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INCREASE PERSONAL EXEMPTION

House Bill 4374 (Substitute H-3)
Sponsor: Rep. Gloria Schermesser

House Bill 4985 (Substitute H-4)
Sponsor: Rep. John Freeman

Committee: Tax Policy
First Analysis (6-18-98)

THE APPARENT PROBLEM:

Governor Engler recently announced a new tax cut proposal that would reduce the income tax rate from 4.4 percent to 3.9 percent in even increments, beginning in the 2000 tax year and extending through the 2004 tax year. (The proposal is embodied in Senate Bills 1079-1083.) House Speaker Hertel has recommended that alternatives to this plan be explored, including the possibility of increasing the personal exemption (the standard amount deducted from taxable income for the taxpayer and each dependent) from $2,800 to $5,000, on the grounds that raising the personal exemption would be more beneficial to families earning $75,000 or less. Legislation to offer this alternative has been drafted.

THE CONTENT OF THE BILLS:

The bills would amend the Income Tax Act to raise the personal exemption. Currently, the personal exemption is $2,500 adjusted annually for inflation (rounded to nearest $100 increment), plus $200. [For the 1998 tax year, the personal exemption is $2,800.] House Bill 4985 would make the starting figure in those calculations $2,900 (rather than $2,500) for the 2000 tax year and $3,200 for the 2001 tax year. House Bill 4374 would make the starting figure $3,500 for the 2002 tax year, $3,800 for the 2003 tax year, and $4,100 for the 2004 tax year and subsequent tax years.

[Note: The actual personal exemption in any year would depend on the amount added due to inflation under Section 206.30(7). For example, if $100 were added each year due to the inflation calculation, in combination with the amounts added by these two bills, the personal exemption for tax year 2004 would be $5,000.]

The two bills are tie-barred to each other and to House Bills 4710 and 5546. Those bills would reduce the tax rate. (One version of the two bills in the House Taxation Committee would reduce the tax rate from 4.4 percent to 4.325 percent as of October 1, 1998 and 4.25 percent as of October 1, 1999.)

MCL 206.30 and 206.30e

FISCAL IMPLICATIONS:

The House Fiscal Agency has estimated that the fiscal impact of House Bill 4985 would be a revenue reduction of about $90 million in 2000 and $210 million when fully phased in. (Fiscal Note dated 5-29-98) House Bill 4374 would result in a revenue reduction of about $67.5 million in 2002 and $270 million annually when fully phased in. (HFA 6-17-98) This means that together the two bills would reduce revenues in 2005 by $480 million.

ARGUMENTS:

For:

Raising the personal exemption is the fairest method of cutting income taxes; it is preferable to cutting the tax rate. Cutting the tax rate provides a greater benefit as the taxpayer's income rises. Raising the personal exemption is neutral as to the taxable income of taxpayers. Each personal exemption reduces taxable income (and taxes) by the same amount for each taxpayer. (Each $100 increase in the personal exemption reduces the tax bill by $4.40 per exemption at the current tax rate, no matter what the income level of the taxable income of the household.) Raising the personal exemption particularly helps low and moderate income working families. These bills would provide significant tax relief to such families by nearly doubling the personal exemption by the 2005 tax year. Proponents of raising the personal exemption to $5,000 have argued that it would provide a family of four (no matter what its income) with a $387 annual income tax reduction. They say that a family would have to earn over $75,000 per year to get an equivalent tax cut from the governor's tax rate cut proposal.

Response:

Cutting the tax rate, rather than increasing the personal exemption, provides equal treatment to all taxpayers. Everyone gets the same rate cut; it is a neutral approach to tax reduction. Obviously, the more taxes a person or family now pays, the greater the dollar amount of tax relief from a rate cut. Far from being unfair, this seems entirely reasonable. Those with the largest tax burdens should get the biggest reductions. With a rate cut, tax relief is broad based, not targeted to some special group. The governor has proposed reducing the rate from 4.4 percent to 3.9 percent over the years 2000-2004. A number of targeted tax cuts have been enacted in the past few years, and the personal exemption has been raised several times and indexed for inflation. It is time now for a broad based, tax rate cut.

Against:

Is it wise to be proposing tax cuts of this magnitude far into the future when the state's fiscal future remains uncertain? Significant tax cuts enacted in recent years have not yet been fully absorbed. New increases in the personal exemption are due to take effect for 1998, along with additional deductions from taxable income for young children. The exemption has been adjusted for inflation and increased by $200 on top of that. Taxpayers can also deduct $600 for each child under 7 and $300 for each child 7 through 12. Is this really the time for an additional set of increases in the personal exemption? These bills and the tax reduction proposal of the governor delay new reductions until the 2000 tax year, apparently on the grounds that the state budget cannot absorb new cuts immediately. But isn't that an argument for waiting to propose additional tax reductions until the state's fiscal picture is clearer? There is no guarantee that the economy, and the resulting state revenues, will remain so robust. These bills would result in a large reduction in state revenue year after year, as would the governor's tax cut proposal.

POSITIONS:

The Department of Treasury opposes the bills. (6-17-98)

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.