SENATE BILL 448

Introduced by Harp

2/15	Introduced
2/15	Referred to Taxation
2/16	Fiscal Note Requested
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	Died in Committee

Senate BILL NO. 448

INTRODUCED BY Harp

BY REQUEST OF THE GOVERNOR

A BILL FOR AN ACT ENTITLED: "AN ACT PROVIDING FOR THE TAXATION OF A MEMBER'S CONTRIBUTIONS TO A MONTANA PUBLIC EMPLOYEE RETIREMENT SYSTEM THAT WERE MADE AFTER JUNE 30, 1985, INCLUDING THAT PORTION OF THE RETIREMENT ALLOWANCE ATTRIBUTABLE TO A MEMBER'S CONTRIBUTIONS AND INTEREST EARNED ON A MEMBER'S CONTRIBUTIONS REFUNDED BEFORE RETIREMENT; REQUIRING THE ADMINISTRATOR OR DESIGNATED COMPANY OF A PUBLIC EMPLOYEE RETIREMENT SYSTEM TO PROVIDE INFORMATION ON TAXABLE DISTRIBUTIONS; AMENDING SECTIONS 15-30-111, 15-30-136, 19-3-105, 19-4-706, 19-5-704, 19-6-705, 19-8-805, 19-9-1005, 19-13-1003, AND 19-21-212, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND AN APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 15-30-111, MCA, is amended to read:

"**15-30-111. Adjusted gross income.** (1) Adjusted gross income shall be the taxpayer's federal income tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954 or as that section may be labeled or amended and in addition shall include the following:

(a) interest received on obligations of another state or territory or county, municipality, district, or other political subdivision thereof;

(b) refunds received of federal income tax, to the extent the deduction of such tax resulted in a reduction of Montana income tax liability; and

(c) that portion of a shareholder's income under subchapter S. of Chapter 1 of the Internal Revenue Code of 1954 that has been reduced by any federal taxes paid by the subchapter S. corporation on the income.

(2) Notwithstanding the provisions of the federal Internal Revenue Code of 1954 as labeled or amended, adjusted gross income does not include the following which are exempt from taxation under this chapter:

(a) all interest income from obligations of the United States government, the state of Montana, county, municipality, district, or other political subdivision thereof;

(b) interest income earned by a taxpayer age 65 or older in a taxable year up to and including $800 for a taxpayer filing a separate return and $1,600 for each joint return;

(c) all benefits, not in excess of $3,600, received:

(i) under the Federal Employees' Retirement Act;

(ii) under the public employee retirement laws of a state other than Montana; or

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(iii) as an annuity, pension, or endowment under any private or corporate retirement plan or system;

(d) all benefits paid under the teachers' retirement law which are specified as exempt from taxation, except as otherwise provided, by 19-4-706;

(e) all benefits paid under The Public Employees' Retirement System Act which are specified as exempt from taxation, except as otherwise provided, by 19-3-105;

(f) all benefits paid under the highway patrol retirement law which are specified as exempt from taxation, except as otherwise provided, by 19-6-705;

(g) all Montana income tax refunds or credits thereof;

(h) all benefits paid under 19-11-602, 19-11-604, and 19-11-605 to retired and disabled firefighters, their surviving spouses and orphans or specified as exempt from taxation, except as otherwise provided, by 19-13-1003;

(i) all benefits paid under the municipal police officers' retirement system that are specified as exempt from taxation, except as otherwise provided, by 19-9-1005;

(j) gain required to be recognized by a liquidating corporation under 15-31-113(1)(a)(ii);

(k) all tips covered by section 3402(k) of the Internal Revenue Code of 1954, as amended and applicable on January 1, 1983, received by persons for services rendered by them to patrons of premises licensed to provide food,

beverage, or lodging;

(l) all benefits received under the workers' compensation laws;

(m) all health insurance premiums paid by an employer for an employee if attributed as income to the employee under federal law; and

(n) all benefits paid under an optional retirement program that are specified as exempt from taxation, except as otherwise provided, by 19-21-212.

(3) In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the said election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S. election were not in effect.

(4) A shareholder of a DISC that is exempt from the corporation license tax under 15-31-102(1)(l) shall include

in his adjusted gross income the earnings and profits of the DISC in the same manner as provided by federal law (section 995, Internal Revenue Code) for all periods for which the DISC election is effective.

(5) A taxpayer who, in determining federal adjusted gross income, has reduced his business deductions by an amount for wages and salaries for which a federal tax credit was elected under section 44B of the Internal Revenue Code of 1954 or as that section may be labeled or amended is allowed to deduct the amount of such wages and salaries paid regardless of the credit taken. The deduction must be made in the year the wages and salaries were used to compute the credit. In the case of a partnership or small business corporation, the deduction must be made to determine the amount of income or loss of the partnership or small business corporation.

(6) Married taxpayers filing a joint federal return who must include part of their social security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income may split the federal base used in calculation of federal taxable social security benefits or federal taxable tier 1 railroad retirement benefits when they file separate Montana income tax returns. The federal base must be split equally on the Montana return.

(7) A taxpayer receiving retirement disability

benefits who has not attained age 65 by the end of the taxable year and who has retired as permanently and totally disabled may exclude from adjusted gross income up to $100 per week received as wages or payments in lieu of wages for a period during which the employee is absent from work due to the disability. If the adjusted gross income before this exclusion and before application of the two-earner married couple deduction exceeds $15,000, the excess reduces the exclusion by an equal amount. This limitation affects the amount of exclusion, but not the taxpayer's eligibility for the exclusion. If eligible, married individuals shall apply the exclusion separately, but the limitation for income exceeding $15,000 is determined with respect to the spouses on their combined adjusted gross income. For the purpose of this subsection, permanently and totally disabled means unable to engage in any substantial gainful activity by reason of any medically determined physical or mental impairment lasting or expected to last at least 12 months.

(8) A person receiving benefits described in subsections (2)(d) through (2)(f), (2)(h), or (2)(i) may not exclude benefits described in subsection (2)(c) from adjusted gross income unless the benefits received under subsections (2)(d) through (2)(f), (2)(h), or (2)(i) are less than $3,600, in which case the person may combine benefits to exclude up to a total of $3,600 from adjusted

gross income. (Subsection (2)(k) terminates on occurrence of contingency--sec. 3, Ch. 634, L. 1983.)"

Section 2. Section 15-30-136, MCA, is amended to read:

"**15-30-136. Computation of income of estates or trusts -- exemption.** (1) Except as otherwise provided in this chapter, "gross income" of estates or trusts means all income from whatever source derived in the taxable year, including but not limited to the following items:

(a) dividends;

(b) interest received or accrued, including interest received on obligations of another state or territory or a county, municipality, district, or other political subdivision thereof, but excluding interest income from obligations of:

(i) the United States government or the state of Montana;

(ii) a school district; or

(iii) a county, municipality, district, or other political subdivision of the state;

(c) income from partnerships and other fiduciaries;

(d) gross rents and royalties;

(e) gain from sale or exchange of property, including those gains that are excluded from gross income for federal fiduciary income tax purposes by section 641(c) of the Internal Revenue Code of 1954, as amended;

(f) gross profit from trade or business; and

(g) refunds recovered on federal income tax, to the extent the deduction of such tax resulted in a reduction of Montana income tax liability.

(2) In computing net income, there are allowed as deductions:

(a) interest expenses deductible for federal tax purposes according to section 163 of the Internal Revenue Code of 1954, as amended;

(b) taxes paid or accrued within the taxable year, including but not limited to federal income tax, but excluding Montana income tax;

(c) that fiduciary's portion of depreciation or depletion which is deductible for federal tax purposes according to sections 167, 611, and 642 of the Internal Revenue Code of 1954, as amended;

(d) charitable contributions that are deductible for federal tax purposes according to section 642(c) of the Internal Revenue Code of 1954, as amended;

(e) administrative expenses claimed for federal income tax purposes, according to sections 212 and 642(g) of the Internal Revenue Code of 1954, as amended, if such expenses were not claimed as a deduction in the determination of Montana inheritance tax;

(f) losses from fire, storm, shipwreck, or other casualty or from theft, to the extent not compensated for by insurance or otherwise, that are deductible for federal tax purposes according to section 165 of the Internal Revenue Code of 1954, as amended;

(g) net operating loss deductions allowed for federal income tax under section 642(d) of the Internal Revenue Code of 1954, as amended, except estates may not claim losses that are deductible on the decedent's final return;

(h) all benefits, not in excess of $3,600, received:

(i) as federal employees' retirement;

(ii) as retirement from public employment in a state other than Montana; or

(iii) as an annuity, pension, or endowment under private or corporate retirement plans or systems;

(i) all benefits paid under the Montana teachers' retirement system that are specified as exempt from taxation, except as otherwise provided, by 19-4-706;

(j) all benefits paid under ~~the~~ The ~~Montana~~ Public Employees' Retirement System Act that are specified as exempt from taxation, except as otherwise provided, by 19-3-105;

(k) all benefits paid under the Montana highway patrolmen's retirement system that are specified as exempt from taxation, except as otherwise provided, by 19-6-705;

(l) Montana income tax refunds or credits thereof;

(m) all benefits paid under 19-11-602, 19-11-604, and 19-11-605 to retired and disabled firemen or their surviving spouses or children;

(n) all benefits paid under the municipal police officers' retirement system that are specified as exempt from taxation, except as otherwise provided, by 19-9-1005.

(3) In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202 is not in effect, net income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax net income by reason of the election under subchapter S. However, the shareholder's net income shall include actual distribution from the corporation to the extent it would be treated as taxable dividends if the subchapter S. election were not in effect.

(4) The following additional deductions shall be allowed in deriving taxable income of estates and trusts:

(a) any amount of income for the taxable year currently required to be distributed to beneficiaries for such year;

(b) any other amounts properly paid or credited or required to be distributed for the taxable year;

(c) the amount of 60% of the excess of the net long-term capital gain over the net short-term capital loss for the taxable year.

(5) The exemption allowed for estates and trusts is that exemption provided in 15-30-112(2)(a) and 15-30-112(8).

(6) A trust or estate excluding benefits under subsections (2)(i) through (2)(k), (2)(m), or (2)(n) may not exclude benefits described in subsection (2)(h) from net income unless the benefits received under subsections (2)(i) through (2)(k), (2)(m), or (2)(n) are less than $3,600, in which case the trust or estate may combine benefits to exclude up to a total of $3,600 from net income."

Section 3. Section 19-3-105, MCA, is amended to read:

"**19-3-105. Exemption from taxes and legal process -- exception.** (1) The right of a person to a retirement allowance or any other benefit under this chapter and the ~~moneys~~ money in the fund created under this chapter is not:

~~(1)~~(a) subject to execution, garnishment, attachment, or any other process;

~~(2)~~(b) except as provided in subsection (2), subject to state, county, or municipal taxes; or ~~except for:~~

(c) assignable except as in this chapter specifically provided.

(2) (a) The exemption provided in subsection (1)(b)

does not apply to:

(i) a refund paid under 19-3-703 of a member's contributions picked up by an employer after June 30, 1985, as provided in 19-3-701, including interest earned on the member's contributions; and

~~(b)~~(ii) that portion of the retirement allowance attributable to the member's contributions, including interest earned, picked up by an employer after June 30, 1985, as provided in 19-3-701.

(b) The administrator of the retirement system shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of 15-30-301. ~~or~~

~~(3) assignable except as in this chapter specifically provided.~~"

Section 4. Section 19-4-706, MCA, is amended to read:

"**19-4-706. Exemption from taxation and legal process -- exception.** The pensions, annuities, or any other benefits accrued or accruing to any person under the provisions of the retirement system and the accumulated contributions and cash and securities in the various funds of the retirement system are:

(1) exempted from any state, county, or municipal tax of the state of Montana except ~~for~~:

(a) a refund paid under 19-4-603 of a member's contributions picked up by an employer after June 30, 1985, as provided in 19-4-602, including interest earned on the member's contributions; and

(b) that portion of the retirement allowance attributable to the member's contributions, including interest earned, picked up by an employer after June 30, 1985, as provided in 19-4-602. The administrator of the retirement system shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of 15-30-301.

(2) not subject to execution, garnishment, attachment by trustee process or otherwise, in law or equity, or any other process; and

(3) unassignable except as specifically provided in this chapter."

Section 5. Section 19-5-704, MCA, is amended to read:

"**19-5-704. Exemption from taxes and legal process -- exception.** (1) Any money received or to be paid as a member's annuity, state annuity, or return of accumulated deductions or the right of any of these shall be exempt from any state or municipal tax, except as provided in subsection (2), and from levy, sale, garnishment, attachment, or any other process whatsoever and shall be unassignable except as specifically provided in 19-5-705.

(2) Interest earned on the deductions that is included in a refund under 19-5-403 or as part of the retirement allowance attributable to the member's contributions is taxable. The administrator of the retirement system shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of 15-30-301."

Section 6. Section 19-6-705, MCA, is amended to read:

"**19-6-705. Exemption from taxes and legal process -- exception.** Any money received or to be paid as a member's annuity, state annuity, or return of deductions or the right of any of these is:

(1) exempt from any state, county, or municipal tax except ~~for~~:

(a) a refund paid under 19-6-403 of a member's contributions picked up by an employer after June 30, 1985, as provided in 19-6-402, including interest earned on the member's contributions; and

(b) that portion of the retirement allowance attributable to the member's contributions, including interest earned, picked up by an employer after June 30, 1985, as provided in 19-6-402. The administrator of the retirement system shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of

15-30-301.

(2) exempt from levy, sale, garnishment, attachment, or any other process; and

(3) unassignable except as specifically provided in 19-6-706."

Section 7. Section 19-8-805, MCA, is amended to read:

"**19-8-805. Exemption from taxes and legal process -- exception.** Any money received or to be paid as a member's annuity, state annuity, or return of deductions or the right of any of these is:

(1) exempt from any state, county, or municipal tax except **for**:

(a) a refund paid under 19-8-503 of the member's contributions picked up by an employer after June 30, 1985, as provided in 19-8-502, including interest earned on the member's contributions; and

(b) that portion of the retirement allowance attributable to the member's contributions, including interest earned, picked up by an employer after June 30, 1985, as provided in 19-8-502. The administrator of the retirement system shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of 15-30-301.

(2) exempt from levy, sale, garnishment, attachment,

or any other process; and

(3) unassignable except as specifically provided in 19-8-806."

Section 8. Section 19-9-1005, MCA, is amended to read:

"**19-9-1005. Exemption from taxes -- exception.** Any money paid in accordance with the provisions of this chapter is exempt from any state, county, or municipal tax except:

(1) a refund paid under 19-9-304 of a member's contributions picked up by an employer after June 30, 1985, as provided in 19-9-601, including interest earned on the member's contributions; and

(2) that portion of the retirement allowance attributable to the member's contributions, including interest earned, picked up by an employer after June 30, 1985, as provided in 19-9-601. The administrator of the retirement system shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of 15-30-301."

Section 9. Section 19-13-1003, MCA, is amended to read:

"**19-13-1003. Exemption from taxes -- exception.** Any money paid in accordance with the provisions of this chapter is exempt from any state, county, or municipal tax except:

(1) refunds paid under 19-13-602 of the member's

contributions picked up by an employer after June 30, 1987, as provided in 19-13-601, including interest earned on the member's contributions; and

(2) that portion of the retirement allowance attributable to the member's contributions, including interest earned, picked up by an employer after June 30, 1987, as provided in 19-13-601. The administrator of the retirement system shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of 15-30-301."

Section 10. Section 19-21-212, MCA, is amended to read:

"**19-21-212. Exemption from taxation, legal process, and assessments -- exceptions.** All contracts, benefits, and contributions under the optional retirement program and the earnings thereon are:

(1) exempt from any state, county, or municipal tax except:

(a) a refund paid by the designated company of the optional retirement program of a member's contributions picked up by an employer, as provided in 19-4-602, after June 30, 1987, including interest earned on the contributions; and

(b) that portion of the retirement allowance

attributable to the member's contributions, including interest earned, picked up by an employer, as provided in 19-4-602, after June 30, 1987. The designated company of the optional retirement program shall provide information returns to the member and the department of revenue of the taxable distributions, consistent with the requirements of 15-30-301.

(2) not subject to execution, garnishment, attachment, or other process;

(3) not covered or assessable by an insurance guaranty association; and

(4) unassignable except as specifically provided in the contracts."

NEW SECTION. **Section 11. Extension of authority.** Any existing authority to make rules on the subject of the provisions of [this act] is extended to the provisions of [this act].

NEW SECTION. **Section 12. Applicability.** [This act] applies to taxable years beginning after December 31, 1989.

NEW SECTION. **Section 13. Effective date.** [This act] is effective on passage and approval.

-End-

STATE OF MONTANA - FISCAL NOTE

Form BD-15

In compliance with a written request, there is hereby submitted a Fiscal Note for SB448, as introduced

DESCRIPTION OF PROPOSED LEGISLATION:

An act providing for the taxation of a member's contributions to a Montana Public Employee Retirement System that were made after June 30, 1985, including that portion of the retirement allowance attributable to a member's contributions and interest earned on a member's contributions refunded before retirement; requiring the administrator or designated company of a Public Employee Retirement System to provide information on taxable distributions; and providing an immediate effective date and an applicability date.

ASSUMPTIONS:

1. As of January 1989, the following retirees were receiving retirement benefits from state administered retirement systems. The bill is not specific as to which current retirees, if any, would have portions of their retirement benefits become taxable. Without many staff hours of manual work, it is not possible to calculate the amount of tax deferred contributions and interest these current retirees had on their active membership accounts prior to retirement.

System	Number	Current Monthly Benefits
TRS	6,283	$3,927,451
PERS	9,364	3,838,169
Judges	21	40,718
Game Wardens	52	44,534
Highway Patrol	169	130,436
Sheriffs	74	36,978
Municipal Police	403	370,048
Firefighters Unified	366	328,420
TOTAL	10,941	$4,789,303

2. Mandatory contributions made by active members of the TRS, PERS, Game Wardens, Highway Patrol, Sheriffs, and Police Retirement Systems have been tax-deferred since July 1, 1985; mandatory contributions made by members of the Firefighters Unified Retirement System have been tax-deferred since July 1, 1987; contributions made by members of the Judges' Retirement System are not tax-deferred.
3. Tax deferred contributions and interest have always been reported to the IRS as taxable income when a terminating member received a lump sum refund; tax deferred contributions have been reported to the state on these lump sum refunds. During calendar year 1988 $8,566,926 in taxable refunds were reported to the IRS; $5,579,128 in taxable refunds were reported to the state. If this bill had been law, an additional $3,487,798 (representing interest payments) would have been taxable on Montana taxes during the 1988 tax year. Assume this amount will remain constant during the next biennium.

Ray Shackleford DATE 2/22/89

RAY SHACKLEFORD, BUDGET DIRECTOR

Office of Budget and Program Planning

John G. Harp DATE

JOHN G. HARP, PRIMARY SPONSOR

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4. The average effective tax rate for the individual income tax is 6%.
5. The proposal applies to taxable years beginning after December 31, 1989, so the impact would first be felt in FY91.
6. The bill specifies that "the portion of the retirement allowance attributable to the member's contributions, including interest earned, picked up by an employer..." will not be exempt from state taxes. The retirement systems affected by the bill are defined benefit plans. (Defined benefits are calculated solely on the salary and years of service of the member prior to retirement.) It is impossible to compute the amount specified by the bill since the benefits paid to members of these retirement systems are not at all attributable to the member's contributions or interest.
7. Federal tax law on retirement benefits specifies what can be excluded from federal taxes. The bill attempts to define what will be included as taxable income. Without specific definition of what will become taxable and over what time period it will be recovered, no assumptions can be made about the amount of retirement benefits paid each year which will become taxable in future years because of this bill. The fiscal impact does not include the effect of taxing the benefits related to the tax-deferred contributions.
8. There would be additional administrative expense for computer programming, but it cannot be quantified without more direction on the taxability of retirement benefits.

FISCAL IMPACT: (Taxing the interest on refunds only)

	FY90	FY91		
Revenue Impact:		Current Law	Proposed Law	Difference
Individual Income Tax	No Impact	$254,428,000	$254,637,268	$ 209,268
Fund Information:				
General Fund		$148,077,096	$148,198,890	$ 121,794
Foundation Program		80,908,104	80,974,651	66,547
Sinking Fund		25,442,800	25,463,727	20,927
TOTAL		$254,428,000	$254,637,268	$ 209,268

LONG-RANGE EFFECTS OF PROPOSED LEGISLATION:
This legislation will increase individual income tax revenue by at least $209,000 a year and will decrease the net retirement benefits payable to Montana public retirees.

TECHNICAL OR MECHANICAL DEFECTS OR CONFLICTS WITH EXISTING LEGISLATION:
1. Instituting a state income tax on Montana's public retirement benefits for current active and retired public employees may be in conflict with previous interpretations of the guarantees extended to employees under law.
2. The bill proposes to make refunds of tax-deferred contributions and interest taxable in 7 of the 8 state public retirement systems. It does not propose to make these amounts taxable in the Sheriffs' Retirement System. This may have been an oversight when the bill was drafted.
3. The bill does not indicate whether it is applicable to all retirees and their beneficiaries receiving state retirement benefits on January 1, 1990, or whether it is applicable to retirees after January 1, 1990, or some other specific date. If it is the intention that all benefits received on or after January 1, 1990 will become taxable in some manner, it should be coordinated with current tax law which provides for a three year "statute of limitations" on tax collections.
4. The bill does not indicate how the taxable amount of each retirement benefit is to be determined. Since benefits paid do not depend on the amount of contributions or interest paid by members prior to retirement, specific instructions for determining the taxable amount of benefits should be included in this legislation.

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