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RETIREMENT/PENSION BENEFITS

House Bill 4459 (Substitute H-2)
First Analysis (1-23-96)

Sponsor: Rep. Deborah Whyman
Committee: Tax Policy

THE APPARENT PROBLEM:

In 1994, the legislature enacted amendments to the Income Tax Act aimed at putting private pension and retirement income on a more equal footing with income from public sector pensions. Prior to the amendments, public pensions were not taxed but income from private pensions and retirement benefits beyond $7,500 for single returns and $10,000 for joint returns was subject to the state income tax. The exemptions for private pensions and retirement benefits were raised in 1994 to $30,000 for a single return and $60,000 for a joint return. Although the act has for years referred to "retirement or pension benefits" in sections that describe how to determine taxable income, that phrase has not been defined in the statute. Instead, tax specialists say, the Department of Treasury has defined the phrase in rules and in revenue administrative bulletins. Legislation has been introduced that would put a definition of "retirement or pension benefits" in statute consistent with Department of Treasury's application of the phrase.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act to define "retirement or pension benefits" as that term is used in the provision that permits the deduction of such benefits from adjusted gross income. "Retirement or pension benefits" would refer to the following.

** Qualified pension trusts and annuity plans that qualify under Section 401(a) of the Internal Revenue Code, including:

-- plans for self-employed persons, commonly known as Keogh or HR 10 Plans.

-- individual retirement accounts that qualify under Section 408 of the Internal Revenue Code if the distributions are not made until the participant has reached 591/2 years of age, except in the case of death or disability.

-- employee annuities or tax-sheltered annuities purchased under Section 403(b) of the Internal Revenue Code by organizations exempt under Section 501(c)(3) of the Internal Revenue Code or by public school systems.

-- employer and employee contributions mandated by the provisions of a plan under Section 401(k) of the Internal Revenue Code.

** The following plans not qualified under the Internal Revenue Code:

-- plans of the United States, state governments other than Michigan's, and political subdivisions, agencies, or instrumentalities of this state.

-- plans maintained by a church or a convention or association of churches.

-- all other unqualified pension trusts that prescribe eligibility for retirement and predetermine contributions and benefits.

** Retirement or pension benefits received by a surviving spouse if those benefits qualified for a deduction prior to the decedent's death. Benefits received by a surviving child are not deductible.

Retirement and pension benefits would <u>not</u> include:

-- amounts received from a plan that allows the employee to set the amount of compensation to be deferred and does not prescribe retirement age or years of service. These plans may include deferred compensation plans under Sections 401(k) and 457 of the Internal Revenue Code and plans under Section 403(b) of the Internal Revenue Code.

-- premature distributions paid on separation, withdrawal, or discontinuance of a plan prior to the earliest date the recipient could have retired under the provisions of the plan.

-- payments received as an incentive to retire early unless the distributions are from a pension trust.

MCL 206.30

FISCAL IMPLICATIONS:

The bill would have no fiscal impact, according to the House Fiscal Agency. (Fiscal Note dated 1-17-96)

ARGUMENTS:

For:

The bill would put into the income tax statute a definition of "retirement and pension benefits" consistent with that developed by the Department of Treasury in rules and revenue administrative bulletins. The bill would make clear in statute what kind of plans and benefits qualify for the pension and retirement benefit deduction under the Income Tax Act.

POSITIONS:

The Department of Treasury supports the bill. (1-18-96)

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.