# Retirement Income

OREGON DEPARTMENT OF REVENUE

## Introduction

This information will help you decide how to report your pension or annuity income on your Oregon income tax return. It will also explain the retirement income credit. Although pensions and annuities are different, the term "pension" is used here to describe both.

Read one of the following federal publications to determine how to report your pension. Pamphlets are available from the Internal Revenue Service. Call toll-free 1-800-TAX-FORM (1-800-829-3676). Or, visit the IRS Web site at www.irs.gov.

Publication 17, *Your Federal Income Tax*.
Publication 524, *Credit for the Elderly or the Disabled*.
Publication 575, *Pension and Annuity Income*.
Publication 590, *Individual Retirement Arrangements (IRAs)*.
Publication 721, *Tax Guide to U.S. Civil Service Retirement Benefits*.

## What is taxable?

Federal income tax rules generally determine the amount of your pension that is taxed by Oregon. However, you may subtract some pensions on your Oregon return that were taxed on your federal return.

These pensions are **not taxed** by Oregon:

- Social Security benefits.
- Veterans Administration benefits.
- Railroad Retirement Board benefits.

Oregon allows a subtraction for part or all of the payments you receive from the federal pension system. See page 4.

**Residents.** Generally, retirement income is subject to Oregon tax when received by an Oregon resident. This includes non-Oregon source retirement income. However, see "Previously taxed employee retirement plans," "Previously taxed IRA conversions," and "Federal government pension income" in this circular for exceptions.

**Nonresidents.** Retirement income received by nonresidents is not subject to taxation by Oregon. This applies to most forms of retirement income, including: public pension plans, corporate retirement plans, Keogh plans, SEPs, and IRAs.

***Retirement income* means income from:**

- Qualifying employer pension and profit sharing plans exempt from tax under Internal Revenue Code (IRC) Section 401(a).
- Annuity plans [IRC Sec. 403(a) and IRC Sec. 403(b)].
- Cash or deferred compensation arrangements [IRC Sec. 401(k) plans and IRC Sec. 457 plans].
- Simplified employee pension plans [IRC Sec. 408(k)].
- Individual retirement arrangements [IRC Sec. 408(a) and IRC Sec. 408(b)].
- Plans for federal, state, or local government employees [IRC Sec. 414(d)].
- Pay for uniformed service members under chapter 71 of Title 10 of the United States Code.
- Trusts that were created before June 25, 1959 [IRC Sec. 501(c)(18)].

Retirement income may include payments received after termination of employment. The payment must be made under a plan, program, or arrangement maintained solely for the purpose of providing retirement benefits that exceed the amounts allowed under the qualified retirement plans described above.

Payments received from nonqualified deferred compensation plans [as described in IRC Sec. 3121(v)(2)(C)], qualify if the payments are:

- Part of a series of substantially equal periodic payments made for the life or life expectancy of the recipient, or
- For a period of at least 10 years.

**Retirement income does not include** income received from:

- Stock options;
- Restructured stock plans;

- Severance plans; or
- Unemployment benefits.

**Taxpayers who have Oregon as their domicile** are taxed as residents, unless they meet the requirements to be taxed as nonresidents. To be taxed as a nonresident, you must meet all of the following requirements:

- You do not maintain a permanent residence in Oregon for yourself or for your family during any part of the year, and
- You maintain a permanent residence outside Oregon during the entire year (a recreational vehicle [RV] is not considered a permanent residence outside of Oregon), and
- You spend less than 31 days of the year in Oregon.

Being taxed as a nonresident means that income earned **outside** Oregon will not be taxed by Oregon. Generally, interest and dividend income will **not** be taxed by Oregon. Income earned in Oregon or sourced to Oregon will still be taxed by Oregon.

Individuals who have Oregon as their domicile are taxed on Oregon source retirement income even if they qualify for nonresident status as explained above.

**Example 1:** Douglas has always resided and worked in Oregon. On March 4, 2003, he retired, sold his Oregon residence, and began to travel throughout the United States. He did not acquire another residence outside Oregon. He receives an Oregon-sourced pension and interest income.

Douglas has not given up his Oregon driver's license. His vehicles are registered with the state of Oregon. He has not changed his voter registration to another state.

Douglas has not shown an intent to give up Oregon as his home. Based on these facts, he is domiciled in Oregon. Oregon will tax his income from all sources.

## Previously taxed employee retirement plans

Oregon allows residents to subtract payments from an individual retirement account (IRA), Keogh plan, Simplified Employee Pension (SEP) plan, and certain government plans if the contributions or a portion of the contributions to the plan have already been taxed by another state. The payments must be included in federal adjusted gross income. **All** of the following conditions must be met for the contributions to qualify:

- Payments consist of contributions made while a nonresident of Oregon.
- No previous state income tax deduction, exclusion, or exemption was allowed or allowable at the time the contributions were made.
- No previous state income tax deduction, exclusion, credit, subtraction, or other tax benefit has been allowed for the payments.
- Payments must have been taxed by another state.

The subtraction continues until all qualifying contributions are recovered.

**Example 2:** Mildred lived in California. From 1980 to 1996 she contributed to an IRA. In 1980 and 1981 she contributed $1,500 each year. From 1982 through 1996 she contributed $2,000 each year.

Both federal and California allowed a maximum deduction of $1,500 for 1980 and 1981. For 1982 through 1986, federal allowed a maximum of $2,000, and California allowed a maximum of $1,500. Both federal and California allowed a maximum of $2,000 for 1987 through 2001.

Mildred contributed $2,500 ($500 × 5 years, 1982–1986) for which no deduction was allowed on her California returns.

Mildred retired and moved to Oregon in June 2003. She receives payments of $350 a month from the California IRA. These payments are subject to tax by Oregon because she is now an Oregon resident. However, Oregon will allow Mildred to subtract the contributions that California has already taxed ($2,500).

Mildred received seven payments of $350 in 2003 for a total of $2,450. Mildred can subtract the entire $2,450 for 2003. In 2004, she will receive 12 payments of $350 for a total of $4,200. Mildred will be able to subtract the balance of $50 ($2,500 – 2,450). From that point on, no subtraction is allowed on the Oregon return for recovery of contributions.

**Example 3:** Use the same facts as in Example 2, except Mildred lived and worked in Washington before moving to Oregon. When she made contributions, Mildred was allowed a federal deduction each year; however, she did not receive a state tax deduction, because Washington does not impose an income tax. After retiring and moving to Oregon, Mildred receives the same payments as above. She does not qualify for the Oregon subtraction because she made her contributions during her residency in a state that does not impose an income tax.

## Previously taxed IRA conversions

Oregon allows a subtraction for amounts included in income from the conversion of a traditional IRA to a Roth IRA when the amount has been previously taxed by another state.

**Example 4:** Susan lived in New York in 2003. In March, she converted her $40,000 traditional IRA to a Roth IRA.

In September, she moved to Oregon. New York state will tax her IRA when she becomes a nonresident even though the account has not yet been distributed. Susan can subtract the amount included in federal income when she files her 2003 Oregon tax return.

## U.S. government interest in IRA or Keogh distribution

Interest and dividends on U.S. bonds and notes are exempt from state tax. Answer the questions below to determine if you have a subtraction on your Oregon return for exempt income related to your retirement distributions.

1. Did you have any distributions from a self-employed retirement plan or an individual retirement account (IRA)?
2. Was any part of your self-employed retirement plan or your IRA invested in U.S. bonds and notes?
3. Did you include your self-employed retirement plan or IRA distribution in your 2003 federal adjusted gross income (AGI)?

If you answered "yes" to **all** of the questions above, you will have an "other subtraction" on your Oregon return for the retirement plan exempt earnings included in your distribution.

Use the worksheet below to calculate your subtraction.

### Worksheet

| | |
|---|---|
| 1. Total account balance at year end. | 1. _______ |
| 2. Add current year distributions. | 2. _______ |
| 3. Line 1 plus line 2. | 3. _______ |
| 4. Total exempt earnings on account at year end. | 4. _______ |
| 5. Total exempt part of distributions from all prior years. | 5. _______ |
| 6. Line 4 minus line 5, but not less than zero. | 6. _______ |
| 7. Line 6 divided by line 3. Oregon exempt ratio. | 7. _______ |
| 8. Line 2 multiplied by line 7. Oregon exempt portion of current year's distribution. | 8. _______ |

**Example 5:** Donna retired and began to take distributions of $10,000 each year from her IRA. The IRA was always invested solely in U.S. government securities. Donna uses the following information to calculate her subtraction for years 1 and 2:

| | **Year 1** | **Year 2** |
|---|---|---|
| Current year earnings | $4,000 | $5,000 |
| Current year distribution | $10,000 | $10,000 |
| Account balance at 12/31 | $100,000 | $95,000 |
| Total exempt earnings on account at 12/31 | $ 40,000 | $45,000 |

| **Worksheet** | **Year 1** | **Year 2** |
|---|---|---|
| 1. Total account balance at year end. | $100,000 | $95,000 |
| 2. Add current year distribution. | + 10,000 | + 10,000 |
| 3. Line 1 plus line 2. | $110,000 | $105,000 |
| 4. Total exempt earnings on account at year end. | $ 40,000 | 45,000 |
| 5. Total exempt part of distributions from all prior years. | -0- | 3,636 |
| 6. Line 4 minus line 5, but not less than zero. | $40,000 | $41,364 |
| 7. Line 6 divided by line 3. Oregon exempt ratio. | .3636 | .3939 |
| 8. Line 2 multiplied by line 7. Oregon exempt portion of current year's distribution. | $3,636 | $ 3,939 |

## Federal pension income

You may be able to subtract some or all of your taxable federal pension included in 2003 federal income. This includes benefits paid to the retiree or to the beneficiary. The subtraction amount is based on the number of months of federal service before and after October 1, 1991:

- If all of your months of federal service occurred before October 1, 1991, subtract 100 percent of the taxable amount of federal pension income you reported on your federal return.
- If you have no months of service before October 1, 1991, you cannot subtract any federal pension.
- If your service was both before and after October 1, 1991, you will subtract a percentage of the taxable federal pension income you reported on your federal return. To determine your percentage, divide your months of service before October 1, 1991, by your total months of service. Once you have determined the percentage, it will remain the same from year to year.

**Example 6:** Elmo worked for the U.S. Department of Agriculture from April 25, 1973, until April 24, 2003. He worked a total of 360 months, of which 221 months were worked before October 1, 1991. In 2003, he received federal pension income of $22,000. He can subtract 61.4 percent (221 ÷ 360) or $13,508 (.614 × $22,100) of his federal pension. He will continue to subtract 61.4 percent of his federal pension from Oregon income in future years.

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Use this worksheet to determine your subtraction amount:

1. Federal pension income included in federal AGI. 1. ___________

2. a. Months of service from _______ (fill in federal service start date) to October 1, 1991. a. _____ months*

   b. Months of service from _______ (fill in federal service start date) to _______ (fill in federal service retirement date). b._____ months**

   Divide the number of months on line a by the total number of months on line b. Round the decimal to three places. Enter here. This is your federal pension subtraction percentage. 2. ___________

3. Multiply line 1 by the decimal on line 2. This is your federal pension subtraction. 3. ___________

* *If your federal service start date was the 1st through the 15th of a month, include the entire month when counting the months of federal service.*

*If your federal service start date was the 16th through the end of a month, do not include the first partial month of service. Start counting the months of federal service with the first full month of service.*

** *If your federal service retirement date was the 1st through the 15th of a month, do not count this final partial month when counting the total months of federal service.*

*If your retirement date was the 16th through the end of the month, include the entire month when counting the total months of federal service.*

**Example 7:** Dinah served in the U.S. Army from November 2, 1981, through January 5, 2003. She received $15,000 in pension benefits in 2003. The following worksheet shows how Dinah will determine her federal pension subtraction for 2003.

| | | | |
|---|---|---|---|
| 1. | Federal pension income included in federal AGI. | | 1. $15,000 |
| 2. | a. Months of service from November 2, 1981, to October 1, 1991. | a. 119 months | |
| | b. Months of service from November 2, 1981, to January 5, 2003. | b. 254 months | |
| | Divide the number of months on line a by the total number of months on line b. Round the decimal to three places. This is your federal pension subtraction percentage. | | 2. .469 |
| 3. | Multiply line 1 by the decimal on line 2. This is your federal pension subtraction. | | 3. $7,035 |

**Nonresidents.** Claim a subtraction for federal pension income only if you reported it on the Oregon return. Oregon does not tax the retirement income of nonresidents unless you have kept Oregon as your domicile. If your pension income is not taxable for federal purposes, do not include it in Oregon income.

## Retirement income tax credit

### Who may claim the credit?

If you were **age 62 or older** on December 31, 2003, and receiving taxable retirement income, you may qualify for a credit. Retirement income includes payments **included in Oregon taxable income** from:

- State or local government public pensions.
- Employee pensions.
- Individual retirement plans.
- Employee annuity plans.
- Deferred compensation plans including defined benefits, profit sharing, and 401(k)s.
- Federal pensions (includes military) not subtracted from Oregon taxable income.

### How do you qualify for the credit?

- Your household income is less than $22,500 ($45,000 if married filing jointly), **and**
- Your Social Security and/or tier 1 Railroad Retirement Board benefits are less than $7,500 ($15,000 if married filing jointly), **and**
- Your household income plus your Social Security and tier 1 Railroad Retirement Board benefits is less than $22,500 ($45,000 if married filing jointly.)

You may claim this credit or the credit for the elderly or the disabled, but not both.

### How much is the credit?

Use the following worksheet.

| | |
|---|---|
| 1. Enter the retirement income of the eligible individual(s) (Form 40, line 8; or Form 40P or 40N Oregon column, lines 16 and 17). | 1. _______ |
| 2. Enter any federal pension income subtracted from Oregon income. See page 4. | 2. _______ |
| 3. Net Oregon taxable pension. Line 1 minus line 2. | 3. _______ |
| 4. Enter $7,500 ($15,000 if married filing jointly). | 4. _______ |
| 5. Enter both spouses' total Social Security and tier 1 Railroad Retirement Board benefits. | 5. _______ |
| 6. Line 4 minus line 5, but not less than -0-. | 6. _______ |
| 7. Enter your **household income.** See the next section to determine household income. | 7. _______ |
| 8. Household income base. Enter $15,000 ($30,000 if married filing a joint return). | 8. _______ |
| 9. Line 7 minus line 8, but not less than -0-. | 9. _______ |

***Worksheet continued on next page***

10. Line 6 minus line 9, but not less than -0-. 10. _______

11. Enter the smaller of line 3 or line 10. 11. _______

12. Multiply line 11 by 9% (.09). 12. _______

This is your credit.

**No carryforward.** The credit cannot be more than your tax liability for Oregon. Any credit not used this year is lost.

## What is included in household income?

Household income generally includes all income (both taxable and nontaxable) of each spouse received during the year. Include gross income reduced by adjustments as reported in your federal adjusted gross income (AGI).

You also need to include items not in your federal AGI. These items include but are not limited to:

- Veteran's and military benefits.
- Gifts and grants (total amount minus $500).
- Disability pay.
- Nontaxable dividends (other than "return of capital" dividends).
- Inheritance.
- Insurance proceeds.
- Nontaxable interest.
- Lottery winnings.
- Railroad Retirement Board benefits (tier 2 only).
- Scholarships.

**Do not include:**

- Social Security and tier 1 Railroad Retirement Board benefits.
- Your state tax refund.
- Pension income excluded from federal AGI that is a return of your contributions.
- Pensions that are rolled over into an IRA.

To determine household income, you must separate income (or loss) from businesses, farms, rentals or royalties, and dispositions of tangible or intangible property. Combine all income from similar sources to arrive at the net income or loss from that source. Any net loss from the source is limited to $1,000. Net operating loss carrybacks or carryforwards are not allowed. Capital loss carryforwards are not allowed.

**Example 8:** Jack owns a farm and has a $4,000 loss. He is also a partner in a partnership whose main activity is farming. Jack has income from the partnership of $1,500. His net farm loss is $2,500. He may claim only $1,000 of this loss to compute his household income. Any net loss Jack has from any of the other sources mentioned in the paragraph above is also limited to $1,000 each. If Jack is claiming more than a $1,000 loss on any line, he must attach a worksheet showing his computations.

If the combined total of your depreciation, depletion, and amortization deductions is more than $5,000, you must add back the excess into household income. You must also increase your household income by the Oregon income tax modification for depletion in excess of basis.

**Example 9:** Callie has a business with gross income of $31,200 for the year. She has a $9,000 depreciation deduction. Other business expenses are $24,650. She reports a business loss for federal purposes of $2,450. She recomputes her business income for household income purposes. The allowable depreciation deduction is $5,000. The business income she reports is $1,550, computed as follows: $31,200 – ($5,000 + $24,650) = $1,550.

## Questions?

**Telephone:** Salem ..................................503-378-4988
Toll-free within Oregon...1-800-356-4222

**TTY (hearing or speech impaired; machine only):** 503-945-8617 (Salem) or 1-800-886-7204 (toll-free within Oregon).

**Americans with Disabilities Act (ADA):** This information is available in alternative formats. Call 503-378-4988 (Salem) or 1-800-356-4222 (toll-free within Oregon).

**For general tax information:** www.dor.state.or.us

***Asistencia en español. Llame al 503-945-8618 en Salem o llame gratis al 1-800-356-4222 en Oregon.***