

**TESTIMONY OF
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DEPARTMENT OF ADMINISTRATIVE AND FINANCIAL SERVICES**

Before the Joint Standing Committee on Taxation
Hearing Date: *May 9, 2023*

LD 1774 – “*An Act Exempting Certain Emergency Distributions and Emergency Savings Accounts from Taxation*”

Senator Grohoski, Representative Perry, and members of the Taxation Committee – good afternoon, my name is Michael Allen, Associate Commissioner for Tax Policy in the Department of Administrative and Financial Services. I am testifying at the request of the Administration Against LD 1774, “*An Act Exempting Certain Emergency Distributions and Emergency Savings Accounts from Taxation.*”

The bill proposes two new income subtraction modifications from Maine adjusted gross income, to the extent included in federal adjusted gross income, equal to: (1) any distribution after December 31, 2023, for emergency personal expenses from an eligible retirement plan under the federal Secure 2.0 Act of 2022, Section 115; and (2) any capital gains, dividends, or interest earned in a pension-linked emergency savings account described under the federal Secure 2.0 Act of 2022, Section 127.

The Administration has proposed to conform to the federal Secure Act 2.0 in LD 7 (“*An Act to Update References to the United States Internal Revenue Code of 1986 Contained in the Maine Revised Statutes*”). This bill, LD 1774, on the other hand, would decouple from the federal treatment of these distributions and accounts. We estimate that the tax savings from this bill will be minimal and may create issues in later tax years by being out of conformity with federal tax law. In

general, conformity, especially with retirement provisions, are preferred for both the taxpayer and MRS.

Generally, distributions from an eligible retirement account are subject to federal and Maine income taxes, except that a pension-linked emergency savings account established under the federal Secure 2.0 Act of 2022 (Secure Act 2.0) is funded with after-tax contributions and withdrawals are generally tax free. Annual contributions to a pension-linked emergency savings account are generally limited to 3% of an employee's pay or \$2,500 (subject to an inflation adjustment after 2024), whichever is less.

For Maine tax purposes, retirement plan distributions included in federal adjusted gross income that are not subject to the federal 10% early distribution penalty under IRC Section 72(t) may be eligible for the pension income deduction under 36 M.R.S. § 5122(2)(M-2), in an amount up to \$30,000 for tax years beginning in 2023 and \$35,000 for tax years beginning on or after January 1, 2024.

For federal tax purposes, early distributions from a retirement plan and withdrawals from a pension-linked emergency savings account taken before age 59 1/2 are generally subject to the federal additional 10% early distribution penalty. However, the Secure Act 2.0 provides an exception to the 10% penalty for early distributions for emergency personal expenses after December 31, 2023, up to \$1,000 annually, and for withdrawals from a pension-linked emergency savings account funded with after-tax contributions for plan years beginning after December 31, 2023. There is no Maine income tax early distribution penalty.

The Administration notes the following technical concerns:

- Section 3 of the bill should be amended to include an application date for Section 2 of the bill.

- The bill should be amended to coordinate the income subtraction modifications with the Maine pension income deduction.

The estimated revenue impact of the bill is not currently available.

The estimated administrative costs are \$22,000 for fiscal year 2024-2025. One-time computer programming costs are included to add two additional lines on Form 1040ME, Schedule 1S, to update check stub messages and notices, to make federal tape changes, and to perform systems testing.

The Administration looks forward to working with the Committee on the bill; representatives from MRS will be here for the Work Session to provide additional information and respond in detail to the Committee's questions.