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SENIOR CITIZEN DEDUCTION AND LOW-INCOME EXEMPTION

House Bill 4699 (Substitute H-1)
Sponsor: Rep. Kirk A. Profit

House Bill 5546 (Substitute H-1)
Sponsor: Rep. Barbara Dobb

Committee: Tax Policy
First Analysis (4-21-98)

THE APPARENT PROBLEM:

In 1994, the legislature enacted amendments to the Income Tax Act aimed at putting private pension and retirement income on a more equal footing with income from public sector pensions. Prior to the amendments, public pensions were not taxed at all but income from private pensions beyond $7,500 for single returns and $10,000 for joint returns was subject to the state income tax. The exemption for private pensions was increased to $30,000 for a single return and $60,000 for a joint return. (These dollar figures were justified on the grounds that very few public pensions exceed them.) At the same time, some people argued that senior taxpayers who had little or no pension income but who had income from savings and investments or from the sale of businesses or farms should get similar consideration. Why, it was asked, should a person who had the misfortune not to receive a pension, but who had the foresight to provide for his or her own retirement, be forced to pay taxes on their income from investments while the pensioner's income is tax free? In response, the 1994 legislation provided for senior citizens a deduction from adjusted gross income for interest, dividends, and capital gains up to $1,000 for single filings and $2,000 for joint filings. Legislation in 1995 subsequently increased the deduction to $3,500 and $7,000 for the 1997 tax year and $7,500 and $15,000 for tax years thereafter. Legislation has now been proposed to provide equal treatment for non-pension retirement income.

At the same time, some people are proposing legislation that would aid people with the lowest incomes by raising the filing threshold (the amount of income that requires that a tax return be filed) and exempting from the tax those with incomes of $5,000 or less for a single return and $10,000 or less for a joint return.

THE CONTENT OF THE BILLS:

House Bill 5546 would amend the Income Tax Act (MCL 206.30) to increase the deduction that senior citizens can take from adjusted gross income to $30,000 for a single return and $60,000 for a joint return for tax years after the 1997 tax year. (The current deduction is set at $7,500 and $15,000.) As now, the amount deducted would have to be reduced by the amount of any deductions for pension and retirement income. The term "senior citizen" refers to a person 65 years of age or older or an unremarried surviving spouse. The bill also would move a recently enacted "child care" deduction from one place to another in the act.

House Bill 4699 would amend the Income Tax Act (MCL 206.51b and 206.311) so that a taxpayer with an adjusted gross income of not more than $5,000 for a single return or $10,000 for a joint return would be exempt from the tax and would not have to file a return. The bill would apply for the 1998 tax year and each tax year thereafter.

The two bills are tie-barred.

FISCAL IMPLICATIONS:

The House Fiscal Agency reports that House Bill 5546 would reduce state revenues by about $75 million per year, based on data from the Department of Treasury. (Fiscal Note dated 4-16-98)

The House Fiscal Agency says House Bill 4699 would reduce income tax revenues by about $24.5 million per year on a full-year basis, based on data from the Department of Treasury. (Fiscal Note dated 4-16-98)

ARGUMENTS:

For:

House Bill 5546 would put non-pension income received by senior citizens on equal footing with public and private pensions. This is a matter of simple fairness. Currently, private pension income up to $30,000 for a single filer and $60,000 for a joint filer is exempt from tax (no matter what the age of the taxpayer). Income from personal investments up to $7,500 for a single filer and $15,000 for joint filers where one of the parties is aged 65 or older is exempt. This means that a retired couple with $60,000 in pension income would not have to pay state income taxes on the pensions while a couple with small pensions totaling, say, $20,000 who had provided for additional retirement income through private investment, would have to pay taxes on their investment income. And under current law, a couple with no pension income and $60,000 in investment income would have to pay taxes on investment income above $15,000. Under this bill, the same $30,000 and $60,000 caps would apply to income for senior citizens whether derived from a pension or from personal investments. Any combination of pension income and income from personal investments up to the caps would be exempt. This approach does away with the fundamentally unfair bias in the law at present against people whose income in later years comes from their own personal investments rather than public or private pensions.

Against:

It should be noted that this bill does not apply, strictly speaking, to retirement income, as the special treatment of pensions does. The deduction that the bill proposes to increase applies to dividends, interest, and capital gains of senior citizens (and their surviving spouses of whatever age) no matter what their status, whether retired or working, and whether the income is needed to live on or not.

Response:

On the other hand, some people continue working even while receiving pensions from one or more sources. In fact, people who do not qualify as senior citizens can do this. So there is nothing unusual or unfair about the approach taken by this bill.

Against:

House Bill 5546 will result in a significant revenue loss to the state. An alternative way to treat all "retirement income" equally is to tax all income from all sources equally (and regardless of the age of the taxpayer).

For:

House Bill 4699 would provide a tax cut targeted at those with the lowest incomes. It would add progressivity to the state tax code and save some people the trouble of filing tax returns. Generally speaking, in 1998, a person earning $5,000 would pay state income tax of $96.80 before any credits if he or she was eligible for the personal exemption and $176 if not, and a couple earning $10,000 would owe $193.60. Under this bill, they would have no tax obligation; they would not be subject to the tax and would not have to file returns. If they were eligible for a refundable tax credit under some other program (such as a home heating credit, property tax credit, prescription drug credit), those returns could be filed separately.

Against:

House Bill 4699, which would significantly reduce state revenue, is problematic in a number of ways. For one thing, it would exempt a person earning $5,000 (or a couple earning $10,000) from the state income tax but would fully tax a person earning $5,100 (or a couple earning $10,100). A person earning $5,000 would pay no state tax while the person earning $5,100 would pay $101.20 if he or she qualified for a personal exemption and $180.40 if not. In other words, the bill offers a "cliff" approach rather than a phased-in income exemption like the homestead property tax credit or an across-the-board exemption like the personal exemption. Further, some have questioned whether the tax exemption should be based on adjusted gross income from the federal tax return, which may not tell the whole story about a person’s financial wherewithal. Additionally, people who would not need to file because they were below the income threshold might fail to claim refundable credits currently available to them, such as the home heating, homestead property, and prescription drug credits. It should be noted that recent state legislation has increased the personal exemption by $200 and has provided a deduction for people with young children. Both of these benefit low-income families. Further, legislation has passed the House that would create a state earned income credit, a refundable credit based on the federal earned income tax credit. That bill would greatly benefit low-income families.

Response:

A recent press release from the Michigan Budget and Tax Policy Project says that "Michigan ranks among the ten states with the lowest tax thresholds - - that is, the lowest income level at which a family owes state income tax." A family of four in Michigan, the organization says, pays the state income tax when its income is only 61 percent of the poverty line. In 1997, Michigan taxed two-parent families of four when their income hit $10,000 and a single-parent family of three at $7,500, said the press release, which accompanied the issuance of a report on state income tax burdens on low-income families issued by the Center on Budget and Policy Priorities, an organization based in Washington, D.C. That report said that the income tax threshold for a family of four was above the poverty level in 21 states, one-half of the states with a state income tax. While this bill would not raise the threshold that much, it would benefit some of the lowest income people.

POSITIONS:

The Michigan Farm Bureau has indicated support for House Bill 5546. (4-1-98)

The Department of Treasury has indicated opposition to the two bills. (4-1-98)

The Michigan Education Association has indicated opposition to the two bills. (4-1-98)

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.