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SFA BILL ANALYSIS

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Senate Bill 1382 (as reported without amendment)
Sponsor: Senator Bill Bullard, Jr.
Committee: Finance

Date Completed: 11-9-00

RATIONALE

Under the Internal Revenue Code, when an individual receives a distribution from an individual retirement account (IRA) or other pension plan, the distribution is added to the individual's income for purposes of calculating Federal adjusted gross income (AGI). If the person directs the distribution to a qualified charity, the taxpayer may deduct the distribution, after calculating AGI, to determine his or her taxable income. The Michigan Income Tax Act requires a taxpayer to begin the calculation of the State income tax by using his or her Federal AGI. This means, then, that a taxpayer who transfers a distribution from an IRA to a charity is taxed on the amount of the distribution at the State level, even though he or she has no Federal tax liability on the distribution. It has been suggested that the State also allow a taxpayer to deduct distributions to charity that are made from an IRA or other pension plan.

CONTENT

The bill would amend the Income Tax Act to allow a taxpayer to deduct from taxable income, to the extent included in Federal adjusted gross income, certain distributions made from a retirement or pension plan to a charitable organization ("qualified charitable distributions"). The bill would apply to tax years beginning after 1999.

The amount a taxpayer could deduct from taxable income would be equal to the amount deductible by the taxpayer under Section 170(c) of the Internal Revenue Code (IRC) with respect to the qualified charitable distribution in the tax year in which the taxpayer made the distribution to the qualified charitable organization, minus deductions the taxpayer claimed for retirement or pension benefits (except Social Security benefits). (Section 170(c) defines "charitable contribution" as a contribution or gift to various specified entities, including the United States, state and local governments, and charitable organizations. In the case of an individual, the aggregate amount of contributions allowable for deduction under Section 170 is limited to 50% of the taxpayer's "contribution base" for the taxable year; that is, the taxpayer's adjusted gross income (computed without regard to any net operating loss carryback to the taxable year).

A "qualified charitable distribution" would be a distribution of assets to a qualified charitable organization by a taxpayer within 60 days after the date the taxpayer received the assets as a distribution from a retirement or pension plan. A distribution would be to a qualified charitable organization if it were made under any of the following circumstances:

-- To a 501(c)(3) organization. (Section 501(c)(3) of the IRC exempts from taxation certain charitable organizations.)
-- To a charitable remainder annuity trust or charitable remainder unitrust as defined in Section 664(d) of the IRC. (These trusts are dedicated to certain charitable organizations after a specified period of time, or the death of the individual(s) for whom the trust is formed.)
-- To a pooled income fund as defined in Section 642(c)(5) of the IRC (which provides that a pooled income fund is a trust in which each donor can make an irrevocable transfer of property to or for the use of certain charitable organizations).
-- For the issuance of a charitable gift annuity as defined in Section 501(m)(5) of the IRC (which describes a charitable gift annuity, in part, as an annuity of which a portion is allowed as a deduction for contributions to certain charitable organizations).

The trust, fund, or annuity described above would be a qualified charitable organization only if no person (other than the taxpayer who received the distribution from the retirement or pension plan, the taxpayer's spouse, or a 501(c)(3) organization) held any interest in the trust, fund, or annuity.

The bill would apply to distributions from retirement or pension plans that were qualified pension, trusts, or annuity plans under Section 401(a) of the IRC (which prescribes the requirements for pension plans), including the following:

-- Plans for self-employed persons (Keogh or HR 10

plans).

-- Individual retirement accounts if distributions are not made until the participant has reached age 59½ years, except in the case of death, disability, or other distributions described in the IRC.
-- Employee annuities or tax-sheltered annuities purchased by public school systems, or by organizations exempt from taxation under Section 501(c)(3) of the IRC.
-- Distributions from a 401(k) plan attributable to employee contributions mandated by the plan or attributable to employer contributions.

The bill also would apply to distributions from the following retirement and pension plans not qualified under the IRC:

-- Plans of the U.S. government, state governments other than Michigan, and political subdivisions, agencies, or instrumentalities of this State.
-- Plans maintained by a church or a convention or association of churches.
-- All other unqualified plans that prescribe eligibility for retirement and predetermine contributions and benefits if the distributions are made from a pension trust.

MCL 206.30

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Because of the interaction between the Income Tax Act and the IRC, people who direct distributions from an IRA or other pension plan to a qualified charity are not taxed on the distribution for Federal tax purposes, but are subject to the State income tax. For instance, if a taxpayer receives a $2,000 distribution from an IRA, the $2,000 must be added to the taxpayer's income to determine his or her Federal AGI. If the $2,000 is given to a qualified charity, the taxpayer can deduct that amount from AGI when calculating his or her taxable income, meaning that the taxpayer has suffered no tax penalty for transferring the amount from the IRA to the charity. For State income tax purposes, however, since calculation of State income tax liability begins with AGI, the $2,000 is still included, meaning that the taxpayer is taxed on the charitable gift. This creates a disincentive for Michigan taxpayers to use IRA or other distributions for charitable purposes. By allowing a taxpayer to deduct such distributions, to the extent the distributions were included in AGI, the bill would make the State tax treatment of charitable gifts more equitable.

Legislative Analyst: G. Towne

FISCAL IMPACT

Fiscal information is not available at this time.

Fiscal Analyst: J. Wortley

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.