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CLIENT BULLETIN

New Michigan Law Affects Taxation and Withholding of Pension Benefits Beginning January 1, 2012

On May 25, 2011, the Governor of Michigan signed legislation restructuring Michigan's tax structure. This new legislation will take effect on January 1, 2012 but does not apply to or otherwise impact 2011 tax returns that are due in 2012. Instead, the first returns that are affected by this legislation are those returns that are due in 2013. *However*, the new law affects *income tax-withholding* by *pension plan administrators* beginning *January 1, 2012.*

The Michigan Department of Treasury has a webpage devoted to the new tax law changes at: *http://www.michigan.gov/taxes/0,4676,7-238--260229--,00.html.*

The above webpage has the helpful links listed below regarding the changes affecting the taxation of and tax-withholding from pension benefits:

Retirement Benefits

- *MI W-4 P Form and Instructions*
- *Webcast Presentation - Changes to Retirement Benefit Treatment for Michigan Individual Income Tax*
- *Retirement Benefit Changes Overview*

Withholding Changes for Pension Administrators

- *Webcast Presentation - Withholding on Pension Benefits for Administrators*
- *2012 Pension Withholding Guide*

A Closer Look at the *2012 Pension Withholding Guide*

The Department of Treasury has also released a useful Guide to help Pension Plan Administrators comply with the new law. We've excerpted the main parts of the Guide on the following pages. The rest of the Guide consists of examples and withholding tables. The Guide is available by "*clicking here.*"

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Introduction

Effective January 1, 2012, Michigan's tax treatment of pension and retirement benefits will change and these benefits will be subject to income tax for many recipients. Michigan law now requires the administrators of pension and retirement benefits to withhold income tax on payments that will be subject to tax.

I. What are Pension and Retirement Benefits

Under Michigan law, qualifying pension and retirement benefits include most payments that are reported on a 1099-R for federal tax purposes. This includes defined benefit pensions, IRA distributions, and most payments from defined contribution plans. However, 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 not pension and retirement benefits under Michigan law. For additional information on pension and retirement benefits, visit *www.michigan.gov/withholding*.

II. Which Benefits Are Taxable?

Beginning in 2012, pension and retirement benefits will be taxed differently depending on the age of the recipient. For married couples, age is determined using the age of the older spouse.

Military pensions, Social Security benefits and railroad retirement benefits continue to be exempt from this tax.

A. Recipients born before 1946

The law remains the same as it was prior to 2012. Those born before 1946 may subtract all qualifying pension and retirement benefits received from public sources, and may subtract private pension and retirement benefits up to $45,842 if single or married filing separate, or $91,684 if married filing a joint return. Withholding will only be necessary on taxable pension payments (private pension payments) that exceed the pension limits stated above for recipients born before 1946.

B. Recipients born between 1946 and 1952

These recipients will be able to deduct $20,000 in pension and retirement benefits if single or married filing separate or $40,000 if married filing a joint return. This exemption does not apply to payments from 457 plans, 401(k) plans, 403(b) plans or any other elective deferral plans if only the employee made contributions to the plan. If the benefit will be less than deduction amounts, no withholding is required unless the recipient requests withholding by submitting an MI W-4P.

The pension tax withholding tables included in this booklet incorporate the deductions of $20,000 for single or married filing separate, and $40,000 married filing a joint return, assuming benefits are paid monthly. If benefits are paid other than monthly, withholding is only due on the amount that exceeds the recipients' deduction amount. Recipients who indicate on the MI W-4P they are married (withhold as single) should have withholding computed as if they are single.

C. Recipients born after 1952

For these recipients, all pension and retirement benefits are taxable. Use the monthly withholding table from the *Michigan Income Tax Withholding Guide* (Form 446) to calculate the appropriate withholding based on the number of personal exemptions claimed on the MI W-4P.

III. How Much to Withhold

Withholding is **required** on taxable pension benefits. Pension administrators should follow the directions from recipients on any MI W-4P received. If you received a MI W-4P from a recipient who has checked box 3, determine the amount of tax withheld using the direct percentage computation or the withholding tables in this book. The withholding rate is 4.35% of any taxable pension or retirement benefit. The taxable portion is determined by subtracting any pension deduction and personal exemption allowance. If you prefer to compute withholding directly, refer to the Withholding Formula section below.

In the absence of an MI W-4P, pension administrators shall do one of the following:

(1) Do not withhold on benefits paid to recipients born before 1946 unless the benefits exceed private pension limits.

(2) If the recipient was born in 1946 or after, withhold on all taxable pension distributions at 4.35%.

Monthly Non-Taxable Deduction Amounts

Single recipient pension deduction $1,666.67
Married recipient pension deduction $3,333.33
Personal exemption allowance .... $ 308.33

Withholding Formula

Withholding = [*Pension or Retirement Payment subject to federal income tax – Monthly pension deduction* – (Allowance per Exemption x Number of Exemptions)] x 4.35%

The rest of the Guide consists of examples and withholding tables. Pension Plan administrators will need to prepare to inform beneficiaries of the change as these pension law changes may result in a balance due if the incorrect amount is withheld from pension or annuity payment(s), according to the MI W-4 P Form and Instructions. Plan administrators will want to confirm that the Plan or its TPA is ready in time to begin following the new withholding rules on January 1, 2012.

See *Benefit News Briefs 2011-56* for information on Michigan's two-year 1% assessment on certain paid health care claims which begins January 1, 2012 and ends January 1, 2014.

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