

Michigan Tax Law Changes: A Summary

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Enclosed are summaries of recently enacted Michigan tax law changes as prepared by the Michigan Department of Treasury and posted on their website. These changes are effective beginning January 1, 2012 and will have no impact on your 2011 income tax returns.

There are many significant changes affecting the way pensions and other retirement income, including social security, will be taxed depending on the age of the taxpayer (the age of the **oldest** spouse determines the tax treatment of both spouses on a joint return).

For **taxpayers born before 1946**, there will be no changes to the taxation of Social Security, public and private pensions or interest and dividends.

For **taxpayers born in 1946-1952** there will be changes depending on when you turn 67. Before age 67, there will be a limited subtraction (\$20,000/\$40,000) for private and public pensions including phase-outs of the subtractions entirely for taxpayers exceeding specified levels of "household resources" (a newly-defined concept in the new tax law) and the subtraction for dividends and interest has been eliminated. Once you turn 67, the limited pension subtraction will be replaced by a limited subtraction (again \$20,000/\$40,000) against **all income** regardless of source. Social Security continues to be exempt both before and after age 67.

For **taxpayers born after 1952**, again there will be changes depending on when you turn 67. There is no pension subtraction before age 67 (either public or private). Social Security is still exempt and there is no interest/dividend subtraction. Once you turn 67, you can elect an exemption (\$20,000/\$40,000) against all sources of income and personal exemptions are not allowed. Alternatively you can elect to exempt Social Security and certain pensions and claim personal exemptions subject to phase-out for taxpayers exceeding specified levels of household resources.

Many credits and deductions have been eliminated including those for public donations and donations to homeless shelters, food banks and community foundations. There is no longer an additional exemption for children under age 18 or for seniors. **Personal exemptions** will be phased out for taxpayers with household resources exceeding \$75,000/\$150,000 and will be completely eliminated for those with household resources exceeding \$100,000/\$200,000.

The homestead property tax credit has been significantly changed. The credit is only available for homes with a taxable value less than \$135,000. Household "resources" will now be used instead of household "income" to calculate the credit and the credit is subject to phase-out as "resources" increase.

Lastly, the law now requires payers to withhold Michigan income tax from pensions and retirement distributions at a rate of 4.35% of the taxable portion of the distribution. The Michigan Department of Treasury will create a withholding certificate that can be used to determine and communicate to the payer how much of the distribution is exempt based on your age or other circumstances. It is unclear how the many payers of retirement benefits will implement this requirement.

Summary

Many of our clients born before 1946 will experience limited changes on their 2012 tax returns, depending on their "household resources". For those clients born after 1946, there will be more drastic changes depending on the makeup and amount of "household resources". The tax law changes result in a broadening of the tax base while largely keeping the tax rate the same (there will be a small reduction in the tax rate in 2013 from 4.35% to 4.25%).

Governor Snyder and the Michigan Legislature have preemptively asked the Michigan Supreme Court for an Advisory Opinion on the constitutionality of the recent changes. This was done to head off challenges to various aspects of the law by a host of affected parties. Oral arguments are currently scheduled to begin on September 7, 2011 and we will be closely paying attention to the progress of the case as it unfolds.

We expect that our tax software will soon allow us to do "what if" projections including the effect of the upcoming tax law changes. If you have questions about how these changes will affect your specific situation please consult your advisor.

Sincerely,

Alan Miller



INCOME TAX CHANGES FOR INDIVIDUALS AND TRUSTS EFFECTIVE TAX YEAR 2012 (FOR RETURNS FILED IN 2013)

On May 25, 2011, Governor Rick Snyder signed legislation amending the Michigan Income Tax Act. This new legislation does not apply to or otherwise impact 2011 income tax returns that are due in April 2012. Instead, the first returns that are affected by this legislation are those returns that are due in April 2013. Important changes that you should be aware of include the following:

Tax rate

- The rate remains at 4.35 % for tax year 2012.
- For 2013 and each tax year thereafter the rate is 4.25%.
- Repeals the annual 0.1% rate reduction.

Exemptions

- Personal exemption set at \$3,700 (same as under current law) and will be indexed to inflation beginning in 2013.
- Phases out personal exemption for taxpayers with “total household resources” over \$75,000 for single filers and \$150,000 for joint filers. Eliminates personal exemption for taxpayers with total household resources over \$100,000 for single filers and \$200,000 for joint filers.
- Repeals special exemptions for seniors.
- Repeals special exemption for unemployment compensation greater than 50% of adjusted gross income (AGI).
- Special exemption for disabled and exemption for disabled veterans remain unchanged.
- Phases out certain pension and retirement income subtractions based on date of birth. See [Retirement Benefit Changes](#) for more detailed information.

Deductions/Subtractions

- Repeals the deduction for reinvestment of gain from Michigan Strategic Fund investments.
- Repeals certain miscellaneous deductions (political donations; prizes won in state-regulated bingo, raffle, or charity games; charitable gifts from retirement plans).
- Removes both the gross income and the related expenses from oil and gas production if the gross income was subject to severance tax.
- Repeals the Renaissance Zone deduction.
- Repeals the \$600 child 18 and under deduction.

Non-refundable Credits

- Repeals the credit for city income taxes.
- Repeals the credit for public contributions.
- Repeals the credit for contributions to homeless shelters, food banks, and community foundations.
- Repeals the credit for contributions to medical savings account.
- Repeals the credit for donations to Family Development Program.

- Repeals the film credit for wage withholding.
- Repeals the credit for automobile donations.
- Repeals the credit for college tuition and fees.
- Ends credits for historic rehabilitation plans certified after 2011.

Refundable Credits

- Reduces Earned Income Tax Credit from 20% to 6%.
- Repeals the excess adoption expense credit.
- Repeals the stillbirth credit.
- Changes the homestead property tax credit as follows:
 - Household income replaced by total household resources which excludes losses from business, rentals and royalties and also excludes net operating losses.
 - Available only for homes with taxable value of less than \$135,000.
 - For senior claimants: Full credit of 100% if total household resources are \$21,000 or less and reduced by 4% for each additional \$1,000 in total household resources until \$30,000 is reached. For total household resources of \$30,000 to \$41,000 senior claimants receive 60% of the credit.
 - All other claimants are eligible for 60% of the tax credit.
 - Credit phase out begins at \$41,000 of total household resources and is reduced by 10% for each \$1,000 increase. Complete phase-out at \$50,000.
 - Alternative credit for eligible serviceperson/veteran still available.

Miscellaneous

- Adopts 100% sales factor apportionment.
- Repeals obsolete “no form” tax filing.
- Ends the tax voucher program for Early Stage Venture Investment agreements entered into after 2011.

**MICHIGAN STATE INCOME TAX CHANGES FOR RETIREMENT BENEFITS
EFFECTIVE FOR TAX YEAR 2012 (FOR RETURNS FILED IN 2013)**

Taxpayers born before 1946	Taxpayers born 1946 to 1952	Taxpayers born after 1952
<p align="center">No change in current law</p> <ul style="list-style-type: none"> ▪ Social Security is exempt. ▪ Senior citizen subtraction for interest, dividends and capital gains is unchanged. ▪ Public pensions exempt. ▪ Private pensions subtract up to \$45,120 for single filers and \$90,240 for joint filers (based on 2010 but indexed for inflation). 	<p align="center">Before the taxpayer reaches age 67</p> <ul style="list-style-type: none"> ▪ Social Security is exempt. ▪ Railroad pension is exempt ▪ Military pension is exempt ▪ Not eligible for the senior citizen exemption for interest, dividends and capital gains. ▪ Public and private pension limited subtraction of \$20,000 for single filers or \$40,000 for joint filers. ▪ Not eligible for pension subtraction when total household resources exceed \$75,000 for single filers or \$150,000 for joint filers. <p align="center">After the taxpayer reaches age 67</p> <ul style="list-style-type: none"> ▪ Social Security is exempt. ▪ Not eligible for senior citizen subtraction for interest, dividends and capital gains. ▪ Subtraction against all income of \$20,000 for single filers and \$40,000 for joint filers. ▪ Not eligible for income exemption when total household resources exceed \$75,000 for single filers or \$150,000 for joint filers. ▪ Not eligible for income exemption if claiming a military or railroad pension exemption. 	<p align="center">Before the taxpayer reaches age 67</p> <ul style="list-style-type: none"> ▪ Social Security is exempt. ▪ Railroad pension is exempt ▪ Military pension is exempt ▪ Not eligible for the senior citizen subtraction for interest, dividends and capital gains. ▪ Not eligible for public or private pension subtraction. <p align="center">After the taxpayer reaches age 67</p> <ul style="list-style-type: none"> ▪ Not eligible for senior citizen exemption for interest, dividends and capital gains. ▪ Not eligible for public or private pension subtraction. <p align="center">Income exemption election</p> <ul style="list-style-type: none"> ▪ ELECT exemption against all income of \$20,000 for single filers or \$40,000 for joint filers. <ul style="list-style-type: none"> ▪ No exemption for Social Security, military or railroad retirement ▪ No personal exemptions. ▪ Not eligible for income exemption when total household resources exceed \$75,000 for single filers or \$150,000 for joint filers. <p align="center">*OR*</p> <ul style="list-style-type: none"> ▪ ELECT to exempt Social Security, military and railroad pension. May claim personal exemptions. <ul style="list-style-type: none"> ▪ Personal exemptions are subject to phase-out for total household resources between \$75,000-100,000 for single filers and \$150,000-200,000 for joint filers.

NOTE: For joint returns, the age of the oldest spouse determines the age category that will apply to the pension and retirement benefits of both spouses regardless of the age of the younger spouse.





NEW WITHHOLDING REQUIREMENTS FOR PENSION AND RETIREMENT DISTRIBUTIONS, EFFECTIVE JANUARY 1, 2012

On May 25, 2011, Governor Rick Snyder signed legislation amending the Michigan Income Tax Act and enacting into law the Michigan Corporate Income Tax (CIT). The revised Act includes changes to withholding, including those changes below dealing with pension and retirement distributions. These new requirements take effect January 1, 2012.

Payers are required to withhold tax from pension and retirement distributions. Beginning January 1, 2012, companies that pay pension and retirement benefits will be required to withhold Michigan income taxes from payments to retirees. The withholding will be 4.35% of the taxable portion of the pension or retirement distribution.

Types of distributions subject to withholding. Pension and retirement benefits include payments made from a pension, individual retirement account, annuity, profit-sharing, stock bonus or other deferred compensation plan. Also included are annuity payments or endowment or life insurance contract payments issued by a life insurance company.

Withholding is not required on tax exempt pension or retirement distributions. Withholding is not required on the portion of a pension or retirement distribution that is exempt from tax. The portion of a distribution that is exempt from tax depends on:

- *Date of birth.* See the [pension and retirement benefits chart](#) to determine whether any portion of the distribution is exempt. Note that for joint filers, the date of birth of the oldest spouse determines the exemption category.
- *Personal exemptions.* The number of personal exemptions may reduce the taxable portion of a distribution. However, the personal exemptions begin to phase out when total household resources exceed \$75,000 for a single filer or \$150,000 for joint filers and are unavailable after total household resources reach \$100,000 for a single filer and \$200,000 for joint filers.
- *Excluded from federal tax.* In certain situations, some distributions will not be included in federal adjusted gross income (AGI). If a portion of a distribution is not in AGI, then it is not subject to Michigan income tax.

Optional withholding certificate. Payers will withhold 4.35% for Michigan income tax on all distributions that are included in federal adjusted gross income unless the Payer receives a withholding certificate from a retiree. The Michigan Department of Treasury will make withholding certificates available before January 1, 2012. A withholding certificate may be used to determine how much of a distribution is exempt from tax because of personal exemptions or because of the age of the retiree. The retiree may provide the withholding certificate to a Payer.