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

BILL ANALYSIS

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

House Bill 5034 (Substitute H-2 as passed by the House)
Sponsor: Representative Aaron Miller
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 12-11-18

CONTENT

The bill would amend the Income Tax Act to specify that, for tax years beginning after December 31, 2017, the tax treatment of retirement income for a married couple filing jointly could be extended to the surviving spouse after the death of the other spouse, subject to the same limitations and restrictions, for a single return, that would have applied based on the date of birth of the older spouse.

Part 1 of the Income Tax Act imposes a tax at the rate of 4.25% on the taxable income of individuals. "Taxable income" means adjusted gross income as defined in the Internal Revenue Code, subject to a number of additions and deductions. In determining taxable income, certain limitations and restrictions on retirement income apply.

For a joint return, these limitations and restrictions must be applied based on the age of the older spouse filing the joint return. The bill would amend this provision to state that the limitations and restrictions would be applied based on the date of birth of the older spouse, instead of his or her age.

In addition, for tax years beginning after December 31, 2017, if a deduction under Section 30(1)(f) of the Act were claimed on a joint return for at least two tax years before the death of a spouse and the surviving spouse had not remarried since the death, the surviving spouse would be entitled to claim that deduction in subsequent tax years subject to the same limitations and restrictions, for a single return, that would have applied based on the date of birth of the older of the two spouses. However, a surviving spouse born after 1945 who had reached the age of 67 and had not remarried since the death of that spouse could elect to take the deduction that was available against all types of income subject to the same limitations and restrictions based on the surviving spouse's date of birth instead of taking the deduction allowed under Section 30(1)(f), for a single return, based on the date of birth of the older spouse.

(When calculating his or her taxable income, Section 30(1)(f) requires a taxpayer to deduct the following to the extent included in adjusted gross income subject to the retirement income limitations and restrictions:

-- Retirement or pension benefits received form a Federal public retirement system or from a public retirement system of or created by the State or a political subdivision of the State.
-- Retirement or pension benefits received from a public retirement system of or created by another state or any of its political subdivisions if the income tax laws of the other state permit a similar deduction or exemption or a reciprocal deduction or exemption of a

-- retirement or pension benefit received from a public retirement system of or created by the State or any political subdivisions of the State.
-- Social security benefits.
-- Beginning on and after January 1, 2007, certain retirement or pension benefits that are not deductible from any other retirement or pension system or benefits from a retirement annuity policy in which payments are made for life to a senior citizen, to a maximum of $42,240 for a single return and $84,480 for a joint return, which amounts may be adjusted as described under the Act.
-- The amount determined to be the Section 22 amount eligible for the elderly and the permanently and totally disabled credit provided in Section 22 of the Internal Revenue Code.)

MCL 206.30 Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bill would reduce individual income tax revenue to the School Aid Fund and General Fund by an unknown, but likely minimal, amount that would depend on the number of taxpayers affected and the total amount of affected income. The number of taxpayers that would be affected by the bill is unknown, although at some point the number affected should decline as fewer taxpayers are likely to be married to an older individual covered by different tax provisions.

To illustrate the potential impact of the bill, approximately 95,000 individuals in Michigan die each year, although the overwhelming majority of them are not married to an individual who would experience different tax treatment of retirement income under the individual income tax. Based on IRS data, pension and annuity income in Michigan averaged $21,800 per return in tax year 2016. If 1% of deaths were affected by the bill, based on average income, and assuming retirement income went from fully exempt to fully taxable, the bill would reduce individual income tax revenue by approximately $900,000 per year. If 2% of the deaths were affected by the bill, the impact would be approximately $1.8 million per year. Because affected individuals likely would be able to still claim deductions against the income, the actual impact on revenue would be less.

Approximately 23.8% of gross individual tax revenue is distributed to the School Aid Fund, while 100% of all refunds are applied to the General Fund. The relative impact of the bill on the School Aid Fund and General Fund is unknown and would depend on whether individuals incorporated the impact of the bill on withholding and/or estimated payments, or claimed the impact as a refund when they filed their returns.

Fiscal Analyst: David Zin

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