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BILL ANALYSIS

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Senate Bill 266 (as reported without amendment)
Sponsor: Senator Ken Horn
Committee: Finance

CONTENT

The bill would amend the Income Tax Act to do the following:

-- 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.
-- Allow a taxpayer to deduct from adjusted gross income pension benefits, as well as retirement benefits, received for service in the United States armed forces.

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, 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).

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

MCL 206.30 Legislative Analyst: Drew Krogulecki

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 after 1952, 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. Other 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 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 per year. 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 2017-18 would be roughly five times the annual impact of the bill. As a result, the bill could reduce FY 2017-18 revenue by as much as $11.0 million to 13.0 million, with revenue reductions in later years declining to approximately $2.3 million to $2.6 million. Approximately 23.8% of any reduction would affect School Aid Fund revenue, with the remaining reduction lowering General Fund revenue.

Date Completed: 5-18-17 Fiscal Analyst: David Zin

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.