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SFA BILL ANALYSIS

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Senate Bill 454 (as passed by the Senate)
Sponsor: Senator Thaddeus G. McCotter
Committee: Finance

Date Completed: 5-18-99

## RATIONALE

The Income Tax Act allows persons to claim a credit against the income tax for property taxes paid on their Michigan residence, or homestead. The Act also allows low-income persons to claim a home heating credit to help them pay for heating costs. For purposes of calculating the homestead property tax credit and the home heating credit, an individual must determine his or her household income. Household income is the total taxable and nontaxable income of all members of a household in a tax year, except income specified as exempt (such as State and local income tax refunds, and health and life insurance premiums paid by an employer). Funds withdrawn from an individual retirement account (IRA) are considered part of household income. Reportedly, some people who have withdrawn funds from a standard IRA for the sole purpose of transferring the money to a Roth IRA have been required to include the transferred amount as household income, thus reducing their available credit or disqualifying them from claiming the credit. It has been suggested that money withdrawn from an IRA for transfer to a Roth IRA be excluded from the calculation of household income.

## CONTENT

The bill would amend the Income Tax Act to provide that, for 1999 and thereafter, for purposes of calculating the homestead property tax credit and the home heating credit, household income would not include an amount withdrawn by a member of the household in a tax year from the member's IRA (established under the Federal Internal Revenue Code), and subsequently contributed to a Roth IRA in the same year.

MCL 206.508

## BACKGROUND

The Federal Taxpayer Relief Act of 1997 created a new type of IRA, the Roth IRA. An individual may make annual nondeductible contributions to his or her Roth IRA of up to $2,000 ($4,000 per couple). After age 59-1/2, or under certain circumstances prescribed in the Internal Revenue Code, the individual may make tax-free withdrawals. In general, qualified taxpayers who open standard IRAs make tax-deductible contributions to those IRAs, but upon withdrawal the contributions and interest earned on the contributions are taxable.

## ARGUMENTS

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### Supporting Argument

In planning for their retirement, some people may find it advantageous or desirable to transfer money from a standard IRA to a Roth IRA. While it may be argued that withdrawals from an IRA for use as discretionary income should be included as household income for the purpose of calculating the homestead property tax credit, it is hard to understand why such a withdrawal should be considered household income when the only purpose of the withdrawal is to move the money to another IRA. The Act, however, requires that all withdrawals from an IRA be included as household income, meaning that some people who have transferred money to a Roth IRA have found themselves with a reduced homestead property tax credit, or have found that they no longer qualified for the credit. By allowing transfers from a standard IRA to a Roth IRA to be excluded from household income, the bill would eliminate the possibility that taxpayers would lose or reduce their homestead property tax credit simply for attempting to manage their retirement investments.

Legislative Analyst: G. Towne

## FISCAL IMPACT

This bill would increase property tax credits, and therefore reduce income tax revenue, by an estimated $2.0 million in FY 1999-2000. This loss in revenue would affect the General Purpose portion of the General Fund.

Fiscal Analyst: J. Wortley

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