COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2285S.01I
Bill No.: SB 585
Subject: Taxation and Revenue - Income
Type: Original
Date: April 24, 2023

Bill Summary: This proposal modifies provisions relating to income tax exemptions for certain retirement benefits.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
General Revenue	$0	($877,968,344)	($859,677,336)
Total Estimated Net Effect on General Revenue	**$0**	**($877,968,344)**	**($859,677,336)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

☐ Estimated Net Effect (savings or increased revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Section 143.124 & 143.125 Retirement Benefit

Officials from the **Department of Revenue (DOR)** note this proposal is changing the taxability of social security payments, pension benefits and retirement income. Currently, depending on the type of retirement benefit and the taxpayer's Missouri adjusted gross income (MAGI) some of the benefits are taxable.

Social Security
Some social security benefits are taxable depending on the amount of income a person has at the federal level, while other amounts are not. Generally, at the federal level if a taxpayer's income is under $25,000 and they file as an individual or $35,000 if they file a combined return, the social security benefits are not taxable. For any income over those amounts then social security benefits are taxable and the taxable portion is calculated into the taxpayer's federal adjusted gross income (FAGI).

Under Missouri law, if social security benefits are included in a taxpayer's FAGI, and the taxpayer's MAGI is over $85,000 for an individual or $100,000 for those that file combined, their social security is taxable in Missouri. If a taxpayers has a MAGI of less than $85,000 for an individual or $100,000 for those filing combined, then they are allowed to deduction up to the social security maximum from their Missouri taxable income.

The maximum social security benefits a person receives is based on when they start to take the social security benefits and how much they paid into the system through the years. A person can take early social security benefits at 62 receiving a lesser amount of benefits. Social security benefits are considered full benefits starting at age 67, based on the year of a person's birth. The maximum social security benefits are given when a person does not take social security until they reach 70. The maximum social security benefit for 2023 is $43,524. It should be noted that social security annually adjusts the benefit numbers.

This proposal starting January 1, 2024, will remove the MAGI limitation determining the taxable portion of social security. If a taxpayer included any portion of their social security benefits into their FAGI they will be allowed a deduction from their Missouri return up to the $43,524 limit of what they claimed in the FAGI.

Public Pensions
Public pensions are any pension issued by the state of Missouri, the federal government or any local political subdivisions (county or city). Currently, a taxpayer is allowed to exempt from tax up to the maximum social security limit ($43,524) of the social security benefits that are included in their MAGI. This exemption however is limited to those taxpayers with less than $85,000 in MAGI as an individual filer or $100,000 MAGI for filers filing combined.

Starting January 1, 2024 this proposal will remove the MAGI limitation and allow all taxpayer's regarding of their MAGI to receive the full maximum social security amount included in their FAGI.

Public Retirement Benefits
Per statutes, any taxpayer may receive up to the first $6,000 in retirement benefits, other than public pension benefits, as an exemption from taxation. This would include pensions from private companies, 401(k), deferred compensation plans, annuities, and self-employed retirement plans (Keogh).

Starting January 1, 2024, this proposal would apply the same exemption for public retirement benefits as the private pensions receive.

Impact
The Department notes these changes are to begin for tax years starting January 1, 2024 and therefore will not fiscally impact the state until FY 2025 based on when the tax returns are filed claiming the exemption.

DOR used information reported by taxpayers on their federal returns to start the calculation of the additional revenue that may be exempt from tax. Then DOR used their internal Individual Income Tax Database for Missouri DOR found the following distribution of filers of public and private pensions.

Pensions	Public	Private
Singles	39%	61%
Married Filing Joint	49%	51%
Head of Household (HOH)	42%	58%

Here is the estimated loss per benefit type:

Estimated Loss by Retirement Income

Retirement Income		4.8%	4.7%	4.6%	4.5%
Individual Retirement Distributions		($216,133,254)	($211,630,478)	($207,127,702)	($202,624,926)
Pensions/Annuities (Public)		($154,777,722)	($151,553,186)	($148,328,650)	($145,104,114)
Pensions/Annuities (Private)		($337,484,918)	($330,453,982)	($323,423,046)	($316,392,111)
Social Security		($154,332,068)	($151,116,816)	($147,901,565)	($144,686,314)
Self-Employed (Keogh)		($15,240,382)	($14,922,874)	($14,605,366)	($14,287,858)
Total GR Loss		**($877,968,344)**	**($859,677,336)**	**($841,386,329)**	**($823,095,323)**

SB 3 adopted in 2022 set the individual income tax rate at 4.95% in tax year 2023. The tax rate is scheduled to continue to reduce over a period of several years until the rate equals 4.5%. At that time it will remain the 4.5%. Since this proposal begins with tax year 2024 (FY 2025) the rate is estimated to be 4.8%. For fiscal note purposes, DOR will show the loss at each of those tax rates over SB 3's implementation period. This will result in a loss to general revenue. DOR estimates the loss to general revenue:

Estimated Loss by Fiscal Year

	Tax Year (Fiscal Year)			
Tax Rate	2024 (FY25)	2025 (FY26)	2026 (FY27)	2027 (FY28)
4.95%	($905,404,854)	($905,404,854)	($905,404,854)	($905,404,854)
4.80%	($877,968,344)	($877,968,344)	($877,968,344)	($877,968,344)
4.70%		($859,677,336)	($859,677,336)	($859,677,336)
4.60%			($841,386,329)	($841,386,329)
4.50%				($823,095,323)

Administrative Impact
This proposal will require modification to the MO-A form and to the MO-1040P form. Additionally DOR will need to modify their website and their individual income tax computer system. These changes are estimated to cost $7,193.

At this time the Department believes it can handle this work with existing resources. However, should DOR reach the number of errors or correspondence to justify additional FTE from this proposal or in combination with other proposals that will pass, DOR will seek the required number of FTE through the appropriation process. The Department is providing the number of errors or correspondence that require additional FTE.

1 FTE Associate Customer Service Rep for every 14,700 errors created
1 FTE Associate Customer Service Rep for every 5,700 pieces of correspondence generated

Officials from the **Office of Administration - Budget and Planning (B&P)** note the following:

Beginning with tax year 2024, a taxpayer will be allowed to subtract all social security and other public retirement income, if such income is included in their federal adjusted gross income. Taxpayers will also be allowed to subtract private pension payments, up to the maximum social security benefit. B&P notes that the maximum social security benefit for calendar year 2023 is $3,627 per month or $43,488 per year.

<u>Section 143.124 – Public and Private Pensions</u>

Individual Retirement Distributions
Currently taxpayers may subtract $6,000 of their individual retirement income, if their Missouri Adjusted Gross Income (MAGI) is less than $25,000 for taxpayers filing single or head of household and $32,000 for married filing combined taxpayers. B&P notes that these payments would include IRAs and 401(k) plans.

This proposal would allow taxpayers, regardless of income, to subtract up to the maximum social security benefit. B&P notes that the maximum social security benefit for calendar year 2023 is $3,627 per month or $43,488 per year.

B&P notes that Roth IRA payments are not taxable as the taxes are paid when the retirement plan contributions are made. Therefore, such payments are not included in an individual's federal adjusted gross income at the time of distributions. B&P notes that under this proposal Roth IRAs would become the only retirement income to remain taxable (because taxes are paid at contribution, not at distribution) in Missouri.

Based on data published by the IRS, B&P estimates that this provision may exempt up to $1,127,994,693 in individual retirement arrangement payments for taxpayers filing single, $314,191,968 for taxpayers filing head of household, and $3,145,307,913 for married filing joint taxpayers; for a total of up to $4,502,776,130 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022). Consequently, B&P estimates that exempting individual retirement arrangement payments could reduce TSR and GR by $222,887,418 (top tax rate 4.95%) or by $216,133,254 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $202,624,926 annually.

Pensions and Annuities
B&P notes that the term "pensions and annuities" includes both public and private retirement funds. For the purpose of this fiscal note, B&P used tax year 2020 (the most recent complete year available) Missouri tax return data to estimate the percentage of payments from public pensions and annuities versus private pensions and annuities.

In tax year 2020, 61% of pension and annuity payments were from private funds and 39% were from public funds for individuals filing single. For married filing combined individuals, 51% of payments were from private funds, while 49% were from public funds. For taxpayers filing as head of household, 58% of pension and annuity payments were from private sources, while 42% were from public sources.

Public Pensions and Annuities
Currently taxpayers who are married filing joint may exempt 100% of their public pension income, if their Missouri Adjusted Gross Income (MAGI) is equal to or less than $100,000. All other taxpayers may exempt 100% of their public pension income if their MAGI is equal to or less than $85,000.

This proposal would allow all taxpayers, regardless of income, to subtract up to the maximum social security benefit.

Based on data published by the IRS, B&P estimates that this provision may exempt up to $529,569,030 in public pension and annuity payments for taxpayers filing single, $144,198,054 for taxpayers filing head of household, and $2,550,768,784 for married filing joint taxpayers; for a total of up to $3,224,535,868 in public pension and annuity income exempted under this provision.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022). Consequently, B&P estimates that exempting individual retirement arrangement payments could reduce TSR and GR by $159,614,525 (top tax rate 4.95%) or by $154,777,722 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $145,104,114 annually.

Private Pensions and Annuities
Currently taxpayers may exempt $6,000 of their private pension and annuity income, if their Missouri Adjusted Gross Income (MAGI) is less than $25,000 for taxpayers filing single or head of household and $32,000 for married filing combined taxpayers.

This proposal would allow taxpayers, regardless of income, to subtract up to the maximum social security benefit. B&P notes that the maximum social security benefit for calendar year 2023 is $3,627 per month or $43,488 per year.

Based on data published by the IRS, B&P estimates that this provision may exempt up to $2,441,451,965 in private pension and annuity payments for taxpayers filing single, $660,395,119 for taxpayers filing head of household, and $4,231,808,836 for married filing joint taxpayers; for a total of up to $7,030,935,791 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022). Consequently, B&P estimates that exempting individual retirement arrangement payments could reduce TSR and GR by $348,031,322 (top tax rate 4.95%) or by $337,484,918 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $316,392,111 annually.

Self-Employed (Keogh) Payments
Currently taxpayers may exempt $6,000 of their Keogh retirement income, if their Missouri Adjusted Gross Income (MAGI) is less than $25,000 for taxpayers filing single or head of household and $32,000 for married filing combined taxpayers.

This proposal would allow taxpayers, regardless of income, to subtract up to the maximum social security benefit. B&P notes that the maximum social security benefit for calendar year 2023 is $3,627 per month or $43,488 per year.

Based on data published by the IRS, B&P estimates that this provision may exempt $41,142,535 in Keogh payments for taxpayers filing single, $9,808,657 for taxpayers filing head of household, and $267,903,351 for married filing joint taxpayers; for a total of $317,507,953 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022). Consequently, B&P estimates that exempting individual retirement arrangement payments could reduce TSR and GR by $15,716,644 (top tax rate 4.95%) or by $15,240,382 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $14,287,858 annually.

<u>Section 143.125 – Social Security</u>
This section would eliminate the income limits for the individual income tax exemption for social security payments beginning with tax year 2024. Currently taxpayers who are married filing joint may exempt 100% of their social security income, if their Missouri Adjusted Gross Income (MAGI) equal to or less than $100,000. All other taxpayers may exempt 100% of social security income if their MAGI is equal to or less than $85,000.

This proposal would allow all taxpayers, regardless of income, to subtract up to the maximum social security benefit.

Based on data published by the IRS, B&P estimates that this section may exempt $689,197,344 in social security payments for taxpayers filing single, $172,665,756 for taxpayers filing head of household, and $2,353,388,312 for married filing joint taxpayers; for a total of $3,215,251,412 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022).

B&P estimates that this section could reduce TSR and GR by $159,154,945 (top tax rate 4.95%) or by $154,332,068 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this section could reduce TSR and GR by $144,686,314 annually.

<u>Summary</u>
B&P estimates that this proposal could reduce TSR and GR by $905,404,854 (top tax rate 4.95%) or by $877,968,344 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this proposal could reduce TSR and GR by $823,095,323 annually. Table 1 shows the estimated loss by provision, while Table 2 shows the estimated loss by tax and fiscal year.

Table 1: Estimated Loss by Retirement Income

Retirement Income	4.95%	4.8%	4.7%	4.6%	4.5%
Individual Retirement Distributions	($222,887,418)	($216,133,254)	($211,630,478)	($207,127,702)	($202,624,926)
Pensions/Annuities (Public)	($159,614,525)	($154,777,722)	($151,553,186)	($148,328,650)	($145,104,114)
Pensions/Annuities (Private)	($348,031,322)	($337,484,918)	($330,453,982)	($323,423,046)	($316,392,111)
Social Security	($159,154,945)	($154,332,068)	($151,116,816)	($147,901,565)	($144,686,314)
Self-Employed (Keogh)	($15,716,644)	($15,240,382)	($14,922,874)	($14,605,366)	($14,287,858)
Total GR Loss	**($905,404,854)**	**($877,968,344)**	**($859,677,336)**	**($841,386,329)**	**($823,095,323)**

Table 2: Estimated Loss by Fiscal Year

	Tax Year (Fiscal Year)			
Tax Rate	2024 (FY25)	2025 (FY26)	2026 (FY27)	2027 (FY28)
4.95%	($905,404,854)	($905,404,854)	($905,404,854)	($905,404,854)
4.80%	($877,968,344)	($877,968,344)	($877,968,344)	($877,968,344)
4.70%		($859,677,336)	($859,677,336)	($859,677,336)
4.60%			($841,386,329)	($841,386,329)
4.50%				($823,095,323)

Oversight will note DOR'S estimated impact for this proposal.

<u>Rule Promulgation</u>

Officials from the **Joint Committee on Administrative Rules** assume this proposal is not anticipated to cause a fiscal impact beyond its current appropriation.

Officials from the **Office of the Secretary of State (SOS)** note many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the SOS for Administrative Rules is less than $5,000. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, the SOS also recognizes that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what the office can sustain with its core budget. Therefore, the SOS reserves the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

FISCAL IMPACT – State Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
GENERAL REVENUE			
Revenue Reduction – §143.124 & §143.125 – Retirement Benefits Exemptions	$0	($877,968,344)	($859,677,336)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**$0**	**($877,968,344)**	**($859,677,336)**

FISCAL IMPACT – Local Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
	$0	**$0**	**$0**

FISCAL IMPACT – Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

Current law allows taxpayers with certain filing status and adjusted gross income below certain thresholds to deduct 100% of certain retirement and Social Security benefits from the taxpayer's Missouri adjusted gross income, with a reduced deduction as the taxpayer's adjusted gross income increases.

For all tax years beginning on or after January 1, 2024, this act allows the maximum deduction to all taxpayers regardless of filing status or adjusted gross income, and also allows the deduction for retirement benefits received from private sources.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Revenue
Office of Administration - Budget and Planning
Office of the Secretary of State
Joint Committee on Administrative Rules

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