

Administrative Release No. 21

**Subject: Income Tax Treatment of Employee Contributions
under the Maryland Pension Pickup Program**

I. Background

Membership in the State Retirement and Pension Systems is required of all persons compensated by the state, all local employees of those municipal corporations that participate in the state systems, and all local employees holding a position eligible to be in the teacher systems. Only members of the General Assembly, officials of the Governor's Office, and certain other public officials have the option of whether or not they want to join the systems.

The Maryland State Teachers' Retirement System was created as of August 1, 1927, and its membership consists of all persons defined as "teachers" hired before January 1, 1980 (except those teachers at public higher education institutions who elected to participate in the Optional Retirement Program established in 1975). The State Employees' Retirement System was created as of October 1, 1941, and its membership consists of all permanent employees of the state of Maryland hired before January 1, 1980 (except those certain elected and appointed officials who elect not to participate) and all of the permanent employees of local governments and agencies that participate in the system. In this release, these systems will be referred to collectively as the "Retirement Systems." Members of the Retirement Systems contribute a portion of their salaries which, when added to their employers' contributions and the systems' investment earnings, funds the benefits of the state's plans.

As of January 1, 1980, to attain full actuarial funding, the state created the Pension System for Employees and the Pension System for Teachers (hereinafter referred to collectively as the "Pension Systems"), and closed membership in the Retirement Systems. Membership in the Teachers' Pension System consists of all persons defined as "teachers" hired on or after January 1, 1980 (except those participating in the Optional Program) and those members of the Teachers' Retirement System

who elected to transfer into the new Pension System. Membership in the Employees' Contributory Pension System consists of all permanent employees of the state hired on or after January 1, 1980, members of the Employees' Retirement System who elected to transfer into the new Pension System, and employees of participating "municipal corporations." Prior to 1998, this was a non-contributory system except for those members whose salaries exceeded the social security wage base. Those members made contributions only on that portion of their salaries in excess of that wage base.

Effective July 1, 1998, a mandatory 2% contribution of the member's earnable compensation is required for certain members of the Employees' Contributory Pension System and Teachers' Pension System.

In 2006, the legislature enacted House Bill 1737 (Chapter 110, Acts of 2006), which increased the amount of the mandatory contribution rate to the following amounts:

- 3% of the member's earnable compensation from July 1, 2006-June 30, 2007;
- 4% of the member's earnable compensation from July 1, 2007-June 30, 2008; and
- 5% of the member's earnable compensation from July 1, 2008 forward.

The mandatory contribution does not apply to: (1) an employee of a participating governmental unit that, on or before December 31, 1999 has not elected to provide the contributory pension benefit for its employees under § 31-116 of the State Personnel and Pensions Article; (2) an employee of a former participating governmental unit that has withdrawn; or (3) a member of the Employees' Pension System or Teachers' Pension System who transferred from the Employees' Retirement

System or Teachers' Retirement System after April 1, 1998.

In 1949, the State Police Retirement System was created for State police officers. In 1974 the State Judicial Pension Plan was set up. It is administered as a subsection of the Employees' Retirement System.

II. The "Pick-up" Law

In 1988, Governor Schaefer signed into law the Maryland Employer Pickup Program to enable members of the Retirement and Pension Systems to defer federal tax on their employee contributions. The legislation is effective for all taxable years beginning after December 31, 1988.

Under the Maryland Employer Pickup Program, each employer must apply for and receive a favorable ruling from the Internal Revenue Service for an employer pickup program in accordance with § 414(h)(2) of the Internal Revenue Code. On receipt of the favorable ruling, the employer obtains a start-up date for implementation of the employer's pickup program from the Board of Trustees of the Maryland State Retirement and Pension System. Thereafter, all employee contributions are covered by the employer's pickup program.

III. Who is Covered

Maryland law requires an addition modification and subsequent subtraction modification for pickup amounts in the following six state retirement systems: (1) Employees' Retirement System; (2) Employees' Contributory Pension System; (3) Teachers' Retirement System; (4) Teachers' Pension System; (5) State Police Retirement System; (6) Judges' Retirement System; and (7) Law Enforcement Officer's Pension System. The program does not apply to private employers.

Other pension plans eligible for pickup contributions include the Correctional Officers Retirement System, the Legislative Plan, and the Law Enforcement Officers Pension System.

Some local governments and agencies, for example, the Baltimore City Fire and Police Departments, have their own pickup programs, but do not participate in the state Retirement and Pension Systems. These programs do not require an addition modification for the amounts picked up by the local government or agency. However, any local government or agency designated as a

"participating governmental unit" that participates in the Employees' Retirement and Employees' Pension System or the Local Fire and Police System requires both the pickup and the addition modification if the participating governmental unit received IRS and Board approval for its pickup program. At the end of this release is a list of employers participating in the state systems that have received IRS and State Board approval as of the date of this release.

IV. Effect on Employees

Formerly, employees who contributed to the systems paid taxes on their compensation, including those amounts contributed to the Retirement System or Pension System. Under the pickup program, the employer is considered to have "picked up" the employee's contributions, i.e., the contributions are treated as if the employer made them for federal tax purposes. The employee's compensation is reduced, pre-tax, by the amount of the contribution picked up by the employer. The pickup contributions are not taxable for federal purposes until they are distributed or made available to the employee. For state income tax purposes, however, the pickup contributions are added to federal adjusted gross income in computing Maryland adjusted gross income pursuant to Tax-General § 10-204(f). The reason for the addition modification is that the amounts reported in Box 1 of the federal Form W-2 do not include, in salaries and wages, the contributions picked up by the state. In order for the state to tax the pickup amount as required under law, an addition modification is provided.

Before the pickup program, the state withheld taxes from the employee's salary and then took out the required pension contributions. Now, the employer will "pick up" the contributions the employee used to pay and reduce the employee's salary by that amount, before any federal taxes are taken out. The result for federal income tax purposes is similar to the tax treatment under deferred compensation programs. However, for state income tax purposes, the tax on the pickup amount is not deferred and taxes are withheld on the employee's total salary and wages, including the pickup amount.

Payment of federal taxes on the pickup amount is deferred until the employee actually begins receiving benefits or otherwise recovers the contributions. For all other purposes, however, the

pickup program does not “reduce” the employee’s income. Other purposes would include, for example, calculating pension benefits, Social Security, or benefits under a flexible benefit program. It also does not reduce the employee’s income for state tax purposes. When calculating Maryland adjusted gross income, the employee is required to add back the pickup amount.

V. Reporting State Pickup Amounts on Contributions

The state pickup amount is required to be reported in Box 14 (Other) of the Federal Form W-2. In addition, the word “STPICKUP” is to appear in Box 14 to the left of the pickup amount. This amount must be reported on the Maryland Form 502, line 3. Nonresidents must report this amount on the Maryland Form 505, line 19, “other” using code letter “g”.

VI. Periodic Distributions (Retirees)

A. Eligible Employees

Retirement-eligible employees who receive a state retirement pension are allowed a subtraction from federal adjusted gross income for the amounts that were required to be added back during the work years. Each year, the employee’s 1099-R will reflect the balance in the pickup program. The subtraction is made each year until it equals the total amount of the employee’s contributions under the pickup program. Beyond that, the retirement benefits are no longer subject to the subtraction modification.

If an employee retires in the middle of the year, the employee will receive a W-2 showing the pickup addition, and a 1099-R showing the pickup subtraction. Both figures should be used in computing Maryland adjusted gross income.

B. Disability Pensions

An employee who receives a state disability pension is allowed to begin recovery of the employee pickup contributions at the time the employee begins receiving the disability payments. The individual does not have to wait until he/she reaches 65 to begin recovery of the pension pickup contributions. After January 1, 1994, the Maryland State Retirement Agency intends to show the disability pension payments as ordinary income on the Form 1099-R. Also, on this form, the agency will show the total amount of pension pickup contributions the individual is entitled to recover.

C. Reporting State Pickup Amounts on Periodic Distributions

The cumulative state pickup amount will be reported on the Federal Form 1099-R, Box 15 entitled “Pickup Contributions,” issued to an employee who receives periodic payments from the State Retirement and Pension Systems. All or part of this amount, not to exceed the taxable amount reported in Box 2a of the Form 1099-R, should be reported on the Maryland Form 502, Line 14, “Other subtractions,” using code letter “r”. Generally, the state pickup amount not allowed to be claimed on the current year tax return may be carried over to subsequent years until the full amount of the state pickup contribution has been claimed. See the instructions to the Maryland Form 502 for further guidance and limitations.

VII. Nonperiodic Distributions

Nonperiodic distributions, such as refunds due to payments made by the Retirement Agency as a result of a member resigning, dying or for other reasons may contain pickup contributions. The Form 1099-R issued for these distributions will include the value of the pickup contributions in the pickup contributions box, along with the taxable amount.

VIII. Governmental Units Participating in the Employees’ Retirement and Pension Systems as of August 1, 2009

Allegany Community College
Allegany County Board of Education
Allegany County Board of Elections Sup.
Allegany County Commissioners
Allegany County Elected Officials
Allegany County Library
Allegany County Masters
Annapolis, City of
Anne Arundel Community College
Anne Arundel County Board of Education
Anne Arundel County Court Masters
Anne Arundel County Elected Officials
Anne Arundel County Government
Anne Arundel County Public Libraries
Anne Arundel County State Board of Elections
Sup.
Circuit Court For Baltimore City Masters
Baltimore City Public Schools
Baltimore City Sheriff’s Department
Baltimore City State Board of Elections
Baltimore County Public Library

Baltimore County Public Schools
Community Colleges of Baltimore County
Baltimore Metropolitan Council
Berlin, Town of
Berwyn Heights, Town of
Bladensburg, Town of
Bowie, City of
Burgess and Comm. of Walkersville
Calvert County Commissioners
Calvert County Officials
Calvert County Public Library
Calvert County Public Schools
Caroline County Elected Officials
Caroline County Public Schools
Caroline County Sheriffs
Caroline County State Board of Elections
Carroll Community College
Carroll County Commissioners
Carroll County Master Judges
Carroll County Officials
Carroll County Public Library
Carroll County Public Schools
Carroll County Public Schools Cafeteria
Carroll County State Board of Elections
Carroll Soil Conservation District
Cecil College
Cecil County Elected Officials
Cecil County Government
Cecil County Library
Cecil County Public Schools
Charles County Public Schools
Chesapeake Bay Commission
Chestertown, Town of
Cumberland, City of
City of Cumberland – Police Dept.
Denton, Town of
District Heights, Town of
Dorchester County Commissioners
Dorchester County Officials
Dorchester County Public Schools
Eastern Shore Regional Library, Inc.
Emmitsburg, Town of
Enoch Pratt Free Library
Federalsburg, Town of
Frederick County College
Frederick County Commissioners
Frederick County Library
Frederick County Public Schools
Frederick County Soil Conservation District
Frederick County State Board of Elections
Garrett County Community College
Garrett County Public Schools

Garrett County Public Schools-Cafeteria
Greenbelt, City of
Greensboro, Town of
Hagerstown, City of
Hagerstown Junior College
Hampstead, Town of
Harford County Community College
Harford County Government
Harford County Public Library
Harford County Public Schools
Harford County State Board of Elections
Howard Community College
Howard County Government
Howard County Government State Elected
Officials
Howard County Library
Howard County Master Judges
Howard County Public Schools
Hurlock, Mayor and Council of
Hyattsville, City of
Kent County Commissioners
Kent County Public Schools
Landover Hills, Town of
Manchester, Town of
Maryland Environmental Service
MD Health and Higher Educational Facilities
Authority
Montgomery College
Montgomery County Government
Montgomery County Public Schools
Mount Rainier, City of
New Carrollton, City of
Northeast Maryland Waste Disposal Authority
Oakland, Town of
Oxford, Town of
Prince George's Community College
Prince George's County Crossing Guards
Prince George's County Elected Officials
Prince George's County Government
Prince George's County Master Judges
Prince George's County Memorial Library
Prince George's County Public Schools
Prince George's County Supv. Elections
Princess Anne, Town of
Queen Anne's County Commissioners
Queen Anne's County, Department of Public
Works
Queen Anne's County Public Schools
Queen Anne's County State Board of Elections
Ridgely, Town of
St. Mary's County Commissioners
St. Mary's County Library

St. Mary's County Officials
 St. Mary's County Public Schools
 St. Mary's County State Board of Elections
 St. Mary's Metropolitan Commission
 Salisbury, City of
 Somerset County Commissioners
 Somerset County Library
 Somerset County Public Schools
 Somerset County Sanitary District, Inc.
 Southern Maryland Regional Library
 Southern Maryland Tri-County Community Action
 Committee
 Takoma Park, City of
 Talbot County Council
 Talbot County Public Schools
 Taneytown, City of
 Thurmont, Town of
 Tri-County Council for the Lower Eastern Shore
 Tri-County Council for Western Maryland, Inc.
 University Park, Town of
 Washington County Board of License Comm.
 Washington County Library
 Washington County Library Janitors
 Washington County Public Schools
 Westminster, City of
 Wicomico County Library
 Wicomico County Public Schools
 Worcester County Government
 Worcester County Library
 Worcester County Liquor Control Board
 Worcester County Public Schools
 Worcester County State Board of Elections
 Worcester County State Officials
 Wor-Wic Tech Community College
***New additions to this list are in bold type**

IX. Withdrawn Governmental Units

Anne Arundel County Commissioners
 Bethesda Fire Department
 Caroline County Roads Board
 Carroll County Government
 Chevy Chase Fire Department
 Elkton, Town of
 Frederick County Government
 Gaithersburg, Town of
 Harford County Liquor Board
 Health Systems Agency of Western Maryland
 Howard County Economic Development Authority
 Interstate Commission on the Potomac River Basin
 Lexington Market Authority
 Maryland Environmental Services

Maryland National Capital Park & Planning
 Commission
 Montgomery County Board of Education
 Montgomery County Commissioners
 Montgomery County Public Library
 Rockville, City of
 St. Mary's Nursing Home
 Takoma Park Police
 University of Maryland
 University of Maryland Medical System
 Washington County Commission
 Washington County License Commissioners
 Washington County Roads Board
 Washington County Sanitary District
 Washington Suburban Sanitary Commission
 Wicomico County Department of Recreation and
 Parks
 Wicomico County Roads Board

Revised: September 2010



Revenue Administration Division Revenue
 Administration Center Annapolis, Maryland
 21411-0001

Telephone: **410-260-7980** or **1-800-MD
 TAXES**

www.marylandtaxes.com

For the deaf or hard of hearing: call via
 Maryland Relay at 711 in Maryland or 1-800-
 735-2258

If you need reasonable accommodation for a disability, please contact us before you visit.

If you need the information in this publication in an alternate format, contact the Comptroller's Office.