THE LEGAL REPORT

Thomas C. Michaud

VanOverbeke, Michaud & Timmony, P.C.

WITHHOLD ON NOW

MICHIGAN PENSION TAX

Happy New Year - unless you are under age 66 this year, in which case, please discount the well wishes by 4.35% , but if you are older than 60 please increase the best regards with a $20,000 tax exemption, and even more so ($40,000) if you file jointly, or if your spouse is age 66 or older; however, these greetings are further subject to rules, regulations, court decisions, laws or other events which may or may not transpire in 2012. On second thought, let me just start over by wishing everyone a Happy Valentine's Day.

Originally proposed as a measure to simplify Michigan's taxes equitably, the law (Public Act 38) signed by Governor Rick Snyder in May of 2011 has resulted in a multi-tiered tax structure in 2012 with numerous complexities in its implications and implementation.

While some issues have been resolved through the legal process with the Michigan Supreme Court ruling 4-3 that the State's personal income tax on public pensions is constitutional (Please see November 18, 2011 decision: In re Request for Advisory Opinion Regarding Constitutionality of PA 38 - SC Docket No. 143157), other issues will remain a topic of future discussion. However, as of this time (January 1, 2012), administrators of public pension benefits (or their paying agents e.g., plan sponsor or custodians) are required to withhold Michigan income tax (4.35%) from payments to retirees (over whom Michigan has taxing jurisdiction), unless specific exemptions apply. So Withhold on NOW.

In an effort to address questions related to the administration of this tax, the Michigan Department of Treasury has created online resources for trustees/administrators: **www.michigan.gov/taxes** (Michigan Tax Changes Information and the 2012 Pension Witholding Guide). The State also has a detailed Webinar on the topic. (Please note that while the video is informative, the Governor will most likely have to restore additional funding to the Michigan film tax incentive for this documentary to win an Academy Award).

The Michigan Department of Treasury has provided brief responses to typical questions in summary as follows:

Which Benefits Will be Taxed? Under Michigan law, qualifying pension and retirement benefits include most payments that are reported on a 1099-R for federal purposes. This includes defined benefit pensions, IRA distributions, and most payments from defined contribution plans. Payments received before the recipient could retire under the provisions of the plan or benefits from 401(k), 457, or 403(b) plans attributable to employee contributions alone are taxable under Michigan law. The changes in tax treatment do not apply to Social Security, Military or Railroad Retirement benefits.

Who is Impacted by the Changes? For couples, the age of the oldest spouse determines the age category.

Pension recipients born before 1946: The law remains the same as it was prior to 2012 (i.e, all benefits from a public Retirement System are exempt).

Pension recipients born during the period 1946 through 1952: For recipients filing single or married filing separate, the first $20,000 of their pension is subtractable from Michigan taxable income. If filing jointly, the first $40,000 of their pension is subtractable from Michigan taxable income.

Pension recipients born after 1952: All public pension and annuity benefits are fully taxable and may not be deducted from Michigan taxable income.

Withholding Guide/MI W-4P: Withholding is required on taxable pension benefits.

Pension administrators should follow the directions from pension recipients on any MI W-4P received:

- If the recipient checked box 1, do not withhold.

- If the recipient marks box 4 use the Income Tax Withholding Tables (Form 446-T) to calculate the appropriate withholding based on the number of exemptions designated.

- If the recipient checked box 3, withhold based on number of exemptions claimed on line 5 and/or any percentage claimed on line 6. For withholding calculation, refer to marital status marked on the form to determine the corresponding Single or Married Withholding Table or Monthly Deduction Amount for the 4.35 percent formula.

What if no MI W-4P is Received? In the absence of an MI W-4P, pension administrators shall do one of the following:

Do not withhold on benefits paid to pension recipients born before 1946 unless the benefits exceed private pension limits. If the recipient was born in 1946 or after, withhold on all taxable pension distributions at 4.35 percent.

Registration Process. Pursuant to MCL 206.703(1), any company, over whom Michigan has jurisdiction, is required to withhold Michigan tax from taxable pension and/or annuity payments. Therefore, these companies must register. Companies, over whom Michigan does not have jurisdiction, but agree to withhold Michigan tax from pension and/or annuity payments for Michigan residents, will also need to register. Pension administrators not currently registered for Michigan Withholding Tax need to complete Registration for Michigan Taxes (Form 518). This form may be completed online at Michigan Business One Stop (www.michigan.gov/business) or the completed application may be mailed to the address listed on the form.

In following the guidance of the Michigan Supreme Court that stated, "this court is not deciding whether 2011 PA 38 represents wise or unwise, prudent or imprudent public policy, only whether 2011 PA 38 is consistent with the constitutions of the United States and Michigan," I would conclude that administrators of public pension plans should act consistently with the changes in the tax law, and direct all comments from retirees (current or future) regarding the wisdom or prudence of the tax policy to the appropriate representatives in Lansing - No Valentine's Day cards required.

End Note: Michigan AARP estimates that about 480,000 tax returns are currently exempt from the new tax, 230,000 returns fall within the 1946 and 1952 tier, and about 150,000 returns are for residents born after 1952.

This summary is intended to be informational only and this article is intended to provide a general overview of the subject matter covered. This information should not be considered the rendering of legal or other professional services and should not be used as a substitute for consultation with professional advisers.