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May 10, 2011

Honorable Mark Jansen, Chair
Senate Reforms, Restructuring, and Reinventing Committee
Capitol Building
Lansing, MI

Dear Senator Jansen and Members of the Senate Reforms Committee:

The Michigan State Employee Retirees Association, which represents over 50,000 state employee retirees and their dependents, **opposes those aspects of HB 4361 targeting pensioners and seniors and HB 4480 abolishing the tax exemption on state employee pensions.**

Illegality of taxing state pensions – At the outset we must point out that taxing state-run pensions is unconstitutional. Michigan Constitution, Article IX, Section 24 states: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby." Attorney General Opinion 6697 of December 18, 1991 held that a change in taxation of prospective members of the public employee retirement systems could be made, but reduction of current pensions was improper unless an equal benefit replaced it. The Governor's proposal does not adequately address this significant legal barrier to taxing public pensions. Our legal advisor Dan McLellan will talk more thoroughly about this aspect of the pension tax proposal.

The tax proposal - The income tax proposal as approved by the House would affect 4 exemptions or credits affecting seniors. It would:

- Eliminate the current total pension income tax exemption and institute a new scheme based on the age of the retiree, eventually instituting a $20,000/$40,000 exemption on total household resources.
- Eliminate the dividends, interest, and capital gains exemption of up to $10,058 single/$20,115 joint received by those 65 and over and institute an age-based scheme;
- Eliminate the $2,300 special exemption for those 65 and over;
- Eliminate the Homestead Property Tax Credit for those 65 and over and replace it with an income-based scheme.

Although we believe the pension tax proposal is unconstitutional as applied to public employees, it is worth some analysis with regard to its fairness. The changes in the senior exemptions and credits will affect all public and private retirees 65 and older.

Increased taxes on seniors - The income tax proposal would increase taxes for pensioners and seniors in the following amounts:

Estimates of the Fiscal Impact of HB 4361 (H-1) & HB 4362 (H-1) On Pensions and Seniors
Effective Date January 1, 2012, in millions of dollars
From House Fiscal Agency Analysis

	FY 2011-12 Estimates			**FY 2012-13 Estimates**		
	GF/GP	**SAF**	**Total**	**GF/GP**	**SAF**	**Total**
1. Modify Public/Private Pension Exemption	177.4	47.5	224.9	269.3	73.5	342.8
Phase-Out Pension Exemption on High Incomes > $75,000/$150,000	4.1	1.0	5.1	6.2	1.6	7.8
2. Repeal Senior Interest, Dividend Exemption Age Based	3.2	0.8	4.1	4.9	1.3	6.2
3. Repeal of Senior Personal $2,300 Exemption	-	-	-	-	-	35.0
4. Eliminate Senior Homestead Property Tax Credit; replace with income basis	-	-	-	-	-	136.0
Total	**184.7**	**49.3**	**234.1**	**416.4**	**76.4**	**527.8**

Although the pension tax has received most of the attention because it is the largest tax exemption removed from pensioners, the changes in the Homestead Property Tax Credit present a significant tax increase for seniors. According to the House Fiscal Agency analysis, in tax year 2008, about 453,200 senior Homestead Property Tax Credits were allowed and the average credit was $770.

Although seniors account for only 13% of Michigan's population, seniors will be contributing over one-third of the $1.5 billion in increased taxes on individuals in Michigan if this tax proposal is signed into law. Seniors will also be contributing substantially to the reduced tax burden on businesses.

House Fiscal Agency Director Mitch Bean has estimated that the public pension portion of the modification in the pension exemption would amount to about $100 million.

Taxpayer Effective Rates – Yesterday you heard from Lt. Governor Calley concerning the income tax proposals. At the end he showed you a bar chart depicting 5 categories of taxpayers. Here is the way we view that chart:

Taxpayer Effective Rates

	Current	Proposed when fully implemented	**Change**
Seniors with qualifying pension, 401k, IRA, etc.	0.24	1.25	**420% increase**
Seniors without qualifying pension, 401k, IRA, etc.	0.97	1.37	**40% increase**
Non-seniors	2.95	3.13	**6% increase**
Pass-through businesses w/o certificated credits	13.23	3.74	**72% decrease**
C corporations w/o certificated credits	14.05	5.94	**58% decrease**

What it shows is that there is going to be a **significant effective tax increase for seniors** (even though the tax rate is still low), a tax increase of at least 6% for non seniors, and huge **decreases** for all businesses. Even businesses facing the new Michigan Business Tax in 2008 did not face a 420% increase in their tax liability! .

Public policy reasons for senior tax breaks - The poverty rate of seniors has been significantly reduced in the last 30-40 years because former Michigan lawmakers wisely elected not to tax senior's social security income, and, for those lucky enough to have them, most pensions and savings. Medicare also helped lift seniors out of poverty so that most are no longer a financial burden on their children or the community. Now is not the time to turn the clock back and take income away from seniors who have only recently gained income security.

Incomes of state employee retirees – About three-quarters of retired state employees receive pensions of $24,000 or less. Over 30 percent receive pensions of $12,000 or less. This is according to the Office of Retirement Services *Comprehensive Annual Financial Report* as of September 30, 2009. Together with our social security and savings, most of us are living on $20,000 to $40,000 a year. The State Employee Retirement Act limits cost-of-living increases to no more than $300 a year, which basically means that with inflation, our pensions are declining in value each year.

Expenses of seniors - We are living so long now that we worry about our money running out and being forced into poverty. Even with cost-of-living adjustments to our Social Security, it doesn't keep up with the increase in the costs of prescription drugs or co-pays, medical needs not covered by Medicare, fuel, utilities, property taxes, and Medicare premium increases. We have long-term care and chore assistance costs others don't have. Our point is that the vast majority of state employee retirees are low to moderate income people with potentially high living costs as they age.

Promises should be kept - We were promised tax-free pensions and made our plans accordingly. Some of us bought expensive extra years of service with our 401k money with the thought that it would enhance that part of our income that wouldn't be taxed. Some of us were lured by the 2010 6.7% early retirement incentive; yet less than six months later, the new administration is advancing a tax take-away that effectively eviscerates the incentive. It is unfair and unjust to change the tax

<u>structure for current pension recipients, regardless of their age, when retirees can no longer adjust their retirement plans. Most cannot go back to work to make up for the loss of income proposed in this tax shift.</u>

Michigan state employee retirees worked and contributed to the economy in Michigan over many years. We have chosen to stay here in part because of the favorable tax climate and because we love Michigan. Taxing our pensions is going to cause some to move out of Michigan and with them, their contributions to Michigan's economy.

Sincerely,

/s/

Mary Pollock
Legislative Representative