Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bills 29 (Substitute S-1) and 232 through 237 (as passed by the Senate)
Sponsor: Senator Michael J. Bouchard (S.B. 29)
Senator Dave Honigman (S.B. 232)
Senator Doug Carl (S.B. 233)
Senator Joel D. Gougeon (S.B. 234)
Senator Glenn D. Steil (S.B. 235)
Senator Jon Cisky (S.B. 236)
Senator Loren Bennett (S.B. 237)
Committee: Finance

Date Completed: 2-9-95

RATIONALE

Changes in the State's tax structure, the overall health of the economy, increases in business activity, low unemployment rates, and increases in State residents' personal income all have contributed to robust State revenue collections. At the required biannual Consensus Revenue Estimating Conference (held on January 12, 1995), part of the consensus agreement was that the State will close the 1994-95 fiscal year $297.3 million in excess of the State's revenue limit. Article 9, Section 26 of the State Constitution prescribes the calculation of the limit, and provides that if total State revenues exceed the limit by 1% or more, the excess must be refunded to Michigan income and single business tax payers. In the Governor's State of the State address, he proposed that, rather than simply waiting until the end of the fiscal year (September 30) to see how much the revenue limit is exceeded and refunding the excess, the projected surplus be used now, for permanent tax cuts. The Governor suggested a package of tax cuts to lower taxes on individuals and businesses. The Governor proposed an increase in the personal exemption to the income tax, and an adjustment for inflation in future years; reductions in the single business tax; and a reduction, and eventual elimination, of the intangibles tax. In addition, it has been suggested that an income tax deduction for college tuition be included in the proposed package. (For a discussion of the proposed amendments to the income tax personal exemption, please see the Senate Fiscal Agency analysis of Senate Bill 96.)

CONTENT

The bills would reduce the single business tax (SBT), beginning in 1995, by the amount of various payments made by employers; reduce the intangibles tax beginning with the 1994 tax year and eliminate it by 1998; and, beginning with the 1995 tax year, allow a taxpayer to deduct from taxable income under the income tax tuition paid on behalf of a dependent to an institution of higher learning.

Senate Bills 29 (S-1), 234, 235, 236, and 237 are tie-barred to Senate Bills 232 and 233, or House Bill 4233, which would amend the intangibles tax Act to reduce the intangibles tax beginning with the 1994 tax year and eliminate it by 1998. Following is a description of each bill.

Senate Bill 232

The bill would amend the intangibles tax Act to increase the credit allowed against the intangibles tax to $280 (from the current $175), or to $560 for a joint return (from $350), for tax years after 1993. Further, the bill would provide for a reduction in the tax for 1994 through 1997; the tax computed under the Act, minus the deduction, would be reduced by 25% in 1994 and 1995, 50% in 1996, and 75% in 1997.

Senate Bill 233

The bill would repeal the intangibles tax Act effective January 1, 1998.

Senate Bill 234

The bill would amend the Single Business Tax Act to remove from the tax base of SBT payers payments to State and Federal unemployment compensation funds, for tax years 1995 and thereafter.

Senate Bill 235

The bill would amend the Single Business Tax Act to remove from the tax base of SBT payers payments under the Federal Insurance Contribution Act (FICA), the Railroad Retirement Tax Act, and similar social insurance programs, for tax years 1995 and thereafter.

Senate Bill 236

The bill would amend the Single Business Tax Act to remove from the tax base of SBT payers payments for workers' compensation insurance (including self-insurance) or Federal Employers Liability Act insurance, for tax years 1995 and thereafter.

Senate Bill 237

The bill would amend the Income Tax Act to allow a taxpayer to deduct, for 1995 and thereafter, to the extent included in Federal adjusted gross income, tuition paid in the tax year by the taxpayer on his or her own behalf or on behalf of a dependent (if that dependent did not claim the deduction) to a Michigan qualified institution of higher learning for undergraduate credits, up to $5,000 per student. A taxpayer could not claim the deduction for more than four years for each student.

For the 1995 tax year, tuition payments to any Michigan qualified institution of higher learning could be deducted. After the 1995 tax year, the deduction could not be claimed for payments made to a Michigan institution that increased tuition and fees during the tax year by more than the rate of inflation (the annual average percentage increase in the U.S. Consumer Price Index).

Senate Bill 29 (S-1)

The bill would amend the General Property Tax Act to specify that intangible personal property would be exempt from property taxes. (Under Section 2e of the intangibles tax Act, personal property subject to or expressly exempt from the intangibles tax is exempt from all general property taxes. Repeal of the intangibles tax Act, pursuant to Senate Bill 233, would remove the exemption.)

Further, Senate Bill 29 (S-1) specifies that the taxable status of computer software, as taxed under the General Property Tax Act, would not be affected by the bill's exemption for intangible personal property. (Under the Act, computer software is exempt from taxation, unless the software is incorporated as a permanent component of a computer or other device and not available separately; or the cost of the software is included as part of the cost of a computer.)

MCL 205.133 (S.B. 232)
205.131-205.147 (S.B. 233)
208.4 (S.B. 234, 235, & 236)
206.30 (S.B. 237)
Proposed MCL 211.93 (S.B. 29)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The State finds itself in the enviable position of having a projected substantial revenue surplus at the end of the current fiscal year. The Governor has proposed that the State should use this opportunity not only to return the surplus to the taxpayers, but also to enact permanent tax cuts, to the benefit of individual and business taxpayers in the future. Specifically, the Governor has proposed changes to the single business tax, the intangibles tax, and the income tax. These tax cuts would put more money in the pockets of taxpayers, both individuals and businesses, further stimulating and strengthening the economy, as well as increasing the potential for investment and new job growth. For many years the taxpayers of Michigan have struggled under the burden of high taxes. This proposal, combined with other recent tax cuts, would continue to improve the State's overall tax climate and further erode the State's reputation as a high tax state.

Supporting Argument

The Consensus Revenue Estimating Conference projected that the State will exceed the constitutional revenue limit by $297.3 million at the end of the 1994-95 fiscal year. (In addition, according to the Auditor General, $176 million of the proceeds of the Accident Fund sale should be counted toward the revenue limit, which would produce a total surplus of $473.3 million.) Under the Constitution, if the limit is exceeded by 1% or

more, the excess must be refunded pro rata based on State income tax and single business tax annual returns. It has been suggested that refunding excess revenue in this manner could result in a costly, administrative nightmare. By allowing taxpayers to keep the projected excess before it occurs, however, the proposed tax cuts would remove the possibility that the revenue limit will be exceeded.

Supporting Argument

The State should take this opportunity to rid itself of an onerous tax that falls disproportionately on persons who have saved their earnings and invested in stocks and other investments. The intangibles tax Act provides for a tax on the privilege of ownership of intangible property such as stocks, bonds, land contracts, annuities, and mutual funds. A person must file an intangibles tax return if the dividends and interest from intangible property exceed $5,000 per year, or if the person owns nonincome-producing intangible property in excess of $175,000 in value for a single return, or $350,000 for a joint return. The tax rate applied to intangible property is the greater of 3.5% of the income from property, or one-tenth of 1% of the value of the property. While it may seem that people who generate over $5,000 per year in interest and dividend income are not financially strapped, it must be remembered that, for some of them, particularly retirees, these investments may be their only source of income. In such cases the intangibles tax can be a significant burden.

Further, it must be pointed out that the intangibles tax is the third tax paid on the same amount of this income, since both Federal and State income tax also must be paid on intangibles income. This is particularly unfair to retirees; in effect, it punishes those who rely on investments instead of pensions. Persons who receive a government pension, on the other hand, pay no State income tax and persons who receive a private pension must receive a substantial amount before they are subject to the tax; none of this pension money is subject to the intangibles tax. Meanwhile, a person who relies on investments for retirement income is subject not only to the 4.4% State income tax, but also to an additional 3.5% intangibles tax. This is a tax that should have been eliminated long ago, if for no other reason than simple fairness.

Response: Though some people make a good case that the tax falls unfairly on low- and middle-income seniors or other retirees, this is not a reason to eliminate the tax entirely. While attempting to help those who may be unfairly burdened by the tax, eliminating it would reward greatly a relative handful of wealthy persons, thus benefiting the most privileged of our society. Clearly, a bill could be structured to provide relief to those low- and middle-income persons affected by the intangibles tax, while maintaining the tax, and the revenue it generates, on the well-to-do. The attempt of the package to return money to taxpayers should not benefit a wealthy few.

Supporting Argument

Repeal of the intangibles tax would have several benefits, among them the removal of a disincentive to save money. Insuring that people no longer had to pay this tax on the accumulation of assets, would encourage more people to accumulate assets. Further, a repeal would relieve tax pressure on those who may have the ability and desire to invest, in effect transferring this tax money to persons to make their own investment decisions, rather than allowing the State to keep the money for its own spending purposes. More money in the hands of Michigan taxpayers would result in more investment in Michigan's economy, producing more jobs.

Response: The repeal of the tax would contain no guarantee that the foregone tax revenue would be invested in Michigan. Persons who would benefit from the repeal, particularly the wealthy, could invest this money in any state or nation they desired.

Supporting Argument

Skyrocketing tuition costs in recent years have put the cost of education beyond the reach of many. It has become evident that if tuition costs are not controlled in some manner, the availability of a higher education to Michigan students will further diminish. While the State has some influence with universities' governing boards in that it appropriates money to the institutions, the universities are autonomous authorities that can raise tuitions any time they desire. Many people feel that colleges and universities too often have raised tuitions in response to increasing costs rather than searching for other options. In an attempt to address these problems, part of the tax cut proposal would provide a deduction from the income tax for undergraduate tuition expenses. The proposed deduction contains a restriction, however, that it could not be claimed for tuition paid to an institution of higher learning that increased tuition beyond the rate of inflation. It is hoped that the deduction, besides offering direct income tax relief for tuition to those who pay it, also would create a strong incentive for universities to keep tuition increases at or below the rate of inflation, and thus make college more affordable.

Opposing Argument
While the package has some appeal, in that it offers a broad-based method of returning excess revenues and would benefit nearly all taxpayers, the approach contains some dangers. Michigan's economy historically has endured periods of low or no growth resulting in reduced or stagnant State revenues. Currently, the economy is perking and State revenues are following that trend, but the good times cannot be expected to last forever. By making permanent changes, the bills could have a substantial negative impact on the State's revenue in the future, especially in those years when the economy turned down. In the interest of fiscal responsibility, perhaps a better response to the temporary problem of excess revenue would be to craft a temporary solution.

Response: The State should do more than offer a one-time rebate of surplus revenue; instead, it should take this opportunity to act decisively in favor of taxpayers. In the past, tax policy that resulted in the enrichment of State coffers usually meant the expansion of State government to accommodate disposal of the income. A permanent tax cut not only would put more money into the hands of taxpayers immediately, it also would help to prevent automatic expansion of State government in the future should the economy continue to grow.

Opposing Argument
The Governor's proposal comes up short. Part of this proposal advocates changes to the single business tax to reduce business's tax burden. There are some who feel, however, that tax changes, particularly those designed to return surplus revenue, should concentrate on benefitting individuals and not businesses. Revenue from that portion of the proposal that would go to business should instead be used to expand the benefit to individuals, particularly people with families. The package should focus on reducing the income tax; it should include a greater increase in the personal exemption, or perhaps include an extra exemption for taxpayers who can claim young dependents and thus target tax relief to families.

Response: Both businesses and individuals pay taxes. The bills must be looked at in the context of the entire proposal, which offers a balance of tax relief among businesses and individuals. While some believe, as argued above, that tax relief should be directed toward individuals, others point out that it is companies and employers that employ and pay the salaries of individuals, and therefore businesses must be included in this discussion of tax relief.

Opposing Argument
Repeal of the intangibles tax simply does not belong as a part of this package. The impetus behind the tax cut proposal is to decide how to dispose of surplus State revenue. This worthy effort should be directed to a broad section of the populace, instead of the approximately 100,000 taxpayers who are subject to the intangibles tax. In effect, repeal of the intangibles tax would target tax relief to a relatively small group of taxpayers, the richest of whom would receive a tremendous windfall. Adjustments to the intangibles tax to help those who are hurt by it could be addressed; however, outright repeal of the tax should not be included as part of the tax cut proposal.

Response: The intangibles tax should be eliminated because it is a bad, unfair tax. The tax was created in 1939, long before the creation of the State income tax, and should have been repealed when the income tax started. Instead, it was allowed to stand and, nearly 30 years later, is still taxing people twice on the same investment income. Further, the application of the tax is a mess; it is widely acknowledged that many taxpayers simply don't know what the intangibles tax is and, having never heard of it, have no idea that it may apply to them. While there is no available information on the level of compliance with the tax, it can be said that the level likely is not high. A tax with a low compliance level is an unfair, ineffective tax, because it falls most heavily on the honest and the informed. Finally, regarding the notion that repeal of the tax would provide great tax relief for the rich, it must be pointed out that, in terms of total dollars, the rich always benefit more than the poor from a tax cut because the rich pay more taxes.

Opposing Argument
The proposal to grant an income tax deduction for tuition payments contains a major flaw: Senate Bill 237 provides that the deduction could not be claimed after 1995 if the taxpayer paid the tuition to a university that increased tuition beyond the rate of inflation. Thus, this proposal would base the ability of a taxpayer to claim a deduction upon the behavior of a university's governing board; that is, it would punish the taxpayer if the institution raised tuition beyond the rate of inflation.

Further, it is unrealistic to expect that the bill would have a significant effect on the tuition cost decisions of universities. Few students, after enrolling in an institution, would be willing to change college programs based upon whether they or their parents could claim an income tax deduction. Institutions of higher learning, particularly private schools that receive no State appropriations, are autonomous entities that will

make tuition cost decisions based upon their funding needs, rather than the ability of their students to claim a tax deduction. Moreover, if a university's appropriations do not keep pace with inflation, the school should not be penalized for being forced to raise tuition beyond that rate.

Response: Restricting the deduction to those universities that limit tuition increases is appropriate. If the legislation did not contain the restriction universities could, without penalty, simply increase tuition rates to correspond to the limit of the credit ($5,000 per student per year), thus creating a backdoor increase in their appropriations. Further, adoption of this deduction could have a significant effect on universities' adoption of tuition increases. Michigan State University recently pledged to keep tuition increases next year to the rate of inflation, and has been praised for its action. Faced with the real possibility of appearing to punish students if an institution increased tuition beyond the rate of inflation, it might think twice about imposing such an increase.

Legislative Analyst: G. Towne

FISCAL IMPACT

The entire tax cut package (including Senate Bill 96) would reduce taxes by an estimated $186 million in FY 1994-95 and $279 million in FY 1995-96. These proposed tax cuts, which occur in the income tax, Single Business Tax, and intangibles tax, are summarized in Table 1. These tax cuts would reduce General Fund/General Purpose revenue by an estimated $171 million in FY 1994-95 and $241 million in FY 1995-96. The reduction in the income tax also would reduce the amount earmarked to the School Aid Fund by an estimated $10 million in FY 1994-95 and $18 million in FY 1995-96. In addition, the reduction in the income tax and the SBT would reduce revenue sharing by an estimated $5 million in FY 1994-95 and $20 million in FY 1995-96.

Senate Bill 232

Increasing the intangibles tax credit from $175 to $280 for single returns and from $350 to $560 for joint returns, would reduce intangibles tax revenue each year by an estimated $14 million. These increases in the tax credits would raise the amount of earnings from intangible property that is exempt from the intangibles tax from $5,000 to $8,000 for single returns and from $10,000 to $16,000 for joint returns. Phasing out the tax under the schedule described above, would further reduce intangibles tax revenue by an estimated $29 million in FY 1994-95 and $31 million in FY 1995-96. As a result of these two reductions in the intangibles tax, total revenue would be cut by an estimated $43 million in FY 1994-95, $45 million in FY 1995-96, $79 million in FY 1996-97, and $115

Table 1
Estimated Fiscal Impact of Tax Cut Bills
FY 1994-95 and FY 1995-96
(millions)

	FY 95	FY 96
Income Tax		
Personal Exemption	$ 69	$ 91
College Tuition Deduction	---	38
Subtotal	69	129
SBT		
Reduce Tax Base	74	105
Intangibles Tax		
Increase Credit	14	14
Phase-Out Tax	29	31
Subtotal	43	45
Total Tax Cut	$186	$279
Loss to Budget Areas:		
General Fund/General Purpose	171	241
School Aid Fund	10	18
Revenue Sharing	5	20
	$186	$279

million in FY 1997-98. These tax cuts would affect the State's General Fund/General Purpose (GF/GP) budget and potentially local governments. The revenue from the intangibles tax goes into the GF/GP budget, except for $9.5 million which is earmarked to cities, villages and townships as part of revenue sharing; however, this revenue sharing payment has not been made since FY 1991-92.

Senate Bill 233

This bill would totally eliminate all revenue from the intangibles tax beginning in FY 1998-99. This loss in revenue would equal an estimated $155 million in FY 1998-99.

Senate Bill 234

This bill would reduce SBT revenue by an estimated $6 million in FY 1994-95 and $8 million in FY 1995-96. The revenue loss in FY 1994-95 would affect General Fund/General Purpose revenue and in FY 1995-96 GF/GP revenue would be reduced by $7 million and revenue sharing would be reduced by $1 million.

Senate Bill 235

This bill would reduce SBT revenue by an estimated $52 million in FY 1994-95 and $74 million in FY 1995-96. The revenue loss in FY 1994-95 would affect General Fund/General Purpose revenue and in FY 1995-96 GF/GP revenue would be reduced by $67 million and revenue sharing would be reduced by $7 million.

Table 2
S.B. 232 & 233: Reduction in Intangibles Tax
Estimated Revenue Impact FY 1994-95 to FY 1998-99
(dollars in millions)

	FY 95	FY 96	FY 97	FY 98	FY 99
Current Law					
Projected Revenue:	$130.5	$137.8	$143.3	$149.0	$155.0
Tax Cut Revenue Reduction					
Exemption Increase	14.0	14.0	14.0	14.0	---
Tax Phase Out Rate	25%	25%	50%	75%	100%
Revenue Reduction	29.1	31.0	64.7	101.3	155.0
Total Tax Cut	$43.1	$45.0	$78.7	$115.3	$155.0

Senate Bill 236

This bill would reduce SBT revenue by an estimated $16 million in FY 1994-95 and $23 million in FY 1995-96. The revenue loss in FY 1994-95 would affect General Fund/General Purpose revenue and in FY 1995-96 GF/GP revenue would be reduced by $21 million and revenue sharing would be reduced by $2 million.

Senate Bill 237

The income tax deduction for college tuition expenses would reduce income tax revenue by an estimated $38 million in FY 1995-96. There would be no revenue impact in FY 1994-95. The reduction in revenue in FY 1995-96 would affect the three areas of the State budget to which various portions of the income tax are earmarked. General Fund/General Purpose revenue would be reduced by $30 million, School Aid Fund revenue would be reduced by $5 million, and revenue sharing would be reduced by $3 million.

The future cost of this deduction would depend on the rate of inflation and the number of Michigan's colleges and universities that keep their annual tuition increase at or below inflation.

Senate Bill 29 (S-1)

This bill would have no fiscal impact on State or local government. Intangible personal property that is taxed under the intangibles tax is presently exempt from the general property tax. This bill would prevent intangible personal property from being taxed if the intangibles tax were repealed.

Fiscal Analyst: J. Wortley

Table 3
S.B. 234-236: Reduction in Single Business Tax
Estimated Revenue Impact FY 1994-95 and FY 1995-96
(millions)

	FY 94-95	FY 95-96
Reduction in Revenue:		
Eliminate from Tax Base payments for Social Security (FICA)	$ 52	$ 74
Workers' Compensation	16	23
Unemployment Insurance	6	8
Total Cut in SBT	$ 74	$105
Loss to Budget Areas:		
General Fund/General Purpose	$ 74	$ 95
Local Revenue Sharing	0	10
Total	$ 74	$105

A9596\S29A

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.