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INDIVIDUAL INCOME TAX TREATMENT OF MOTOR VEHICLE INSURANCE PREMIUM REFUNDS

This bulletin describes the Individual Income Tax treatment of refunds of excess premiums from the Michigan Catastrophic Claims Association (MCCA) made in 1998.

ISSUES:

I. Does the motor vehicle insurance premium refund received in 1998 affect the computation of the Michigan Individual Income Tax base?

II. Is the refund included in household income?

CONCLUSIONS:

I. The refund of a motor vehicle insurance premium does not affect the computation of Michigan taxable income for the individual income tax unless the premium was deducted as a business expense in a prior year. A refund of a federally nondeductible item is not considered to be income.

II. The refund from an individual's motor vehicle insurer is not included in the computation of household income unless it is included in federal adjusted gross income. If the premium had been deducted as a business expense, the recovery of the expense would be in federal adjusted gross income and, that amount must be included in household income.

LAW AND ANALYSIS:

In 1978, when no fault auto insurance was instituted in Michigan, the legislature required the establishment of a catastrophic claims association to indemnify no-fault insurers from losses in excess of $250,000 for personal protection insurance coverage. The Michigan Catastrophic

Claims Association (MCCA) was established for this purpose. Michigan law requires that every no-fault insurer be a member of the (MCCA) and gives the association the authority to charge a premium to its members who pass the amount along to their policyholders in auto insurance premiums.

As announced in Insurance Bureau Bulletin 98-01, the Michigan Catastrophic Claims Association voted to return $1.2 billion of its excess premiums to its member insurance companies by June 30, 1998. The amount returned to the association members was to be refunded directly to the individual policyholders in the form of premium refunds of $180.00 per vehicle covered.

Individual Income Tax Treatment

The Income Tax Act, at Michigan Compiled Laws (MCL) 206.30(1); MSA 7.557(130)(1) prescribes the computation of Michigan taxable income as:

> "Taxable income" means, for a person other than a corporation, estate, or trust, adjusted gross income as defined in the internal revenue code subject to the following adjustments and the adjustments provided in subsections (2) to (4)…

The statutory adjustments to federal adjusted gross income for the computation of Michigan taxable income do not include the refund of an insurance premium. Therefore, if the refund is not included in federal adjusted gross income, it is not included in Michigan taxable income and is not subject to Michigan income tax. Under the Internal Revenue Code (IRC), a refund of a nondeductible item, e.g., an auto insurance premium, is generally not considered to be income, and therefore, not included in adjusted gross income.

However, if the premium was a deductible item on the federal return, such as a business expense, the recovery of the expense would be in federal adjusted gross income in the year of the refund or recovery. *See* IRC section 111. In such a case, the amount of the recovery of the expense that is included in federal adjusted gross income is included in Michigan taxable income.

The computation of household income is prescribed at MCL 206.510(1); MSA 7.557(1510)(1), which states in part:

> "Income" means the sum of federal adjusted gross income as defined in the internal revenue code plus all income specifically excluded or exempt from the computations of the federal adjusted gross income . . .

Therefore, a refund of insurance premium received in 1998 is not included in household income unless it is required to be included in federal adjusted gross income.

Household income is used in the computation of the homestead property tax credit, home heating credit, senior citizens' prescription drug credit, and the farmland preservation credit.