Legislative Analysis

MICHIGAN EMPLOYMENT SECURITY ACT: ROLLOVER DISTRIBUTIONS

House Bill 5756
Sponsor: Rep. Steven Lindberg
Committee: Labor

Complete to 3-1-10

A SUMMARY OF HOUSE BILL 5756 AS INTRODUCED 1-20-10

House Bill 5756 would amend the Michigan Employment Security Act to prohibit the state from reducing unemployment compensation when certain rollover distributions occur from pension plans.

As a result of an amendment made by the federal ***Worker, Retiree, and Employer Recovery Act of 2008***, all of the states are now prohibited from reducing unemployment compensation due to non-taxable pension rollover distributions. In particular, the following new language was added to Section 3304(a)(15) of the Federal Unemployment Tax Act: "*(B) the amount of compensation shall not be reduced on account of any payments of governmental or other pensions, retirement or retired pay, annuity, or other similar payments which are not includible in the gross income of the individual for the taxable year in which it was paid because it was part of a rollover distribution...*" (Under the law, whether a rollover distribution is "not includible in the gross income of the individual for a taxable year is determined under guidelines of the Internal Revenue Service.) House Bill 5756 would add language to the Michigan Employment Security Act to bring the state statute into compliance with the federal law, in order not to impair Michigan employers' full tax credit against the tax imposed by the Federal Unemployment Tax Act.

MCL 421.27

FISCAL IMPACT:

The bill is necessary to ensure the continued conformity with the Federal Unemployment Tax Act (26 USC 3304), as amended by the Worker, Retiree, and Employer Recovery Act of 2008, PL 110-458.[1] Conformity with the FUTA is required if Michigan employers

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[1] The Worker, Retiree, and Employer Recovery Act of 2008 provides that the amount of unemployment compensation shall not be reduced on account of any payments of governmental or other pensions, retirement or retired pay, annuity, or other similar payments which are not included in the gross income of the individual for the tax year in which it was paid because it was part of a rollover distribution. On this point, in Unemployment Insurance Program Letter 10-09, the U.S. Department of Labor notes, "as a result of the 2008 amendment, states are prohibited from reducing [unemployment compensation] due to these nontaxable distributions. Whether a rollover distribution is 'not includible in the gross income of the individual' for a taxable year is determined under IRS guidelines. In general, a distribution from an eligible retirement plan is not includible in gross income when the

are to claim a credit against their FUTA tax liability that effectively reduces the tax rate from 6.2% to 1.1% on a taxable wage base of $7,000 per employee. The credit equates to $357 per employee.[2] If the Michigan Employment Security Act remains out of conformity with federal requirements, Michigan employers would be ineligible for the FUTA credit, thus increasing their tax liability.

Conformity with federal requirements is also a condition, under Title III of the Social Security Act, for the continued receipt of federal funding to administer the state's unemployment insurance program. For FY 2010, the year-to-date total spending authorization (line item and boilerplate) in federal UI administrative funds is $170.5 million. Administrative funds could be withheld by the Department of Labor if Michigan Employment Security Act were to remain out of conformity with federal requirements.[3]

No estimate is available from the Unemployment Insurance Agency as to the impact of adding this exclusion for non-taxable rollover distributions has in determining the level of benefits payable to UIA claimants.

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[2] Normally, the FUTA credit reduces the tax rate from 6.2% to 0.8%. However, because the state Unemployment Trust Fund has had an outstanding Title 12 loan balance on January 1 for each of the past two years, the FUTA credit is reduced by 0.3 percentage points, raising the effective FUTA rate for Michigan employers from 0.8% to 1.1%. This reduction in the FUTA credit went into effect in January 2010. In January 2011, the FUTA credit will again be reduced by another 0.3 percentage points, raising the effective FUTA tax rate for Michigan employers to 1.4%. Under the Michigan Employment Security Act, positive-balance employers (i.e., those that have paid more in state unemployment taxes than the UTF has paid in benefits to their former employees) receive a credit against the state unemployment tax equal to one-half of the additional FUTA tax paid because of the credit reduction. The additional revenue generated by the FUTA credit reduction is used to pay back the Title 12 loans received. According to the U.S. Department of Treasury, Bureau of the Public Debt, as of February 24, 2010, the state's outstanding Title 12 loan balance was $3,518,682,333.32.

[3] In addition to the pension provisions at issue here, the U.S. Department of Labor has also raised a concern regarding the anti-SUTA dumping provisions contained in the Michigan Employment Security Act. For a discussion see the HFA Analysis of House Bill 6386 of the 2007-2008 Legislative Session. Similar legislation in the 2009-2010 Legislative Session – House Bill 4238 – is also pending before the House Committee on Labor.

taxpayer 'rolls over' the distribution to another eligible retirement plan within 60 days." In *Koontz v. Ameritech Services, Inc.*, 466 Mich 304 (2002), the Michigan Supreme Court held that retirement funds rolled-over by a UI claimant into an IRA were "received" by the claimant, and should therefore be used by the UIA to offset the amount of UI benefits for which the claimant was otherwise eligible.