LEGISLATIVE SNAPSHOT

THREE TIERED TREATMENT OF RETIREMENT INCOME

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Summary

2011 PA 38 made significant changes to the Income Tax Act, including changes to the way retirement income is taxed in Michigan. The collection of income taxes on retirement income has commonly been referred to as the "Pension Tax."

Pre-2011 System

Before the 2011 changes, Social Security, military, federal, and state and local government retirement income were fully exempt from taxation. Private retirement income (e.g., from private pensions, 401(k)s, etc.) was exempt up to a specific threshold that was adjusted annually for inflation. Seniors also were able to claim a deduction for interest, dividends, and capital gains received from investments, up to a cap that was adjusted annually for inflation. In addition, defined benefit plans (i.e., pensions) from public employment were fully exempt.

Three-Tiered System

2011 PA 38 created a three-tier system under which the taxpayer's (or their spouse's) birth year determines how retirement income is taxed. For spouses filing a joint return, the treatment of retirement income is based on the birth year of the older spouse. Under changes made by 2020 PA 65, if the older spouse dies, the surviving spouse can continue claiming the same treatment of retirement income as long as they do not remarry.

The taxation of retirement income is currently as follows:

- **Tier 1**: Taxpayers born before 1946 continue to be taxed under the same system that existed before the 2011 changes. For the 2022 tax year, the deduction of private retirement income was capped at $56,961 for single filers and $113,922 for joint returns. The deduction for investment income was capped at $12,697 for single filers and $25,394 for joint returns. These taxpayers remain able to claim other personal exemptions for which they are eligible.
- **Tier 2**: Taxpayers born from 1946 to 1952 (all of whom have now reached age 67) are able to take a limited deduction ($20,000 for single filers/$40,000 for joint returns) against all types of income. These taxpayers remain able to collect other personal exemptions for which they are eligible.
- **Tier 3**: Taxpayers born after 1952 are not able to exempt any retirement income until reaching age 67, except for Social Security income. After turning 67, these taxpayers can choose between taking the $20,000/$40,000 deduction described above or continuing to exempt Social Security income and claiming other personal exemptions for which they are eligible.

Taxpayers in Tiers 2 and 3 are not eligible to claim the $20,000/$40,000 deduction if they deduct retirement income from the Armed Forces or under the federal Railroad Retirement Act.

The table on page 2 presents a simplified version of the above information.

Current Tax Treatment of Retirement Income

Tier 1	Tier 2	Tier 3
Born before 1946	Born 1946-1952	Born after 1952
Public pension benefits 100% tax free	No deduction for retirement/pension	No deduction for retirement/pension
Private retirement benefits deductible $56,961 single / $113,922 joint, less public benefit	Standard deduction on all income up to $20,000 single / $40,000 joint	At 67, standard deduction on all income up to $20,000 single / $40,000 joint
plus personal exemption	plus personal exemption	no personal exemption