

STATE OF MICHIGAN



JOHN ENGLER, Governor

DEPARTMENT OF TREASURY
TREASURY BUILDING, P.O. BOX 1528, LANSING, MICHIGAN 48901
DOUGLAS B. ROBERTS, State Treasurer

REVENUE ADMINISTRATIVE BULLETIN 1997- 2

INDIVIDUAL INCOME TAX TREATMENT OF DEFERRED COMPENSATION

Approved: March 17, 1997

(RAB 97-2 Replaces Revenue Administrative Bulletin RAB 88-15)

RAB 97- 2. This bulletin describes the Michigan income tax treatment of contributions to and distributions from deferred compensation plans. The Department's policy changed as a result of a federal amendment to the United States Code.

Amendment to the United States Code

Public Law 104-95 added section 114 to Title 4 of the U.S. Code. This amendment prohibits a state from taxing **nonresidents'** 401(k), 457, and certain nonqualified deferred compensation plan distributions described in 3121(v)(2)(C) of the Internal Revenue Code. This amendment is effective for distributions received after December 31, 1995.

Federal Treatment

Generally, a contribution made to a deferred compensation plan is not subject to taxation until the amount is made available or distributed to an employee or participant in the plan. The distribution, including interest earned and credited to the account of an employee or participant, is considered deferred compensation and is subject to Federal income tax upon the distribution.

Michigan Treatment

The Michigan Income Tax Act, MCL 206.30(1); MSA 7.557(130)(1) defines taxable income as adjusted gross income as defined in the Internal Revenue Code, subject to certain adjustments. Therefore, deferred compensation is subject to Michigan Income Tax in the tax year that it is included in federal adjusted gross income.

Resident

A distribution of deferred compensation and the accrued interest to a Michigan resident is subject to Michigan income tax to the extent it is included in Federal adjusted gross income pursuant to MCL 206.110(1); MSA 7.557(1110) and MCL 206.113; MSA 7.557 (1113). The state of Michigan will tax these distributions to residents

regardless of the state in which the compensation was earned.

For 1995 and prior tax years, the Michigan income tax act, MCL 206.255(1),(3); MSA 7.557(1255) allows a credit for residents whose deferred compensation income is taxed by another state. For tax years beginning with 1996, this credit will no longer be allowed on deferred compensation distributions described in the federal code because the non-domiciliary state cannot tax a nonresident on this income.

Nonresident

1996 and Subsequent Tax Years:

As a result of the amendment to Chapter 4, Title 4 of the United States Code, Michigan is prohibited from taxing distributions from the plans specified in the amendment made to nonresidents of Michigan who earned the deferred compensation in Michigan.

1995 and Prior Years

Distributions from a deferred compensation plan received for personal services performed in this state are subject to the Michigan income tax in the year received, unless the taxpayer is a resident of a state that is a party to a reciprocal agreement as provided for in MCL 206.256(3); MSA 7.557 (1256).

In *Molter v Michigan Department of Treasury*, 443 Mich 537; 505 NW2d 244 (1993), the Michigan Supreme Court exempted earned interest on deferred compensation distributions received by a nonresident from the Michigan income tax. Interest income accrued on the contributions is allocated to the taxpayer's state of residency when received. Therefore, only the distributions of contributions made to the plan will be taxable to Michigan when received by a nonresident for tax years through 1995.

Household Income

For purposes of computing a property tax credit, home heating credit, farmland preservation tax credit, or senior citizen prescription drug credit, a deferral of compensation to a later year is included in household income only in the year the compensation is included in the taxpayer's Federal adjusted gross income under the Department of Treasury Income Tax Rules, 1979 AC, R 206.4.