



**House
Legislative
Analysis
Section**

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TAX CREDITS: ALLOW CARRYOVERS, ETC.

Senate Bill 785 (Substitute H-2)

First Analysis (6-23-88)

RECEIVED

Sponsor: Sen. Norman D. Shinkle

Senate Committee: Finance

House Committee: Taxation

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THE APPARENT PROBLEM:

Public Act 254 of 1987 (Senate Bill 506) made numerous changes to the Income Tax Act recommended by the Department of Treasury, some of which were intended to make the state law conform with the recently amended federal tax law. (The act also increased the personal exemption as a method of dealing with the so-called windfall to the state from federal changes.) One of the amendments altered the way net operating losses are treated for purposes of the homestead property tax credit, known as the circuitbreaker. The change required taxpayers to add to their income net operating loss carryforwards or carryovers. (Carryovers are losses that cannot be used to offset income in the year suffered and so are carried over to offset income in the next tax year.) Previously, loss carryovers were not included as income, so the change was expected to reduce the size of property tax credits. The rationale provided at the time was that because the property tax credit is based on the relation between a taxpayer's income in a given year and property taxes paid in the same year, losses from a prior year should not be used in calculating current year income. Tax specialists say the change has little effect on the typical household, but has had a significant, apparently unintended, effect on farmers. This is because the credit they receive under the Farmland and Open Space Preservation Act (Public Act 116 of 1974) is calculated by using the definition of household income in the Income Tax Act. Under Public Act 116, a farmer essentially enters a contract with the state that grants a special property tax credit in return for keeping farmland in agricultural use. With the change in the definition of household income, farmers were denied the use of operating loss carryovers in determining their P.A. 116 credits. This reduced the tax credits of some farmers considerably for the 1987 tax year, over \$2 million in aggregate, partly because of the losses suffered in the 1986 floods. (In one case cited by the Farm Bureau, a farmer anticipating a credit of over \$12,000, already promised to pay debts, received less than \$4,000 due to this change.) Representatives of farm interests say that this complicated tax accounting change, made very late in 1987 with little understanding of its potential impact on farmers, ought to be reversed.

THE CONTENT OF THE BILL:

The bill would amend Chapter 9 of the Income Tax Act to modify the definition of "household income" used in calculating farmland preservation tax credits and homestead property tax credits so that beginning with the 1988 tax year a deduction for a carryback or carryover of a net operating loss could not exceed federal modified taxable income as defined in the federal Internal Revenue Code. (This has the effect, tax specialists say, of allowing the deduction of net operating losses from household income but restricting their use to the actual amount of loss suffered.) Because the bill would remove the language added to this section by Public Act 254 of 1987, and would make the change effective for tax years beginning after December 31, 1986, the treatment of net operating loss

carrybacks or carryovers for the 1987 tax year would be the same as for prior years before the 1987 amendment.

MCL 206.510

HOUSE COMMITTEE ACTION:

In its Senate-passed form, the bill would have excluded net operating losses carried forward or carried back from the definition of household income for taxpayers claiming the credit under the Farmland and Open Space Preservation Act. The House substitute would limit somewhat the deduction of net operating loss carryovers and carrybacks, but would allow them to be deducted by all taxpayers for both the farm credit and the circuitbreaker credit.

FISCAL IMPLICATIONS:

The Department of Treasury estimates that the bill will cost about \$4 million per year. This represents the increase in credits to farmers and other small businesses from allowing net operating losses to be excluded from the calculation of household income for the purpose of calculating both farm credits (under P.A. 116) and circuitbreaker credits. (6-22-88)

ARGUMENTS:

For:

The bill would reverse a change in tax law made late in 1987 that inadvertently deprived farmers in the state of over \$2 million in anticipated Public Act 116 (farmland preservation) property tax credits. The 1987 change disallowed the use of operating loss carryovers; that is, the use of losses from past years to offset income in the current year. This meant that farmers had to increase their incomes by adding loss carryforwards when determining their Public Act 116 credits, which reduced the amount of the credits. While this change may have been justified for homestead property tax credits, it does not take into account that farm operations are businesses and that farmers' incomes are more volatile than most. The floods of 1986, which produced huge losses for some farmers, have driven this point home and have made the need for excluding loss carryovers from household income more obvious. The legislature did not intend to apply this change in the tax law to farmers who have pledged under Public Act 116 agreements to keep land in agricultural use and ought to reverse the policy. In its current form, the bill would allow the use of net operating losses both for farm credits and for circuitbreaker credits, which means some small businesses other than farms will benefit from reversal of the policy instituted in the 1987 amendment. This ensures that other businesses will be treated in the same manner as farm businesses. Generally speaking, the bill would restore the law on tax credits to its previous condition with, however, some limitation on the amount of net operating losses that could be used to reduce income.

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POSITIONS:

The Department of Treasury supports the bill. (6-22-88)

A representative of the Michigan Farm Bureau testified in favor of restoring to farmers the use of net operating losses in calculating the Public Act 116 credits. (6-22-88)