SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 785 (as enrolled) (Public Act 261 of 1988)
Sponsor: Senator Norman D. Shinkle
Senate Committee: Finance
House Committee: Taxation

Date Completed: 9-7-88

RATIONALE

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 Reform Act. One of the amendments altered the way net operating losses are treated for purposes of the homestead property tax credit, known as the circuit breaker. 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 a ratio of 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. Apparently the change has had little effect on the typical household, but some say it has had a significant, 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 into 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 Public Act 116 credits. It is claimed that this reduced the tax credits of some farmers considerably for the 1987 tax year. (In one case cited by the Farm Bureau, a farmer anticipating a credit of over $12,000 received less than $4,000 due to this change.) Some people feel that adding loss carryforwards to the definition of income regarding the Homestead Property Tax Credit was appropriate, but that its effect on the Farmland Preservation Tax Credit was unintentional and could cause hardship to farmers who are eligible to claim that credit.

CONTENT

The bill would amend Chapter 9 of the Income Tax Act to modify the definition of "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. (Reportedly, this would have the effect 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 years prior to the 1987 amendment.

MCL 206.510

FISCAL IMPACT

The bill would result in a minor, indeterminate decrease in General Fund/General Purpose revenues for the State.

ARGUMENTS

Supporting Argument

The bill would reverse a change in tax law made late in 1987 that inadvertently deprived farmers in the State of 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 did not take into account that farm operations are businesses and that farmers' incomes are more volatile than those of most households. The floods of 1986, which produced huge losses for some farmers, have driven this point home and have highlighted the need for excluding loss carryovers from household income. In its current form, the bill would allow the use of net operating losses both for farm credits and for circuit breaker credits, which means some small businesses other than farms would benefit from reversal of the policy instituted in the 1987 amendment. This would ensure that other businesses were 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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