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## NO-FORM INCOME TAX PROPOSAL

House Bill 5694 as enrolled  
Public Act 264 of 1996  
Sponsor: Rep. James Ryan

House Bill 5695 as enrolled  
Public Act 265 of 1996  
Sponsor: Rep. Beverly Bodem

House Committee: Tax Policy  
Senate Committee: Finance

Second Analysis (8-30-96)

### ***THE APPARENT PROBLEM:***

In his State of the State address on January 17, 1996, Governor Engler proposed simplifying the state income tax through a program that would allow some taxpayers to escape filing a state income tax form. The governor's proposal featured an option for taxpayers with wages-only income and minimal other income (interest, investments, etc.) to notify their employers that they do not intend to file a state income tax form and instead want their state taxes withheld at a specified rate. Employers would then send copies of the withholding statements of those selecting the no-file option to the Department of Treasury. Legislation has been introduced to implement this proposal.

### ***THE CONTENT OF THE BILLS:***

House Bill 5695 would amend the Income Tax Act to allow certain taxpayers to elect to forgo filing an annual state income tax return and instead calculate and pay their state income tax by multiplying taxable compensation, minus an amount equal to personal exemptions and dependency exemptions, by 4.4 percent. House Bill 5694 also would amend the Income Tax Act. It would require an employer to deduct and withhold state income taxes as specified for those electing to choose the no-file option and to require an employer to provide the Department of Treasury with a copy of the exemption certificate of an employee who elects the no-file method.

Under House Bill 5695, to be an "eligible taxpayer", a person would have to file a withholding exemption certificate electing to pay the tax without filing and could not have taxable income of \$100 or more for a single return or \$200 or more for a joint return from sources other than taxable compensation (e.g., dividends and

interest). The taxpayer also could not have any taxable income subject to the standard withholding calculations during the tax year. A taxpayer choosing the no-file method could claim the prescription drug credit and the home heating credit. (Those credits require separate forms.) A taxpayer who elected to use the no-file method could subsequently elect to file an annual return and pay the tax as calculated by the usual method.

The bill would apply to tax years beginning after December 31, 1996. The bill would also specify that, as regards taxpayers choosing the no-form option, the running of the statute of limitations for violations of the act would begin on the date that the annual return would otherwise have been due.

The term "taxable compensation" would apply, generally, to compensation subject to withholding by an employer and does not include Social Security benefits; retirement benefits, pension benefits, and similar benefits up to the amount allowed as a deduction from state income taxes; all retirement benefits and pension benefits from a federal public retirement system or a public retirement system of the state of Michigan or one of its subdivisions; and compensation, including retirement benefits, received for service in the U.S. armed forces.

House Bill 5695 would also require, for the 1998 tax year and tax years thereafter in which the no-form option is permitted, that Department of Treasury file a report no later than July 1 with the House Tax Policy Committee and the Senate Finance Committee on the use of the no-form option. The report would have to contain the total number of taxpayers electing to use the no-form option,

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the number by county and city, and the average income of such taxpayers.

As mentioned above, House Bill 5694 would require an employer to deduct and withhold state income taxes as specified for those electing to choose the no-file option and to require an employer to provide the Department of Treasury with a copy of the exemption certificate of an employee who elects the no-file method. The bill would require the exemption certificate to be filled out by the employee to state: "Electing to file using the no-form option may not be for everyone who is eligible. If a taxpayer chooses the no-form option, he or she may not be eligible for some of the credits allowed under this act including the property tax credit . . . , the tuition tax credit . . . , and the city income tax credit."

The two bills are tie-barred to one another.

MCL 206.51a et al.

### **FISCAL IMPLICATIONS:**

The House Fiscal Agency notes that the Department of Treasury estimates that the proposal will be revenue neutral, but the HFA says it believes the proposal could result in either a small increase or small decrease in revenues. The HFA estimates the revenue changes, if any, at \$5 million or less. (Fiscal Note dated 3-20-96 on the bills as introduced.)

### **ARGUMENTS:**

#### ***For:***

The no-form income tax proposal would simplify the income tax for tens of thousands of Michigan taxpayers, say representatives of the Engler administration. The proposal would permit taxpayers with little income outside of wages to declare their intent not to file a tax form and instead to direct their employers to withhold state income taxes at a rate of 4.4 percent. Taxpayers could change their minds and file a return if it appeared advantageous. The program would be entirely optional. While this would not be a good option for many taxpayers, some will find it beneficial, and some might even be willing to pay slightly more in taxes to avoid the hassle of filling out the income tax form. This is a tax simplification proposal. It would save some taxpayers time and effort, and it would reduce the number of returns the Department of Treasury must handle and process.

#### ***Against:***

The proposal has drawbacks. For one thing, some taxpayers could unwittingly wind up paying more in state income taxes by choosing the no-form option. (It should

be noted that the main way to find out whether it makes sense not to fill out and send in a form is to fill out the form.) For another, the current forms, particularly the EZ form, are relatively simple to complete. A taxpayer, moreover, would still have to first fill out the federal income tax form, which is where most of the complexity lies. The no-form option also would lead to a loss of revenue to the checkoffs on the income tax form, to the child abuse prevention fund, the wildlife fund, and to the state campaign fund (for gubernatorial campaigns). Further, it would require additional work for the treasury department, which would have to make sure the people using the option were eligible for it (by checking on interest and investment income). Concern has also been expressed about how taxpayers might manipulate this option (e.g., married couples filing separately).

#### ***Response:***

While there may be some negatives attached to the proposal, on balance they are outweighed by the very clear advantages, principally the value of tax simplification. Over time, any administrative and enforcement problems could be worked out. It must be emphasized that the no-form option would be voluntary; taxpayers could choose to use it or they could choose to file a return. And, they could change their minds and file a return for a tax year after having earlier notified the employer and the state of their selection of the no-form option. (They could not, of course, decide not to file part way through the year.) The fact that a few taxpayers might make a bad decision should not keep the choice from being available.

#### ***Against:***

In its current form, the legislation would allow people who have selected the no-form option to claim the prescription drug credit and the home heating credit. This will require that they send in those separate forms. This runs counter to the whole purpose of the bill, which is the avoidance of paperwork.

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.