2	62
100	*	26

*Less than 0.5 percent

FEDERAL RETIREES:

It would be remiss if the special situation of federal retirees was not at least briefly discussed when dealing with the pension exclusion. (Such a discussion would also be applicable to members of the state retirement systems receiving "basic" retirement benefits but the data presented only applies to federal retirees.) Federal retirees have always represented that they were uniquely discriminated against by the changes in the pension exclusion due to the fact that they receive no social security. However, these representations just do not agree with the facts. As the table below indicates, 73 percent of federal retirees in 1979 received social security benefits. The vast majority of these retirees qualified for their benefits based on their own covered employment; not due to their spouse's employment. In other words, most federal retirees qualified based on other part-time employment or employment prior or subsequent to their federal service. As a result, because of the manner in which social security benefits are determined and the fact that their covered employment was of short duration and/or for relatively low wages, their benefits are generally lower than those of the entire population of social security recipients. In addition, recent federal law changes will reduce the social security benefits of future federal retirees until those covered by social security in their position as federal employees begin to retire. Consequently, while it is not generally true that federal retirees are not receiving any social security benefits they are receiving social security benefits of a lesser amount than their contemporaries. To an extent, this does result in some inequity with regard to the state's taxation of senior citizens but of a far less pronounced degree than that affecting seniors receiving no social security or pension benefits at all.

PRIMARY INSURANCE AMOUNTS OF FEDERAL RETIREES RECEIVING SOCIAL SECURITY BENEFITS AND ALL SOCIAL SECURITY BENEFICIARIES ENTITLED TO RETIRED WORKER SOCIAL SECURITY BENEFITS (as opposed to spousal benefits), 1979

	Federal Retirees	All Social Security Recipients
Number in Thousands	512.7	18,953.4
Percent	100	100
Primary Insurance Amount		
$1-$199	60	25
$200-$299	26	25
$300-$369	8	20
$370 or more	6	30
Percent with Minimum	28	12
Median Amount	$180	$300

SUMMARY AND CONCLUSIONS:

The original rationale for the pension exclusion was to equalize the after-tax income of public pension recipients with private pension recipients by providing public pension recipients with a tax exemption similar to that enjoyed by private pension recipients through the social security exclusion. With the advent of "coordinated" benefit plans for public employees, that rationale began to disappear and, in 1977, the legislature attempted to restore some equity between private and public pension recipients by taxing the latter. The resultant outcry forced a partial abandonment of the latter objective, and in 1978, 1979, 1980 and 1984 the amount of public pension payments subject to state taxation was reduced. Concurrently, private pensions were equated the same treatment as public pensions for the first time.

In spite of these post-1977 liberalizations, the legislature's initial assessment that the rationale for the public employee pension exclusion's original enactment had largely dissipated was correct. Two recent events have further weakened the case for a differential public pension exclusion. The first is a recent federal change which provides that, for the first time, a portion of social security payments for higher-income retirees will be subject to federal taxation. This change was selected as an alternative preferable to a benefit reduction; it is likely that, should another action be necessary to "fix" the social security system in the future, Congress will choose again to further tax social security benefits in lieu of a benefit reduction.

Second, as mentioned earlier, federal employees hired since 1983 are no longer exempt from the social security system. Although it will take many years for the current block of federal employees to work their way through the system, this change insures that retirees not covered by social security will eventually decline to insignificance.

When these additional factors are taken into account, it becomes even more apparent that any "gap" between the tax exempt income of public and private retirees is dissipating as time progresses.

Once the need to address the gap in tax exempt income between public and private retirees is put aside, the focus is shifted to the pension and social security exclusions as overt state policies to enhance senior citizens' welfare in general. Unfortunately, the conclusion has to be that they are fraught with defects because:

1. A significant number of senior citizens nationally do not receive either social security or other pension income (the difference between the number receiving social security and/or other retirement income and the total population age 65 and over in the table labeled, "FREQUENCY DISTRIBUTION: UNITED STATES SENIOR CITIZENS BY COMPREHENSIVE INCOME CLASS BY INCOME SOURCE, 1982"). There is no reason to believe that Minnesota seniors are different in this regard. This is partially reflected in the fact that only 73,296 out of 255,972 senior citizen taxpayers claim the pension exclusion. Consequently, the pension exclusion fails to assist a significant number of seniors and, in fact, actually discriminates against them.

2. In addition to this discrimination between seniors who receive no pension or social security benefits and those who do, a second source of discrimination results from the relative mix of those sources of income with others. In other words, two pension recipients, both with $15,000 of income, can pay significantly different taxes depending on the relative mix of their pensions with other incomes.

3. Other taxpayers besides seniors receive pensions, many of whom are still actively employed. Nevertheless, they are still accorded the same benefit as seniors on their pensions. If the pension exclusion is designed in part to take into account a special need of those retired and over age 65, then the inequity of this is even more troublesome than that which exists among seniors.

4. Both the state and federal tax systems explicitly exempt most forms of retirement savings from tax at the time of contribution, presumably to encourage financial preparation for retirement. This shields portions of high pre-retirement earnings from high marginal tax rates along with the interest earned on those retirement savings. Under federal law, the income is then taxed at the time of distribution but generally at much lower marginal tax rates. Absent the pension exclusion, this is also the manner in which this income would be taxed by the state. This initial "shielding" from tax along with the effects of inflation (a dollar saved now is worth more than a dollar later) already grants significant tax benefit to retirement earnings. Consequently, a legitimate question exists as to how much more the state should favor retirement income: Does it really merit "double exemption" at both the time of distribution and contribution?

5. Finally, state policy makers should be very concerned about the future dollar costs of an already costly tax provision which is of benefit to an expanding portion of the state's population.

K:pk
12-11-84

OVER 65 TAXPAYERS CLAIMING THE PENSION EXCLUSION

FROM THE 1982 INDIVIDUAL INCOME TAX SAMPLE

Federal Adjusted Gross Income Range	FAGI	Pension Exclusion		U.S. Bond Interest		Municipal Bond Interest		Federal Tax Deduction	Number of Low Income Credit Filers	Tax Liability
		Number of Filers	Amount	Number of Filers	Amount	Number of Filers	Amount			
Gross Loss	$- 1,277,354	104	$ 327,859	*	$ *	*	$ *	$ 19,188	14	$ 51,807
$ 0 - $ 999	116,172	307	104,018	0	0	0	0	4	0	267
1,000 - 1,999	1,895,043	1,331	1,143,110	*	*	0	0	234,374	200	11,123
2,000 - 2,999	3,013,362	1,164	1,160,731	131	100,707	0	0	89,319	0	31,834
3,000 - 3,999	8,168,898	2,361	3,520,509	131	5,515	0	0	80,207	131	100,026
4,000 - 4,999	17,698,369	3,880	7,030,621	132	136,353	0	0	241,319	266	224,931
5,000 - 5,999	32,805,794	6,015	14,685,151	397	316,525	0	0	508,500	524	393,447
6,000 - 6,999	50,926,102	7,866	23,846,067	1,065	528,136	0	0	1,308,347	0	628,331
7,000 - 7,999	41,437,171	5,516	18,512,222	994	882,983	0	0	955,647	400	557,624
8,000 - 8,999	45,955,344	5,398	25,107,724	668	294,338	0	0	1,161,125	262	410,543
9,000 - 9,999	62,480,243	6,589	25,425,279	861	1,912,782	0	0	2,996,077	133	1,115,100
10,000 - 10,999	40,715,326	3,914	18,951,136	273	934,474	0	0	1,297,861	266	670,908
11,000 - 11,999	49,901,028	4,357	25,185,015	512	1,027,131	0	0	1,879,002	132	550,808
12,000 - 12,999	42,599,073	3,388	14,676,112	862	2,836,472	*	*	2,580,648	140	959,592
13,000 - 13,999	43,973,258	3,249	22,756,727	465	1,151,444	0	0	2,571,319	200	770,262
14,000 - 14,999	39,603,672	2,732	17,121,790	200	33,150	0	0	2,399,937	333	816,523
15,000 - 19,999	148,724,180	8,602	58,973,794	1,992	4,175,644	533	325,252	11,431,786	266	3,663,556
20,000 - 24,999	88,844,267	4,043	23,295,537	1,263	6,037,326	200	30,354	9,313,588	0	3,024,337
25,000 - 29,999	63,238,901	2,390	3,414,598	1,066	8,654,307	0	0	7,571,373	0	2,953,356
$30,000 And Over	5,060,715	90	240,903	0	0	*	*	1,153,711	0	471,806
TOTAL	$785,879,564	73,296	$305,478,903	11,315	$29,217,453	935	$386,343	$47,793,332	3,267	$17,406,181

*Not available due to data privacy considerations.

Source: Minnesota Department of Revenue
Research Office
October 5, 1984

W:mtb:4-015

OVER 65 TAXPAYERS NOT CLAIMING THE PENSION EXCLUSION

FROM THE 1982 INDIVIDUAL INCOME TAX SAMPLE

Federal Adjusted Gross Income Range	FAGI	Pension Exclusion		U.S. Bond Interest		Municipal Bond Interest		Federal Tax Deduction	Number of Low Income Credit Filers	Tax Liability
		Number of Filers	Amount	Number of Filers	Amount	Number of Filers	Amount			
Gross Loss	$- 28,712,476	2,114	$0	45	$ 200,021	12	$ 58,978	$ 208,899	54	$ 3,208
$ 0 - $ 999	2,422,846	4,735	0	278	622,251	132	29,671	3,416,378	0	50,419
1,000 - 1,999	11,410,207	7,491	0	465	482,533	132	2,769	306,777	403	164,768
2,000 - 2,999	24,342,934	9,616	0	404	231,291	0	1,074	627,017	132	553,199
3,000 - 3,999	44,445,832	12,677	0	599	183,437	0	0	703,589	726	1,165,738
4,000 - 4,999	80,268,885	18,015	0	800	1,272,275	*	*	1,596,866	794	1,980,263
5,000 - 5,999	74,427,244	13,584	0	937	1,267,797	134	505,330	2,208,860	532	2,190,254
6,000 - 6,999	83,641,309	12,888	0	1,198	2,124,706	0	0	3,445,692	333	2,641,922
7,000 - 7,999	83,251,720	11,166	0	734	1,659,883	42	107,801	4,734,959	533	2,960,273
8,000 - 8,999	85,664,889	10,086	0	1,575	1,327,244	199	32,346	5,875,568	1,005	3,295,249
9,000 - 9,999	76,327,657	8,089	0	1,196	2,247,201	*	*	5,518,662	134	2,962,599
10,000 - 10,999	62,407,925	5,961	0	797	4,017,923	20	3,623	4,729,475	200	2,524,994
11,000 - 11,999	83,706,693	7,276	0	925	4,434,686	0	0	7,568,415	400	3,520,979
12,000 - 12,999	52,462,714	4,218	0	868	2,783,278	0	0	4,267,571	333	2,188,952
13,000 - 13,999	66,561,285	4,947	0	473	2,594,240	0	0	7,214,939	200	3,213,130
14,000 - 14,999	72,526,607	4,995	0	59	472,957	0	0	8,474,579	0	3,770,259
15,000 - 19,999	258,091,758	15,049	0	2,621	8,667,839	*	*	30,147,755	800	12,594,759
20,000 - 24,999	155,011,814	7,012	0	1,122	3,367,778	145	171,820	21,832,351	198	9,276,623
25,000 - 29,999	162,508,242	5,873	0	1,132	5,592,216	*	*	23,628,657	0	9,668,276
30,000 And Over	1,176,331,568	16,884	0	6,095	74,191,816	1,337	5,234,679	234,761,414	199	65,191,636
TOTAL	$2,627,099,653	182,676	$0	22,323	$117,741,372	2,153	$6,148,091	$371,268,423	6,976	$129,917,500

*Not available due to data privacy considerations.

Source: Minnesota Department of Revenue
Research Office
October 5, 1984

CW:mtb:4-017

UNDER 65 TAXPAYERS CLAIMING THE PENSION EXCLUSION

FROM THE 1982 INDIVIDUAL INCOME TAX SAMPLE

Federal Adjusted Gross Income Range	FAGI	Pension Exclusion		U.S. Bond Interest		Municipal Bond Interest		Federal Tax Deduction	Number of Low Income Credit Filers	Tax Liability
		Number of Filers	Amount	Number of Filers	Amount	Number of Filers	Amount			
Gross Loss	$- 3,930,351	201	$ 845,077	5	$ 6,701	0	$ 0	$ 27,340	20	$ 40
$ 0 - $ 999	220,760	688	480,739	0	0	0	0	7,303	0	538
1,000 - 1,999	853,311	553	636,117	141	40,943	0	0	13,077	0	1,205
2,000 - 2,999	1,957,648	823	692,149	134	241,980	0	0	17,791	21	16,545
3,000 - 3,999	2,703,584	745	1,843,272	0	0	0	0	67,250	131	17,750
4,000 - 4,999	6,803,254	1,488	2,560,240	138	28,492	0	0	269,598	0	100,735
5,000 - 5,999	9,507,682	1,747	6,622,946	264	11,227	0	0	167,174	0	63,397
6,000 - 6,999	14,684,446	2,295	8,572,889	7	37,697	200	68,235	440,368	0	181,701
7,000 - 7,999	18,484,864	2,476	12,622,941	465	531,645	0	0	504,342	7	86,528
8,000 - 8,999	15,493,927	1,825	8,187,059	0	0	0	0	639,687	147	181,383
9,000 - 9,999	17,987,000	1,878	10,445,553	0	0	0	0	653,149	133	195,139
10,000 - 10,999	17,141,589	1,635	9,390,520	138	80,822	7	14,294	551,285	28	52,859
11,000 - 11,999	27,314,744	2,409	14,119,819	205	118,162	0	0	1,630,213	200	520,857
12,000 - 12,999	28,455,826	2,274	18,558,006	41	4,993	0	0	1,092,902	133	291,295
13,000 - 13,999	16,113,090	1,218	7,001,579	207	32,962	0	0	978,403	0	492,162
14,000 - 14,999	24,088,176	1,660	11,992,781	200	38,707	0	0	1,481,659	334	467,543
15,000 - 19,999	93,472,388	5,349	28,779,741	932	1,349,743	0	0	7,989,965	466	2,760,550
20,000 - 24,999	85,620,372	3,834	18,056,340	1,061	2,473,386	200	998	9,028,525	0	3,340,740
25,000 - 29,999	38,944,497	1,469	1,846,219	141	605,692	0	0	5,393,421	0	2,226,251
$30,000 And Over	17,656,634	423	711,001	0	0	0	0	2,237,243	0	819,958
TOTAL	$433,573,441	34,990	$163,964,988	4,079	$5,603,152	407	$83,527	$33,190,695	1,620	$11,817,176

Source: Minnesota Department of Revenue
Research Office
October 5, 1984

CW:mtb:4-010