



RICK SNYDER  
GOVERNOR

STATE OF MICHIGAN  
DEPARTMENT OF TREASURY  
LANSING

NICK A. KHOURI  
STATE TREASURER

## REVENUE ADMINISTRATIVE BULLETIN 2018-21

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### INDIVIDUAL INCOME TAX DEDUCTION OF RETIREMENT AND PENSION BENEFITS RECEIVED FROM A PUBLIC RETIREMENT SYSTEM OF ANOTHER STATE

Replaces Revenue Administrative Bulletin 1988-25

Pursuant to MCL 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006 and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

**RAB 2018-21.** This Revenue Administrative Bulletin (RAB) describes the Michigan Income Tax Act treatment of retirement and pension benefits received from a public retirement system of another state. This RAB updates RAB 1988-25 to include the effect of the date of birth limitations on the deduction of retirement or pension benefits that began in 2012 as a result of 2011 PA 38. This RAB also removes references to 1979 AC, R 206.11, which was rescinded because it did not reflect the current maximum inflation-indexed deduction limits and otherwise merely restated existing statutory language. In addition, RAB 1988-25 did not reflect the correct interpretation of 1994 amendments that restricted all out-of-state public retirement benefits to the same deduction limits as “private” retirement benefits. Throughout this RAB, “retirement benefits” or “benefits” mean both retirement and pension benefits. “Private” retirement benefits generally means non-public retirement benefits.

#### **Public retirement benefits received from another state after 1994 and before 2012.**

Before September 30, 1994, a Michigan resident could claim a deduction on a Michigan income tax return for full public retirement benefits received from another state if the other state permitted a similar deduction of Michigan public retirement benefits for its residents.<sup>1</sup> If the other state did not provide a similar deduction, then the maximum Michigan deduction was the “private” retirement benefits limit.

<sup>1</sup> MCL 206.30(1)(f)(ii) provided a deduction for “[a]ny retirement or pension benefits received from a public retirement system of or created by another state or any of its political subdivisions if the income tax laws of the other state permit a similar deduction or exemption or a reciprocal deduction or exemption of a retirement or pension benefit received from a public retirement system of or created by this state or any of the political subdivisions of this state.”

After September 30, 1994, the out-of-state public reciprocal retirement benefits deduction was limited by 1994 PA 268. The reciprocal state public retirement benefit was subject to the same single and joint filer limits as all “private” retirement benefits. In addition, the reciprocal state public retirement benefits deduction no longer caused a dollar-for-dollar reduction in any “private” retirement benefit deduction or the senior citizen deduction for interest, dividends and capital gains that the taxpayer may have received.<sup>2</sup>

The maximum “private” retirement benefits deduction was restricted beginning in tax year 2012 based on the taxpayer’s date of birth.

### **Public retirement benefits received from another state during or after 2012.**

#### ***Michigan resident taxpayers born before 1946.***

Beginning with 2012, the income tax deduction for public retirement benefits became subject to limits based on the date of birth of the taxpayer, or the taxpayer’s spouse on a joint return. As a result, the full federal or Michigan public retirement benefit deduction is only available to single-filer taxpayers born before 1946 (Tier 1 taxpayers). For joint filers, the full federal or Michigan public retirement benefit deduction is available if either spouse was born before 1946, regardless which spouse receives the public retirement benefit.

Although resident taxpayers born before 1946 may claim an unlimited federal or Michigan public retirement benefit deduction, this does not extend to a public retirement benefit deduction from another state because of 1994 PA 268. The deduction that may be claimed is the same as the “private” retirement benefits deduction. The 2018 “private” retirement benefits deduction limit for those born before 1946 is \$51,570 for a single filer and \$103,140 for joint filers.

The Michigan “private” retirement benefits deduction limit<sup>3</sup> applies to the public retirement benefits paid by all other states of the United States as well as public retirement benefits of foreign countries and their political subdivisions.

The taxpayer who receives public (Michigan or federal) retirement benefits and receives retirement benefits from any other source must reduce the maximum allowable deduction for the latter retirement benefits by the amount of any Michigan and federal public retirement benefits.

#### ***Example 1: Tier 1 taxpayers with Michigan and Illinois public retirement benefits.***

Lee was born in 1944. His spouse, Gale, was born in 1945. Lee earned public retirement benefits from Michigan. Lee’s retirement benefit in 2018 was \$65,000. Gale had worked for Illinois and receives a public retirement benefit from Illinois of \$52,000. They were Michigan residents for all of 2018. The public Illinois retirement benefits are treated the same as “private” retirement benefits. The 2018 maximum “private” pension deduction is \$103,140 for joint filers and \$51,570 for single filers. (The “private” retirement benefit is indexed to inflation.) Lee’s public Michigan retirement benefit deduction reduces Gale’s Illinois public retirement benefit dollar-for-dollar in the same manner as a

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<sup>2</sup> The section affected by 1994 PA 268 has been renumbered and updated. It is currently MCL 206.30(1)(f)(iv).

<sup>3</sup> MCL 206.30(1)(f)(iv).

“private” retirement benefit. Although the total retirement benefits received is \$117,000, the joint return is limited to a total deduction of \$103,140. If the couple filed separately, the maximum combined deduction is \$116,570.

*Lee and Gale file a joint return.*

Joint maximum private retirement benefit deduction	\$103,140
Less: Public retirement benefits	<u>-65,000</u>
Allowable Illinois public retirement benefits deduction	\$38,140

Lee and Gale’s total retirement deduction is:

Michigan public retirement benefits deduction	\$65,000
Maximum Illinois public retirement benefits deduction	<u>38,140</u>
Total joint return deduction	\$103,140

*Lee files a separate return.*

Full Michigan public retirement benefit deduction	\$65,000
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*Gale files a separate return*

Limited to maximum “private” retirement benefit	\$51,570 <sup>4</sup>
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***Michigan resident taxpayers born after 1945.***

Beginning with the 2012 tax year, there is no difference between private and public retirement benefits for retirees born after 1945.

*Tier 2 taxpayers.* Tier 2 taxpayers (born 1946-1952) who are single filers may deduct up to \$20,000 in retirement benefits on a return. Tier 2 taxpayers who file a joint return may deduct up to \$40,000 if the older spouse was born between 1946 and 1952, regardless of the age of the taxpayer who earned the benefits. The treatment is the same for “private” and public retirement benefits.<sup>5</sup>

The retirement benefit deduction is replaced by a standard deduction against all income when the Tier 2 taxpayer reaches age 67. The standard deduction is \$20,000 for a single filer and \$40,000 for joint filers. Joint filers may claim a \$40,000 standard deduction when the older spouse reaches age 67.

*Example 2: Tier 2 taxpayer with retirement benefits from another state.*

Lynn was born in 1951. Lynn’s spouse, Taye, was born in 1952. Lynn earned public retirement benefits as the chief financial officer for a Florida city. Lynn’s retirement benefit in 2018 was \$39,000. Taye earned a pension of \$18,000 from a private school. They were Michigan residents for all of 2018.

<sup>4</sup> If Gale had been a Tier 2 taxpayer (born 1946-1952) filing separately, the deduction would be \$20,000. If Gale had been a Tier 3 taxpayer (born after 1952) filing separately, the deduction would be zero.

<sup>5</sup> MCL 206.30(9)(b).

Lynn and Taye may deduct total retirement benefits of \$40,000 on a joint return. If they file separately, Lynn may claim a deduction of \$20,000 and Taye may claim a deduction of \$18,000.

*Tier 3 taxpayers.* Tier 3 taxpayers (born after 1952) generally may not deduct either public or “private” retirement benefits. At age 67, a Tier 3 taxpayer may claim a standard deduction against all income. The standard deduction is \$20,000 for a single filer and \$40,000 for joint filers. Joint filers may claim the standard deduction when the older spouse reaches age 67. However, if the standard deduction is claimed, the taxpayer may not also claim a deduction for social security that was included in federal AGI or a deduction for personal exemptions.<sup>6</sup>

Special retirement benefits deductions apply to Tier 2 and Tier 3 taxpayers whose public employment was not covered by social security. See MCL 206.30(c), (d), and (e).

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<sup>6</sup> MCL 206.30(e).