

MEMO# 6241

September 26, 1994

INSTITUTE COMMENT LETTER ON SOURCE STATE TAXATION LEGISLATION

September 26, 1994 TO: OPERATIONS MEMBERS NO. 34-94 PENSION MEMBERS NO. 30-94
TRANSFER AGENT ADVISORY COMMITTEE NO. 38-94 RE: INSTITUTE COMMENT LETTER ON
"SOURCE STATE TAXATION" LEGISLATION

The Institute has submitted the attached letter to the House Judiciary Committee to convey its concerns about the "source-state taxation" provisions in Section 801 of the Bankruptcy Amendments Act of 1994 (S. 540). S. 540 has been passed by the Senate and is pending in the House Judiciary Committee. "Source-state taxation" is the assessment of state income tax on pension distributions to a nonresident on the basis of the portion of the total pension that was "earned" while the retiree worked in the "source" state. Section 801 would exempt from "source" state taxation only (1) \$25,000 per year in annuity-type pension distributions meeting certain requirements, and (2) an additional \$25,000 (indexed for the cost-of-living) pursuant to a one time election and which is received after the age of 59-1/2. As currently drafted, Section 801 could lead to state taxing authorities requiring that mutual funds and similar financial institutions report or withhold "source" state income taxes on pension income. A mutual fund, however, typically will not know the total accruals or account balance in a plan for any participant, and a distribution from a mutual fund may represent only a portion of the total annual or lump sum retirement distributions for that participant. Furthermore, mutual funds typically do not have the information needed to allocate pension distributions by "source" state, because they have no means of tracking the states in which participants "earn" their pension and the amount "earned" in each state. For these reasons, the Institute urged that Section 801 be amended to protect mutual funds and similar financial institutions that make retirement benefit distributions from being required by any state to deduct and withhold income taxes or to issue any reports with respect to any such tax. We will keep you informed of developments. John J. Canary, Jr. Assistant Counsel - Pension Attachment