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BILL ANALYSIS

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House Bill 4001 (as passed by the House)
Sponsor: Representative Angela Witwer
House Committee: Tax Policy (discharged)
Senate Committee: Committee of the Whole

Date Completed: 1-31-23

CONTENT

The bill would amend the Income Tax Act to allow a taxpayer, beginning in the 2023 tax year, to choose between the current limitations on the deductibility of retirement and pension income or the limitations specified in the bill, and to modify the amount of gross collections from the individual income tax (IIT) that the Department of Treasury must deposit into the State School Aid Fund (SAF).

Modifications to Limitations & Restrictions of Retirement Income

Under the Act, "taxable income" means, for a person other than a corporation, estate, or trust, adjusted gross income (AGI) as defined in the Internal Revenue Code, subject to the adjustments specified in the Act. These adjustments generally include a deduction to the extent included in AGI for certain retirement or pension benefits. Under current law, the specific deduction that a taxpayer may claim depends on the year in which he or she was born, particularly with respect to seniors and those who receive retirement or pension benefits. The deductions for these types of income are subject to various limitations and restrictions specified in the Act, which are discussed in **BACKGROUND**.

Under the bill, in determining taxable income, a taxpayer would have the option to use the following limitations and restrictions for the deductibility of retirement income instead of those currently applicable:

-- For the 2023 tax year: a taxpayer who was born after 1945 and before 1959 could deduct an amount of retirement or pension benefits not to exceed 25% of the maximum amount of those benefits that the taxpayer would be allowed to deduct for the tax year for other retirement benefits or annuity income (i.e., not military, State, or Federal retirement benefits) if the taxpayer were subject to the limitations for those born before 1946.
-- For the 2024 tax year: a taxpayer who was born after 1945 and before 1963 could deduct an amount of retirement or pension benefits not to exceed 50% of the amount described above.
-- For the 2025 tax year: a taxpayer who was born after 1945 and before 1967 could deduct an amount of retirement or pension benefits not to exceed 75% of the amount described above.
-- For the 2026 tax year and subsequent tax years: a taxpayer may deduct eligible retirement or pension benefits received from a Federal or State public retirement system, Social Security benefits, and, a maximum of $42,240 for a single return and $84,480 for a joint return, as adjusted for inflation since 2007, for retirement benefits from another retirement or pension system or a retirement annuity policy, without any additional limitations or restrictions.

For a joint return, the proposed limitations and restrictions would have to be applied based

on the date of birth of the older spouse filing the return. If a deduction for State, Federal, or nonmilitary retirement or pension benefits were claimed on a joint return for a tax year in which a spouse died and the surviving spouse had not remarried since the death of that spouse, the surviving spouse would entitled to claim the deduction in subsequent tax years subject to the same restrictions and limitations that would have applied based on the date of birth of the older of the two spouses.

<u>Distributions to SAF</u>

The Act currently requires that percentage of the gross collections before refunds from the IIT that is equal to 1.012% divided by the income tax rate (i.e., currently approximately 23.81% of gross collections) be deposited in the SAF. Under the bill, this would apply through fiscal year (FY) 2022-23. After that, the following distributions would be required:

-- For FY 2023-24 only: the percentage of the gross collections before refunds from the IIT that is equal to 1.019% divided by the income tax rate.
-- For FY 2024-25 only: the percentage of the gross collections before refunds from the IIT that is equal to 1.031% divided by the income tax rate.
-- For FY 2025-26 and later fiscal years: the percentage of the gross collections before refunds from the IIT that is equal to 1.045% divided by the income tax rate.

MCL 206.30 & 206.51

<u>BACKGROUND</u>

<u>Retirement Income Deduction; Limitations</u>

As noted above, an individual's taxable income is computed in part by deducting various retirement or pension income. The deduction for other retirement or pension income is subject to various limitations and restrictions specified in the Act, depending on age and date of birth. These are grouped and discussed below.

<u>Born before 1946</u>. For an individual born before 1946, a taxpayer may deduct to the extent included in AGI, military, National Guard, or railroad pension and retirement income. A taxpayer also may deduct, to the extent included in AGI, eligible retirement and pension benefits received from a Federal or State public retirement system, Social Security benefits, and a maximum of $56,961 for a single return and $113,922 for a joint return for the 2022 tax year (the amounts in statute are set at $42,240 (single), $84,480 (joint), but are adjusted for inflation) for retirement benefits from another retirement or pension system or a retirement annuity policy.

<u>Born in 1946-1952</u>. For an individual born in 1946 through 1952, the sum of the deduction for the benefits described above, except for Social Security benefits, is limited to $20,000 for a single return and $40,000 for a joint return. After he or she reaches the age of 67, the deduction for those benefits does not apply and he or she is eligible for an unrestricted deduction of $20,000 for a single return and $40,000 for a joint return against all types of income. A person who takes the deduction for a military, National Guard, or railroad pension or retirement benefits is not eligible for the unrestricted deduction.

In addition, for these taxpayers, and for taxpayers born after 1945 and who retired as of January 1, 2013, if the taxpayer receives retirement or pension benefits from employment from a governmental agency not covered by the Social Security Act, the sum of the deduction is limited to $35,000 for a single return and $55,000 for a joint return. If both spouses on a joint return receive these benefits, the deduction is limited to $70,000. After he or she reaches

67 years of age, the restrictions do not apply and he or she is eligible for an unrestricted deduction of $35,000 for a single return, $55,000 for a joint return, or $70,000 for a joint return if applicable, against all types of income. A person who takes the deduction for a military, National Guard, or railroad pension or retirement benefits is not eligible for the unrestricted deduction.

<u>Born after 1952</u>. Except as noted above for those retired as of January 1, 2013, for a person born after 1952 who is 62 through 66 years of age and who receives retirement or pension benefits from employment with a government agency not covered by the Social Security Act, the deduction is limited to $15,000 for a single return and, generally, $15,000 for a joint return. If both spouses receive these types of benefits, the deduction is limited to $30,000.

Otherwise, when a taxpayer in this category reaches 67 years of age, he or she is eligible for an unrestricted $20,000 for a single return and $40,000 for a joint return. If the taxpayer takes this deduction, he or she may not take the deduction for Social Security benefits and may not claim a personal exemption; a taxpayer may claim the set of deductions/exemptions that reduces his or her liability the most. A person who takes the deduction for military, National Guard, or railroad retirement or pension benefits is not eligible for the unrestricted $20,000/$40,000 deduction.

<u>Joint Returns & Surviving Spouses</u>

For joint returns, the limitations and restrictions listed above are applied based on the older spouse's date of birth. If a deduction for nonmilitary or nonrailroad retirement or pension benefits was claimed on a joint return for a tax year in which a spouse died and the surviving spouse has not remarried, the surviving spouse may claim the deduction for those benefits in subsequent tax years subject to the same restrictions and limitations, for a single return, that would have applied based on the date of birth of the older of the two spouses.

Beginning with the 2020 tax year, a surviving spouse born after 1945 who has reached the age of 67 and has not remarried since the death of his or her spouse may take the unrestricted deduction subject to the same limitations and restrictions based on the surviving spouse's date of birth instead of the deduction allowed for nonmilitary/nonrailroad retirement or pension benefits for a single return, based on the date of birth of the older spouse.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

Based on estimates from the Department of Treasury, the bill would reduce General Fund revenue by approximately $39.0 million fiscal year (FY) 2022-23, $175.0 million in FY 2023-24, $339.0 million in FY 2024-25, and $455.0 million in FY 2025-26. The bill's provisions would not be fully phased in by FY 2025-26. Consequently, FY 2026-27 would be the first full fiscal year to reflect the fully phased-in provisions and the revenue loss likely would exceed $500.0 million. The revenue loss would continue to increase in later years because of population demographics, which are projected to result in an aging population. These demographic changes will increase the share of total taxpayers affected by tax provisions on senior or retirement income, meaning that revenue losses from exempt senior or retirement income will not be fully offset by increased revenues from new entrants to the tax system.

Fiscal Analyst: David Zin

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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.