Frequently Asked Questions (FAQ)

Pension and Retirement Income and Income Tax Liability

A subtraction is allowed on the Michigan return for qualifying distributions from retirement plans. Retirement plans include private and public employer plans, and individual plans such as IRA's. To be considered a qualified distribution for the subtraction, several requirements must be met. For employer plans, an employee generally must have retired under the provisions of the plan, the pension benefits must be paid from a retirement trust fund, and the payment must be made to either the employee or a surviving spouse. (Payments made to a surviving spouse are only deductible if the employee qualified for the subtraction at the time of death.)

If the conditions were met, there may be a limitation on the amount of the exemption that can be claimed.

If you received a pension or retirement benefit payment, you also received a Form 1099R. There is a box on Form 1099R titled "Distribution code(s)". Look in the "Distribution code(s)" box for the number that describes the condition under which the pension or retirement benefit was paid.

- ***Code 1**,* "Early distribution, no known exception." This condition is not eligible for the Michigan tax exemption.
- ***Code 2**,* "Early distribution, exception applies." This condition is not eligible for the Michigan tax exemption unless part of a series of mainly equal periodic payments made for the life of the employee or the joint lives of the employee and their beneficiary. Distributions from a 457 plan are not exempt.
- ***Code 3**,* "Disability." This condition is eligible for the Michigan tax exemption.
- ***Code 4**,* "Death." This condition is eligible for the Michigan tax exemption for surviving spouse only, and only if the decedent would have also qualified for a normal distribution under Distribution Code 7 at the time of death (dollar limits may still apply). The condition is not eligible for the Michigan exemption for all other beneficiaries or if paid as a death benefit payment made by an employer but not made as part of a pension, profit sharing, or retirement plan.
- ***Code 5**,* "Prohibited transaction." This condition is not eligible for the Michigan tax exemption.
- ***Code 6**,* "Section 1035 exchange" (the exchange of life insurance, endowment insurance and annuity contracts). This condition is not eligible for the Michigan tax exemption.
- ***Code 7**,* "Normal distribution." That is, a normal distribution from a plan, a distribution from a traditional IRA, if the participant is at least 59 ½; a Roth conversion if the participant is at least age 59 ½; and a distribution from a life insurance, annuity, or endowment contract. This condition is eligible for the Michigan tax exemption (dollar limits may still apply).
- ***Code 8**,* "Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 2006." This condition is not eligible for the Michigan tax exemption.
- ***Code 9**,* "Cost of current life insurance protection." This condition is not eligible for the Michigan tax exemption.

CONTINUED ON REVERSE

Michigan and federal public pensions. Federal and Michigan public pensions are totally exempt. Public pensions include benefits received from the federal civil service, State of Michigan public retirement systems and political subdivisions of Michigan, military retirement and Tier 2 railroad retirement. If the conditions of the plan are met, then these payments are totally exempt from Michigan income tax.

Public pensions from other states. Michigan residents can treat the public pensions received from the following states as totally exempt: Alaska, Florida, Hawaii, Illinois, Massachusetts, Mississippi, Nevada, New Hampshire, Pennsylvania, South Dakota, Tennessee, Texas, Washington, and Wyoming because they do not tax Michigan public pensions.

Michigan residents who receive public pensions from states not listed above are subject to the private pension exemption limits.

Private Pensions. Private pension subtractions are limited to $40,920 on a single return and $81,840 on joint returns for tax year 2006.

Combined Private and Public Pension Distributions. If you received both public and private pension distributions then the maximum allowable subtraction exemption for the private pension must be reduced by the amount the combined pensions exceed any public pension amount.

Can I subtract a rollover from a regular IRA to a Roth IRA?

If you are 59 ½ *in the year the rollover occurs*, you may deduct the rollover as a pension deduction within the limits for deducting pension income.

Can I subtract a distribution from a Roth IRA?

No. Distributions from a Roth IRA are already excluded from income on your federal return and therefore may not be subtracted on the Michigan return.

Can I subtract a distribution from deferred compensation?

- A 457 plan does not meet the qualifications for subtraction. You cannot subtract distributions from a 457 plan.
- Distributions from a 401(k) or 403(b) plan are deductible if they are the result of the employer's contributions **or** employee contributions required by the plan. Employee's contributions required by the plan to obtain an employer match are considered mandated. Amounts distributed from a 401(k) or 403(b) plan that allows the employee to set the amount of compensation to be deferred and does not prescribe retirement age or years of service do not qualify as retirement and pension benefits.
- You may not subtract any distributions that are reported by the payer on a W-2 Form