

STATE OF MICHIGAN
COURT OF APPEALS

RUTH MAGEN,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,

Defendant-Appellant.

FOR PUBLICATION
February 21, 2013
9:15 a.m.

No. 302771
Court of Claims
LC No. 09-00075-MT

Before: M. J. KELLY, P.J., and WILDER and SHAPIRO, JJ.

SHAPIRO, J.

Defendant appeals as of right from an order granting summary disposition in favor of plaintiff regarding the taxability of distributions from a private IRA whose principal wholly originated in a non-taxable 403(b) retirement account. We affirm because placing otherwise tax-free money into an IRA does not create an obligation to pay taxes on that money.

I. BACKGROUND

Plaintiff's now-deceased husband, Myron Magen,¹ was formerly employed by Michigan State University. While employed, Magen contributed to a 403(b) retirement account sponsored by MSU. Upon his retirement, Magen transferred the 403(b) monies to a private individual retirement account. The entire principal amount in the IRA was previously held in the MSU 403(b) account. Later, plaintiff received distributions from the IRA and deducted the sums from his state income tax.

Defendant disagreed with the Magens' deductions, asserting that the sums were not deductible and issued an intent to assess the Magens for the income tax deficiency. Plaintiff appealed to the Court of Claims, which granted summary disposition to plaintiff. The Department of Treasury appealed to this Court.

Resolution of this case requires that we interpret two provisions of the Michigan Income Tax Act. One defines certain retirement accounts as not subject to state income tax. A second

¹ All references to "Magen" are to the decedent.

defines certain retirement accounts that are subject to state income tax. In reaching a conclusion, our primary goal must be to give effect to the intent of the Legislature. *Kessler v Kessler*, 295 Mich App 54, 60; 811 NW2d 39 (2011). The intent of the statutes must be determined from an examination of their language and from an “examination of the [statute] within the structure of the [Act] as a whole.” *Henry v Dow Chemical Co*, 484 Mich 483, 495; 772 NW2d 301 (2009).²

In 1967, the Legislature passed the Michigan Income Tax Act, under which an individual’s taxable income is equal to her adjusted gross income as defined by federal tax law, subject to certain additions and deduction. MCL 206.30(1). MCL 206.30(1)(f)(i) calls for a taxpayer to deduct from her adjusted gross income any “[r]etirement or pension benefits received from a federal public retirement system or from a public retirement system of or created by this state or a political subdivision of this state.”

As used in subsection (1)(f), “retirement or pension benefits” means distributions from all of the following:

(a) Except as provided in subdivision (d), qualified pension trusts and annuity plans that qualify under section 401(a) of the internal revenue code, including all of the following:

* * *

(iii) Employee annuities or tax-sheltered annuities purchased under section 403(b) of the internal revenue code by organizations exempt under section 501(c)(3) of the internal revenue code, or by public school systems.

* * *

(d) Retirement and pension benefits do not include:

(i) Amounts received from a plan that allows the employee to set the amount of compensation to be deferred and does not prescribe retirement age or years of service. [MCL 206.30(8)].

The parties agree that the 403(b) account in which plaintiff’s money originated constituted the type of plan protected by MCL 206.30(8)(a)(iii). It is also undisputed that a private IRA would normally fall under MCL 206.30(8)(d), and would not be tax-free. Defendant argues that because the distributions came directly from the private IRA, they must be taxed regardless of the fact that the principal in the IRA originally came from a tax-free retirement plan.

² “When interpreting a court rule or statute, we must be mindful of ‘the surrounding body of law into which the provision must be integrated’” *Haliw v Sterling Hts*, 471 Mich 700, 706; 691 NW2d 753 (2005) (citing *Green v Bock Laundry Machine Co*, 490 US 504, 528; 109 S Ct 1981; 104 L Ed2d 557 (1989) (Scalia, J., concurring)).

It is not disputed that a state retiree may receive those tax-free benefits in the form of periodic annuity payments or in the form of a single lump sum payment at the time of his or her retirement. It is also agreed that if a retiree opts for the lump sum payment and places that sum in a bank account or an ordinary investment account, the amount deposited is not subject to Michigan income tax when withdrawn. The interest earned on those monies is taxable, but the principal composed of Michigan state pension benefits is not taxed upon withdrawal from the account or sale of the investment purchased.

The state, however, now asserts that if the lump sum payment is placed into an Individual Retirement Account, the entire principal, i.e. all the pension income, is subject to Michigan income tax, not merely the interest or other gains based on that principal. The state bases this argument on the fact that MCL 206.30(8)(d) provides for taxation of withdrawals from IRAs. However, we cannot simply select one statute to follow and ignore the other. It is instead our responsibility to harmonize them. And in this case, harmonizing the statutes is fully consistent with the legislature's intent to excuse from state income tax those sums earned by state employees and placed, until their retirement, in a 403(b) account.

IRA withdrawals are fully taxable because the monies normally deposited in such accounts are "tax deferred." Indeed, providing a mechanism for tax deferral of otherwise taxable income is the very reason for the creation of IRAs. Placement of the pension payment in an IRA provides tax *deferral* of federal income tax otherwise due upon receipt.³ Michigan's Income Tax Act was written to operate the same way. Instead of being taxed at the time that the money is earned, the tax is not applied until the funds are distributed from the IRA. MCL 206.30.

However, in this case the income placed into the IRA was not *state-tax-deferred* income; it was *state-non-taxable* income. Obtaining deferral on applicable taxes by rolling those monies over into an IRA does not create a deferred obligation to pay Michigan income tax on monies that were not subject to state income tax to begin with. Moreover, it would be an absurd construction of the statute to conclude that the Michigan Legislature intended to make pension benefits non-taxable unless they were placed in an IRA. We can conceive of no rational basis to make such benefits taxable if placed in an IRA, but not if placed in an ordinary investment account or a bank or in a mattress. The Department of Treasury argues that Magen still got the benefit of his 403(b) account status when he rolled the funds into the IRA, but this is incorrect. The money would not have been taxed going *into* the IRA under any circumstances.

³ Michigan has no authority to declare its pension benefits not subject to federal taxes.

An IRA is a vehicle to defer taxes due; not to create taxes where none exist. The trial court thus properly concluded that plaintiff's IRA distributions were not subject to Michigan income tax.⁴

Affirmed.

/s/ Douglas B. Shapiro

/s/ Michael J. Kelly

⁴ Our dissenting colleague fairly observes that if one looks solely at the language of MCL 206.30(8)(d), the Department of Treasury should prevail. What the dissent fails to take into account, however, is that there are *two* statutes at issue here; the legislature passed them both and it is not for us as judges to simply select one to apply and one to ignore. Rather, it is our role to give effect to each of them and to harmonize them consistent with their language and purpose. Moreover, we cannot, as the dissent wishes to do, resolve this case on the basis of federal income tax law since the whole point of this case is that the applicable *Michigan* tax law, quite unlike the *federal* law, does not defer state income tax on state pensions, but rather eliminates it. Lastly, we reject the dissent's suggestion that we have reached our conclusion because we "perceive a contrary result to be absurd". Our opinion makes no such statement and that is not our view. The outcome suggested by the Department of Treasury and the dissent is not absurd. It is, however, based upon a flawed analysis given its premise that a statute passed by the legislature that limits the state's authority to tax its citizen's income can simply be ignored.