Presentation to
Legislative Commission on Pensions & Retirement

Effects of TCJA on Pensions

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1. **TCJA makes only a few explicit changes to the tax rules applicable to retirement plans and pensions** – three to be precise. The estimated federal revenue effects of all of the provisions are minor. The three provisions:

    a. **Roth conversion re-characterizations.** Repeal the authority to re-characterize Roth conversions; this will eliminate the permitted practice of "do-overs" for Roth conversions when the value of the account declines after the conversion was made. Repeal is estimated to raise $0.5 billion in federal revenues over the 10-year period. DOR has preliminarily estimated that conforming to the provision will raise state tax revenues by $450,000 in the FY 2018-19 biennium and by $600,000 in the FY 2020-21 biennium.

    b. **Length of service awards.** Increase the annual limit on length-of-service awards for volunteer fire-fighters, EMTs, and similar. The limit under prior law was $3,000/year. The TCJA increased that to $6,000/year, effective for tax year 2018, and indexes the limit for inflation in the future. This provision is estimated to reduce federal revenues by $0.5 billion over the 10-year period. DOR estimates no effect on state revenues during the FY 2018-21 period. (The federal revenue effects mainly appear in the last half of the 10-year period.)

    c. **Rollover of "loan offsets."** Extend the period for roll-overs of "loan offsets" for qualified plans, 403(b), and 457 plans. These occur when an individual with a plan loan terminates employment or the plan liquidates. Under prior law, rollovers were required to be made within 60 days; TCJA extends that to the due date for the income tax return for the taxable year. The effects on federal and state revenues is estimated to be negligible.

2. **The bills passed by the House and Senate included a few more provisions affecting pensions and retirement plans**. These provisions, however, were dropped by the conference committee. The provisions generally did not make major policy changes, although some could have materially affected public pension operations or benefits.

3. **Effects of TCJA's tax changes on recipients of Minnesota public pensions are expected to be little different than on most other taxpayers who are wage earners**. In general, this will typically mean modest tax reductions for most recipients. A small share of recipients – particularly those with above average incomes, large deductions for state and local taxes, older dependents, and certain types of deductions – may see tax increases as a result of TCJA's enactment.

In broad outline, TCJA:

a. Increases the standard deduction – for a married joint filer, the standard deduction increases from $13,000 to $24,000 (all amounts are for tax year 2018)

b. Eliminates personal exemptions – the tax year 2018 amounts (personal and dependent) were scheduled to be $4,150. Because TCJA does not replace the personal exemption (other than by increasing the standard deduction amounts), this effectively means itemizers will lose the benefit of the personal exemption.

c. Replaces the dependent exemption with increases in the child credit – $1,000/child maximum under prior law goes to $2,000; refundable portion from $1,000 to $1,400. In addition, the income limits are increased. Under prior law, the credit began phasing out at $75,000 of adjusted gross income or AGI ($110,000 for married joint filers). TCJA increases those limits to $400,000 of AGI ($200,000 for single and head of household filers). Note that the child credit amounts are not adjusted for inflation, while the exemption amounts were.

d. For dependents older than 16, a child credit of $500 is allowed. This provides a tax benefit roughly equal to the $4,150 dependent exemption allowance at a 12% tax rate. Filers with dependents older than age 16 will lose tax benefits, if they are in a rate bracket higher than 12% (> $77,400 of taxable income for married joint filers in tax year 2018).

e. Limits the itemized deduction for state and local taxes to $10,000

f. Repeals the itemized deductions for home equity interest, casualty losses, and miscellaneous itemized deductions, imposes stricter limits on mortgage interest deductibility, and so forth

g. Lowers the AGI threshold for the itemized deduction for medical expenses from 10% to 7.5%, allowing more taxpayers to qualify for this deduction (applies only to tax years 2017 and 2018)

h. Repeals the income phase-out of itemized deductions

i. Increases the AMT exemption amount and the threshold limit for the income phase-out

j. Reduces rates

k. Changes indexing rules to a slower-growing measure of inflation (chained-CPI, rather than CPI-U). This affects all of the various inflation adjustments.

l. Most of the individual changes (not the indexing rules, though) are temporary

Many of TCJA's major changes in individual income taxation focus on businesses – e.g., the 20% deduction for qualified business income, expansion of the availability of and benefits under section 179 and bonus depreciation, disallowance of some business interest, and so on. These provisions do not affect the taxation of pension income or a typical pension recipient, unless they or their spouses are operating businesses. The business provisions will yield the largest tax reductions for individuals. Effects will vary based on the characteristics of the business, amount of capital investment, and so forth. None of this is directly relevant to the pension recipients, though.