

State Tax Conformity Update

Here is the latest on the issue of state tax conformity with the retirement provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Please note that *only* nonconforming states (or states previously considered to be nonconforming) are listed below - For all other states, either they automatically conform with EGTRRA or conformity was never an issue (e.g. the state does not have an income tax). Note that by 'nonconforming,' we mean those states whose income tax codes generally track the definition of income provided by the federal Internal Revenue Code but need to be updated for changes made at the federal level. Some states, notably Pennsylvania and New Jersey, generally do not track the federal tax code and therefore are not included in this list. This list focuses only on the retirement savings provisions of EGTRRA and may not track conformity with other provisions of EGTRRA such as estate tax repeal.

Arizona - Arizona is a conforming state! Arizona's EGTRRA conformity bill, H.B. 2712, passed both houses of the Arizona legislature and was signed by Governor Hull on June 4 (H.B. 2712 is the same as the other conformity bill, S.B. 1071, that previously was approved by the full state Senate on March 21).

Arkansas - The Arkansas state legislature does not convene until 2003. However, the Arkansas Department of Finance and Administration (DFA) anticipates that the General Assembly will retroactively adopt these provisions early during the 2003 legislative session. As a result, DFA has developed the following plan to address conformity to federal tax law changes: 2002 state income tax forms will be revised to accommodate the retroactive adoption of these recent federal law changes; there will be an aggressive taxpayer education program; the state will inform taxpayers and tax professionals that the 2003 General Assembly may adopt retroactively these federal law changes early in the 2003 legislative session; the state will encourage taxpayers and tax professionals to refrain from filing their 2002 tax returns until the General Assembly has addressed these federal law changes; DFA will prepare a conformity bill that can be pre-filed and be ready for consideration early in the 2003 legislative session; and, if the General Assembly determines that certain provisions of the new federal law should not be adopted retroactively, DFA will abate interest and penalty assessed against taxpayers who followed the federal law changes when preparing their return.

California - California is a conforming state! On May 8, Governor Davis signed into law the two conformity bills, S.B. 657 and A.B. 1122. To offset the

estimated revenue cost of conformity, the bills eliminate the business deduction for employee compensation in excess of \$1 million, eliminate deductions for business club dues, require taxpayers electing Subchapter S or Subchapter C corporate elections on federal forms to make the same elections on state tax returns and accelerate estimated tax payments by requiring payment of 90 percent of estimated taxes rather than the current 80 percent.

Georgia - Georgia is a conforming state! House Bill 1026, which would update the Georgia Public Revenue Code to reference the Internal Revenue Code as enacted or in existence as of January 1, 2002, was signed into law on April 18.

Hawaii - Senate Bill 2824, which would conform the Hawaiian income tax code to the Internal Revenue Code in existence as of December 31, 2001, was approved by the Hawaii legislature on May 2 and was sent to the governor on May 7.

Idaho - Idaho is a conforming state! House Bill 492 was signed by the governor on March 4. The bill amends the state tax code to refer to the Internal Revenue Code in existence as of January 1, 2002.

Indiana - Indiana is a conforming state! Conformity legislation - House Bill 1195 (which included the original conformity bill, H.B. 1356) - was approved by the Governor on March 28.

Iowa - Iowa is a conforming state! House File 2116, providing for full conformity to the changes made by EGTRRA by conforming to the Internal Revenue Code as of January 1, 2002, was signed by the Governor into law on April 4.

Kentucky - Kentucky is a conforming state! On April 24, Governor Patton signed into law the Kentucky conformity bill, H.B. 457.

Maine - Maine is a conforming state! On March 25, Maine Governor King signed L.D. 2080, a supplemental budget law that included state tax conformity.

Massachusetts - The Massachusetts Department of Revenue (MDOR) on May 10 issued Technical Information Release (TIR) 02-6 on the tax consequences of EGTRRA nonconformity for plan sponsors and participants who live in Massachusetts. The TIR makes clear that federal law determines the qualified status of a plan and that Massachusetts will not challenge the qualified status of a plan that takes advantage of EGTRRA's provisions. In

addition, gross income for Massachusetts tax purposes will include any deferral that exceeds the limits under the 1998 version of the Internal Revenue Code (Code), adjusted for inflation. The MDOR has determined that the 401(k) deferral limit is \$11,000 for 2002, the same amount as set by EGTRRA. Massachusetts does not recognize catch-up contributions under the new Code section 414(v). Massachusetts may be forced to pay state taxes on rollovers that were not permitted prior to EGTRRA but only if the amount was first distributed to the participant and then rolled over within the 60-day time limit. TIR 02-6 may be obtained at www.dor.state.ma.us/rul_reg/.

On March 1, the MDOR released an analysis of the impact of conformity with the changes made by EGTRRA. The midpoint estimate for conformity cost is \$6.4 million in 2002, with the cost increasing to \$27.5 million for 2009.

On April 29, Massachusetts Senator Robert O'Leary has introduced legislation, which would provide for full EGTRRA conformity for Massachusetts taxpayers. Senate Bill 2339, "An Act Enabling Retirement and College Education Savings In Conformity with Federal Law," enjoys the support of many Massachusetts legislators, and the next step for SB 2339 is a public hearing before the Taxation Committee. The biggest hurdle to passage of SB 2339 is its cost. The Massachusetts Department of Revenue is currently reviewing its original cost estimate of \$20 million over the next two fiscal years, and it may revise its cost estimate downwards.

The Massachusetts corporate excise tax provisions automatically conform to changes in the federal tax law. In addition, for Massachusetts state income tax purposes, the current version of the Internal Revenue Code applies to Roth IRAs, Coverdell Education Savings Accounts, and the Massachusetts Government Employees' Deferred Compensation Plan. Finally, the Massachusetts Department of Revenue has taken a very favorable approach to direct rollovers after EGTRRA, as more fully described in the draft Technical Information Release, which it issued on December 28, 2001. Accordingly, SB 2339 is targeted at the following four areas:

1. Age 50 and over catch-up contributions
2. 401(k) and 403(b) contribution limit consistency
3. Full rollover portability, and
4. Tax-free college savings plan distributions

Minnesota - Minnesota is a conforming state! There were some conflicting reports with regard to Minnesota, but we now understand that the Governor signed conformity legislation, H. 1, into law last June. The Minnesota tax

laws would follow the Internal Revenue Code as amended through June 15, 2001.

North Carolina - The General Assembly will not consider the conformity issue until it reconvenes on May 23, but key legislators expressed doubts about the importance of conformity because of budgetary pressures. However, the North Carolina Department of Revenue announced on April 19 its support for conformity legislation and provided guidance on dealing with differing federal and state treatment of retirement contributions. The department stated that it would revise state tax forms and waive penalties in certain cases.

South Carolina - South Carolina is a conforming state! On April 22, the governor approved H. 4695, which provides for the conformity of the South Carolina tax code to the federal tax code.

West Virginia - West Virginia is a conforming state! On March 7, Governor Wise signed into law S. 140, which amends the state tax code to conform to the Internal Revenue Code as amended through December 31, 2001.

Wisconsin - Legislation bringing Wisconsin in line with the pension and IRA changes made by EGTRRA is currently tied up in a budget reform bill that is the subject of a legislative conference. There is little current information as to whether or when such legislation will pass, and news reports indicate that legislators have met for five weeks in trying to address a budget shortfall but have made little progress in resolving differences. Separately on May 16, the Wisconsin Department of Revenue and the Department of Employee Trust Funds issued a recommendation to the legislature that Wisconsin conform to the changes made by EGTRRA. Previously, Governor McCallum announced his support for conformity legislation on January 23.

Note: Virginia Gov. Warner April 2 signed a bill (S.B. 121) that brought the commonwealth's retirement law into compliance with certain provisions of EGTRRA. Previously, Virginia did not permit trustee-to-trustee transfers or rollovers that would match Internal Revenue Code Section 401(a). The measure, effective July 1, also increased the maximum creditable compensation used for computing benefits from \$160,000 to \$200,000 for calendar quarters beginning July 1, 2001.

For more information, contact John C. Scott, the Council's director, retirement policy, at jscott@abcstaff.org or at (202) 289-6700.