Legislative Analysis

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APPLY INCOME TAX TO PUBLIC PENSION BENEFITS EXCEEDING SPECIFIED AMOUNTS

House Bills 4801 and 4802, without amendments
Sponsor: Rep. Chris Ward
Committee: Oversight and Investigations

Revised Summary
Complete to 5-23-07

A REVISED SUMMARY OF HOUSE BILLS 4801 & 4802 AS REPORTED FROM COMMITTEE

House Bill 4801 would eliminate the full subtraction of most public pension benefits from taxable income in Michigan. Instead, public retirement and pension benefits exceeding $40,920 for a single filer or $81,840 for a married filer (2006 tax year amount) would be subject to the state income tax. Federal and military pensions would remain fully exempt from the state income tax. The bill amends the Income Tax Act.

House Bill 4802 would, correspondingly, amend the State Employees' Retirement Act to allow the taxation of certain benefits received by certain public employees under the Income Tax Act.

More details about the bills are provided below.

House Bill 4801

Currently, Section 30(1)(f) of the Income Tax Act of 1967 allows most forms of public employee retirement and pension benefits to be subtracted from taxable income for the purposes of Michigan income tax law (to the extent included in adjusted gross income for federal tax purposes). This deduction applies to benefits received from public retirement systems created by the State of Michigan (or its political subdivisions) as well as benefits received from pension systems created by other states and political subdivisions (to the extent that other state's income tax laws permit a similar deduction or exemption for retirement benefits earned from Michigan public retirement systems).

The bill would eliminate the full deduction for state and local government retirement and pension benefits received from public retirement systems in Michigan or other states as of January 1, 2007. (Federal and military pension income would remain fully deductible to the extent included in adjusted gross income.) However, under Section 30(1)(f)(v) of the Income Tax Act, retirement and pension benefits (except for federal and military pensions) would still be deductible up to a maximum of $40,920 for a single return and $81,840 for a joint return (2006 amounts).[1] The effect of the bill, therefore, would be to subject public employee retirement and pension benefits above this threshold amount to the state income tax.

Section 30(8) of the Income Tax Act defines the meaning of "retirement or pension benefits" for purposes of Section 30(1)(f). Generally speaking, the phrase "retirement and pension benefits" includes benefits from both qualified and non-qualified pension plans, but excludes deferred compensation plans under Section 457 of the Internal Revenue Code, distributions from 401(k) plans attributable to voluntary employee contributions, certain premature distributions, and certain early retirement incentives. Presumably, if a benefit is not a "retirement or pension benefit" as defined in Section 30(8), it would be fully includable in Michigan taxable income, rather than simply taxable above the indexed deductible amount provided under Section 30(1)(f).

MCL 206.30

House Bill 4802

Currently, Section 40(1) of the State Employees' Retirement Act provides, among other things, that an individual's right to a pension, annuity, retirement allowance, optional benefit, or other accrued or accruing right under the provisions of the Act is exempt from any state, county, municipal, or other local tax and is subject to the Public Employee Retirement Benefit Protection Act, Public Act 100 of 2002.

Under the bill, this provision would not apply to the taxation of retirement or pension benefits under the Income Tax Act of 1967.

MCL 38.40

FISCAL IMPACT:

Because the additional pension income that would no longer be deducted from taxable income would receive the same treatment as private pension income, the bills would increase income tax revenue by a relatively small amount.

Additional revenue from taxing State of Michigan pension income (as well as pension income from its subdivisions) is expected to total less than $2.0 million. In addition, while a precise impact of taxing pension income from other states is not known, the estimated fiscal impact would probably be even less.

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[1] The maximum amount of pension income that can be deducted is adjusted annually by the percentage increase in the consumer price index for the preceding calendar year.