DEPARTMENT OF REVENUE

INDIVIDUAL INCOME TAX
Soc. Sec & Public Pension Subtractions

January 11, 2023

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of S.F. 15 (Putnam)

	Fund Impact			
	F.Y. 2024	**F.Y. 2025**	**F.Y. 2026**	**F.Y. 2027**
	(000's)			
Social Security Subtraction	($603,500)	($656,500)	($718,900)	($776,500)
Public Pension Subtraction	($40,100)	($40,000)	($39,900)	($39,800)
Interaction	$2,000	$2,000	$2,000	$2,000
General Fund Total	($641,600)	($694,500)	($756,800)	($814,300)

Effective beginning tax year 2023.

EXPLANATION OF THE BILL

Current Law: A taxpayer may subtract a portion of Social Security income when calculating Minnesota taxable income. For 2023, the maximum subtraction is $5,840 for married joint filers, $2,920 for married separate filers, and $4,560 for single and head of household filers.

The subtraction is reduced by 20% of provisional income over the following thresholds for 2023: $88,630 for married joint filers, $44,315 for married separate filers, and $69,250 for single and head of household filers. Provisional income is income used to calculate the federally taxable portion of Social Security benefits. The thresholds and maximum subtractions are adjusted annually for inflation.

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 taxable under Minnesota law to the extent they are included in federal adjusted gross income.

Proposed Law:
Social Security Subtraction. Under the bill, the entire amount of Social Security benefits received by a taxpayer during the tax year is allowed as a subtraction, to the extent included in federal taxable income.

Public Pension Subtraction. The bill would also create a new subtraction for public pension recipients, provided their benefits are based on service for which they are not receiving Social Security benefits.

The public pension subtraction's amount would be the sum of a "federal exclusion" and a "state exclusion."

EXPLANATION OF THE BILL (Cont.)

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 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 2024.

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

REVENUE ANALYSIS DETAIL

Social Security Subtraction

- The House Income Tax Simulation (HITS 7.2) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in November 2022. The model uses a stratified sample of 2019 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts were allocated to the following fiscal year.

Public Pension Subtraction

- The estimate is the sum of eight separate analyses: one for each of the seven state-level public pension plans, and one for the corresponding federal pension plan, the Civil Service Retirement System (CSRS).
- The 2022 valuation reports for six of 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. The 2022 report for the SPTRFA plan was unavailable; in this case, the 2021 report was used instead.
- The U.S. Office of Personnel Management’s Civil Service Retirement and Disability Fund Annual Reports and a Congressional Research Service report were used to estimate the average pension benefit and the number of taxpayers eligible for this subtraction from federal service.
- 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 group of filers reporting Social Security income and replacing their Social Security income with a hypothetical pension income from one of the eligible public 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 and CSRS forecast.
- The cost estimates for each of the state pension plans 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, a weighted average 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.
- 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 1,600 qualifying pensioners from other states who retire in Minnesota.
- The federal estimate was discounted by 7.5% to account for the already tax-free portion of CSRS benefits.

REVENUE ANALYSIS DETAIL (Cont.)

- Minnesota pension plan growth rates through 2022 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.
- CSRS growth rates were based on the average historical growth rates for CSRS pension payments.
- The public pension subtraction estimate was reduced by 5% due to interactions between the Social Security subtraction and the public pension subtraction, since some taxpayers would qualify for both.
- Tax year impacts are allocated to the following fiscal year.

Number of Taxpayers: About 473,000 tax returns would be affected by the expanded Social Security subtraction in tax year 2023. The average decrease in tax from the expanded Social Security subtraction would be $1,276.

About 48,200 taxpayers would be affected in tax year 2023 by the public pension subtraction, including 20,300 Minnesota state pension recipients, 1,600 non-Minnesota state pension recipients and 26,300 federal pension recipients. The average decrease in tax from the pension subtraction would be $833.

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

sf0015_1 SS Full and Public Pension Sub / mcy sat