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SBT REDUCTION/PENSION EQUITY

House Bill 4801 (Substitute H-5)
Sponsor: Rep. Michael J. Griffin

House Bill 5278 (Substitute H-7)
Sponsor: Rep. Bill Martin

House Bill 4958 (Substitute H-5)
Sponsor: Rep. Lynn Owen

House Bill 5090 (Substitute H-3)
Sponsor: Rep. Willis Bullard, Jr.

House Bill 5614 (Substitute H-2)
Sponsor: Rep. Kirk A. Profit

Committee: Taxation

Senate Bill 145 (Substitute H-1)
Sponsor: Sen. Jon Cisky
Senate Committee: Local Government and Urban Development
House Committee: Taxation

Senate Bill 1145 (Substitute H-2)
Sponsor: Sen. Glenn Steil
Senate Committee: Finance
House Committee: Taxation

First Analysis (6-14-94)

THE APPARENT PROBLEM:

Budget specialists point out that improved economic conditions have significantly improved the outlook for state tax revenues. In fact, the consensus revenue estimate for fiscal year 1994-95, arrived at by legislative and administration budget experts, predicts revenues in that year will for the first time exceed the constitutional revenue limit by $180 million. (This is also a result of the state assuming a much larger portion of the funding for public schools in the state under the new school financing system that begins with the 1994-95 school year.) The state constitution contains a limit on "the total amount of taxes which may be imposed by the legislature in any fiscal year on the taxpayers of this state." The limit was placed in the constitution by voters in 1978 as one element of the so-called Headlee Amendment, and restricts state revenue to a proportion of total personal income in the state. Revenue cannot exceed 9.49 percent of the previous calendar year's total personal income or of the average of the previous three years, whichever limit is higher. The constitution says if revenues exceed the limit by one percent or more, excess revenues must be refunded pro rata based on personal income tax and single business tax liability. If the limit is exceeded by less than that, the excess can be transferred to the State Budget Stabilization (or "rainy day") Fund. (As a report from the House Fiscal Agency notes, the final numbers for fiscal year 1994-95 cannot be calculated until the spring of 1996, and any refunds would be received after that.) One way to address in advance this anticipated substantial increase in state revenues is to return money to taxpayers through reduced taxes. An agreement has been reached by the administration and legislative leaders on how to do that.

THE CONTENT OF THE BILLS:

SBT Amendments. Five of the bills would amend the Single Business Tax Act (MCL 208.31 et al.) in the following ways:

** Under Senate Bill 1134, the tax rate would be lowered from 2.35 percent to 2.30 percent as of October 1, 1994. Under Senate Bill 145, the Department of Treasury would annualize the rate as necessary for tax years ending after September 30, 1994.

** House Bill 5090 would increase the filing threshold from $100,000 to $250,000 for tax years beginning after December 31, 1994. The threshold would be $137,500 for calendar year 1994. Businesses with gross receipts below this amount would not have to file a return or pay the tax. An affiliated group or a controlled group of corporations or an entity under common control would have to consolidate the gross receipts of the entities to determine if the group was required to pay a tax or file a return.

** House Bill 5614 would reduce the alternative tax rate for small businesses from three percent of adjusted business income to two percent, with the rate to be annualized for 1994.

** Under House Bill 4598, payments to local units of government from SBT revenues would, beginning in 1996, be increased by .53 percent of the gross collections before refunds for the 12-month period ending on the June 30 before the payment date. (Tax specialists say this would hold local units harmless for SBT revenue sharing.)

Pension Amendments. House Bills 4801 and 5278 would amend the Income Tax Act (MCL 206.30 and 206.30a) to alter the way private pensions and other retirement income are taxed. The current provisions regarding public pensions would remain unchanged.

** Taxpayers could deduct from taxable income, up to certain limits, retirement or pension benefits from private sources received after September 30, 1994, or benefits received after that date from a retirement annuity policy in which payments were made for life to a senior citizen. The limits would be $30,000 for a single return and $60,000 for a joint return. (The limits would be adjusted annually by the percentage increase in the Detroit consumer price index.) Those amounts would be reduced by the amount of any deductions a taxpayer had for public retirement or pension benefits. The term "senior citizen" would refer to a person 65 years of age or older or an unremarried surviving spouse. (House Bill 4801 provides for the deduction; House Bill 5278 contains the deduction limits.)

** Also, after September 30, 1994, senior citizens (and unremarried surviving spouses) not eligible for either the public or private pension deduction would be able to deduct interest and dividend income up to $1,000 for a single return and $2,000 for a joint return. These amounts would be adjusted annually, too. (House Bill 5278)

The current exemption of $7,500 for a single return and $10,000 for a joint return allowed for retirement or pension benefits from private systems would not apply as of October 1, 1994.

All seven bills are tie-barred to one another.

FISCAL IMPLICATIONS:

According to estimates provided to the House Taxation Committee, the bills would reduce state revenues by $155 million. The SBT amendments would reduce revenues by $85 million and the pension amendments by $70 million. The SBT revenue reductions are broken down as follows: the general rate reduction, $45 million; increase in the filing threshold, $30 million; and decrease in alternative profits tax rate, $10 million. (6-9-94)

ARGUMENTS:

For:

This package of bills, taken together, will provide Michigan taxpayers with over $150 million in annual tax relief, and it does so by addressing two longstanding tax issues, the impact of the single business tax and the need to provide equal treatment to public and private pension income. Reportedly, some small businesses pay more to tax preparers to figure out their SBT liability than they owe in taxes. The proposal helps the smallest businesses by increasing the filing threshold to $250,000 in gross receipts. Many more very small businesses will no longer have to file returns or pay the tax. Further, the rate for an alternative tax calculation used by small businesses (those with under $10 million in gross receipts that meet other requirements) would be reduced. The general SBT rate reduction benefits all businesses, no matter what their size and no matter what kind of enterprise they are engaged in, and provides some $45 million in tax relief. This is a straightforward and fair way to reduce business taxes.

Response:

Some people argue that the single business tax is in need of fundamental reform far exceeding the provisions in this proposal. Many in the business sector advocate its repeal. While this proposal helps some small businesses and provides a small rate decrease, it does not address the larger issues. Further, exempting more businesses from the tax merely narrows the tax base and worsens the division between those businesses who must pay the tax and those who need not. If one important element of this kind of tax is a broad tax base and low rate, continuing to reduce the base in this way may weaken the tax in the long run. Some people advocate a change in the three-factor apportionment formula (which affects how payroll, property, and sales are treated) so as to benefit Michigan-based manufacturers.

For:

The proposal takes a major step in treating pension income equally for income tax purposes. Currently, public pensions are not taxed by the state but private pensions are (although the first $7,500 for a single filer and $10,000 for a joint filer are exempt). This proposal would exempt the first $30,000 (or $60,000 for joint filers) of pension income or pension-like income (i.e., annuities paid over a lifetime). Very few public pensions in Michigan exceed this amount. Further, the legislation would also provide a deduction to those without pensions for some income derived from interest and dividends. While this does not do all that some would like on this issue, it does provide a simple solution that goes a long way toward providing equity.

Response:

The issue needs to be framed differently. Typically, this issue is discussed in terms of treating private pensions in the same manner as public pensions. The issue ought to be the equal treatment of all retirement income. The estimates are that about half of the state's retirees don't receive a pension. Why should their interests be ignored? This approach leaves out a great many retired people.

Against:

What happens in future years when state revenues are no longer so robust? Isn't it premature to take this action before the state knows for sure whether the revenue limit will be exceeded and by how much? This is of particular concern since the new state school financing formula remains untested. Shouldn't the state if possible set aside revenues for future revenue crises? These proposed tax reductions are permanent reductions in the tax base. It will be difficult to recover this revenue from other sources when the inevitable budget crunch arrives several years from now. If money is to be returned to taxpayers, why not do it through temporary rate reductions?

POSITIONS:

Representatives of the Department of Treasury testified in support of the package before the House Taxation Committee. (6-9-94)

The Michigan State Chamber of Commerce supports the bills. (6-13-94)

The Small Business Association of Michigan supports the bills. (6-9-94)

The National Federation of Independent Business supports the bills. (6-13-94)

The Michigan Retailers Association supports the package. (6-13-94)

The Michigan Merchants Council and Associates supports the package. (6-13-94)

The Michigan AFL-CIO supports the pension amendments. (6-13-94)

The Michigan Manufacturers Association does not oppose the package. (6-13-94)