



Michigan Taxation of Seniors and Retiree Income

Background and Description

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Outline

- ▶ General Taxation Principles
- ▶ Selected Michigan Tax and Population Demographics
- ▶ Treatment of Seniors and Retirement Income During Tax Year 2011
- ▶ Treatment of Seniors and Retirement Income Beginning Tax Year 2012

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General Taxation Principles

- **Equity**
 - Vertical
 - Horizontal
- **Compliance Burden**
 - Taxpayer
 - Tax Administration
- **Other Considerations**
 - Broad Base
 - Lower Rates
 - Tax Cliffs/Effective Rates
 - Stability/Adequacy
 - Interstate Competition
 - Ability-to-pay vs. Benefits-received

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Practice is More Difficult Than Theory

- **Equity**
 - Vertical Equity: relevant time period
 - Horizontal Equity: what is the relevant basis for “similar”
- **Compliance**
 - Differentiating taxpayers adds complexity
 - Relationship between complexity and audit need
- **Other issues**
 - Race to the bottom
 - Desirability of what is included in a “broad base”
 - Balancing ability-to-pay with benefits-received
- **No perfect tax**

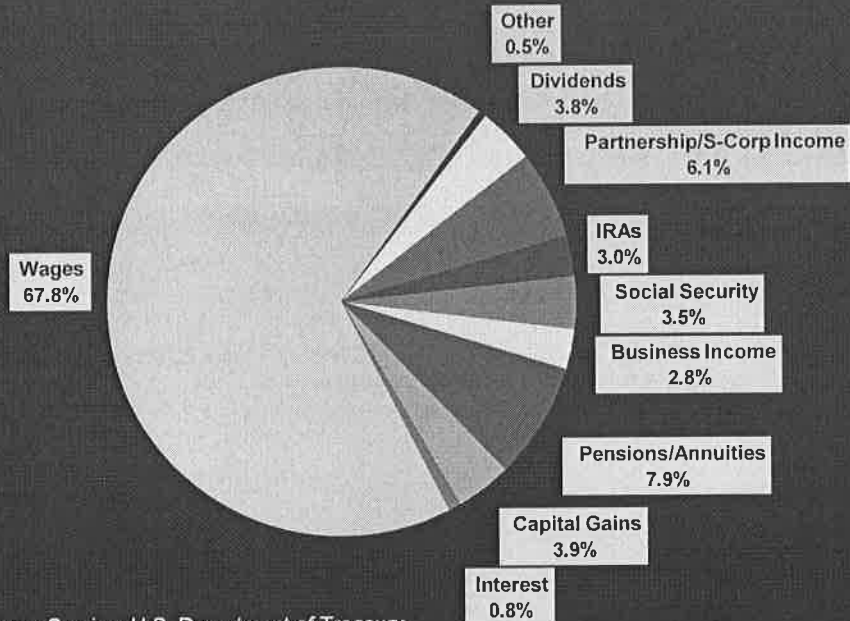
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Sources of Retirement Income

- **Employer-sponsored retirement plans**
 - Pensions, 401k/403b/457 plans, SIMPLE/SEP IRAs, KEOGH
- **Annuities/Insurance**
- **Individual Retirement Arrangements (IRAs)**
- **Social Security**
- **Investments (i.e. Stocks/Bonds)**
- **Savings/CDs**
- **Rents/Royalties**
- **Inheritances**
- **Employment**
- **Home Equity**
- **Pensions**
 - only source that actually requires “retirement”

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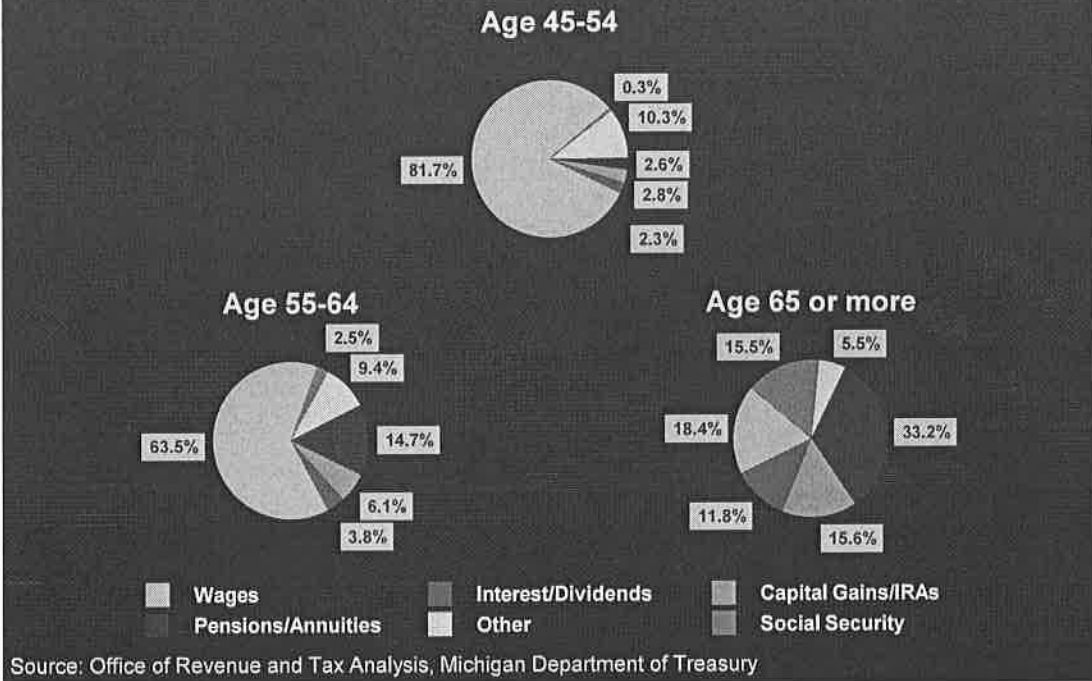
Income Sources Federal Total Income in Michigan, 2016



Source: Internal Revenue Service, U.S. Department of Treasury

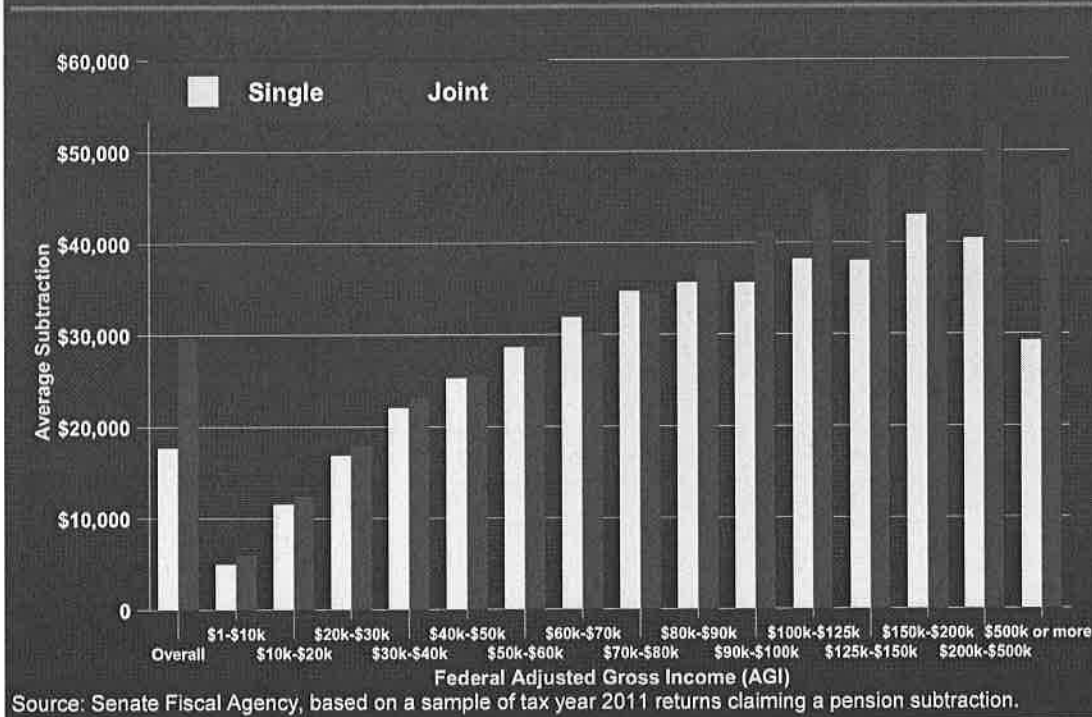
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Federal Total Income on Michigan Tax Returns By Age Group, 2010



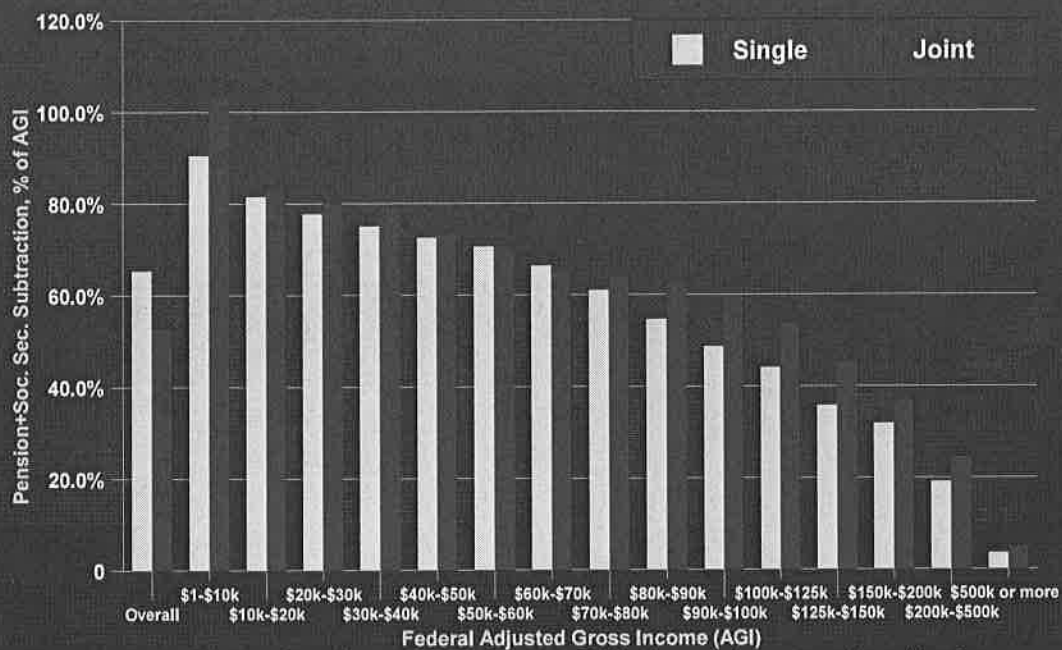
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Average Michigan Pension Subtraction Tax Year 2011



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Michigan Pension and Social Security Subtraction Share of Federal AGI, Tax Year 2011



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Michigan Income Tax for Tax Year 2011

- **Definition of taxable income focused on source of income**
- **Exemptions commonly affecting retirees included**
 - **Military compensation and retirement/pension benefits**
 - **Public retirement/pension benefits**
 - **Social security benefits**
 - **Retirement/pension and annuity benefits not listed, up to a maximum that is adjusted for inflation**
 - **Limited senior exemption for interest/dividends/capital gains**
- **Pension/retirement benefit effectively depend on whether or not the employer sets rules on the plan and/or contributes to the plan**
- **Additional personal exemption for seniors**
- **Select withdrawals/contributions from retirement plans exempt from tax**

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2011 Tax Restructuring Legislation

- Public Acts 38, 39, and 40 of 2011 restructured Michigan's business and personal income taxes
- Repealed the Michigan Business Tax for most taxpayers
- Created a new Corporate Income Tax
- Eliminated most credits, deductions and exemptions for individuals
- Substantially modified
 - Homestead Property Tax Credit
 - Earned Income Tax Credit
 - Treatment of "retirement" income

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Fiscal Impact of 2011 Tax Restructuring Legislation

- FY 2014-15 impact
 - \$1.8 billion tax reduction on businesses
 - From \$2.2 billion to approximately \$445 million
 - \$1.8 billion tax increase on individuals
 - \$618 million from delayed/eliminated rate changes
 - \$357 million from changes related to pensions
 - \$278 million from reductions in the Earned Income Tax Credit
 - \$273 million from changes in the Homestead Credit
 - \$110 million from repealing non-refundable credits
- Fund shifts
 - \$688 million reduction in School Aid Fund revenue
 - \$714 million increase in General Fund revenue
- P.A. 224 increased the personal exemption, reducing individual income tax revenue by \$32 million

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Key Provisions of the 2011 Individual Income Tax Changes Affecting All Taxpayers

- **Additional senior deduction eliminated**
 - Maximum impact of \$98 per senior
 - Only affected taxpayers age 65 or older
- **Homestead property tax credit changes**
 - Eliminated for those with income above \$50,000, or with homes with a taxable value of \$135,000 or more
 - Business income (both losses and gains) excluded from household resources
- **Income used for special purposes**
 - IRA withdrawals used to pay higher education expenses taxed
 - Charitable contributions made from a retirement plan no longer exempt

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2011 Restructuring Divided Taxpayers Into Age Groups

- **Definition of taxable income differs based on year of birth**
- **Group 1: Born before 1946**
 - Older than age 65 at the time
 - Will be 74 or older this year
- **Group 2: Born between 1946 and 1952**
 - Those who were age 59-65 at the time
 - These taxpayers will be between 67 and 73 this year
- **Group 3: Born after 1952**
 - These taxpayers were younger than 59 at the time
 - Oldest members of this group turn 66 this year

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Tax Changes for Those Born Before 1946

- **Generally no changes in the treatment of retirement income**
 - **Benefits under the Railroad Retirement Act of 1974 exempted**
- **Still affected by the changes that applied to all taxpayers**
 - **Senior exemption**
 - **Homestead property tax credit changes**
 - **Taxation of higher education withdrawals and charitable donations**
 - **Elimination of non-refundable credits**

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Tax Changes for Those Born Between 1946 and 1952

- **Treatment of retirement income depends on whether or not the taxpayer is age 67 or older**
- **If taxpayer is under age 67**
 - **Limited exemption for retirement/pension income**
 - \$20,000 single return/\$40,000 joint return
 - **Social security benefits exempt**
 - **Interest/dividends/capital gains taxed**
- **If taxpayer is age 67 or older**
 - **Limited exemption expanded to include all income**
 - **Social security benefits exempt**
- **Limited exemption is not available if the taxpayer chooses to exempt military and/or railroad benefits**

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Tax Changes for Those Born After 1952

- Treatment of retirement income depends on whether or not the taxpayer is age 67 or older
- If taxpayer is under age 67
 - Social security benefits exempt
 - Military/Railroad benefits exempt
 - Interest/dividends/capital gains taxed
- If taxpayer is age 67 or older
 - Taxpayer chooses between two exemption provisions
 - Option 1: Limited exemption available against all income
 - May not claim the personal exemption
 - Option 2: Social security benefits exempt
 - May claim the personal exemption
 - All other income is taxed

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Final Notes on the 2011 Restructuring Legislation

- Compared to the prior law, makes the age of the taxpayer more relevant than the source of the income
- Did not change the definition of “retirement or pension benefits”
 - Includes qualified plans such as KEOGH, IRAs with distributions made after age 59 ½, annuities, and 401k distributions from employer contributions or employer-mandated contributions
 - Includes non-qualified plans such as public plans, church plans, spousal benefits, certain pension trust
 - Does not include
 - 457 plans
 - “Elective” contributions to 401k and 403b plans
 - Distributions paid prior to the earliest date one could retire under the plan
- Exemption against all income makes the definition of retirement/pension benefits largely irrelevant

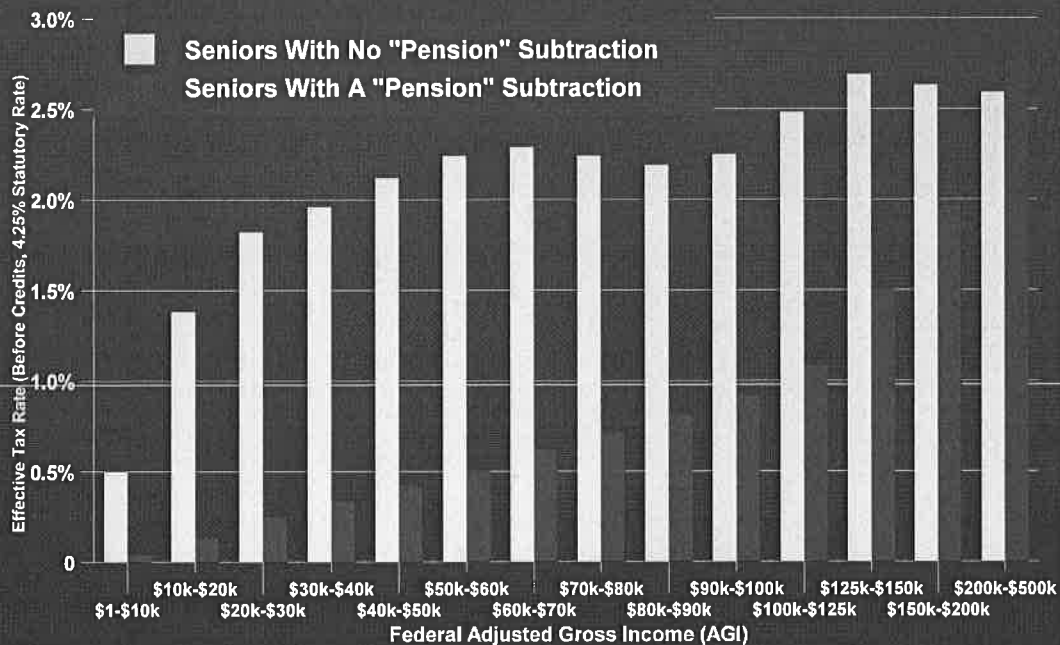
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Final Notes on the 2011 Restructuring Legislation (Continued)

- Limited exemption is not adjusted for inflation
- Special provisions for individuals who worked for an employer not covered by Social Security
- 2011 legislation did not define “retired” or “retire”
 - Prior law also did not have any definition
- Demographic distribution means the impact of both the legislation, and any changes, will increase over time

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Under Prior Law Effective Tax Rates Differed Substantially



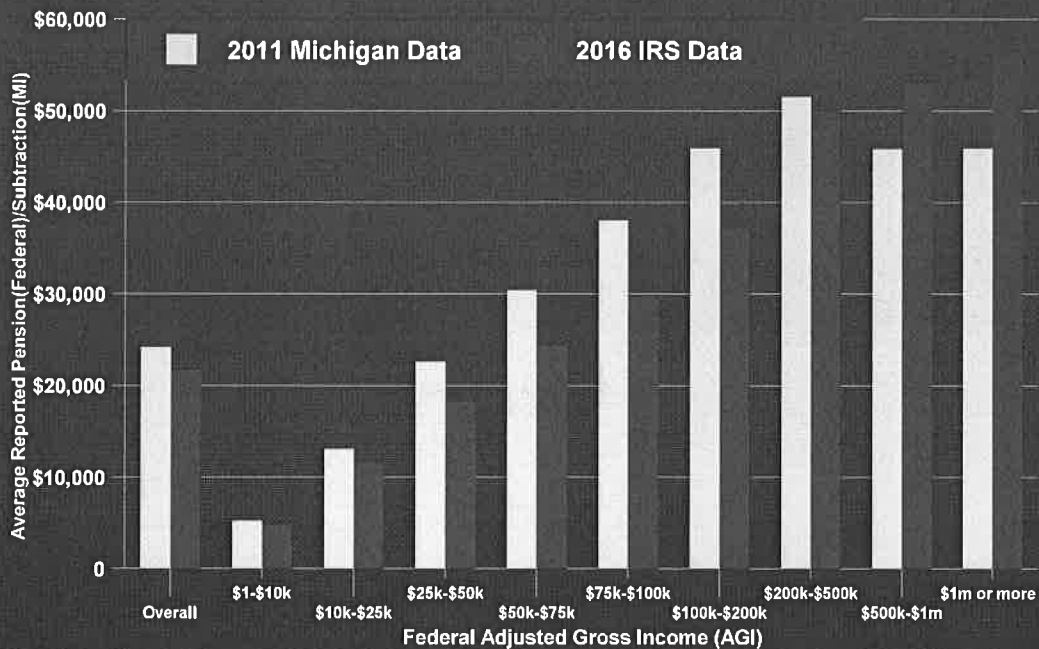
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Questions?

- More background information is available at:
- www.senate.michigan.gov/sfa
 - *State Notes, Summer 2011: Michigan Income Taxes on Seniors and Retirees Under the 2011 Tax Restructuring Legislation*
- https://www.michigan.gov/documents/treasury/IIT2011_432075_7.pdf
 - *Individual Income Tax 2011*
- <http://www.legislature.mi.gov/documents/2011-2012/billanalysis/Senate/pdf/2011-SFA-4361-N.pdf>
 - *Fiscal analysis for House Bills 4361, 4362, and 4479, as enacted*

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Comparing 2011 Sample Data With 2016 IRS Data



Source: IRS & Senate Fiscal Agency (MI data: sample of tax year 2011 returns claiming a pension subtraction.)

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