HB92

173442-1

By Representative Greer

RFD: Ways and Means Education

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SYNOPSIS: Under current law for Alabama income tax purposes, all individuals are exempt from the reporting of distributions received from a defined benefit plan to the extent it is taxable for federal income tax purposes. Distributions received from a defined contribution plan are not exempt from reporting.

This bill would remove the exemption from the reporting and taxation of such distributions and require such benefits be reported on an individual's income tax returns effective for the 2016 calendar tax year and provide an exemption of the first $50,000 of pension and annuity income.

A portion of such distributions may be exempt from taxation for the recapture of any basis, under certain circumstances.

A BILL

TO BE ENTITLED

AN ACT

To amend Sections 16-25-23, 36-27-28, 36-27-170, 40-18-14, and 40-18-19 repeal Section 40-18-20 Code of Alabama 1975, to require individuals, including state retirees, to include in gross income, distributions received from defined benefit plans in determining their tax liability for the calendar year; to exempt the first $50,000 in pension and annuity income; and generally to allow a 60 month period in which to recapture any basis in reporting distributions from a defined benefit plan.

BE IT ENACTED BY THE LEGISLATURE OF ALABAMA:

Section 1. Sections 16-25-23, 36-27-28, 36-27-170, 40-18-14, and 40-18-19 are amended as follows:

"§16-25-23.

"The right of a person to a pension; an annuity, or a retirement allowance; to the return of contributions; the pension, annuity or retirement allowance itself; any optional benefit or any other right accrued or accruing to any person under the provisions of this chapter; and the moneys in the various funds created by this chapter are hereby exempt from ~~any state or~~ municipal tax and exempt from levy and sale, garnishment, attachment or any other process whatsoever, and shall be unassignable except as in this chapter specifically otherwise provided.

"§36-27-28.

"The right of a person to a pension, an annuity, a retirement allowance or to the return of contributions, the pension, annuity or retirement allowance itself and any optional benefit or any other right accrued or accruing to any person under the provisions of this article and the moneys in the various funds created by this chapter are hereby exempt from ~~any state or~~ municipal tax and exempt from levy and sale, garnishment, attachment or any other process whatsoever and shall be unassignable except as in this article specifically otherwise provided.

"§36-27-170.

"(a) As governed by this subsection, there exists as a part of this retirement system, an optional account known as the Deferred Retirement Option Plan, which may be cited as "DROP." The purpose of DROP is to allow, contractually, in lieu of immediate withdrawal from service and receipt of a retirement allowance, continued employment for a specific period of time, coupled with the deferral of receipt of a retirement allowance until the end of such period of participation, at which time the member shall withdraw from service.

"(b) Participation in DROP is an option available to any member of this retirement system who meets all of the following:

"(1) Has at least 25 years of creditable service exclusive of sick leave.

"(2) Is at least 55 years of age, or in the case of a state police member, is at least 52 years of age.

"(3) Is eligible for service retirement.

"(c) An election to participate in DROP may be made in one year increments not to exceed five years, nor to be less than three years. A member may participate in DROP only one time. Any voluntary termination within the first three years in DROP will result in a forfeiture of a portion of his or her DROP account that constitutes the retirement allowance. However, member contributions will not be forfeited nor will any interest attributable to the retirement allowance. There will be no forfeiture if the participation period is interrupted due to an involuntary dismissal, disability, involuntary transfer of his or her spouse, or death of the participant.

"(d) A member who chooses to participate in DROP may elect an option allowance set out for members of the Employees' Retirement System in subsection (d) of Section 36-27-16 at the beginning of the participation period. Otherwise, he or she shall receive the maximum benefit. Such election shall be irrevocable once the participation period begins except as otherwise provided in this chapter.

"(e) For purposes of DROP, sick leave may not be converted for purposes of establishing retirement eligibility, nor used in the calculation of the original retirement allowance except as provided in Section 36-27-171. A person electing to enter the DROP program is not eligible for a lump-sum payment for any annual or sick leave until withdrawal from service.

"(f) The election to participate in DROP shall be made in accordance with procedures set forth in a uniform and nondiscriminatory election and application form adopted by the Board of Control. The election to participate in DROP may be made at any time on or after the date the member becomes eligible to participate as set out in subsection (b). Such application must be made at least 30 days, but not more than 90 days, before the effective date of participation in DROP, and shall be made no later than March 24, 2011. A member must be eligible to participate, as provided above, at the time the application is made.

"(g) Upon the effective date of the commencement in DROP, the member's service shall remain as it existed on that date for the duration of DROP. Once a member enters DROP, service credit purchases are prohibited. Both the employer and employee member contribution shall continue to be made. The monthly retirement allowance that would have been payable, had the person elected to withdraw from service and receive a retirement allowance, shall be paid into a DROP account that reflects the credits attributed to the person in DROP. However, the monies shall remain a part of the regular retirement fund until disbursed to the participating member in accordance with this section. Any monies paid into this account are subject to the exemptions set out in Section 36-27-28 <u>and will not be subject to further taxation under Chapter 18 of Title 40, Code of Alabama 1975, except to the</u>

extent that such amounts exceed the limits contained in Section 40-18-19.

"(h)(1) The DROP account shall earn interest at the same rate that interest is posted to active member accounts as defined in subdivision (12) of Section 36-27-1. A person who participates in this plan shall not be eligible to receive a retiree cost-of-living increase while participating in DROP, and shall not be eligible for a retiree cost-of-living increase until participation in the plan ceases and he or she withdraws from service and has been receiving a retirement allowance for at least one full year.

"(2) Notwithstanding any other provision of this chapter, for any member who has fulfilled his or her obligation under DROP and does not withdraw from service and any member who begins participation in DROP on or before April 1, 2011, and fulfills his or her obligation under DROP and does not withdraw from service, the amount of interest payable on benefit deposits after March 24, 2011, shall be the lesser of (1) the investment performance of the immediately preceding fiscal year but no less than $0, or (2) as provided in subdivision (1) of subsection (d) of Section 36-27-171.

"(i) DROP shall not be subject to any fees, charges, or other similar expenses of any kind for any purpose.

"(j) Participation in DROP shall not affect the rights of any state employee under the state personnel system, including, but not limited to, his or her rights to longevity pay.

"(k) Participation in DROP shall not affect the accrual of annual and sick leave by the participant.

"(l) Participants in DROP may receive salary cost-of-living adjustments and salary increases.

"§40-18-14.

"The term "gross income" as used herein:

"(1) Includes gains, profits and income derived from salaries, wages, or compensation for personal services of whatever kind, or in whatever form paid, including the salaries, income, fees, and other compensation of state, county, and municipal officers and employees, or from professions, vocations, trades, business, commerce or sales, or dealings in property whether real or personal, growing out of ownership or use of or interest in such property; also from interest, royalties, rents, dividends, securities, or transactions of any business carried on for gain or profit and the income derived from any source whatever, including any income not exempted under this chapter and against which income there is no provision for a tax. The term "gross income" as used herein also includes alimony and separate maintenance payments to the extent they are includable in gross income for federal income tax purposes under 26 U.S.C. § 71 (relating to alimony and separate maintenance payments). The term "gross income" as used herein also includes any amount included in gross income under 26 U.S.C. § 83 at the time it is so included under 26 U.S.C. § 83.

"(2) For purposes of this chapter, the reductions in tax attributes required by 26 U.S.C. § 108 shall be applied only to the net operating losses determined under this chapter and the basis of depreciable property. The basis reductions of depreciable property shall not exceed the basis reductions for federal income tax purposes. All other tax attribute reductions required by 26 U.S.C. § 108 shall not be recognized.

"(3) Gross income does not include the following items which shall be exempt from income tax under this chapter:

"a. Amounts received under life insurance policies and contracts paid by reason of the death of the insured in accordance with 26 U.S.C. § 101;

"b. Amounts received, other than amounts paid by reason of the death of the insured, under life insurance, endowment or annuity contracts, determined in accordance with 26 U.S.C. § 72;

"c. The value of property acquired by gift, bequest, devise, or descent, but the income from such property shall be included in the gross income, in accordance with 26 U.S.C. § 102;

"d. Interest upon obligations of the United States or its possessions; or securities issued under provisions of the Federal Farm Loan Act of July 18, 1916;

"e. Any amounts received by an individual which are excludable from gross income under 26 U.S.C. § 104 (relating to compensation for injuries or sickness) or 26 U.S.C. § 105 (relating to amounts received under accident or health plans);

"f. Interest on obligations of the State of Alabama and any county, municipality, or other political subdivision thereof;

"g. The rental value of a parsonage provided to a minister of the gospel to the extent excludable under 26 U.S.C. § 107;

"h. Income from discharge of indebtedness to the extent allowed by 26 U.S.C. § 108;

"i. For each individual resident taxpayer, or each husband and wife filing a joint income tax return, as the case may be, any gain realized from the sale of a personal residence of the taxpayer shall be excluded to the extent excludable for federal income tax purposes under 26 U.S.C. § 121;

"j. Contributions made by an employer on behalf of an employee to a trust which is part of a qualified cash or deferred arrangement (as defined in 26 U.S.C. § 401(k)(2), or 5 U.S.C. § 8437) under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash and contributions made by an employer for an employee for an annuity contract, which contributions would be excludable from the gross income (for federal income tax purposes) of the employee in accordance with the provisions of 26 U.S.C. § 403(b). The limitations imposed by 26 U.S.C. § 402(g) shall apply for purposes of this paragraph;

"k. Amounts that an employee is allowed to exclude from gross income for federal income tax purposes pursuant to 26 U.S.C. § 125 (relating to cafeteria plans) and 26 U.S.C. § 132 (relating to certain fringe benefits); and

"l. Amounts paid or incurred by an employer on behalf of an employee if the amounts may be excluded from gross income for federal income tax purposes by an employee pursuant to 26 U.S.C. § 129 (relating to dependent care expenses).

"<u>m. Contributions made on or after January 1, 2017, to a Defined Benefit Plan, pursuant to 26 USC 414(j), which is any plan that is not a defined contribution plan.</u>

"(4) The term "gross income," in the case of a resident individual, includes income from sources within and outside Alabama, including without limitation, the resident's proportionate share of any income arising from a Subchapter K entity, Alabama S corporation, or estate or trust, regardless of the geographic source of the income. The term gross income, in the case of a nonresident individual, includes only income from property owned or business transacted in Alabama. For purposes of this article, proportionate share shall be defined by reference to (i) the status of the individual owner as a partner or member of a Subchapter K entity, shareholder of an Alabama S corporation, or beneficiary of an estate or trust, and (ii) the allocable interest in that entity owned by the individual.

"§40-18-19.

"(a) The following exemptions from income taxation shall be allowed to every individual resident taxpayer:

"~~(1) Retirement allowances, pensions and annuities, or optional allowances, approved by the Board of Control of the Teachers' Retirement System of Alabama, which exempt status is set out in Section 16-25-23.~~

"~~(2) Retirement allowances, pensions and annuities or optional allowances, approved by the Board of Control of the Employees' Retirement System of Alabama, which exempt status is set out in Section 36-27-28.~~

"~~(3) The first eight thousand dollars ($8,000) of any retirement compensation, retirement allowances, pensions and annuities, or optional allowances, received by any eligible firefighter, as defined in Sections 36-32-1 and 36-32-2, or his or her designated beneficiary, from any firefighting agency established in the State of Alabama, but only if such retirement compensation, retirement allowances, pensions and annuities, or optional allowances as are awarded as a result of fire protection services rendered. This subdivision shall become effective for the taxable years beginning January 1, 1987, and thereafter following its passage and approval by the Governor, or upon its otherwise becoming a law; provided, that for the taxable years beginning on or after January 1, 1991, all of the pension and retirement payments shall be exempt from taxation.~~

"~~(4) The first eight thousand dollars ($8,000) of any retirement compensation, retirement allowances, pensions~~

~~and annuities, or optional allowances received by any eligible peace officer, as defined in subsection (11) of Section 36-21-60, or his or her designated beneficiary, from any police retirement system established in the State of Alabama, but only if the retirement compensation, retirement allowances, pensions and annuities, or optional allowances are awarded as a result of police services rendered. This subdivision shall become effective for taxable years beginning January 1, 1984, and thereafter; provided, that for the taxable years beginning on or after January 1, 1991, all of the pension and retirement payments shall be exempt from taxation.~~

"~~(5) Income received as annuities under the United States Retirement System from the United States Government Civil Service Retirement and Disability Fund including income received from the Tennessee Valley Authority's pension system, income received as annuities under the United States Foreign Service Retirement and Disability Fund or income received from any other United States government retirement and disability fund.~~

"~~(6) Beginning January 1, 1991, all payments made on or after such date to a retiree or his designated beneficiary under a "defined benefit plan," as defined under Section 414(j) of the Internal Revenue Code of 1986, as amended from time to time, to the extent such payment would be taxable for federal income tax purposes.~~

"(1) Up to $50,000 of income from pensions and annuities for an individual taxpayer. If the taxpayer is married and filing a joint tax return and both taxpayers receive pension and annuity income, then both taxpayers shall be allowed the deduction; and

"(2) An allowance for the recapture of any basis, not previously recovered, in reporting distributions from a Defined Benefit Plan. A defined benefit plan shall have the same meaning as described in 26 USC 414 (j), which is any plan that is not a defined contribution plan.

"(i) A taxpayer's total basis includes any contributions made by the employee, after tax, not including interest. Contributions made on behalf of the employee can not be included in the taxpayer's basis.

"(ii) Taxpayers will be allowed a basis recovery period, not to exceed 60 months, up to a maximum recovery of 20% per year. Participants in a Deferred Retirement Option Plan, as defined in section 36-27-170, Code of Alabama 1975, do not qualify for this exemption as payments previously made into a Deferred Retirement Option Plan fund represent a recovery of the retiree's basis.

"(iii) Distributions above a taxpayer's basis are includable in gross income.

"~~(7)~~ (3) Net income realized by individuals and partnerships from time to time in the business of conducting a financial business employing moneyed capital coming into competition with the business of national banks, but only if such individuals and partnerships are subject to an excise tax imposed by this state on or with respect to such income.

"~~(8)~~ (4) In the case of a single person or a married person not living with husband or wife, a personal exemption of one thousand five hundred dollars ($1,500) or, in the case of a head of a family or a married person living with husband or wife, a personal exemption of three thousand dollars ($3,000), but a husband and wife living together shall receive only one personal exemption of three thousand dollars ($3,000) against their aggregate income, and in case they make separate returns each must claim a personal exemption of one thousand five hundred dollars ($1,500).

"~~(9)~~ (5) a. Three hundred dollars ($300) for each person, other than husband or wife, dependent upon the taxpayer, and over half of whose support, for the calendar year in which the taxable year for the taxpayer begins, was received from the taxpayer.

"b. For tax years beginning after December 31, 2006, for taxpayers with adjusted gross income equal to or less than $20,000, one thousand dollars for each person other than husband or wife, dependent upon the taxpayer, and over half of whose support, for the calendar year in which the taxable year for the taxpayer begins, was received from the taxpayer.

"c. For tax years beginning after December 31, 2006, for taxpayers with adjusted gross income in excess of $20,000 and equal to or less than $100,000, five hundred dollars for each person other than husband and wife, dependent upon the taxpayer, and over half of whose support, for the calendar year in which the taxable year for the taxpayer begins, was received from the taxpayer.

"For the purposes of this section, "dependent" shall mean: A son or daughter of the taxpayer or a descendant of either; a stepson or stepdaughter of the taxpayer; a brother, sister, stepbrother, or stepsister of the taxpayer; the father or mother of the taxpayer or an ancestor of either; a stepfather or stepmother of the taxpayer; a son or daughter of a brother or sister of the taxpayer; a brother or sister of the father or mother of the taxpayer; a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer. As used in this paragraph the terms "brother" and "sister" include a brother or sister by the half blood. For the purpose of determining whether any of the foregoing relationships exist, a legally adopted child of a person shall be considered a child of such a person by blood.

"~~(10)~~ (6) Beginning January 1, 1998, all income, interest, dividends, gains, or benefits of any kind received from savings accounts or prepaid tuition contracts administered under Title 16, Chapter 33C, are exempt from all income taxation by the state and by all of its political subdivisions to the extent that the amounts remain on deposit in the PACT Trust Fund or the ACES Trust Fund, or are used to pay the designated beneficiary's qualified higher education expenses as defined in Section 529 of the Internal Revenue

Code of 1986, as amended, or are refunded under such terms as would not carry a penalty under Section 529 of the Internal Revenue Code of 1986, as amended.

"~~(11)~~ (7) Beginning January 1, 2016, all income, interest, dividends, gains or benefits of any kind received from ABLE savings accounts administered under Title 16, Chapter 33C, are exempt from all income taxation by the state and by all of its political subdivisions to the extent that the amounts remain on deposit in the ABLE Trust Fund, or are used to pay the designated beneficiary's qualified disability expenses as defined in Section 529A of the Internal Revenue Code of 1986, as amended, or are refunded under such terms as would not carry a penalty under Section 529A of the Internal Revenue Code of 1986, as amended, or other applicable federal law.

"(b) Of the following personal exemptions allowed resident taxpayers, each nonresident individual taxpayer shall be allowed that proportion thereof that the adjusted gross income received by said nonresident individual taxpayer from sources within the State of Alabama bears to his or her adjusted gross income received from sources within and without the State of Alabama: In the case of a single person or a married person not living with husband or wife, a personal exemption of one thousand five hundred dollars ($1,500) or, in the case of a head of a family or a married person living with husband or wife, a personal exemption of three thousand dollars ($3,000), a husband and wife living together shall receive but one personal exemption of three thousand dollars ($3,000) against their aggregate income; and, in case they make separate returns, each must claim a personal exemption of one thousand five hundred dollars ($1,500); and the amount in subdivision (9) of subsection (a) for each person, other than husband or wife, dependent upon and receiving his chief support from the taxpayer."

Section 2. Section 40-18-20 is hereby repealed.

Section 3. The provisions of this act are severable. If any part of this act is declared invalid or unconstitutional, that declaration shall not affect the part which remains.

Section 4. All laws or parts of laws which conflict with this act are hereby repealed.

Section 5. This act shall become effective on the taxable years beginning after December 31, 2015 and following its passage and approval by the Governor, or upon its otherwise becoming law.