MEMORANDUM

To: House Taxation Committee

From: Alan D. Conroy, Executive Director

Date: February 8, 2017

Subject: State Tax Treatment of Retirement Plan Contributions

During the January 30^{th} meeting of the Taxation Committee, KPERS provided information regarding other state's treatment of pension contributions and distributions. The Committee requested that KPERS bring additional detail on the treatment of employer contributions to pension plans on behalf of employees in the nine other states that, like Kansas, do not tax pension distributions.

Of the nine states that were included in the prior report:

- Two states (New York and Hawaii) require tax filers to add employee pension contributions back to federal adjusted gross wages for state income tax calculations.
- Three states (Alabama, Massachusetts, and Pennsylvania) appear to include pension contributions in state gross wages on W-2 forms. However, Massachusetts employees can then deduct up to $2,000 of those contributions;
- Three states (Illinois, Mississippi and Louisiana) do not appear to include employee contributions to pension plans in state taxable income; and
- Michigan was initially reported as not taxing distributions. However, starting in tax year 2012 pension distributions are subject to state income tax based on certain age criteria.

More detail on these nine states can be found in Attachment A. I hope this information is responsive to the Committee's request. I would be happy to provide any additional information the Committee might need.

Attachment.

KPERS

TAXATION OF CONTRIBUTIONS TO PUBLIC PENSIONS

State	Taxation of Contributions
Alabama	**Taxed.** Contributions to the Alabama State Retirement System are reported as wages at the state level on W-2's. Alabama Form 40 instructions state that: "State of Alabama employees will find that the amount taxable for state purposes is, in most cases, more than the amount taxable for federal purposes. This is due to the fact that amounts deducted from their wages as "Contributions to the Alabama State Retirement System" qualify for deferral on the Federal return, but do not qualify for deferral on the Alabama return."
Hawaii	**Taxed.** Members of Hawaii's contributory and hybrid plan for state and county employees are required to add their pension contributions to their federal adjusted gross income. Instructions for Line 8 of Form N indicate they are to include the difference between federal and state wages as reported on their W-2 as an addition to their federal adjusted gross income. (Hawaii also has a "non-contributory" retirement plan for state and county employees with membership dates between 1984-2006. For that plan, there are no member contributions.)
Illinois	**Not taxed.** Like Kansas, employers affiliated with the Illinois Teachers Retirement System pick up and pay the contributions on a pre-tax basis. However, the contribution amounts are **NOT added back** into the member's taxable income. Federal adjusted gross income is used as the starting point for Illinois income taxes. Schedule M, which lists additions and subtractions to federal adjusted income, does not list any public pension contributions among the items to be added back into income. (See also 40 ILCS 5/16-152.1, from Ch. 108 1/2, par. 16-152.1, and 40 ILCS 5/16-154, from Ch. 108 1/2, par. 16-154) Note: Employers of the Teachers Retirement System can choose to pay some or all of the employee contribution on their behalf.
Kansas	**Taxed.** The K-40 uses federal adjusted gross income as the starting point for income tax calculations. Schedule S requires that KPERS contributions be added to federal adjusted gross income, making them taxable.
Louisiana	**Not taxed.** Income tax withholding instructions indicate that wages exempt from withholding are the same as for federal withholding purposes so that wages exempt for federal withholding are also exempt for Louisiana withholding.
Massachusetts	**All but $2,000 taxed.** State W-2 wages for state, city, county and town employees are higher than reported federal wages as pension contributions are included for purpose of Massachusetts incomes taxes. However, employees can then deduct up to $2,000 of their contributions.
Michigan	**Tax exclusion for pension *benefits* is being phased out.** It appears that, while public sector pension benefits had been excluded from income up to stated limits,

	beginning in 2012, new limitations on such exclusions have been in place. For example: • Those born before 1946 may subtract qualifying public and private pension and retirement benefits up to $49,811 if single or married filing separately, or $99,623 if married and filing a joint return. • Recipients born during the period 1948 through 1952 are able to deduct $20,000 in pension and retirement benefits if single or married filing separately or $40,000 if married and filing a joint return. • Recipients who receive pension benefits from employment with a governmental entity that was exempt from the federal Social Security Act are entitled to larger deductions, beginning with tax year 2013. • For recipients born after 1952, all pension and retirement benefits are generally taxable and subject to withholding. Therefore, many of the active members of who currently are making contributions will receive taxable *benefits*.
Mississippi	**Not taxed.** There are no state taxes paid for Public Employees Retirement System of Mississippi contributions or retirement benefit payments. All contributions are picked up by the employer, and they are **not added in** for tax purposes. The state of Mississippi excludes employee contributions from gross income in the same manner as the federal government.
New York	**Taxed.** Similar to Kansas, tax filers must add employer contributions for 414(h) retirement contributions to their federal adjusted gross income for state income tax calculations.
Pennsylvania	**Taxed.** Payments made by employers into pension plans on behalf of employees by employee salary reduction agreement are taxable and included in Pennsylvania gross wages on W-2 forms.