FYI – For Your Information

Pension/Annuity Subtraction

GENERAL INFORMATION

Colorado allows a pension/annuity subtraction for:

• taxpayers who are at least 55 years of age as of the last day of the tax year;

• beneficiaries of any age (such as a widowed spouse or orphan child) who are receiving a pension or annuity because of the death of the person who earned the pension.

This subtraction allows all or a portion of pension and annuity income taxable on the federal return to be exempt from Colorado tax. [§39-22-104(4)(f), C.R.S.]

AMOUNT OF SUBTRACTION

Qualified taxpayers who are under age 65 as of the last day of the tax year can subtract the smaller of:

- $20,000, or
- the taxable pension/annuity income included in federal taxable income.

Taxpayers who are 65 years of age or older as of the last day of the tax year can subtract the smaller of:

- $24,000, or
- the taxable pension/annuity income included in federal taxable income.

Each spouse must qualify by age to claim the pension subtraction. Each spouse's subtraction is computed separately and no part of one spouse's $20,000 or $24,000 subtraction may be claimed by the other.

QUALIFYING INCOME

To qualify for the subtraction, a payment must be:

- pension or annuity income that is not considered a premature distribution, and
- reported on the federal return as taxable IRA distributions, pension and annuities, or social security benefits (lines 15b, 16b, or 20b of 2007 federal form 1040, lines 11b, 12b, or 14b of 2007 federal form 1040A), or reported as a lump sum distribution on line 3 of Colorado Form 104.

This includes the following:
1) a retirement benefit that is a periodic payment (made at least annually) attributable to personal services performed by an individual prior to his retirement from employment and which arose from:

a) an employer-employee relationship;

b) service in the uniformed services of the United States;

c) contributions to a retirement plan that are deductible (deferred) for federal income tax purposes.

2) a lump sum distribution from a pension or profit sharing plan to the extent such distribution qualifies for the federal tax averaging computation;

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3) a distribution from an individual retirement arrangement or a self-employed retirement account to the extent such distribution is not deemed to be a premature distribution for federal income tax purposes (A premature distribution is one on which the taxpayer is required to pay a federal penalty tax);

4) amounts received from a privately purchased (non-employment related) annuity;

5) Social Security benefits.

Premature distributions, regardless of the source, do not qualify for the subtraction.

EXAMPLE

Joseph (age 66) and Catherine (age 63) receive social security benefits of $20,000, $6,000 of which was taxable on their joint federal return. Joseph received $12,000 of the benefits while Catherine received $8,000. Catherine also earned a private pension of $22,000, $18,000 of which was taxable on the federal return.

• Joseph's pension subtraction is computed by taking his share of the total Social Security benefits paid times the taxable benefits (60% of $6,000), which is $3,600.
• Catherine's pension subtraction is computed by taking her share of the Social Security benefits times the taxable benefits (40% of $6,000) and adding her taxable private pension ($18,000), which is $20,400. Because Catherine is under age 65 her subtraction is limited to $20,000.

EXPANDED INFORMATION FOR CERTAIN BENEFITS

457 Plan Benefits

An eligible section 457 plan distribution is reported on Form 1099-R and is reported as an annuity on the federal return. The distribution will qualify for the state pension/annuity subtraction to the extent it is included in federal taxable income.

Benefits Received Due to the Death of the Person Who Earned the Pension

A $20,000 pension/annuity subtraction is available to taxpayers under the age of 55, but only to beneficiaries (such as widowed spouse or orphaned child) who receive eligible pension or annuity income because of the death of the person who earned the pension. The beneficiary does not have to be related to the decedent to qualify for the subtraction and there is no requirement that the deceased be 55 or older.

Disability Retirement Benefits

Disability retirement payments received by persons 55 years of age or older qualify for the pension subtraction even if such payments may be reported as wages for federal income tax purposes. Disability retirement payments received by persons under 55 years of age **do not** qualify for the pension subtraction.

Nonqualified Deferred Compensation Benefits

Nonqualified deferred compensation payments received by persons 55 years of age or older qualify for the pension subtraction even if such payments may be reported as wages for federal income tax purposes to the extent they qualify as retirement income under 4 USC Section 114(b)(I).

PERA or Denver Public Schools Retirement Benefits

Recipients of retirement benefits from:

- Public Employees Retirement Association (PERA) who worked for the state of Colorado in 1984, 1985 or 1986, or
- Denver Public Schools who worked for DPS in 1986

may be able to deduct additional retirement income over that available from the pension/annuity subtraction. This one time subtraction is reported on the "other subtractions" line of the Colorado individual income tax Form 104. Additional information is available in FYI Income 16.

Railroad Retirement Benefits

Railroad retirement benefits (Tier 1 and Tier 2) and disability payments are exempt from state taxation under Section 231m of the Railroad Retirement Act. To the extent included in federal taxable income, railroad retirement benefits are subtracted on the "other subtractions" line of the Colorado Individual Income Tax Form 104. Claiming a subtraction for railroad retirement benefits does not use up any of the pension subtraction. The limitations of 55 years of age and a pension subtraction of $20,000/$24,000 do not apply to railroad retirement beneficiaries.

Roth IRA Rollovers

When a traditional IRA is rolled over into a Roth IRA, the roll over amount is included in federal adjusted gross income as an IRA distribution. This income qualifies for the pension subtraction in the year the amount is included in the federal adjusted gross income if the taxpayer is over 55 as of December 31 of that year. This is true whether the roll over is reported in full in the year of the conversion or reported over a four-year period.

Social Security Benefits

Only the taxable portion of Social Security benefits qualifies for the pension/annuity subtraction. If a married couple both receive Social Security benefits during the year, see FYI Income 18 for information on determining how much to subtract for each spouse.

Trusts/Estates

The pension/annuity subtraction is available to trusts and estates to the extent the amount is received as a result of the death of the person who earned the pension/annuity. The amount of the subtraction is the smaller of $20,000 or the taxable pension/annuity income that is not distributed to the beneficiaries of the trust or estate.

Each beneficiary who receives pension/annuity income distributed from the trust or estate will be eligible for a separate pension/annuity subtraction of $20,000 if the amount is received as a result of the death of the person who earned the pension/annuity.

FURTHER INFORMATION

For more information on related topics, consult the following DOR publications:

- FYI Income 18 "Pension Subtraction For Married Couples When Both Spouses Receive Social Security";
- FYI Income 16 "Subtraction from Income for Recipients of PERA or Denver Public Schools Retirement Benefits."

FYIs, commonly used forms and additional tax information are available on the Web at *www.taxcolorado.com*

For additional Colorado tax information visit the "Tax Information Index" which covers a variety of topics including links to forms, publications, regulations, statutes and general questions and answers. The "Tax Information Index" is located at *www.taxcolorado.com*

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