# *Income Tax Topics: Social Security, Pensions, and Annuities*

COLORADO
Department of Revenue
Taxation Division

Individuals may be allowed to claim a subtraction on their Colorado Individual Income Tax Return for pension and annuity income included in their federal taxable income. This publication provides information on different pension and annuity income that may qualify for the subtraction and certain limitations that apply.

Separate Colorado subtractions discussed in this publication are allowed for certain specific types of pension and annuity income:



Multiple subtractions may not be claimed for the same income.

This publication is designed to provide general guidance regarding Colorado subtractions allowed for pension and annuity income and to supplement guidance provided in the *Colorado Individual Income Tax Guide*. Nothing in this publication modifies or is intended to modify the requirements of Colorado's statutes and regulations. Taxpayers are encouraged to consult their tax advisors for guidance regarding specific situations.

## Pension and annuity subtraction

Qualifying individuals may claim a subtraction on the *Subtractions from Income Schedule* (DR 104AD) for pension and annuity income included in their federal adjusted gross income.

Joint filers have additional considerations to claim the subtraction. To determine the subtraction allowed in the case of a joint return, each spouse must separately determine their eligibility for the subtraction (based on their age or receipt of death benefits) and the amount of the subtraction they may claim (based on their respective qualifying income and the maximum allowable amounts, discussed later in this publication). The amount of the subtraction is computed separately for each spouse. If a taxpayer's qualifying pension and annuity income exceeds the maximum allowable amount, the excess income cannot be subtracted either by that taxpayer or their spouse, even if the amount of the spouse's pension and annuity income is less than the maximum allowable subtraction amount.

### Qualifying taxpayers

The subtraction is generally allowed only to individuals 55 years of age or older (general age limitation) but may also be claimed by individuals under age 55 for pension and annuity income they receive as a death benefit. The subtraction is generally limited to $20,000 each year or, for individuals 65 years of age or older, $24,000 (general income limitation). In the case of joint filers, the subtraction is allowed separately to each taxpayer included in the joint return.

### Non-qualifying taxpayers

The subtraction is not allowed for non-individual taxpayers such as C corporations, trusts, estates, and their beneficiaries.

Individual taxpayers under 55 years of age may not claim the subtraction unless the pension and annuity income is a death benefit.

## Qualifying pension and annuity income

In general, the pension and annuity subtraction may be claimed for the following types of income included in an individual's adjusted gross income and reported on their federal income tax return (IRS Form 1040 or 1040-SR) in the same year the subtraction is claimed:

- pensions and annuities reported on line 5b of the federal return;
- social security benefits reported on line 6b of the federal return;
- certain IRA distributions reported on line 4b of the federal return; and
- disability payments reported on line 1 of the federal return because the recipient has not yet reached retirement age.

Please see the following sections for additional information regarding each of these types and other types of income that do not qualify for the subtraction.

### Pensions and annuities

Pensions and annuities are periodic payments made to an individual that are attributable to personal services he or she performed prior to retirement, arising from one of the following:

- an employee-employer relationship;
- Service in the uniformed services of the United States; or
- Contributions previously made to a retirement plan that were deductible for federal income tax purposes in the year the contributions were made.

Pensions and annuities are made in a series of payments at regular intervals (such as weekly, monthly, or yearly) over a period greater than one year.

When looking at the taxpayer's federal return, the amount on line 5b, which is the amount included in federal taxable income, is the amount that is eligible for the subtraction, not the amount on line 5a.

Amounts received from privately purchased annuities that have fully matured also qualify for the pension and annuity subtraction.

### Death benefit

An individual taxpayer who is under 55 years of age and who receives pension and annuity benefits due to the death of the person originally entitled to receive such benefits may subtract such pension and annuity income. In this case, the amount the individual may subtract is limited to $20,000. A taxpayer who receives a death benefit should see distribution code 4 in box 7 of IRS Form 1099-R.

Individual taxpayers who are 55 years of age or older may claim the subtraction for pensions and annuities regardless of whether any benefit received was a death benefit.

Death benefit income only qualifies if the income is paid directly to the individual taxpayer. If death benefit income is paid to a non-individual, such as a trust, estate, partnership, or other legal entity, and then redistributed to an individual taxpayer, that income does not qualify for the subtraction.

### Social security benefits

Not all social security benefits are included in federal taxable income. The subtraction is allowed only for social security benefits that are included in the taxpayer's federal taxable income. This is the amount on line 6b of the federal return, not the amount on line 6a. *IRS Publication 915* provides a worksheet to help a taxpayer determine the amount of social security benefits that are taxable.

For income tax years prior to January 1, 2022, social security benefit income is capped at $20,000 for a taxpayer who is at least 55 years of age but not more than 64 years of age at the end of the tax year, and $24,000 per tax year for a taxpayer who is 65 years of age or older at the end of the tax year. For income tax years beginning January 1, 2022, and after, taxpayers 65 years of age or older at the end of the tax year may subtract the entire amount of social security benefit income included in the taxpayer's federal taxable income. For those taxpayers who are at least 55 years of age but not more than 64 years of age, the cap remains at $20,000.

While social security benefit income qualifies for the pensions and annuities subtraction, for tax years 2022 and later, the subtraction for social security benefits is claimed on a separate line on the *Subtractions from Income Schedule* (DR 104AD). The pension and annuity subtraction has a strict limit on the amount of income that can be claimed (the general income limitation, referenced above under *Qualifying taxpayers*). The combined amounts subtracted on both the social security line and the pension and annuity line cannot exceed $24,000 or the amount of social security benefits included in the taxpayer's federal taxable income, whichever is greater. For example, if $5,000 is deducted on the social security line, no more than $19,000 ($24,000 minus $5,000) may be subtracted on the pension and annuity line. If $24,000 or more is subtracted on the social security line, no amount may be subtracted on the pension and annuity line.

To determine the subtraction allowed for social security benefits in the case of a joint return, social security benefits included in federal taxable income shall be apportioned in a ratio of the gross social security benefits of each taxpayer to the total gross social security benefits of both taxpayers. See the formula below to determine what part of each spouse's benefits is included in their federal taxable income and therefore eligible for the pension and annuity subtraction.

### Joint social security benefits worksheet

Use this worksheet to calculate joint social security benefits that are eligible for subtraction.

1) Spouse A's total Social Security benefits for the year $__________
2) Spouse B's total Social Security benefits for the year $__________
3) Total of lines 1 and 2 $__________
4) Spouse A's percentage (line 1 divided by line 3) $__________
5) Spouse B's percentage (line 2 divided by line 3) $__________
6) Taxable Social Security benefits included on line 6b of federal Form 1040 or 1040-SR $__________
7) Spouse A's share of taxable Social Security benefits (amount on line 6 multiplied by percentage on line 4) $__________
8) Spouse B's share of taxable Social Security benefits (amount on line 6 multiplied by percentage on line 5) $__________

### IRA distributions

IRA distributions may include distributions made from a traditional IRA, a simplified employee pension (SEP) IRA, or a savings incentive match plan for employees (SIMPLE) IRA. When looking at the taxpayer's federal return, the amount on line 4b, which is the amount included in federal taxable income, is the amount that is eligible for the subtraction, not the amount on line 4a.

Distributions deemed to be premature distributions for federal income tax purposes do not qualify for the subtraction. In general, a distribution is considered premature if it is made to an individual who has not yet reached age 59½, but not if one of several exceptions apply. Please see the *instructions for IRS Form 5329* for information about these exceptions.

### Disability payments

Certain disability payments may qualify for the pension and annuity subtraction. Taxable permanent disability benefits received by an individual who meets the general age limitation qualify for the subtraction, even if the compensation is characterized as wages rather than pension and annuity income for federal income tax purposes.

However, disability payments that are not for permanent disability, regardless of their source, do not qualify for the subtraction, even if reported as pension and annuity income on a taxpayer's federal income tax return.

Railroad disability benefits are exempt from state taxation under Section 231m of the Railroad Retirement Act, along with other railroad retirement annuity benefits. Taxpayers receiving railroad disability benefits in their federal taxable income can claim the railroad benefit subtraction, rather than the pension and annuity subtraction, for those benefits. For more information on railroad retirement benefits, see *Railroad retirement benefits subtraction*, later in this publication.

### Divorce settlement

Subject to all applicable requirements and limitations, payments made pursuant to a divorce settlement or decree that arise from one of the qualifying pension and annuity sources listed above may qualify for the subtraction. The divorce settlement or decree must expressly state the amount of the pension or annuity benefit allocated to the taxpayer for the taxpayer to claim the subtraction. A nonperiodic payment representing a future stream of periodic payments from a pension or annuity plan made pursuant to the divorce settlement or decree will not qualify for the subtraction, unless the pension or annuity plan benefit is from:

- an individual retirement arrangement (IRAs);
- self-employed retirement accounts;
- fully matured privately purchased annuities;
- social security benefits; or
- amounts paid by reason of permanent disability or death of the person entitled to receive the benefits.

## Nonqualifying Income

The pension and annuity subtraction is not allowed for any income for which another subtraction is claimed. Additionally, the following income does not qualify for the subtraction.

### Premature distributions

Distributions from an IRA or self-employed retirement account plan (e.g., a 401(k), savings incentive match plan for employees (SIMPLE), or Simple Employee Pension (SEP) retirement plan for a self-employed taxpayer) that are deemed to be premature for federal income tax purposes do not qualify for the subtraction. A premature distribution (sometimes referred to as an early distribution) for federal tax purposes means a distribution that is subject to a federal income tax penalty (sometimes referred to as additional federal tax).

In general, a distribution made before a taxpayer reaches the minimum retirement age required by the pension or annuity plan is subject to the premature distribution penalty. However, federal law does not impose the premature distribution penalty for certain distributions made prior to the minimum retirement age (e.g., death, hardship, etc.). These distributions may be included in the subtraction if they otherwise meet the requirements and limitations for the subtraction. The restriction regarding premature distributions does not apply to pension and annuity benefits distributed from sources other than an IRA or self-employed retirement account plan.

For more information about premature distributions and possible penalties for such distributions, see *Retirement Topics - Exceptions to Tax on Early Distributions*.

## Limitations

The amount of income that can be subtracted is limited to:

- $20,000 for a taxpayer who is at least 55 years of age, but not more than 64 years of age, at the end of the tax year;
- $20,000 for a taxpayer under 55 years of age who received a death benefit; or
- $24,000 for a taxpayer who is at least 65 years of age at the end of the tax year, or the amount of social security benefits included in their federal taxable income.

For tax years 2022 and later, social security benefits in excess of $24,000 will increase the limit for taxpayers 65 years of age or older. See the section on social security benefits above for more information.

Taxpayers may not take the pension and annuity subtraction for any income for which another subtraction is claimed.

The subtraction applies only to the extent the taxpayer reports, in the same tax year that the subtraction is claimed, the pension or annuity benefit as federal taxable income on their federal income tax return.

## Railroad retirement benefits subtraction

Federal law exempts railroad retirement benefits from state income taxes. The railroad retirement benefits subtraction is allowed on the *Subtractions from Income Schedule* (DR 0104AD) for any railroad retirement benefits reported on Form RRB-1099 or Form RRB-1099-R and included in a taxpayer's federal taxable income. Railroad retirement benefits that are eligible for the subtraction include:

- Tier I benefits (both Social Security Equivalent Benefits (SSEB) and Non-Social Security Equivalent Benefits (NSSEB));
- Tier II benefits;
- Vested dual benefits;
- Supplemental annuity benefit; and
- Railroad disability benefits.

Not all Tier I SSEB benefits are included in federal taxable income. Tier 1 SSEB benefits are reported and treated in the same manner as social security benefits, and the taxpayer must determine the taxable amount. To determine the amount of Tier I SSEB benefits that can be included in the subtraction, see *IRS Publication 915*, the *Explanation of Form RRB 1099*, or the *social security section* in this publication.

Railroad retirement benefits qualify regardless of whether such benefits meet the general age or income limitations. The amount of such subtraction is not subject to the general income limitation. If a taxpayer receives both railroad retirement benefits and pension and annuity benefits, then the amount of railroad retirement benefits is not included when determining whether pension or annuity benefits have exceeded the general income limitation.

## Military retirement benefits subtraction

A retired servicemember may claim one of two subtractions for all or part of the military retirement benefits that are included in their federal taxable income. In general, military servicemembers that are eligible for the subtraction include any member of the Army, Navy, Air Force, Marine Corps, Space Force, or Coast Guard. The subtraction that may be claimed depends on the retired servicemember's age at the end of the tax year.

### Retired servicemembers under 55 years of age

If a retired servicemember is under 55 years of age at the end of the tax year, they may claim the military retirement subtraction on the applicable line of the Colorado *Subtractions from Income Schedule* (DR 0104AD) for military retirement benefits included in their federal taxable income, subject to the following limitations based on the tax year:

Military Retirement Subtraction Limits

| *Tax year(s)* | *Limit* |
|---|---|
| 2019 | $ 4,500 |
| 2020 | $ 7,500 |
| 2021 | $10,000 |
| 2022-2028 | $15,000 |

### Retired servicemembers age 55 or older

If a retired servicemember is at least 55 years old at the end of the tax year, they may claim the regular pension and annuity subtraction on the applicable line of the Colorado *Subtractions from Income Schedule* (DR 0104AD) for military retirement benefits included in their federal taxable income. The regular pension and annuity subtraction is not subject to the limitations applicable to retired servicemembers under 55 years of age, but rather is subject to its own limitations, discussed earlier in this publication.

## PERA/DPSRS subtraction

Under certain circumstances, a portion of pension income paid by the Colorado Public Employees Retirement Association (PERA) or the Denver Public Schools Retirement System (DPSRS) and included in a taxpayer's federal taxable income may qualify for subtraction. Most PERA and DPSRS retirement benefits will not qualify for subtraction. The subtraction is only allowed to retirees who made contributions to PERA between 1984 and 1986 and to DPSRS in 1986.

Current state employees cannot claim a subtraction for PERA contributions they made during the current tax year.

A taxpayer may qualify for this subtraction if:

- employee contributions were made to PERA any time between July 1, 1984, and December 31, 1986, and PERA benefits are received during the current tax year; or
- employee contributions were made to DPSRS any time between Jan. 1, 1986, and Dec. 31, 1986, and DPSRS benefits are received during the current tax year.

These contributions were subject to state income tax in the years they were made but were tax-deferred for federal income tax purposes. This means federal income tax must be paid when receiving benefit payments upon retirement or termination. The subtraction on the Colorado return enables a taxpayer to subtract from taxable income the amount of pension benefits on which state income tax was already paid.

If a taxpayer's total federally taxable pension income from all sources is less than $20,000 and the taxpayer is 55-64 years of age, or if the federally taxable pension from all sources is less than $24,000 and the taxpayer is 65 years of age or older, then the taxpayer will not need to use this subtraction because all their pension income is fully excludable for Colorado income tax purposes under the regular pension subtraction.

The subtraction does not apply to a taxpayer if:

- the taxpayer began receiving PERA benefits before July 1, 1984, or DPSRS benefits before January 1, 1986; or
- the taxpayer has already subtracted the total amount of previously taxed contributions on Colorado income tax returns in prior years.

If a taxpayer is eligible for both the PERA/DPSRS subtraction and the pension subtraction, in most cases the taxpayer should claim $20,000 or $24,000, as applicable, of the pension subtraction first and then claim the remainder of the pension (if any) as a PERA or DPSRS subtraction. A taxpayer is allowed to carry the remaining PERA or DPSRS subtraction amount forward to the next tax year.

Example: Ms. Matilda Q. Taxpayer retired at age 55. She contributed $5,000 to PERA between July 1, 1984, and December 31, 1986, that were subject to Colorado income tax at the time. She received $21,000 in PERA benefits. Ms. Taxpayer could claim a $20,000 pension and annuity subtraction and a $1,000 PERA subtraction. She would still be able to subtract up to $4,000 in a subsequent year. In the next year, she receives $22,000 and claims a $20,000 pension subtraction and a $2,000 PERA subtraction, leaving $2,000 that can be subtracted in a subsequent year. In the third year, she has $23,000 in pension income, claims a $20,000 pension subtraction, and then claims a $2,000 PERA subtraction, fully exhausting the amount she can claim for PERA subtractions.

For PERA contribution information, contact PERA at www.copera.org or call 303-832-9550 or 1-800-759-7372.

### PERA/DSPRS worksheet

Use the following worksheet to determine the amount, if any, that can be entered as a subtraction on the Colorado income tax return.

| | |
|---|---|
| 1) Enter the amount of contribution to PERA or DPSRS that was previously taxed for Colorado income tax purposes but not for federal income tax purposes. For PERA members, this would be 8% of the state, local government, or public school salary or wages earned for the period July 1, 1984 through December 31, 1986. For DPSRS members, this would be the amount contributed to DPSRS during 1986. | 1) $ ________ |
| 2) Enter the amount claimed on prior year's Colorado income tax returns as a PERA/DPSRS retirement income subtraction. | 2) $ ________ |
| 3) Subtract line 2 from line 1. | 3) $ ________ |
| 4) Amount in box 2a of 1099-R (federally taxable amount). | 4) $ ________ |
| 5) The potential current year subtraction is the smaller of the amount on line 3 or line 4. Enter the amount on this line and on the other subtractions line of Form 104. | 5) $ ________ |

## Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to pensions and annuities. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

### Statutes and regulations

- § 39-22-104(4)(c), (4)(f), (4)(y), C.R.S. Income tax imposed on individuals, estates, and trusts
- Rule 39-22-104(4)(f). Pension and Annuity Subtraction.

### Forms and guidance

- *Colorado.gov/Tax*
- *Tax.Colorado.gov/individual-income-tax-forms*
- *Subtractions from Income Schedule (DR 104AD)*
- *Colorado Individual Income Tax Guide*