

*Maryland Income Tax*  
**ADMINISTRATIVE RELEASE**

---

**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**

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 2009

#### **IX. Withdrawn Governmental Units**

Anne Arundel County Commissioners  
 Bethesda Fire Department  
 Caroline County Roads Board



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

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

**[taxhelp@comp.state.md.us](mailto:taxhelp@comp.state.md.us)**

**[www.marylandtaxes.com](http://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.