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INCOME TAX DEDUCTION FOR CERTAIN RETIREMENT INCOME

House Bill 4396 (reported from Committee as H-1)
Sponsor: Rep. Joseph N. Bellino, Jr.
Committee: Tax Policy
Complete to 6-9-17

BRIEF SUMMARY: House Bill 4396 would amend the Income Tax Act (MCL 206.30) to provide an increased tax deduction for retirement income to a specific group of retirees who were not covered by the federal Social Security system. Specifically, the bill would provide an increased income tax deduction for individuals that meet the following criteria: (1) were born after 1952; (2) retired as of January 1, 2013; and (3) receive retirement or pension benefits from employment with a governmental agency that was not covered by Social Security.

(A deduction reduces taxable income in the calculation of tax liability. A credit directly reduces tax liability.)

The bill would also appear to standardize the use of the term "retirement or pension benefits" throughout the section.

FISCAL IMPACT: The bill would reduce revenues by $2.3 to $2.6 million on an annual basis. Approximately 76.2% of any revenue reduction would impact the General Fund and 23.8% would impact the School Aid Fund.

THE APPARENT PROBLEM:

State taxation of retirement and pension income has changed in recent years, and state tax policy has affected various groups of retirees in different ways.[1] When legislation was passed in 2011 (Public Act 38), individuals, depending on year of birth and age, could deduct all or a portion of various types of income, including both Social Security income and public and private pensions. This provision created a tax disadvantage for individuals who were employed by governmental agencies that opted out of Social Security.

That is, these individuals only had one primary type of retirement income—pension income, but not Social Security income—to deduct. Public Act 597 of 2012 increased the deduction amounts for individuals whose employer opted out of Social Security, but that legislation maintained deduction limits and two levels of deductions based on the taxpayer's year of birth and age. HB 4396 would extend the highest level of deductions to affected individuals who were born after 1952 and were retired as of January 1, 2013, roughly the date when the 2012 legislation went into effect.[2]

[1] For a chart of the current tax treatment of retirement income, see Michigan Department of Treasury, "Income Tax for Retirement Benefits Effective for Tax Year 2016." http://www.michigan.gov/documents/taxes/2016RetirementAndPensionBenefitsChart_544015_7.pdf
[2] PA 597 became effective January 9, 2013.

THE CONTENT OF THE BILL:

Currently, a person **born in 1946 through 1952 who has not yet reached the age of 67** and who receives retirement or pension benefits from employment with a governmental agency that was not covered by Social Security can deduct up to:

- **$35,000** in retirement or pension benefits from that agency (single filer)
- **$55,000** in retirement or pension benefits from that agency (joint filers)
- **$70,000** in retirement or pension benefits from that agency (joint filers, if both spouses worked at an "uncovered" agency)

Once the person **reaches the age of 67**, the deduction amounts remain the same, but the deduction is available against all types on income and is not restricted to income from retirement or pension benefits.

House Bill 4396 would extend the income tax treatment described above to **any person born after 1945 who was retired as of January 1, 2013.** (Thus, the *new* individuals receiving this benefit would be those who born after 1952 **and** who were retired as of January 1, 2013). The person would still need to have been employed by and receive retirement or pension benefits from a governmental agency that was not covered by Social Security.

ADDITIONAL INFORMATION:

Under current law, a person **born after 1952 who has reached the age of 62 through 66 years of age** and who receives retirement or pension benefits from employment with a governmental agency not covered by Social Security can deduct up to:

- **$15,000** in retirement or pension benefits from that agency (single AND joint filers)
- **$30,000** in retirement or pension benefits from that agency (joint filers, if both spouses worked at an "uncovered" agency)

Under HB 4396, these provisions would still apply to those who were not retired as of January 1, 2013.

DISCUSSION AND ARGUMENTS:

This legislation would extend a benefit currently received by those born between 1946 and 1952 to any individual who was retired as of the date when the 2012 amendments became effective.

According to testimony before the House Tax Policy Committee (5-24-17), the groups affected by the bill are generally retired police officers and fire fighters from the City of Detroit and retirees from the Michigan State Police. There are thought to be about 1,000 retirees and spouses with employment from the City of Detroit, and about 500 retirees and spouses from the Michigan State Police. There are other smaller police and fire departments that could be affected.

Supporters of the legislation say that this seems a reasonable benefit to provide to individuals who dedicated their careers to protecting public safety. Additionally, since many police and firefighters retire early because of mandatory retirement ages, the bill would be a significant boost to these individuals during their many years of retirement. Finally, the benefit would further support retirees from the City of Detroit who have seen their pension benefits and retiree health care benefits reduced by the city's bankruptcy.

Supporters of the legislation also point to the fact that the beneficiaries of the legislation have been promised favorable tax treatment of their pension income, but that promise has yet to be fulfilled. When the original tax legislation passed in 2011, these individuals were put at a tax disadvantage. Moreover, the original intent of the 2012 amendments to fix this problem (SB 409 of 2011 "as introduced") was to exclude <u>all</u> applicable pension income from taxation for these affected individuals, but that legislation was amended to include deduction limits, as well as year of birth and age criteria.

Opponents of the bill argue that the bill would exacerbate the inequities between retired taxpayers. Under the bill, an individual born in 1958 who retired in December 2012 would get a $35,000 (single) or $55,000 (joint) exemption for his or her entire retired life. On the other hand, an individual born in 1958 who retired in February 2013, just a few months later, would get a $15,000 (single <u>and</u> joint) exemption between 62 and 66, then a standard $20,000 (single) or $40,000 (joint) deduction after turning 67. This treats two similar taxpayers differently simply because they retired three months apart. There are other numerous examples in which a younger individual could receive a larger deduction than an older individual, or where an employee who has fewer years of service could receive a larger deduction than an individual who retired with more service.

It is also be a concern that this legislation represents an erosion of the principles of the comprehensive tax overhaul enacted in 2011. This could lead to other stakeholders and interest groups petitioning for greater income tax deductions in the future.

(During committee hearings, the Department of Treasury expressed concern about the retroactive nature of the bill as introduced. The committee substitute, however, removes the retroactive provision.)

POSITIONS:

- A representative of the Retired Detroit Police and Fire Fighters Association testified in <u>support</u> of the bill. (5-24-17)
- A representative of the Michigan State Police Troopers Association indicated <u>support</u> for the bill. (5-24-17)
- The Michigan Department of Treasury testified in <u>opposition</u> to the bill:

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