Legislative Analysis

INCOME TAX TREATMENT OF RETIREMENT INCOME OF SURVIVING SPOUSE

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House Bill 4124 (reported from committee as H-2)
Sponsor: Rep. Jim Townsend
Committee: Tax Policy
Complete to 7-22-15

BRIEF SUMMARY: Under Section 30 of the Income Tax Act (MCL 206.30), the treatment of retirement income of married couples filing jointly is based on the age of the older spouse. House Bill 4124 would continue this tax treatment for the younger spouse after the death of the older spouse, as long as the surviving spouse did not remarry during the tax year. The language used is permissive, allowing taxpayers to choose the tax treatment that is most advantageous in their particular situation.

FISCAL IMPACT: As written, the bill would reduce gross income tax revenue to the state, impacting the General Fund and School Aid Fund. The amount of this reduction depends on the specific characteristics of individual taxpayers, including their age, marital status, and source and size of retirement income. This particular data cannot be compiled in advance; therefore, a quantitative estimate of the impact of this bill cannot be done at this time.

THE APPARENT PROBLEM:

With changes to the income tax treatment of retirement income in 2012, some married couples found themselves in different "tiers" (age brackets). While both spouses are alive, they may make an election to file according to whichever tier they prefer, usually that of the oldest spouse. However, if the older spouse dies, the younger spouse may face increased state income tax liability because tax treatment will be now be based solely on the age of the surviving younger spouse. This could result in hardship, since the tax change may not have been accounted for in their long-term financial planning. House Bill 4124 would prevent this situation by allowing the surviving spouse to elect to continue using the tax treatment based on the age of the deceased spouse.

THE CONTENT OF THE BILL:

The bill amends subsection 9(f) in Section 30 of the Income Tax Act. Currently, this section allows a married couple with retirement income, filing jointly, to receive the income tax treatment of the older spouse. House Bill 4124 adds to this section to allow for anyone who claimed a deduction under subsection 1(f) on a joint return with a spouse who had died during the tax year, to retain that treatment on a single return as long as they remain unmarried.

Subsection 1(f) denotes what types of income are considered exempt retirement income, and sets the limits on the amount that is exempt. Subsection 9 (added as PA 597 of 2012) contains the recent changes to retirement income tax treatment (summarized below in the ***Background Information*** section). This section contains the age based restrictions on exemptions and deductions taken under 1(f).

The new language refers to the tax treatment received under 1(f), which is in-turn subject to the restrictions in subsection 9, covering all combinations of age and retirement income source. The language is also permissive, allowing for the taxpayer to choose the tax treatment that will minimize their liability. It also specifies that the surviving spouse's tax treatment is for a single return, not a joint return as they were filing in the past.

BACKGROUND INFORMATION:

Michigan taxpayers are divided into three age groups that determine the treatment of their retirement tax income; those born before 1946, those born from 1946 through 1952, and everyone born after 1952. The table below describes how most retirement income for each of these groups is treated.

Income Tax Treatment of Retirement Income by Filer's Birth Year		
Before 1946	1946-1952	After 1952
○ All public pension income and Social Security is exempt ○ For private pensions, up to $49,207 for single, and $98,054 for joint filers can be exempted, less any public benefits already exempted ○ Up to $10,767 (single filer) or $21,534 (joint filer) of interest, dividends, or capital gains can be exempted, less any pension income that has been exempted	○ Social Security income is exempt ○ Before turning 67, retirement income can be exempted up to $20,000 for single and $40,000 for joint filers ○ After 67 those same maximum exemptions can be applied against all types of income, not just retirement income	○ Between the ages of 62 and 66, retirement benefits from government agencies not covered by Social Security can be exempted up to $15,000 per individual ○ After age 67 taxpayers can choose either a $20,000 single or $40,000 joint exemption against all types of income OR Exempt Social Security, railroad, and military pensions and the taxpayer may take the personal exemption.

ARGUMENTS:

For:

Retirees are often in a difficult financial position, simply due to their fixed incomes. The state tax code should not result in unexpected tax burdens on these citizens, especially after the tragic event of losing a spouse. This bill will allow married retirees to plan out their long term financial future beforehand.

Against:

This bill would create a separate treatment for a specific group of taxpayers. Retirees who are widows and widowers retirees will get tax benefits that their single counterparts are not afforded. The tax code should be applied fairly and equally to all taxpayers, and this bill undermines that principle.

POSITIONS:

The Department of Treasury supports the bill as reported (6-3-15)

A representative of the Michigan State Employee Retirees Association testified in support of House Bill 4124 (2-25-15)

The Michigan Association of Certified Public Accountants supports the bill (6-3-15)

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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.