

Written Testimony
House Tax Policy Committee
March 28, 2011
Re: HB 4361

Leon C. LaBrecque, JD, CPA, CFP®, CFA¹
Troy, MI
Leon.labrecque@ljpr.com

HB 4361 proposes to tax municipal and public pensions, including the pensions of police and fire units in the state of Michigan. There are two issues relating to the state income taxation of police and fire pensions:

First, it is highly likely that the taxation of police and fire pensions is unconstitutional as a violation of Article 9 §24 of the Michigan constitution, which provides, in relevant part:

The accrued financial benefits of each pension plan and retirement plan of the state and its political subdivision shall be a contractual obligation which thereof shall not be diminished or impaired thereby...

As pointed out in written testimony by D. Daniel McClellan², Michigan law provides exemption to Michigan taxation in two statutory sources: § 40 of the State Employees' Retirement system Act (SERS Act), and the Income Tax Act of 1967. HB 4361 is only addressing the Income Tax Act. SERS provides a full income tax exclusion for pension under the Act. As Mr. McClellan continues to point out, the OAG has ruled twice on the exemption, ruling that taxation could only be applied prospectively to new members of the system. Mr. McClellan's analysis is sound.

Second, prior to 1984, many municipal systems were exempt from Social Security. For example, in police and fire pension systems in the City of Detroit, or Dearborn, or St. Clair Shores; employees are exempt for Social Security and as a result either do not receive a Social Security benefit or receive a greatly reduced benefit computed based on outside earnings. Their pension plan generally absorbs a greater employee contribution to make up the difference. Employees of a covered system would receive a pension benefit and social security, which under the proposed law, the pension only would be taxed.

Thus, members of an exempt system would be paying Michigan tax on their pension, whereas members of a nonexempt system would get a portion of their comprehensive retirement benefits (e.g. pension and social security) partially exempt from Michigan tax. In the event the legislature does pass the law, and it is deemed to pass constitutional muster, this disparity has an essential feature of unfairness that taxes some police and fire retirees to a greater degree than others.

The House should consider these factors as it deliberates on HB 4361.

¹ Licensed attorney, CPA, Certified Financial Planner and Chartered Financial Analyst and consultant on multiple policed and fire units in the state of Michigan.

² Written testimony to the House Tax Policy Committee, March 16, 2011