

COMMITTEE ON LEGISLATIVE RESEARCH  
OVERSIGHT DIVISION

**FISCAL NOTE**

L.R. No.: 2303H.01I  
Bill No.: HB 1140  
Subject: Taxation and Revenue - General; Taxation and Revenue - Income; Revenue,  
Department of; State Employees; Retirement Systems and Benefits - General;  
Retirement - State  
Type: Original  
Date: February 23, 2021

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Bill Summary: This proposal would exempt state employee retirement benefits from state income tax.

**FISCAL SUMMARY**

<b>ESTIMATED NET EFFECT ON GENERAL REVENUE FUND</b>			
<b>FUND AFFECTED</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>
General Revenue*	\$0	Less than or greater than (\$27,164,870) up to (\$52,169,051)	Less than or greater than (\$27,145,113) up to (\$52,149,294)
<b>Total Estimated Net Effect on General Revenue</b>	<b>\$0</b>	<b>Less than or greater than (\$27,164,870) up to (\$52,169,051)</b>	<b>Less than or greater than (\$27,145,113) up to (\$52,149,294)</b>

\*Oversight is unsure if the language of the proposal would also allow an additional deduction of income that is already deducted for Missouri taxable income calculation. Therefore, Oversight has ranged the fiscal impact to include that possibility (roughly \$25 million additional annual impact - see pages 6-7).

<b>ESTIMATED NET EFFECT ON OTHER STATE FUNDS</b>			
<b>FUND AFFECTED</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>
<b>Total Estimated Net Effect on <u>Other</u> State Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

Numbers within parentheses: () indicate costs or losses.

<b>ESTIMATED NET EFFECT ON FEDERAL FUNDS</b>			
<b>FUND AFFECTED</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>
<b>Total Estimated Net Effect on <u>All</u> Federal Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

<b>ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)</b>			
<b>FUND AFFECTED</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>
General Revenue – DOR	0 FTE	2 FTE	2 FTE
<b>Total Estimated Net Effect on FTE</b>	<b>0 FTE</b>	<b>2 FTE</b>	<b>2 FTE</b>

☒ 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.

<b>ESTIMATED NET EFFECT ON LOCAL FUNDS</b>			
<b>FUND AFFECTED</b>	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>
<b>Local Government</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

## FISCAL ANALYSIS

### ASSUMPTION

Officials from the **Missouri Department of Revenue (DOR)** state this proposed legislation would allow the total amount of any retirement benefits received by a taxpayer as a result of the taxpayer's service as an employee for the government of this state to be subtracted from their Missouri adjusted gross income for the purpose of calculating their tax.

This will reduce their adjusted gross income and the amount they would owe in tax. It appears this proposed legislation would only allow the state employee to receive this benefit (taxpayer's service as an employee) and not their surviving spouse.

Currently, a portion of a public employee's retirement benefits may be eligible to be claimed as a deduction depending on their income. The public employee may work for any public retirement system including the federal, state or local government to be eligible for the current deduction. The maximum amount of the deduction is equal to the maximum social security benefit of \$39,014 which was the maximum benefit for Tax Year 2020.

The Missouri State Employees' Retirement System (MOSERS) handles the distribution of retirement benefits to state employees, including the state's judges (judicial retirees). MSEP reported the following amount was distributed in Fiscal Year 2020 to retiree's only:

	Number of Retirees	Total Annual Benefits	Average Annual Benefits
MSEP Combined	45,176	\$738,747,900	16,353
Judicial	590	\$40,112,028	67,988
Total	45,766	\$778,859,928	

This proposed legislation is assumed to allow \$778,861,008 to be subtracted from retirees' Missouri adjusted gross income.

Additionally, the Missouri Department of Transportation and Missouri State Highway Patrol Employees' Retirement System (MPERS) reports that 7,208 retirees receive \$203,365,258 in benefits.

Using the current average social security benefit of \$18,516 this would create a combined income for state employee retirees of \$34,869 (\$18,516 + \$16,353). Using the current MO-1040 tax return calculators, it is estimated that, on average, \$7,095 of their current retirement is already exempt. This suggests that \$320,523,720 is already exempt out of the \$738,747,900 such retirees receive in benefits. The remaining \$418,224,180 would become exempt under this proposed legislation.

Using the same average social security benefit for the judicial retirees would result in a combined income of \$86,502. Using the current MO 1040 tax return calculators it is estimated that, on average, \$24,777 of their current retirement is already exempt. This suggests that \$14,618,430 is already exempt out of the \$40,112,028 such retirees receive in benefits. The remaining \$25,493,598 would become exempt under this proposed legislation.

Using the same average social security benefit for the MPERS retirees would result in a Missouri adjusted gross income of \$46,730. Using the current MO 1040 tax return calculators it is estimated that on average \$18,956 of their retirement is already exempt. This means that \$136,634,848 is already exempt out of the \$203,365,258 they receive in benefits. The remaining \$66,730,410 would become exempt under this proposal.

Therefore, the potential benefits eligible under this proposed legislation is:

MSEP	\$418,224,180
Judicial	\$25,493,598
MPERS	\$66,730,410
	\$510,448,188

DOR notes a deduction is not a dollar for dollar loss but is a reduction based on the individual income tax rate at the time. While this proposed legislation begins with Tax Year 2022, the returns claiming the deduction will not be filed until January 1, 2023 (Fiscal Year 2023).

Tax Rate	Tax Year / Fiscal Year			
	2022 (FY23)	2023 (FY24)	2024 (FY25)	2025 (FY26)
5.40%	(\$27,564,202)	(\$27,564,202)	(\$27,564,202)	(\$27,564,202)
5.30%	(\$27,053,754)	(\$27,053,754)	(\$27,053,754)	(\$27,053,754)
5.20%	-	(\$26,543,306)	(\$26,543,306)	(\$26,543,306)
5.10%	-	-	(\$26,032,858)	(\$26,032,858)

DOR anticipates this would most likely require a new section to be added to Form MO-A, Part 3, on the individual Form(s) MO-1040 and MO-1040P. DOR anticipates the need for one (1) FTE Associate Customer Service Representative for every 14,700 errors created, one (1) FTE Associate Customer Service Representative for every 5,700 pieces of correspondence generated, one (1) temporary employee for the new line item(s) and additional equipment and expense for forms and programming changes.

**Oversight** assumes DOR anticipates this would require a new section to be added to Form MO-A, Part 3 to identify individuals that would qualify for the exemption of their full benefits, as permitted under this proposed legislation.

Due to the number of individuals that could potentially claim the exemption created under this proposed legislation, Oversight will include DOR's administrative costs being paid from GR. However, Oversight assumes DOR can absorb the temporary employee requested. Oversight notes the exemption created would be for all tax years beginning on or after January 1, 2022. Tax Year 2022 tax returns would not be filed until after January 1, 2023 (Fiscal Year 2023). Therefore, Oversight assumes DOR can hire the FTE requested beginning July 1, 2022 (Fiscal Year 2023) and have six (6) months remaining to train such FTE before the first tax returns claiming the exemption created are filed.

Officials from the **Office of Administration – Budget & Planning Division (B&P)** state, beginning with Tax Year 2022, this proposed legislation would exempt retirement benefits received by a taxpayer for that taxpayer's service as a state employee.

Based on information published by the MOSERS during Fiscal Year 2020, there were 45,176 state employee retirees receiving \$738,747,900 in retirement benefits and 590 retirees receiving \$40,112,028 in benefits under the Judicial Plan. In addition, based on MPERS there were 7,208 state retirees receiving \$203,365,258 in retirement benefits. Therefore, B&P estimates that this proposal could exempt \$982,225,186 in retirement income from individual income tax.

However, B&P notes that a portion of public pension retirement income is already exempt from taxation. B&P utilized the average social security retirement payment (\$1,543 per month in January 2021) as well as the average MSEP (\$16,353), Judicial Plan (\$67,986), and MPERS (\$28,214) retirement benefits to determine the average amount of each benefit currently exempt. Using the 2020 individual income tax form, B&P estimates that for MSEP recipients the average amount of retirement income currently exempt is \$7,095. For Judicial Plan recipients, the average amount of retirement income currently exempt is \$24,777. For MPERS recipients the average amount of retirement income currently exempt is \$18,956. Therefore, B&P estimates that under current law \$471,776,998 in retirement income  $[(\$7,095 \times 45,176 \text{ MSEP retirees}) + (\$24,777 \times 590 \text{ Judicial Plan retirees}) + (\$18,956 \times 7,208 \text{ MPERS retirees})]$  is already exempt from taxation.

Based on the above information, B&P estimates that this proposed legislation may exempt \$510,448,188 in retirement income. 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 509 (2014).

Tax Rate	Tax Year / Fiscal Year			
	2022 (FY23)	2023 (FY24)	2024 (FY25)	2025 (FY26)
5.40%	(\$27,564,202)	(\$27,564,202)	(\$27,564,202)	(\$27,564,202)
5.30%	(\$27,053,754)	(\$27,053,754)	(\$27,053,754)	(\$27,053,754)
5.20%	-	(\$26,543,306)	(\$26,543,306)	(\$26,543,306)
5.10%	-	-	(\$26,032,858)	(\$26,032,858)

**Oversight** notes this proposed legislation would exempt one hundred percent of the retirement benefits received by a taxpayer for that taxpayer's service as a state employee.

**Oversight** notes this proposed legislation states, "...in addition to all other subtractions authorized under Section 143.124, and notwithstanding any provisions of this section or any other provision of law to the contrary, for all tax years beginning on or after January 1, 2022, there shall be subtracted from Missouri adjusted gross income.... the total amount of any retirement benefits received by a taxpayer..."

**Oversight** assumes, since the exemption created would be in additional to any and all other subtractions authorized under this section, that Missouri state retirees may be permitted to claim the Public Pension Exemption permitted under current law **and** the exemption created under this proposed legislation. Oversight notes, then, each exemption would be calculated using the same retirement income.

**Oversight** notes that DOR and B&P have removed the amount(s) of Public Pension Exemption currently estimated to be claimed by Missouri state employee retirees when calculating the impact of this proposed legislation.

**Oversight** assumes, however, such full amount(s) of the retirement benefits received by taxpayers for such taxpayers' service as a state employee may be permitted to be claimed under the exemption created. Oversight assumes the taxpayer may be able to claim the existing Public Pension Exemption for their state retirement benefits **and** the exemption created under this proposed legislation for their state retirement benefits.

Therefore, Oversight has recalculated the estimated impact using the estimated total amount of retirement income provided by DOR and B&P.

**Oversight** estimates the total retirement income that could be exempt under this proposed legislation totals \$982,225,186 (\$738,747,900 + \$40,112,028 + \$203,365,258).

**Oversight** notes the current Individual Income Tax rate is 5.4% (with three (3) additional rate reductions pending pursuant to SB 509 – 2014). As stated in the fiscal note for [HB 555 \(2021\)](#), B&P assumes, based on current revenue forecasts and average revenue growth, that revenues in Fiscal Year 2021, Fiscal Year 2024, and Fiscal Year 2025 will reach the SB 509 (2014) growth trigger requirement for reductions to the top rate of tax. Therefore, the top rate of tax will be reduced by 0.1% in Tax Year(s) 2022 (5.3%), 2025 (5.2%), and 2026 (5.1%) under SB 509 (2014).

Therefore, Oversight will report the impact(s) to the fiscal years reported in this fiscal note using a tax rate of 5.3%.

**Oversight** estimates this proposed legislation could reduce GR by \$52,057,935 (\$982,225,186 \* 5.3%) annually when assuming that individuals are permitted to claim all existing exemption(s) permitted under current law **and** the exemption created under this proposed legislation as it relates to retirement income received as the result of having served as an employee of this state.

Oversight notes the difference between DOR's and B&P's and Oversight's estimates is \$25,004,181 (\$52,057,935 - \$27,053,754).

**Oversight** notes this proposed legislation is for all tax years beginning on or after January 1, 2022. Oversight notes Tax Year 2022 tax returns will not be filed until after January 1, 2023 (Fiscal Year 2023).

For purposes of this fiscal note, Oversight will report a revenue reduction equal and amount "Less than or greater than" \$27,053,754, as estimated by DOR and B&P when using a tax rate of 5.3%.

In addition, Oversight will report a separate revenue reduction equal to \$0 (individuals **cannot** claim existing exemption(s) permitted under current law **and** the exemption created under this proposed legislation) up to \$25,004,181 (difference between DOR's and B&P's estimates and Oversight's estimates, beginning in Fiscal Year 2023).

<u>FISCAL IMPACT – State Government</u>	FY 2022 (10 Mo.)	FY 2023	FY 2024
<b>GENERAL REVENUE FUND</b>			
<u>Revenue Reduction</u> – Section – Section 143.124 – Tax Exemption For Missouri State Employee Retirement Benefits – (Part 1 of 2)	\$0	Less than or greater than (\$27,053,754)	Less than or greater than (\$27,053,754)
<u>Revenue Reduction</u> – Section 143.124 – Possible Increase In Tax Exemption Created Should Taxpayers Be Allowed To Claim All Existing Exemptions In Addition To The Tax Exemption For Missouri State Employee Retirement Benefits Created – (Part 2 of 2)	\$0	\$0 up to (\$25,004,181)	\$0 up to (\$25,004,181)
<u>Cost</u> – Section 143.124 - DOR			
Personnel Services	\$0	(\$49,207)	(\$49,699)
Fringe Benefits	\$0	(\$40,487)	(\$40,653)
Equipment & Expense	\$0	(\$21,422)	(\$1,007)
Total Cost	\$0	(\$111,116)	(\$91,359)
FTE Change – DOR	0 FTE	2 FTE	2 FTE
<b>ESTIMATED NET EFFECT ON GENERAL REVENUE FUND</b>	<b>\$0</b>	<b><u>Less than or greater than (\$27,164,870) up to (\$52,169,051)</u></b>	<b><u>Less than or greater than (\$27,145,113) up to (\$52,149,294)</u></b>



<u>FISCAL IMPACT – Local Government</u>	FY 2022 (10 Mo.)	FY 2023	FY 2024
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

FISCAL IMPACT – Small Business

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

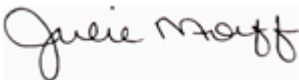
FISCAL DESCRIPTION

Beginning with Tax Year 2022, this proposed legislation would exempt retirement benefits received by a taxpayer for that taxpayer's service as a state employee.

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

Office of Administration – Budget & Planning Division  
Missouri Department of Revenue



Julie Morff  
Director  
February 23, 2021



Ross Strobe  
Assistant Director  
February 23, 2021