S T A T E O F M I C H I G A N

C O U R T O F A P P E A L S

RUTH MAGEN, Plaintiff-Appellee,	FOR PUBLICATION February 21, 2013 9:15 a.m.
v	No. 302771 Court of Claims
DEPARTMENT OF TREASURY,	LC No. 09-00075-MT
Defendant-Appellant.	Advance Sheets Version

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

SHAPIRO, J.

Defendant, the Department of Treasury, appeals as of right an order granting summary disposition in favor of plaintiff, Ruth Magen, regarding the taxability of distributions from a private individual retirement account (IRA) whose principal wholly originated in a nontaxable 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.

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 IRA. The entire principal amount in the IRA had previously been held in the MSU 403(b) account. Later, Magen received distributions from the IRA and, in tax years 2005 through 2007, deducted the sums from the state income tax returns he filed jointly with plaintiff.

Defendant disagreed with the Magens' deductions, asserting that the sums were not deductible, and assessed the Magens for the income tax deficiency. Plaintiff appealed in the Court of Claims, which granted summary disposition to plaintiff and vacated the assessments. Defendant appealed in this Court.

Resolution of this case requires that we interpret two provisions of the Income Tax Act, MCL 206.1 *et seq*. One defines certain retirement accounts as not subject to state income tax. A second defines certain retirement accounts that are subject to state income tax. In reaching a

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

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. See *Henry v Dow Chem Co*, 484 Mich 483, 495; 772 NW2d 301 (2009).[2]

In 1967, the Legislature passed the Income Tax Act, under which an individual's taxable income is equal to that person's adjusted gross income as defined by federal tax law, subject to certain additions and deductions. MCL 206.30(1). Currently, as during the tax years at issue, MCL 206.30(1)(f)(*i*) calls for taxpayers to deduct from their 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 [MCL 206.30(1)(f)], "retirement or pension benefits" means distributions from all of the following:
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> (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:
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> * * *
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> (*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.
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> * * *
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> (d) Retirement and pension benefits do not include:
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> (*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.

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[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), quoting *Green v Bock Laundry Machine Co*, 490 US 504, 528; 109 S Ct 1981; 104 L Ed 2d 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 IRA, 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-*nontaxable* 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 nontaxable 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.

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]

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

[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

Affirmed.

/s/ Douglas B. Shapiro
/s/ Michael J. Kelly

to give effect to each of them and to harmonize them consistently 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 on a flawed analysis given its premise that a statute passed by the Legislature that limits the state's authority to tax its citizens' income can simply be ignored.