

## ELIMINATE THREE-TIERED TREATMENT OF RETIREMENT INCOME

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House Bill 4006 as referred to second committee

Sponsor: Rep. Joseph N. Bellino, Jr.

1st Committee: Tax Policy

2nd Committee: Ways and Means

Complete to 3-14-19

Analysis available at  
<http://www.legislature.mi.gov>

**BRIEF SUMMARY:** House Bill 4006 would amend the Income Tax Act by allowing an exemption for the distribution of retirement income after December 31, 2018. This exemption would apply to retirement income for all taxpayers, regardless of the taxpayer's date of birth. The bill would also allow for all senior citizens a deduction of certain investment income that is currently only available to those born before 1946.

**FISCAL IMPACT:** As written, the bill would reduce individual income tax revenue on a full fiscal year basis by about \$330 million, and that amount would be expected to grow by about \$15 million per year as new retirees become eligible and retirement accounts continue to grow. The School Aid Fund would be reduced by approximately \$75 million, and the remaining \$255 million reduction would be borne by the general fund.

### ***THE CONTENT OF THE BILL:***

Currently under the act, retirement income is taxed in a three-tier system, depending on the taxpayer's date of birth:

In the first tier, for taxpayers born before 1946, public pension and social security income is tax-exempt. Eligible taxpayers in this tier may subtract private retirement income, but the exemption for private retirement income or for a combination of private retirement income and tax-exempt public retirement income cannot exceed a specific limit, which for tax year 2018 is \$51,570 for single filers and \$103,140 for joint filers.

In the second tier, for taxpayers born between 1946 and 1952, taxation of retirement income varies depending on whether the taxpayer has reached the age of 67. For those who have not, their social security, railroad pension, and military pension income is tax-exempt. They are eligible for an exemption against retirement income of \$20,000 for single filers or \$40,000 for joint filers. Once they reach age 67, they are eligible for an exemption against all income of \$20,000/\$40,000, but only if they do not choose to claim a military or railroad pension exemption.

In the third tier, for taxpayers born after 1952, taxation once again varies based on whether the taxpayer has reached the age of 67. For those younger than 67 (currently everyone in this cohort), social security, railroad pension, and military pension income is once again tax-exempt. These taxpayers also are ineligible for

retirement income exemptions. Once they turn 67, they are eligible for an exemption against all income of \$20,000 for single filers and \$40,000 for joint filers, if they claim no social security, military or railroad pension, or personal exemptions; or, they may choose to receive the prior exemptions, but not the overall exemption of \$20,000/\$40,000.

For joint returns under this system, the date of birth of the older spouse determines the tax treatment of income reported jointly, regardless of the date of birth of the younger spouse.

The bill would remove this tiered system, and all taxpayers would receive the exemptions for retirement income currently allowed to taxpayers under the first tier.

Further, under current law, taxpayers who were born before 1946 (those in the first tier, above) may deduct income such as dividends, interest, and capital gains, up to a deduction limit that is indexed to inflation, with the maximum allowable deduction reduced by any subtraction from income made for retirement income exemptions. (For tax year 2018, the deduction limit is \$11,495 for single filers and \$22,991 for joint filers.)

The bill would allow this deduction for all taxpayers 65 years of age or older.

The bill would apply beginning with the 2019 tax year.

MCL 206.30

***BACKGROUND:***

This bill is understood to be a partial repeal of 2011 PA 38, which first introduced the three-tiered tax system for taxpayers collecting retirement income.

***ARGUMENTS:***

***For:***

Supporters of the bill have argued that the three-tiered system puts an undue burden on Michigan's senior population at a time of slow economic growth, when many of them are having trouble making ends meet. They argue that 2011 PA 38 was unfair to retirees when it was implemented, as these retirees had worked hard and saved up for retirement under a fixed income only for the rules of the game to be changed. They argue that this is especially unfair to retirees on public pensions, whose pension income was exempt before 2011 PA 38, and many of whom had spent their career working for lower wages than their privately employed counterparts with the understanding that their pensions would be exempt from the state income tax. In addition, supporters have held that the tiered system will put a greater tax burden on future generations of retirees and have criticized this as unequal and unfair. They argue that the current system was implemented when Michigan's budget was in a tight spot following the recession and that, with Michigan back on more solid fiscal footing, the state can afford to forgo this particular source of revenue.

***Against:***

Opponents of the bill have argued that it leaves a shortfall in Michigan's annual budget of over \$300 million, without providing a solution for making up the difference, and note that much of the forgone revenue would come out of the School Aid Fund. They also argue that this shortfall will only grow larger as Michigan's taxpaying population ages, producing more retirees who are paying fewer taxes. Opponents also expressed concern that repealing the tiered system could result in an added tax burden elsewhere to balance the budget.

***POSITIONS:***

A representative of the Department of Treasury testified in support of the bill. (2-28-19)

AARP Michigan indicated support for the bill. (2-27-19)

A representative of the National Federation of Independent Business testified with a neutral position regarding the bill. (2-28-19)

A representative of the Michigan Association of School Boards testified in opposition to the bill. (2-28-19)

The following organizations indicated opposition to the bill (2-28-19):

- Wayne RESA
- Michigan Association of Intermediate School Administrators

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