



House Legislative Analysis Section

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FEDERAL PENSION TAX REFUNDS

Senate Bill 473 (Substitute H-1)
First Analysis (11-29-90)

Sponsor: Sen. Norman D. Shinkle
Senate Committee: Finance
House Committee: Taxation

THE APPARENT PROBLEM:

In March of last year, the U.S. Supreme Court struck down Michigan's practice of taxing the pensions of retired federal workers but not those of retired state workers. (More than two dozen other states were affected by the decision in the case, which was brought originally against the State of Michigan by Paul Davis, a retired federal employee from East Lansing.) The court said Michigan's tax system violated federal intergovernmental tax law and remanded the case to the Michigan Court of Appeals, whose decision it had reversed. The appeals court has extended the income tax exemption to federal retirees pending any legislative solution. The courts have not specifically addressed the question of refunds of taxes. The state tax tribunal recently said that a provision in the Income Tax Act that allows a taxpayer to claim a refund up to four years after the tax filing date overrides a Revenue Act provision that more severely restricts refunds in cases when the claim for a refund is related to the question of the legal or constitutional validity of a state tax law. A method of refunding past income taxes has been proposed that is acceptable to federal retirees and the Department of Treasury and that basically affirms the decision of the tax tribunal in this case.

THE CONTENT OF THE BILL:

The bill would amend the Revenue Act to allow refunds to be claimed for income taxes paid for the 1984 tax year or subsequent tax years on federal retirement or pension benefits if the claimant waives any claim for the refund of such taxes paid for a tax year before 1984. Claims for refunds would be paid on the following schedule:

<u>Refunds for Tax Year</u>	<u>Payable on or after</u>
1988 and 1987	July 1, 1990
1986	July 1, 1991
1985	July 1, 1992
1984	July 1, 1993

(The provision would be an exception to a requirement in the Revenue Act that "a claim for a refund based upon the validity of a tax law based on the laws or constitution of the United States or the state constitution of 1963 shall not be paid unless the claim is filed within 90 days after the date set for filing a return.")

The bill would also repeal a provision in the Income Tax Act that says: "A taxpayer who has paid a tax which he or she claims was not due under this act may, on or before the expiration date of 4 years from the date set for the filing of the annual or final return for the year or the date the tax was paid, whichever is later, and not after, petition the commissioner in writing to refund the amount paid."

The bill is tie-barred to House Bill 4634, which contains identical provisions.

MCL 205.27a

HOUSE COMMITTEE ACTION:

The House Taxation Committee adopted a substitute that makes Senate Bill 473 nearly identical to House Bill 4634 (H-1), which passed the House on 6-29-90. The substitute essentially achieves the same aim as Senate Bill 473 as it passed the Senate.

FISCAL IMPLICATIONS:

A spokesperson for the Department of Treasury has said that department staff estimates the bill will cost between \$6 million and \$12 million. (11-28-90)

ARGUMENTS:

For:

The bill would allow retired federal employees to claim a refund of income taxes paid on their pension or retirement benefits from 1984 on, and would spread those refunds out over four years to reduce the effect on state revenues, as recommended, tax specialists say, by the National Association of Retired Federal Employees. The U.S. Supreme Court has ruled that Michigan's tax system illegally discriminated against federal retirees by taxing their pensions but not the pensions of state workers. The decision, however, did not address the question of refunds, except for the person who brought the suit. The state's tax tribunal recently ruled in a dispute over refunds for federal retirees that the provision in the Income Tax Act allowing taxpayers four years to claim refunds of taxes they believe not to be due supersedes the requirement of the Revenue Act that refund claims based on the legal or constitutional validity of a tax law be made within 90 days of the filing deadline (i.e., in the year the taxes are paid). The bill would put into law for this case the decision of the tax tribunal. However, the Income Tax Act provision would be repealed so that in the future the Revenue Act would determine how refunds could be claimed. (The Revenue Act allows a taxpayer four years to claim a refund, except in cases when a tax law's validity has been challenged.)

Response: Some people believe the whole area of the taxation of pension and retirement benefits needs to be examined. Currently, private pensions are subject to the state income tax but public pensions, whether state or federal, are not. Is this fair? Some states have moved toward a partial exemption for all pensions rather than a full exemption for some and no exemption for others. This and other alternatives should be examined.

POSITIONS:

The Department of Treasury supported identical provisions in House Bill 4634 (H-1). (6-27-90)

A representative of the National Association of Retired Federal Employees testified in favor of the bill before the House Taxation Committee. (11-28-90)