Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 368 (as passed by the Senate)
Sponsor: Senator Ken Horn
Committee: Finance

Date Completed: 12-11-15

RATIONALE

In 2011, several legislative measures were enacted to restructure Michigan's taxes on businesses and individuals. The legislation that amended the Income Tax Act included changes in the deduction allowed for pension and retirement income, including Social Security income. The amount of the deduction now depends, in part, on a taxpayer's age and whether he or she was born before 1946, between 1946 and 1952, or after 1952, with smaller deductions allowed for those in the second two categories. For taxpayers born before 1953, the Act retains a full deduction for Social Security income, while the tax treatment differs for those born in 1953 or later. After these amendments were enacted, it was pointed out that many retirees, such as former police officers and firefighters, do not receive Social Security income because the governmental entity they worked for opted out of the Social Security system. As a result, the deduction for Social Security income does not benefit these individuals, which means that a proportionately higher amount of their pension and retirement income is subject to taxation.

To address this, Public Act 597 of 2012 increased the deduction for taxpayers who receive retirement or pension benefits from governmental employment that was not covered by Social Security. This legislation, which took effect on January 9, 2013, also differentiates based on the age of the taxpayer, with a higher deduction allowed for taxpayers born between 1946 and 1952, than allowed for those born after 1952. For example, for a taxpayer filing a single return, the maximum deduction is $35,000 if he or she was born between 1946 and 1952, and $15,000 for a taxpayer born in 1953 or later. It now has been suggested that the higher amount should be available to those born after 1952 if they were retired when Public Act 597 took effect.

CONTENT

The bill would amend the Income Tax Act to extend to a person who was born after 1952 and retired as of January 1, 2013, an increased deduction for retirement or pension benefits from governmental employment that was not covered by Social Security.

The bill would be retroactive and effective for tax years beginning on and after January 1, 2013.

Currently, as a rule, a taxpayer born between 1946 and 1952 may deduct from taxable income public or private pension and retirement income, subject to a limit of $20,000 for a single return or $40,000 for a joint return. After the taxpayer reaches age 67, the limit remains the same but applies to all income, including retirement and nonretirement income. The Act also allows a full deduction for Social Security income and other select types of income.

A taxpayer born after 1952 may not deduct public or private pension or retirement income other than Social Security income, until he or she reaches age 67. At that time, the person may take a deduction (limited to $20,000 for a single return or $40,000 for a joint return) against all income, including Social Security income and other types of income (including retirement and nonretirement income), instead of the standard personal exemption.

Beginning January 1, 2013, these provisions apply except as described below.

For a person born between 1946 and 1952 who receives retirement or pension benefits from employment with a governmental agency that was not covered by Social Security, the deduction for retirement or pension income is limited to $35,000 for a single return or $55,000 for a joint return. The maximum deduction is $70,000 for a joint return, if both the husband and wife filing jointly receive retirement or pension benefits from employment with a governmental agency that was not covered by Social Security. When the taxpayer reaches age 67, the deduction amount remains the same but includes all income. Under the bill, this also would apply to a person born after 1945 (including someone born after 1952) who was retired as of January 1, 2013.

Currently, if a person born after 1952 is between 62 and 66 years of age, and receives retirement or pension benefits from employment with a governmental agency that was not covered by Social Security, the Act allows a deduction of retirement or pension income subject to a limit of $15,000 for a single or joint return. The maximum deduction for a joint return is $30,000, if both the husband and wife receive retirement or pension benefits from such employment. Under the bill, this would apply except as otherwise provided for a person who was retired as of January 1, 2013 (i.e., for a person born after 1952 who was retired on that date).

Also, the bill would refer to both "spouses", rather than both "the husband and wife", in these provisions.

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

Public Act 597 of 2012 was enacted to bring a measure of fairness to retirees who do not receive Social Security income. These taxpayers are primarily public safety officers who worked for local units of government that opted out of the Social Security system (which is allowed if the local units meet certain criteria). Unlike many or most other retirees, who receive both a pension and Social Security retirement, these public safety officers receive only retirement or pension income. Until the 2012 amendments were enacted, this income was deductible only to the same extent as other retirees' income.

Although the amendments improved the situation for the affected retirees, those who were born after 1952 are at a disadvantage. The deduction allowed for this population is smaller than that allowed for those born before 1952 and it does not apply until the individual reaches age 62. Someone who was born in 1957 and retired in 2012, for example, might find his or her entire retirement income subject to taxation and, once he or she turns 62, will be allowed to deduct only $15,000. This is not an unlikely scenario if the person retired from a local unit with an early mandatory retirement age. In addition, it is not uncommon for police officers and fire fighters to retire at a relatively early age due to the physical and emotional demands of the job.

The changes proposed by the bill would affect only those who were born after 1952 and were retired as of January 1, 2013. The bill would put these taxpayers on the same footing as those born before 1953 who retired from government employment that was not covered by the Social Security Act. Allowing an increased deduction of retirement benefits would reduce the financial burden on individuals who worked to protect the safety of the public.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce General Fund and School Aid Fund revenue by an unknown, but likely minimal, amount that would depend on the number of individuals affected and their specific financial characteristics. The bill would affect individuals born after 1945, who were retired as of January 1, 2013, and receive retirement or pension benefits from employment with a government agency that was not covered by the Federal Social Security Act. The bill does not define the criteria an individual would have to meet in order to be considered retired. Some of these individuals, who were born before 1953, already receive a deduction for a portion of the affected income. For these individuals, the increase in the deduction would be between $20,000 and $25,000. Individuals affected by the bill but born after 1952 do not receive any deduction until they reach age 62, and if they are not receiving a deduction, the bill would provide a deduction of either $35,000 or $55,000.

While the bill would increase the amount of retirement income that may be deducted from taxable income to $55,000 per return, depending on filing status, the maximum impact for any individual taxpayer would be a liability reduction of $2,338 per year for a joint return not currently receiving any deduction. Some taxpayers would not have sufficient income to fully claim the increased deduction amounts and would experience lesser reductions in liability.

The number of individuals born after 1945, who were retired as of January 1, 2013, and receive retirement or pension benefits from employment with a government agency that was not covered by the Federal Social Security Act, is unknown. The most commonly affected individuals were employed in police or fire protection occupations, which represent approximately 0.07% of total Michigan employment, and at least a portion of these individuals worked in positions covered by the Social Security Act. Assuming 0.07% of Michigan residents over the age of 65 would be affected by the bill, and all of these individuals experienced the maximum liability reduction available under the bill, the bill would reduce State revenue by approximately $2.6 million. To the extent that some individuals already receive some deduction, some individuals file as singles, and some report less income than the proposed deduction, the impact of the bill would be less.

Because the bill indicates it would be retroactive, the impact in FY 2015-16 would be roughly three times the annual impact of the bill. As a result, the bill could reduce FY 2015-16 revenue by as much as $7.8 million, with revenue reductions in later years declining to approximately $2.6 million.

Fiscal Analyst: David Zin

A1516\s368a