

701—40.50(422) Computing state taxable amounts of pension benefits from state pension plans. For tax years beginning on or after January 1, 1995, a retired member of a state pension plan, or a beneficiary of a member, who receives benefits from the plan where there was a greater contribution to the plan for the member for state income tax purposes than for federal income tax purposes can report less taxable income from the benefits on the Iowa individual income tax return than was reported on the federal return for the same tax year. This rule applies only to a member of a state pension plan, or the beneficiary of a member, who received benefits from the plan sometime after January 1, 1995, and only in circumstances where the member received wages from public employment in 1995, 1996, 1997, or 1998, or possibly in 1999 for certain teachers covered by the state pension plan authorized in Iowa Code chapter 294 so the member had greater contributions to the state pension plan for state income tax purposes than for federal income tax purposes. Starting with wages paid on or after January 1, 1999, to employees covered by a state pension plan other than teachers covered by the state pension plan authorized in Iowa Code chapter 294, contributions made to the pension plan will be made on a pretax basis for state income tax purposes as well as for federal income tax purposes. However, in the case of teachers covered by the state pension plan authorized in Iowa Code chapter 294, contributions to the pension plan on behalf of these teachers on a pretax basis for state income tax purposes may start after January 1, 1999.

For example, in the case of a state employee who was covered by IPERS and had wages from covered public employment of \$41,000 or more in 1995, that person would have made posttax contributions to IPERS of \$1,517 for state income tax purposes for 1995 and zero posttax contributions to IPERS for federal income tax purposes for 1995. The \$1,517 in contributions to IPERS for federal income tax purposes was made on a pretax basis and was considered to have been made by the employee's employer or the state of Iowa and not the employee. At the time this employee receives retirement benefits from IPERS, the retired employee will be subject to federal income tax on the portion of the benefits that is attributable to the \$1,517 IPERS contribution made in 1995. However, this employee will not be subject to state income tax on the portion of the IPERS benefits received which is attributable to the \$1,517 contribution to IPERS for 1995.

This rule does not apply to members or beneficiaries of members who elect to take a lump sum distribution of benefits from a state pension plan in lieu of receiving monthly payments of benefits from the plan.

The following subrules further clarify how the portion of certain state pension benefits that is taxable for state individual income tax purposes for tax years beginning on or after January 1, 1995, is determined.

40.50(1) Definitions related to state taxation of benefits from state pension plan. The following definitions clarify those terms and phrases that have a bearing on the state's taxation of certain individuals who receive retirement benefits from state pension plans:

a. For purposes of this rule, the terms "state pension," "state pensions," and "state pension plans" mean only those pensions and those pension plans authorized in Iowa Code chapter 97A for public safety peace officers, chapter 97B for Iowa public employees (IPERS), chapter 294 for certain teachers, and chapter 411 for police officers and firefighters. There are other pension plans available for some public employees in the state which may be described as "state pensions" or "state pension plans" in other contexts or situations, but these pension plans are not covered by this rule. An example of a pension plan that is not a "state pension plan" for purposes of this rule is the judicial retirement system for state judges authorized in Iowa Code section 602.9101.

b. For purposes of this rule, "member" is an individual who was employed in public service covered by a state pension plan and is either receiving or was receiving benefits from the pension plan.

c. For purposes of this rule, "beneficiary" is a person who has received or is receiving benefits from a state pension plan due to the death of an individual or member who earned benefits in a state pension plan.

d. For purposes of this rule, the term "IPERS" means the Iowa public employees retirement system.

e. For purposes of this rule, the term “pretax,” when the term is applied to a contribution made to a state pension plan during a year from a public employee’s compensation, means a contribution to a state pension plan that is not taxed on the employee’s income tax return for the tax year in which the contribution is made. The contribution is considered to have been made by the state or the employee’s employer and not by the employee so this contribution is not part of the employee’s basis in the pension that is not taxed when the pension is received.

f. For purposes of this rule, the term “posttax,” when the term is applied to a contribution made to a state pension plan during a year from a public employee’s compensation, means the contribution is included in the employee’s taxable income for the tax year of the contribution and the contribution is considered to have been made by the employee. That is, the contribution is part of the employee’s basis in the pension which is not taxed at the time the pension is received.

40.50(2) *Computation of the taxable amount of the state pension for federal income tax purposes.* An individual who receives benefits in the tax year from one of the state pension plans is not subject to federal income tax on the benefits to the extent of the pensioner’s or member’s recovery of posttax contribution to the pension plan. The individual receiving benefits in the year from a state pension plan should get a Form 1099-R showing the total benefits received in the tax year from the pension plan. The individual can determine the federal taxable amount of the benefits by using the general rule or the simplified general rule which is described in federal publication 17 or federal publication 575. Note that members who first receive pension benefits after November 18, 1996, must compute the federal taxable amount of their pension benefits by using the simplified general rule shown in the federal tax publications. Note also that individuals receiving benefits in the tax year from IPERS who started receiving benefits in 1993 or in later years will receive information with the 1099-R form which shows the amount of gross benefits received in the tax year that is taxable for federal income tax purposes.

40.50(3) *Computing the taxable amount of state pension benefits for state individual income tax purposes.* An individual receiving state pension benefits in the tax year must have a number of facts about the state pension in order to be able to compute the taxable amount of the pension for Iowa income tax purposes. The individual must know the gross pension benefits received in the tax year, the taxable amount of the pension for federal income tax purposes, the employee’s contribution to the pension for federal income tax purposes, and the employee’s contribution to the pension for state income tax purposes. In situations where the employee’s contribution for state income tax purposes is equal to the contribution for federal income tax purposes, the same amount of the pension will be taxable on the state income tax return as is taxable on the federal return.

In cases when all of an individual’s employment covered by a state pension plan occurred on or after January 1, 1995, so that all the contributions to the pension plan (other than posttax service purchases) for the employee were made on a pretax basis for federal income tax purposes, all of the benefits received from the pension would be taxed on the federal income tax return. In this situation, the state taxable amount of the pension would be computed using the general rule or the simplified general rule shown in federal publication 17 or federal publication 575. The employee’s state contribution or state basis would be entered on line 2 of the worksheet in the federal publication that is usually used to compute the taxable amount of the pension for the federal income tax return.

To compute the state taxable amount of the state pension in situations where the employee had a contribution to the pension for federal tax purposes, the federal taxable amount for the year is first subtracted from the gross pension benefit received in the year which leaves the amount of the pension received in the year which was not taxable on the federal return. Next, the member’s posttax contribution or basis in the pension for federal tax purposes is divided by the member’s posttax contribution or basis in the pension for state income tax purposes which provides the ratio of the member’s federal basis or contribution to the member’s state contribution or basis. Next, the amount of the state pension received in the year that is not taxed on the federal return is divided by the ratio or percentage that was determined in the previous step, which provides the exempt amount of the pension for state tax purposes. Finally, the state exempt amount determined in the previous step is subtracted from the gross amount received in the year, which leaves the taxable amount for state income tax purposes. Note that individuals who retired in 1993 and in years after 1993 and are receiving benefits from IPERS will receive information from

IPERS which will advise them of the taxable amount of the pension for state income tax purposes. The examples in subrule 40.50(4) are provided to illustrate how the state taxable amounts of state pension benefits received in the tax year are computed in different factual situations.

40.50(4) Examples.

a. A state employee retired in April 1996 and started receiving IPERS benefits in April 1996. The retired state employee received \$1,794.45 in gross benefits from IPERS in 1996. The federal taxable amount of the benefits was \$1,690.36. The employee's federal posttax contribution or basis in the pension was \$4,907 and the state posttax contribution or basis was \$7,194. The nontaxable amount of the IPERS benefits for federal income tax was \$104.09 which was calculated by subtracting the federal taxable amount of \$1,690.36 from the gross amount of the benefits of \$1,794.45. The ratio of the employee's posttax contribution to the pension for federal income tax purposes was 68.21 percent of the employee's contribution to the pension for state income tax purposes. This was determined by dividing \$4,907 by \$7,194. The nontaxable amount of the IPERS benefit for federal income tax purposes of \$104.09 was then divided by 68.21 percent, which is the ratio determined in the previous step, and which results in a total of \$152.60. This was the nontaxable amount of the pension for state income tax purposes. When \$152.60 is subtracted from the gross benefits of \$1,794.45 paid in the year, the remaining amount is \$1,641.85 which is the taxable amount of the pension that should be reported on the individual's Iowa individual income tax return for the 1996 tax year.

b. A state employee retired in July 1995. The retired employee received \$1,881.88 in IPERS benefits in 1996 and \$1,790.60 of the benefits was taxable on the individual's federal return for 1996. The person's federal posttax contribution to the IPERS pension was \$3,130 and the posttax contribution for state income tax purposes was \$3,821. The amount of benefits not taxable for federal income tax purposes was \$91.28 which was computed by subtracting the amount of pension benefits of \$1,790.60 that was taxable on the federal income tax return from the gross benefits of \$1,881.88 received in 1996. The retiree's federal posttax contribution of \$3,130 to IPERS was divided by the retiree's posttax contribution of \$3,821 to IPERS for state income tax purposes which resulted in a ratio of 81.91 percent. The amount of IPERS benefits of \$91.28 exempt for federal income tax purposes is divided by the 81.91 percent computed in the previous step which results in an amount of \$111.44 which is the amount of IPERS benefits received in 1996 which is not taxable on the Iowa return. \$111.44 is subtracted from the gross benefits of \$1,881.88 received in 1996 which leaves the state taxable amount for 1996 of \$1,770.44.

This rule is intended to implement Iowa Code section 422.7 as amended by 1998 Iowa Acts, House File 2513.