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DYNAMIC REVENUE FORECASTING/ TOBACCO SMUGGLING

House Bill 5315 as enrolled
Public Act 368 of 1998
Second Analysis (11-10-98)

Sponsor: Rep. Kirk A. Profit
House Committee: Tax Policy
Senate Committee: Finance

THE APPARENT PROBLEM:

When a change is proposed to state tax policy, such as raising or lowering a tax rate or granting an exemption from a tax, policy makers want to know what the effect will be on state tax revenues. The effect on revenues can be estimated, say tax specialists, using a "static" approach or a "dynamic" approach. The former assumes the tax change will have little or no impact on the behavior of taxpayers or on overall economic activity while the latter attempts to factor in changes in behavior and in levels of activity. In March of 1997, the House Fiscal Agency, Senate Fiscal Agency, and the Department of Treasury issued a joint report entitled Dynamic Revenue Estimating: Will It Work In Michigan? This report summarizes the findings of a research study on dynamic forecasting conducted by the three entities; explains the advantages and disadvantages of static versus dynamic analysis; contrasts the estimating procedures currently used in Michigan with those in states using dynamic analysis; and discusses other related issues, including the availability of models for use in dynamic analysis.

According to the March 1997 report, tax analysts in Michigan "currently prepare static revenue estimates and adjust the static estimates for the effects of policy-induced changes in taxpayer behavior. The adjustments are based on standard price and income elasticity estimates. For proposed changes to the Single Business Tax or the Individual Income Tax, micro-simulation models that use a sample of actual taxpayer returns are used to produce a static estimate. When appropriate, static estimates derived from the models are also adjusted for policy-induced changes in taxpayer behavior." Legislation has been introduced, based in part on recommendations in the recent report, to move state tax analysts toward dynamic revenue estimating.

On another matter, legislation has been proposed to help prevent smuggling of tobacco products into the state that were manufactured in this country but intended for overseas sale or were manufactured overseas. In either case, the products would not meet federal laws regarding taxes, trademarks and copyrights, and health warnings.

THE CONTENT OF THE BILL:

Dynamic revenue forecasting. The bill would amend the revenue act to specify that, beginning January 1, 1999, forecasting reports made by the Department of Treasury may include dynamic revenue forecasting. The term "dynamic revenue forecasting" would mean forecasting the direct impact of a tax law change on revenues and the other effects of tax law changes on the behavior of taxpayers and on overall economic activity.

Tobacco provisions. The bill would also add to the revenue act a number of provisions related to the regulation of tobacco products. Under the bill:

-- A person would be prohibited from importing into the state a tobacco product that violates any federal requirement for the placement of labels, warnings, or any other information, including health hazards, required to be placed on the container or individual package.

-- A person would be prohibited from placing a stamp or a counterfeit stamp on a tobacco product unless the package complies with all federal tax laws, federal trademark and copyright laws, and all federal laws regarding the placement of labels, warnings, or any other information on a package of tobacco products.

-- A person who acquires, possesses, sells, or offers for sale packages of tobacco products stamped or marked in violation of the abovementioned provisions would be subject to the same penalties described in Section 9 of the Tobacco Products Tax Act. A person that acquires, possesses, sells, or offers for sale packages of tobacco products stamped or marked in violation of the abovementioned provisions would be subject to criminal charges as provided in the Tobacco Products Tax Act. The Department of Treasury would be authorized to revoke the license of a licensee under the tobacco act for a violation of the abovementioned provisions, and could assess tax due, penalty, and interest on tobacco products acquired, possessed, sold, or offered for sale in violation of the abovementioned provisions.

-- The state treasury department would be authorized to obtain and exchange information with the United States Customs Service for the purpose of enforcing the bill's provisions.

MCL 205.14 and 205.18

FISCAL IMPLICATIONS:

The provision regarding the use of dynamic revenue forecasting is permissive; it is not a requirement. Earlier versions of the bill required the development of microsimulation models for various taxes and required that by a certain date the Department of Treasury provide an analysis of dynamic revenue impact for all proposed changes in tax policy that would have a static impact of $20 million or more annually. Cost estimates for those versions of the bill varied from $400,000 to $1 million. The ongoing cost of maintaining and operating the models was estimated at $100,000 to $200,000 annually. (See the fiscal note dated 11-3-97 from the House Fiscal Agency and the analysis dated 5-15-98 from the Senate Fiscal Agency.)

ARGUMENTS:

For:

The bill would encourage the Department of Treasury to use dynamic revenue forecasting. Some people believe that this would provide policymakers with more valuable information than currently exists regarding the effect of changes in the state tax system.

Response:

The March 1997 report from the legislative fiscal agencies and the treasury department noted:

"Although it is technically feasible to produce dynamic estimates with an appropriate model, there is still very limited experience with developing and operating [such a model]. No states are currently conducting dynamic analyses on a regular basis (although California will start to do so this year), and only three or four states have any experience in building and operating these types of models." The report also noted, "state of the art dynamic analysis is not yet at the place where reliable long-run estimates of the impact of dynamic feedback effects on revenue are feasible. However, experts are continuing to refine and expand the models and are likely to resolve these problems in the near future."

For:

The bill contains provisions aimed at preventing smuggling of cigarettes into the state that were intended for foreign markets or were manufactured in other countries to be sold illegally here (so-called look-alike or knockoff products). Penalties for violations of federal laws would be put into the state's revenue act, and cooperation would be authorized between the state's Department of Treasury and the United States Customs Service.

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.